Having a TFSA works. Get one working for you.

The benefits and flexibility provided by a Tax-Free Savings Account (TFSA) make it ideal for saving for multiple financial goals. While TFSA contributions are not tax deductible, they grow tax-free, can be withdrawn tax-free at any time, and there are no restrictions on how you use the funds once they're withdrawn from your TFSA.

Whether you're saving for a new car, advanced educational degree, home purchase, your child's education or retirement, a TFSA can help you reach your financial goals sooner.

Contributions and withdrawals

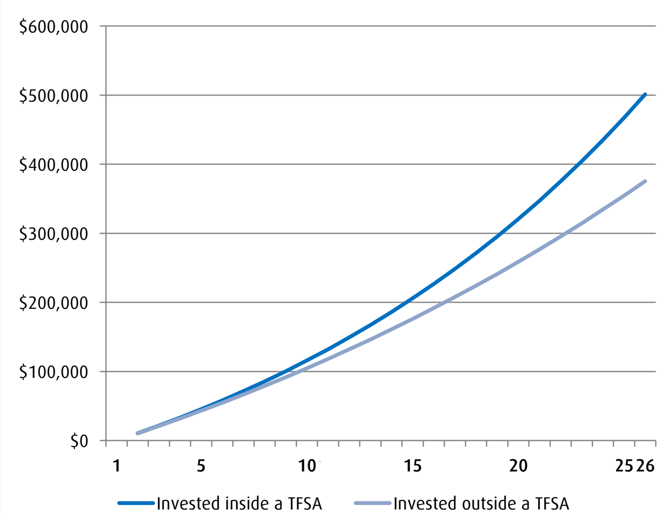
Once you reach the age of majority,[1] you can begin making TFSA contributions. The April 2015 Federal Budget proposes to increase the TFSA contribution limit to $10,000 from $5,500, effective for 2015 and subsequent years.[2] The Canada Revenue Agency (CRA) has confirmed that financial institutions and individuals may act upon this change immediately.

Unused contribution room – dating back to 2009 when TFSAs were first introduced, or the year you turned 18 – carries forward and can be used in any future year. If you've never contributed to a TFSA and were at least 18 years of age in 2009, your 2015 contribution limit will be $41,000. Individuals are responsible for monitoring their TFSA contribution limit, which can be confirmed by contacting the CRA by phone or through their My Account service.

Withdrawals from your TFSA are tax-free and any amount withdrawn in the current year will be added back to your TFSA contribution room at the beginning of the following calendar year. For example, let's assume that you have no current unused TFSA contribution room and you withdraw $15,000 from your TFSA in October 2015. On January 1, 2016, your TFSA contribution limit will increase to $25,000 ($15,000 withdrawn in 2015, plus your 2016 TFSA contribution limit of $10,000). In addition, TFSA withdrawals won't impact your eligibility for federal income-tested benefits and credits such as Old Age Security, Guaranteed Income Supplement, employment insurance benefits, child tax benefit and the GST credit.

The graph below compares the growth of annual $10,000 contributions to a TFSA versus saving $10,000 annually in a non-registered investment account. Assuming a five per cent rate of return, after 25 years the TFSA will grow to $501,135, while the non-registered account grows to only $375,530. As a result of the tax-free growth of the TFSA, you'd have over $125,000 (or 33 per cent) more to fund your financial goals.

Benefits of Tax-Free Growth in a TFSA



Assumptions: $10,000 annual contributions earning a five per cent annual rate of return. Contributions are made on January 1st of each year for 25 years. Income generated outside the TFSA is taxed at a 40 per cent marginal tax rate.

Investment options

Generally, investments that qualify for an RRSP can also be held in a TFSA, including equities, bonds, mutual funds, GICs and exchange traded funds (ETFs).

Continued

TFSA or RRSP – Determining the best savings option for you

Since the introduction of TFSAs, many Canadians have questioned whether to contribute to a TFSA or RRSP for their retirement savings. While both plans allow your investments to grow tax-free inside the plan, there are major differences in the tax treatment of contributions and withdrawals. TFSA contributions are not tax-deductible and all withdrawals are tax-free. With an RRSP the opposite is true; contributions are tax-deductible and all withdrawals (including any income earned while inside the RRSP) are taxed as ordinary income when withdrawn.

As a result, when deciding whether to make a TFSA or RRSP contribution, the most important financial factor is your marginal tax rate today, and your expected marginal tax rate in retirement. The table below compares three scenarios where a pre-tax $10,000 contribution is made to both a TFSA and RRSP, and the contribution earns a five per cent rate of return over 20 years. At the end of 20 years, the funds are withdrawn from each plan.

If your marginal tax rate is 40 per cent at the time of the TFSA or RRSP contributions and withdrawals, your after-tax savings will be identical. However, if you're in a higher tax bracket when making your TFSA or RRSP contributions than when making your withdrawals, the RRSP provides more after-tax savings than the TFSA. Conversely, if you're in a lower tax bracket when making your TFSA or RRSP contributions than when making your withdrawals, the TFSA provides more after-tax savings than the RRSP.

