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RETIREMENT

INFO ADVICE

Tax-Free Savings Accounts (TFSAs)

... or a dual purpose tax tool!

The Tax-Free Savings Account, or TFSA, has been part of the financial landscape of Canadians for almost 10 years, specifically since January 1, 2009. Besides the increase in the contribution limit in 2015, there have been few changes to this tax vehicle since its creation.

The TFSA in Canada*

- 11.7 Million account holders
- 40% of Canadian taxpayers have a TFSA
- $45.8 Million in annual contributions
- $151.6 Million invested in this tax vehicle.

** CRA statistics relative to TFSAs (2014 tax year)*

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How TFSAs Work

Contributions

- As of January 2009, Canadian residents aged 18 years and older[1] (no upper age limit) with a valid Social Insurance Number residing in Canada have the right to open a TFSA.
- In 2018, the annual contribution rights are equal to $5,500 regardless of how much is contributed to an RRSP or a Registered Pension Plan (RPP).
- The TFSA annual contribution rights are indexed according to inflation and rounded to the nearest $500.
- TFSA contribution rights do not depend on the level of earned income.
- Unused TFSA contribution room may be carried forward to future years.
- TFSA contributions are not deductible when calculating income tax.
- An individual may consult his/her TFSA contribution rights in *"My Account"* on the Canada Revenue Agency website.
- Investment income accumulation on contributions is tax-sheltered.
- Excess contributions above the limit are subject to a 1% tax every month of the excess amount, until they are withdrawn.

Indexing the TFSA Dollar Rights

The TFSA dollar rights are independent of earned income. For 2009, the limit is $5,000. Afterwards, it was intended to be indexed to inflation, and rounded to the nearest $500. This methodology still holds, with the exception of a one-time increase to $10,000 in 2015, which was reduced back to $5,500 in subsequent years. To better explain the calculation methodology, see below the evolution of the TFSA contribution limit since 2009. The inflation rate is the one used for federal tax parameters. We expect to see the contribution limit set at $6,000 starting in 2019.

TFSA LIMITS

Year	**TFSA Amount**	Inflation	Annual Contribution Rights	Cumulative Contribution Rights
2009	$5,000		$5,000	$5,000
2010	$5,030	0.60%	$5,000	$10,000
2011	$5,100	1.40%	$5,000	$15,000
2012	$5,243	2.80%	$5,000	$20,000
2013	$5,348	2.00%	$5,500	$25,500
2014	$5,396	0.90%	$5,500	$31,000
2015	$5,488	1.70%	$10,000[2]	$41,000
2016	$5,559	1.30%	$5,500	$46,500
2017	$5,637	1.40%	$5,500	$52,000
2018	$5,722	1.50%	$5,500	$57,500

[1] In certain provinces and territories, the legal age (according to the legal age of majority) at which an individual can sign a contract (including opening a TFSA) is 19 years. However, since 2009, an 18-year-old individual who is otherwise eligible can accumulate TFSA contribution rights for that year and add them to the contribution rights of a TFSA in the following year. These provinces are British Columbia, New Brunswick, Newfoundland, Nova Scotia, the NorthWest Territories, Yukon and Nunavut.

[2] The one-time contribution limit for 2015 was $10,000.

Example:

An individual, born in 1996 and a Canadian resident since birth, opens her first TFSA account in 2017 to celebrate turning 21. Her TFSA contribution rights have accumulated since the year she turned 18, that is, since 2014. They are $5,500 for 2014, $10,000 for 2015, $5,500 for 2016, $5,500 for 2017 and $5,500 for 2018, for a cumulative total of $32,000.

She will therefore be able to contribute a maximum amount of $32,000 to hew new TFSA.

Withdrawals

- Withdrawals of TFSA principal and income amounts are non-taxable.
- TFSA funds may be withdrawn at any time if the financial product allows (no age limit) and an amount equal to the amount withdrawn can be recontributed in subsequent years.
- TFSA withdrawals and investment income do not affect the calculation of government benefits based on the taxpayer or his/her spouse's income, such as:
  - Old Age Security (OAS) pension;
  - Guaranteed Income Supplement (GIS);
  - Child Tax Benefit (CTB);
  - GST credit, medical expense tax credit and the Age Amount credit;
  - Employment Insurance benefits.

Example:

Over the years, Sophie has contributed a total amount of $20,000 into her TFSA, whose current value in March 2016 was $22,500. On January 1, 2016, she has unused TFSA contribution rights of $26,500 and has not contributed since. In March 2016, she withdrew $22,000 from her TFSA to pay for home renovations.

If, in September 2016, she wishes to recontribute to her TFSA the maximum amount possible, she could contribute a total of $26,500 (the amount of unused TFSA contribution rights), and she could add an additional $27,500 on or after January 1, 2017.

