Welcome to financial possibility moneyville

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Why this six-time grandmother has a tax-free account

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Investor Mary Cuddihy is a mother, grandmother and college teacher living in Ottawa,

by Suzanne Wintrob

Mary Cuddihy has long saved for her future, making regular contributions to a Registered Retirement Savings Plan since she and her husband, Harvey, started their family in the early 1980s. Two-and-a-half years ago, shortly after the federal government began encouraging Canadians to open Tax-Free Savings Accounts, the Ottawa teacher and six-time grandmother took $100 and set one up.

She then arranged an automatic transfer of $80 per week from the couple's joint account to her TFSA, which she aptly renamed their travel fund.

"When the TFSAs came out, I thought it would be a brilliant way of putting money aside," says Cuddihy, 55.

Today, Cuddihy has stashed away $3,600 and tries not to touch it unless it's to travel, although once she had to dip in to it to pay the vet. to heal her ailing cat.

Barring any other emergencies, her smart saving will pay off next year when the couple jet off to Ireland to celebrate Harvey's 65th birthday.

According to Canada Revenue Agency, 4.8 million Canadians opened TFSAs and these, collectively, had $19 billion in then in 2009. All Canadian residents, 18 and older, can contribute up to $5,000 annually to a TFSA. Contents can include cash, mutual funds, Guaranteed Investment Certificates (GICs) and bonds.

TFSAs differ from RRSPs in one very simple way: Timing.

As Carole Bezaire, vice-president of tax and estate planning at Mackenzie Financial in Toronto, explains, an RRSP provides income upon retirement but withdrawals are taxable. A TFSA, on the other hand, can be used as a rainy-day fund or "a personal line of credit" with withdrawals made tax-free.

“One of the things that confuses people is it’s not just a savings account,” she says. “It is a registered plan similar to an RRSP, meaning the investment income earned in the account doesn’t get taxed in the years that you earn it. So it gets to build a little bit faster for you. It’s a simple, simple concept for saving.”

Bezaire thinks everyone should have a TFSA, but the reasons they should will vary. Younger people earning minimum wage can use it to start saving even if they don’t need to fund their RRSP until they earn more money. A small contribution such as $50 a month can motivate them to start saving.

Later, as their earnings increase, they can use the TFSA to provide their RRSP contribution.

High-income earners, who have already maxxed out their RRSP, should max out their TFSA, too, so their retirement cash-flow comes out as tax-efficient, she says.

Low-income earners, who may not need RRSPs right now, can use a TFSA as an emergency fund, “which many people in a lower income bracket don’t have,” Bezaire says.

Seniors who have to turn their RRSPs into Registered Retirement Income Funds (RRIFs) when they hit 71, but don’t really need the income, can withdraw the money, pay tax on it, put the after-tax amount into a TFSA and never pay tax on it again.

Later on, this will have reduced their exposure to the Old Age Security clawback, if they make over a certain amount of money each year.

Grandparents can open a TFSA and name a grandchild over 18 as beneficiary (except in Quebec), and leave a legacy for their heir. The TFSA can remain tax-free as long as the grandchild has the contribution room, she adds.

Many people are still not aware of the TFSA, says Doug Caroll, vice-president of tax and estate planning at Invesco Trimark.

TFSAs haven’t received the attention they deserve, he says, and they carry the wrong moniker. As he explains, RRSPs were introduced in the 1950s, and investors have grown up with them.

TFSAs are new, so people haven’t had time to digest their many tax advantages. And younger folks may not yet be in investing or saving mode, so they haven’t paid much attention to RRSPs or TFSAs.

“The name gives the impression it is a savings account in that you place your money in [a bank account], then just leave it be,” says Mr. Caroll. “It really is much more broadly available as an investment opportunity.

“I hope people will realize it’s a place where they can do some nice tax-shelter investing, a place for this that they didn’t have before.”

Advice on TSFAs

Thinking of opening a Tax-Free Savings Account? Consider this advice from the pros:

• Accumulation rocks! If you’re a Canadian resident over 18 and haven’t yet opened a TFSA, you’re eligible to deposit $15,000 in 2011. That’s $5,000 for every year TFSAs have been in existence.

• Stick to the $5,000 limit! You will be charged 1 per cent per month as a penalty for every dollar you over-contribute.

• Think like a Capricorn! If you have to withdraw money from a TFSA, consider doing so at the end of the year. That way if you have already made your maximum contribution that year,you can put the money back in at the beginning of the next calendar year and not be penalized.

• Get help! You can set up a self-directed TFSA and decide,yourself,what goes into it. But a financial advisor can help you examine your overall financial picture and help to figure out how a TFSA can help you down the road.