

The announcement of the Tax Free Savings Account in the last federal budget was widely welcomed. Many commentators saw it as a useful complement to well-established tax-favoured savings vehicles such as the RRSP and RESP.

Reaction from employers has also been positive with many planning to introduce payroll deduction group TFSAs when the rules are formalized in the New Year.

But what do you tell your employees about the TFSA? How do you prevent the TFSA from becoming a source of confusion – just one more program they don't understand and resolutely ignore?

First, let's look at the ground rules for TFSAs. Beginning in 2009, Canadian residents aged 18 or older can contribute up to \$5,000 annually to a TFSA. Contributions are not tax-deductible, however, all capital gains, investment income, and capital withdrawals will be tax-free. Withdrawals can be made at any time and monies withdrawn will be added to the plan-holder's contribution room for the following year. Re-contributions can be made at any time and unused contributions can be carried forward indefinitely.

will find himself paying increasingly higher taxes in future years than he pays today. In his situation, maximizing RRSP contributions may not be his best strategy. A better alternative would be to save with a TFSA and, perhaps, generate a good portion of the down payment he will need for his home purchase in a few years. This strategy provides Karol with the opportunity to re-contribute the funds removed from the TFSA at a later date without affecting his other available contribution room.

RRSP Deduction

An alternative strategy would be for Karol to utilize the TFSA (which is more tax-efficient for employees with income below the YMPE) during the early years of his employment and then move the accumulated money into his RRSP later in his career when he is faced with higher tax brackets and the RRSP deduction is worth more to him.

Angie, 55, has 28 years of service and earns 10 per cent less than YMPE. She plans to retire in five to seven years. She anticipates she will be entitled to GIS supplements based on her projected retirement income. Angie has not made any RRSP contributions for several years because withdrawals from

What To Tell Your Employees About TFSAs

Individual Circumstances

The good news about the TFSA is the way it can work for so many individuals of different ages and at stages of life. It is very adaptable to the individual circumstances of all your staff and has the potential to be a highly appreciated component of your total benefits strategy. Do some of your people feel they pay too much tax? Do you have employees who are uncertain about the future and want to keep all of their financial options open? Have some of your highly paid workers maxed out on the traditional tax favoured plans? If yes, the TFSA might be what you need to attract their attention to the company benefits – and hold it there long enough for them to appreciate the helping hand you're offering them.

Of course, that appreciation is linked to understanding, so any employer wishing to sponsor a group TFSA needs to launch it with clarity and relevance. Here are some case studies to help you on your way. We'll look at real-life situations where the TFSA can be used constructively.

Karol, 26, is a new hire with no knowledge of money matters and little appreciation of the company's RPP (doesn't even know if it's Defined Benefit or Defined Contribution). His most important financial considerations are:

- ◆ what kind of car to purchase
- ◆ which vacation destination to take next
- ◆ what IT gadgets he wants to acquire
- ◆ perhaps getting on the real estate ladder within a few years

Karol has substantial upside salary potential and



Chart 1 Quantum Leap Your Returns With 'Double Duty Dollars'

Imagine combining your RRSP with the TFSA to accelerate your plans for an early retirement. **Case Profile** – Sam Giordano, age 40 currently earns \$97,300 which entitles him to an contribution of about \$17,500, but he can only manage about \$12,500 each year. Look how Sam turns \$12,500 capital into \$17,500.

DESCRIPTION	RRSP	TFSA
RRSP Contribution	\$12,500	Transfer the tax savings of \$5,000 into a TFSA
Less income tax rate @ 40%	-\$5,000	
After-tax cost of RRSP	\$7,500	
Capital Available for Investment	\$12,500	\$5,000
Assume 6% real rate of return for 20 years	\$527,498	\$210,999
If Sam retires at age 60 and he maintains the 6% real rate of return his income from these two resources will be	\$31,650 Taxable	\$12,660 Non-taxable



RETIREMENT PLANNING

By: Graydon G. Watters

RRSPs in retirement are penalized by taxes combined with exorbitant clawbacks of government benefits – a real disincentive for lower income Canadians to save.

The TFSA is the ideal solution for Angie to put money away for retirement because withdrawals are tax-free and are not included in the eligibility for income-tested benefits such as the GIS. It is estimated that many millions of Canadians are like Angie, with little or no pension savings. They will be incented to use TFSAs knowing they can protect their basic federal benefits including the GIS.