In summary, if you expect your marginal tax rate to be lower (including the possible clawback of government benefits, such as Old Age Security) when you retire, then an RRSP is generally more beneficial. If you expect your marginal tax rate to be higher in retirement than it is today, then contributing to a TFSA may be the better option.

It's also important to note that for many, an RRSP offers a higher contribution limit than a TFSA. The RRSP contribution limit for 2015 can be as high as $24,930, whereas the TFSA contribution limit is currently $10,000. Ideally, investors should maximize contributions to both plans to take advantage of the income tax savings benefits. However, from a financial standpoint, this may not always be possible. While everyone's situation is unique, the following guidelines can assist you in deciding between a TFSA or RRSP contribution:

- If you're in the top marginal tax bracket, maximize your RRSP contribution first, and then contribute excess funds to your TFSA to build your retirement assets. Use any income tax refund to top-up your TFSA for continued tax-free growth.

TFSA vs. RRSP Comparison

	Scenario 1		Scenario 2		Scenario 3	
	Marginal Rate 40% when contributed; 40% when withdrawn		Marginal Rate 40% when contributed; 20% when withdrawn		Marginal Rate 20% when contributed; 40% when withdrawn	
Plan	**TFSA**	**RRSP**	**TFSA**	**RRSP**	**TFSA**	**RRSP**
Pre-tax Income	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000
Income Tax Payable	$4,000	n/a	$4,000	n/a	$2,000	n/a
Net Contribution	$6,000	$10,000	$6,000	$10,000	$8,000	$10,000
Value 20 Years Later @ 5% Growth	$15,920	$26,533	$15,920	$26,533	$21,226	$26,533
Income Tax Payable Upon Withdrawal	n/a	$10,613	n/a	$5,307	n/a	$10,613
Net Withdrawal	**$15,920**	**$15,920**	**$15,920**	**$21,226**	**$21,226**	**$15,920**

Please note: The RRSP withdrawal is for comparison purposes only as actual withdrawals would generally occur after the RRSP is converted to a Registered Retirement Income Fund (RRIF).

- If you're just starting your career, you may want to consider delaying your RRSP contributions until you're in a higher tax bracket. The RRSP tax deduction won't save you as much tax today as it might in the future. Instead, contribute to a TFSA for tax-free growth and later, when you're in a higher tax bracket, consider withdrawing funds from your TFSA to make an RRSP contribution and capitalize on the larger tax deduction. You can then use your income tax refund to make a TFSA contribution.

Other important factors to consider include:

- Most people are hesitant to make RRSP withdrawals due to the tax consequences. Except for amounts qualifying for the Home Buyers' Plan or Lifelong Learning Plan, a withdrawal from your RRSP will result in the amount being added to your taxable income for the year – and you will lose the contribution room forever. Since TFSA withdrawals are easy to make and tax-free, you may be more inclined to make a withdrawal from your TFSA when you need funds.
- In retirement, RRSP/RRIF withdrawals will be added to your income – along with your pension and other income – and could put you in a higher tax bracket, triggering the claw back of Old Age Security (OAS) payments. In 2015, OAS benefits start being clawed back when your net income exceeds $72,809. A TFSA may be advantageous as withdrawals do not affect federal income benefits including the OAS.
- While the plan you contribute to may change from time-to-time, depending on your income and financial goals, a general rule of thumb would be that if you contribute to an RRSP, use the resulting tax refund wisely, and if you contribute to a TFSA, try not to withdraw funds unless necessary – especially if you are using the account to save for retirement.

Planning opportunities

TFSAs are ideal for implementing a variety of planning strategies, including:

- Income splitting – You can gift funds to your spouse/common law partner (spouse/partner) or adult child to allow them to contribute to their own TFSA (subject to their personal TFSA contribution limit). Income earned within a spouse's/partner's or adult child`s TFSA will not be attributed back to you.
- Consider holding investments in your TFSA that would otherwise be taxed at high rates outside a registered account, such as interest income.

Open your TFSA today

With a TFSA you'll benefit from a plan that provides tax-free growth and offers the flexibility you need to meet multiple financial priorities over your lifetime.

Your BMO Nesbitt Burns Investment Advisor will work with you to develop a financial plan that includes effective savings strategies to help you attain your financial goals and objectives. For more information about TFSAs, please contact your BMO Nesbitt Burns Investment Advisor.

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You know where you want to be. We'll show you how to get there. To learn more about wealth planning and the issues, challenges and trends impacting Canadians, visit **bmo.com/wealthinstitute**

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[1] Individuals must be the age of majority in their province of residence to open a TFSA with BMO Nesbitt Burns. In BC, NS, NB , Newfoundland, Yukon, Northwest Territories and Nunavut, the age of majority is 19.

[2] Quebec residents should note that the Quebec government has not disclosed its intention to join or opt out of the TFSA contribution limit increase. This may lead to a different tax situation for Quebec residents on their tax liability at the provincial level.