If Sophie waited until January 1, 2017 to recontribute to her TFSA, she could contribution a total of $54,000 at that time.

Previous years' unused contribution rights, prior to January 1, 2016	$26,500
(+) The amount withdrawn from the TFSA in 2016 (other than eligible transfers)[3]	$22,000
(-) The amount contributed to the TFSA in 2016	($26,500)
(+) The new contribution rights for 2017	$5,500
Total contribution rights for 2017	$27,500

[3] An eligible transfer is a direct transfer between the TFSAs of a given holder or a transfer from the holder's TFSA to the TFSA of his/her previous or current spouse carried out following a court order or judgement or a written agreement associated with the separation of property following the settlement of rights arising from the breakdown of the relationship if they lived separately at the time of the transfer.

Comparison with RRSPs from a Tax Perspective

The following is a comparison of the features of TFSAs and RRSPs.

Similarities with RRSPs:

- Tax-free income accumulation.
- No restrictions on withdrawals.
- Unused annual contribution room is carried forward.
- Penalties for overcontributions.
- Interest on loans made to contribute to these plans is not deductible.
- Similar qualifying investments.
- Account can be rolled over to spouse at death.
- Deemed disposition when securities are transferred from a regular account to a TFSA. Capital gains are taxable but losses are deemed nil.

Differences:

- No $2,000 exemption for excess contributions to a TFSA.
- TFSA contributions are not deductible for income tax purposes.
- Withdrawals of capital gains, income and contributed capital are not taxable.
- Minimum age to open a TFSA is 18 (19 in certain provinces); there is no minimum age for RRSPs.
- No expiry date (RRSPs must be converted at age 71).
- Annual contribution rights for TFSAs are attributed regardless of income earned.
- TFSA funds can be used as collateral if the lender allows.
- There is no spousal TFSA, but money can be given to a spouse for his/her contribution without triggering the attribution rules.
- Withdrawals (other than eligible transfers) create additional contribution room of equal amount for the following calendar year or for any other following calendar year.
- TFSA withdrawals have no impact on social-tax programs (for example, recovery of Old Age Security (OAS) or the Guaranteed Income Supplement (GIS)) nor on income-based tax credits.
- TFSAs are not included in family patrimony in Quebec.

The tax treatment for TFSAs is comparable to that for RRSPs if the tax rate at the time of the RRSP contributions is the same as the rate at the time of the withdrawals. This is usually the case for high-income individuals who are taxed at the top marginal rate for both contributions and withdrawals.

RRSPs or TFSAs?

An RRSP is can offer a tax savings for an individual with a current tax rate that is higher than the rate applicable at the time of the withdrawal of his or her contributions. As well, pension income splitting rules generally favour RRSPs, as the spouse's tax rate may be even lower than the individual's at withdrawal.

A TFSA is more beneficial for individuals who may suffer a reduction in OAS or GIS following an increase in income caused by a RRSP/RRIF withdrawal. As well, a student with a low tax rate would be better off contributing to a TFSA rather than an RRSP to build up their savings and retain RRSP contribution rights for the future. The great flexibility of the TFSA is also interesting for the individual who plans to retire in the near term. Effectively, and as opposed to the RRSP, TFSA withdrawals create new contribution rights that are recoverable as early as the subsequent year.

A TFSA will be attractive for many individuals who do not have RRSP contribution rights as well as retirees over the age of 71 years who are required to withdraw from their RRIF and do not require this income. Effectively, retirees could continue to accumulate tax-sheltered investment income by simply transferring their RRIF amounts into a TFSA once their taxes have been paid. The TRFS will greatly benefit individuals who already have non-registered savings (and have maxed out their RRSPs), as well as for some individuals with low incomes who still manage to save.

The two savings plans complete each other favorably as they generally fulfill different needs.

- The RRSP is principally conceived to save for retirement.
- The TFSA, because of non-taxable withdrawals, is a chosen vehicle to save for a project: buying a car, renovating a home, launching a business, travelling, etc.

TFSA/RRSP Comparative Table

	TFSA	RRSP
Effective date	2009	1957
Minimum age	18 years*	None
Plan maturity (winding up)	None	Year of 71st birthday
Contribution limit	2018: $5,500	2018: $26,230
Limit as a % of earned income	None	18%
Carrying forward unused room	Accumulated annually	Accumulated annually
Withdrawal limits	None	None
Re-contribution of withdrawals	Yes	No
Tax deductions for contributions	No	Yes
Tax on income	No	Yes
Tax on withdrawals	No	Yes
Excess contributions	1% penalty/month	1% penalty/month if > $2,000
Impact on government benefits	No	Yes
Family patrimony (QC)	No	Yes
Seized during bankruptcy	Yes	No, except contributions made in the 12 months preceding the bankruptcy
Contribution to spousal account	No, but funds can be given to spouse for contribution	Yes
Attribution rules	No	No, except for the "three December 31s" rule for spousal RRSPs
Tax impact at death	No	Yes, unless rollover by "reimbursement of premiums"
Transfer to spouse	Yes, rights unaffected	Yes, rights unaffected
Use as collateral	Yes	No
Loan interest for borrowed contributions	Non-deductible	Non-deductible