Romeo, 67, is a long service employee who hopes to work until age 71 when he will no longer be able to contribute to his Group RRSP. The TFSA is a great alternative for him to create non-taxable investment income as he plans to live off his company pension, RRSPs, and investment income while continuing to contribute to his TFSA to earn tax-free income which can be withdrawn later to help pay some of his retirement living expenses.

Retirement Income

Andrea, 52, is a mid-career executive in the 40 per cent tax bracket. She is married to Tyler, a homemaker spouse who has no company pension plan and minimal savings. Andrea expects to have retirement income in excess of \$90,000 from government and company pensions and other non-registered investments at retirement. She has topped out her tax-sheltered retirement savings and is looking for strategies that will save tax and avoid the OAS clawback. Can she do it? Yes, because the TFSA allows her to contribute to her spouse's TFSA without facing the attribution rules that normally restrict one spouse from giving investment money to the other. The TFSA, along with the new pension income-splitting rules, will enable Andrea to reduce her marginal tax rate and avoid the OAS clawback.

Saul, 46, is a middle income employee with 12 years of service who has taken advantage of all of the benefits his employer offers. He's worried about his mortgage down the line. If we apply some basic financial planning principles and look at possible future scenarios, we can see how the TFSA can work for Saul. Assume it is now 2012 and Saul has accumulated \$19,000 in his TFSA (averaging a return of six per cent per year). Assume inflation has reared its ugly head, interest rates have risen substantially, and Saul's five-year mortgage at 4.75 per cent has come due with current renewal rates offered around 8.25 per cent.

Most Difficult

Under those conditions, Saul feels it would be most difficult to earn an investment return greater than the 8.25 per cent interest rate on the mortgage. Accordingly, he wisely decides to pay down the principal on his mortgage using the \$19,000 in his TFSA. If, and when, mortgage rates decline to a rate of six per cent or less, Saul plans to re-contribute the \$19,000 back into his TFSA. Saul is no longer worried.

Sylvia, 59, is in a 33 per cent marginal tax bracket and plans to semi-retire next year and take a well-deserved vacation for six weeks. Upon her return, she plans to complete a few projects and some other meaningful activities that she has been putting off for years. Sylvia plans to begin a second career as a consultant and has discussed the potential opportunity of working for her former employer on a contractual basis to supplement her retirement income.

Sylvia plans to start her CPP at age 60 instead of the normal commencement date at age 65. She will be entitled to 70 per cent of her full CPP which amounts to \$619 per month and she plans to invest \$5,000 annually, or \$417 on a monthly basis, into a TFSA. How much will she have if she invests from age 60 to 65 at a return of 6.5 per cent? Using the shelter of a TFSA her total contributions of \$25,000 over the five years will grow to \$30,207.

Simple Tax Planning

Teresa, 37, a member of the sales team for 15 years, has a fluctuating income and wants to flatten the peaks by directing money to the

company-sponsored TFSA each year. In peak earning years when she is paying the highest rate of tax, she plans to lower her tax burden by contributing to her RRSP with funds accumulated in her TFSA. The key principle Teresa is using here is simple tax planning. It is conventional wisdom to make RRSP contributions in high tax bracket years and plan on withdrawing retirement income at a time when the investor is enjoying a lower tax bracket. The TFSA allows this principle to be put to use during Teresa's working years.

Of course, the TFSA is merely another example of how the financial world is constantly changing. Markets go up and down; interest rates rise and fall; and inflation recedes and then reappears. As the examples above amply demonstrate, your employees' needs continually evolve as their careers unfold, their pay changes, they marry and raise families, and the children leave – and nowadays often return! As they close in on their retirement years, it is essential to equip them to cope with these predictable – and sometimes unpredictable – life events. To do so means engaging them in an ongoing process of education. Effective education is holistic, treating the students as whole human beings and sharing with them the wisdom of life experience as well as the technical details of the latest new thing in the financial world.

As the introduction of the new TFSA draws near, it's not too early to prepare a comprehensive education strategy to help your employees understand how they can use the TFSA to achieve their personal financial goals. The better they understand this new vehicle, the better they will appreciate all you do for their financial security. ■

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