** 19 in some provinces*

The Non-Resident

Individuals can contribution to a TFSA up to the day that they cease to be a residents of Canada. TFSA contribution rights can accumulate for the year of departure, if the individual is 18 years or older and is considered to have been residing in Canada at least one day during the year of departure. As such, if the individual returns to reside in Canada later on, he/she could use his/her accumulated contribution rights. No TFSA contribution rights accumulate for the complete years that the individual does not reside in Canada. Even if non-resident cannot contribute to their TFSA, they can maintain an existing TFSA; investment income and withdrawals continue to be non-taxed in Canada.[4]

All withdrawals made by an individual while he/she is not residing in Canada will be added to TFSA contribution rights for the subsequent year and will be available should the individual return to live in Canada. If a non-resident contributes to a TFSA during the period of non-residence (except in the case of an qualifying transfer or exempt contribution), he/she will be required to pay a tax of 1% for each month that they contribution remains in the account.

The same principle applies for the arrival of an immigrant to Canada: if the individual is reputed to have resided in Canada at least one day in a given year and is 18 years of age or older, he/she is eligible for the entire TFSA contribution rights for that year; the annual contribution limit is not pro-rated through the emigration or immigration year.

Example:

> *An individual becomes a Canadian resident in March 2017 and has a valid SIN. He/she can therefore open a TFSA account in 2017 and deposit a maximum amount of $5,500, as the full annual TFSA contribution rights accumulate starting the first year of residence.*

TFSAs and Marriage Break-up

A TFSA can be transferred directly between the TFSA of two previously married spouses if the transfer is conducted following a court order or judgement, or a written separation agreement between the ex-spouses.

To settle the share of property accumulated during the marriage at the time of dissolution, it is possible, as with an RRSP, to complete an admissible transfer and to transfer part or the whole of a TFSA of one spouse to the other spouse's TFSA without affect contribution rights of either spouses. That is, the TFSA contribution rights of the transferor will not be increased by the amount of the transfer, and the receiver's rights will not be decreased.

In Quebec, it is important to note that the TFSA is not part of the family patrimony. However, during a divorce, the sharing of a TFSA will be established according to the rule of the matrimonial regime established at the time of the marriage. If the spouses chose a partnership of acquests, the default matrimonial regime since July 1, 1970 in Quebec, the TFSA will be sharable in the case of divorce or separation.

[4] The TFSA is not considered to be a tax shelter in the United States. American residents must declare income from their TFSA in their U.S. income tax return. It is recommended that all Americans (citizens or residents) meet with an accountant specialized in U.S. tax law before contributing to a TFSA.

TFSAs at Death

At the time of death, the TFSA ceases to exist unless a replacement holder is named[5], but the TFSA can be bequeathed through a will to anyone. However, only a surviving married or common-law spouse has the option to designate the accumulated amount in the TFSA as an exempt contribution and to transfer the balance at the time of death into his or her own TFSA without impacting his/her personal contribution rights.

For the surviving spouse to be able to designate an exempt contribution, he/she must receive the amount and contribute it to his/her TFSA during the rollover period (a period that starts at the time of death of the TFSA holder and ends on December 31 of the following calendar year). As well, the survivor must declare the survivor payments as exempt contributions on the RC240 form: Designation of an Exempt Contribution – Tax-Free Savings Account (TFSA), and send the declaration within 30 days following the date of contribution to his/her TFSA. Failure to fill in this form will cause a taxation of 1% per month on the amount exceeding the survivor's TFSA rights.

The total amount of exempt contributions declared within the rollover period cannot exceed the market value of the deceased's TFSA at the time of death. If there has been investment income and gains in the TFSA between the date of death and the transfer date, this amount will be taxable to the survivor.

Example:

Claire died on February 2, 2016. She lived in Quebec with her common-law spouse Rémi. The value of her TFSA at her time of death was $20,000. Her estate was settled on August 15, 2016. During this period, an amount equal to $500 was earned and the total amount of $20,500 was paid to Rémi. The value of Claire's TFSA at her time of death, $20,000, is non-taxable. The additional $500 earned after the date of death is taxable to Rémi and will be indicated on a T4A tax slip.

Since the amount paid to Rémi, as surviving spouse, was made during the rollover period, Rémi can transfer up to $20,000 (the value of the TFSA at the time of death) into his own TFSA as an exempt contribution, as declared on a RC240 form, without affecting his own contribution rights.

If, at the time of death, the TFSA holder resides in a province that recognizes beneficiary designation[5], the surviving spouse can be designated as the successor holder in the TFSA contract or in a will[6].

If the survivor is named as a successor holder, he/she becomes the new TFSA holder immediately after the death of the original holder. The TFSA therefore continues to exist and its value at the time of death of the original holder, as well as any income gained after this date, continues to be tax-free for the new successor holder.

It is also important to note that, as of the time of death, no additional contribution is permitted to the deceased's TFSA and unused contribution rights cannot be transferred to the surviving spouse. If there were unused TFSA contribution rights at the time of death, these rights are lost.

When a TFSA is bequeathed to someone other than the deceased's spouse, the amount accumulated up to the time of death is not taxable and is distributed to the heir. Heirs can, if they wish, deposit the amount in total or in part in their own TFSA if they have unused contribution rights.

In the absence of a will, the TFSA holder's estate will receive the amounts in the TFSA and the executor/liquidator will distribute these funds according to the rules of distribution of assets of an estate without a will. In all cases where the spouse does not inherit the TFSA, income and gains accumulated in the account between the date of date and the date of transfer are taxable to the estate.

[5] In Quebec, it is not possible to designate a beneficiary or successor holder for TFSAs (except for annuity or insurance contracts).
[6] Source: Government of Canada: https://www.canada.ca/en/revenue-agency/services/tax/individuals/topics/tax-free-savings-account/death-a-tfsa-holder/successor-holder.html.

Excess TFSA Contributions

You have an excess TFSA at any time during the year as soon as the total of all contributions to a TFSA that you have made in the year (other than qualified transfers or exempt contributions) exceed

- the total of your TFSA contribution rights at the start of the year, plus
- all **eligible** amounts withdrawn during the year.

Any excess TFSA contribution will be taxed at a rate of 1% per month.

Example:

In 2016, Julie started the year with $5,500 in TFSA contribution rights.

Julie's contributions and withdrawals during 2016 are as follows:

- *Contribution on April 25 of $1,500*
- *Contribution on May 16 of $4,000*
- *Withdrawal on June 15 of $2,000*
- *Contribution on August 23 of $2,000*
- *Withdrawal on September 8 of $1,500*

Julie's first two contributions, in April and May, reduced her TFSA contribution rights to zero. Since her June withdrawal is not added to her contribution rights until the following year, her August contribution caused an excess TFSA amount of $2,000 during that month. The withdrawal of $1,500 in September will be considered as a part of an eligible withdrawal in the calculation of the maximum excess amount for the following month (October). Julie has an excess TFSA amount of $500 up to the end of the year and will have to pay a 1% tax for the months of August to December.

Julie's tax will be calculated as follows:

- *The maximum excess TFSA amount for the months of August and September = $2,000. Tax = 1% per month on the maximum excess = $2,000 x 1% x 2 months = $40.*
- *The maximum excess TFSA amount for the months of October to December = $500. Tax = 1% per month on the maximum excess = $500 x 1% x 3m months = $15.*[7]

[7] RC4466 2016 "Tax-Free Savings Account (TFSA), Guide for Individuals", p.16.

Did you know that…

A TFSA is the better option if the holder expects to make withdrawals in the short or medium term (home purchase, travel, etc.). Unlike RRSPs, withdrawn amounts may be recontributed in subsequent years.

Choosing an RRSP allows an individual to build up more pre-tax savings for the same expenditure due to the tax deductibility of contributions.

When savings are intended essentially for retirement, RRSPs offer a better disincentive to making withdrawals for other purposes because of the tax impact.

At death, a TFSA can be transferred up to December 31 of the year following death.

A TFSA might be of interest to individuals concerned over future tax increases or who wonder if income-based rules will be introduced to finance government programs such as healthcare.

In the event of a relationship breakup, it is possible to transfer one spouse's TFSA to the other's without any adverse impact on contribution rights.

A capital loss on a non-registered investment may be deemed nil if it is sold in a taxable account and bought by a TFSA within 30 days before or after the disposition (as for RRSPs).

TFSAs may not be held in a spousal testamentary trust.

Individuals should maximize their TFSAs and RRSPs before thinking about other types of savings. Those with young children should also give serious thought to RESPs because of the related grants.

As opposed to RRSPs, which allow the use of unused contribution rights to contribute to a spousal RRSP in the year of death or the first 60 days of the following year, unused TFSA contribution rights disappear when an individual dies.

It is possible to benefit twice by contributing an amount in an RRSP and then reinvesting the tax savings in a TFSA.