The Tax-Free Savings Account

The Tax-Free Saving Account (TFSA) was proposed in the 2008 federal budget, and has been in effect since 2009. Possibly one of the most significant changes to Canada's savings system since the introduction of the Registered Retirement Savings Plan (RSP) in 1957, the TFSA is a tax-efficient and flexible savings option which should complement any financial plan.

Canadian residents who are at least 18 years of age and who have a valid social insurance number are permitted to contribute to a TFSA throughout their lifetime. Residents of provinces and territories where the age of majority is 19 (British Columbia, New Brunswick, Newfoundland and Labrador, Northwest Territories, Nova Scotia, Nunavut and Yukon) cannot open a TFSA until they reach age 19; however, the accumulation of contribution room starts at age 18.

An individual could contribute up to $5,000 to a TFSA for each of the years 2009 to 2012; and up to $5,500 for each of the years 2013 and 2014. According to the 2015-2016 federal budget, the TFSA annual contribution limit will be $10,000 for 2015 and subsequent taxation years. The limit is subject to change by the federal government, and starting in 2015, the limit will not be indexed to inflation.

If you do not contribute to a TFSA in any given year or if you contribute less than your maximum amount for the year, any unused contribution room from previous years and any withdrawals made in previous years are added to the annual TFSA contribution limit, which can be carried forward indefinitely on a cumulative basis.

While contributions to a TFSA are not tax-deductible, any income earned in the account *(e.g.*, investment income and capital gains) is tax-free, as withdrawals are generally. Since TFSA withdrawals are treated as non-taxable income, income earned in the account or amounts withdrawn from a TFSA will not affect your eligibility for federal income-tested benefits and credits, such as the Guaranteed Income Supplement, Old Age Security, Employment Insurance Benefits or the Canada Child Tax Benefit.

Other Characteristics of the TFSA

- You can use the TFSA to split income with your spouse or common-law partner by giving them funds to contribute to their TFSA and not have income attributed back to you.

- On death, your TFSA can:
  - be paid out to your beneficiaries tax-free, subject to certain conditions;
  - be transferred to your spouse or common-law partner's TFSA if he or she is the beneficiary, upon satisfying certain conditions; or
  - continue with your spouse or common-law partner as the successor holder.

- Beneficiary and successor holder designations can be made on TFSA accounts in all provinces except Quebec, where the beneficiary designation can be made through a Will.
- When there is a breakdown in a marriage or common-law relationship, an amount can be transferred directly from one individual's TFSA to the other's TFSA without affecting either individual's contribution room, so long as certain conditions are met.
- At any time during a given month, if you have contributed more than your allowable TFSA contribution room, you will be subject to a penalty tax equal to 1% of the highest excess TFSA amount in the month.
- You will not be able to deduct interest on money borrowed to invest in a TFSA.
- TFSA assets can be used as collateral for a loan.
- If you cease being a Canadian resident, any contributions made while you are a non-resident will be subject to a 1% per month special tax until you become a Canadian resident, or until you withdraw the amount and designate it as a withdrawal of a non-resident contribution. In addition to this tax, you may also be subject to the penalty tax described above of 1% per month if any of the same contributions create an excess TFSA amount. Furthermore, no contribution room will accrue for any year in which you are a non-resident for the entire year. Your TFSA will continue to grow on a tax-free basis in Canada and you will not be subject to any Canadian withholding taxes on withdrawals. (To determine the tax treatment of the TFSA in your new jurisdiction, you should consult a tax advisor in your new country of residence.)

Registered Retirement Savings Plan or Tax-Free Savings Account?

You may wonder whether you should put your money into an RSP or a TFSA. The answer will depend on a number of factors, including whether you will need to access the money on a short-term basis and your expected tax rates both at the time of contribution and withdrawal. If you expect your tax rate to be lower in retirement than when you make your contribution, then an RSP strategy may be preferable. Conversely, if you expect your tax rate to increase in retirement, then contributing to a TFSA may be more advantageous. If you expect your tax rate to remain the same at the time of RSP contribution and withdrawal, then the TFSA and RSP strategies may produce the same result. Please consult your tax advisor to discuss your personal circumstances.

While the RSP is intended to be a retirement savings vehicle, the TFSA is intended to encourage savings in general. The RSP provides immediate tax savings, but a TFSA does not. However, the TFSA provides a tax-free savings vehicle for people who have limited access to RSPs, namely:

- individuals who do not generate earned income (*e.g.*, young adults and homemakers);
- seniors who want to shelter investment income;
- individuals who have maximized their RSP contribution room; and
- individuals with large pension plans that generate large pension adjustments.

As the two options are not mutually exclusive, and the TFSA is offered in addition to the current RSP limits, you may choose to have a combination of RSPs and TFSAs for different savings goals. In addition, you can use the tax savings from the RSP contribution to contribute to the TFSA.

Registered Retirement Savings Plan vs. Tax-Free Savings Account

	RSP	TFSA
Contribution limit	18% of previous year's earned income to a maximum of $24,930 (2015), adjusted for certain amounts (*e.g.*, pension adjustment, past service pension adjustment, pension adjustment reversal)	The total of: ▪ $5,000 for 2009-2012, $5,500 for 2013 and 2014, and $10,000 for 2015 and subsequent tax years; ▪ Withdrawals made from the TFSA in the previous year; plus ▪ Unused TFSA contribution room from the previous year
Contributions	Tax-deductible	After-tax
Income & Growth	Tax-deferred	Tax-free
Withdrawals	▪ Taxable: affects income-tested amounts ▪ Amount withdrawn cannot be re-contributed	▪ Tax-free: does not affect federal income-tested amounts ▪ Amount withdrawn is added to the contribution room in the following year
Primary purpose	Retirement savings	Savings for any purpose
Plan maturity	End of year when you turn 71	None, there is no upper age limit on contributions
Spousal plan	Permitted	Not permitted
Creditor protected	▪ Creditor protected in the event of bankruptcy (other than contributions in the previous 12 months) ▪ Some provinces may provide additional creditor protection	Generally not protected

Given the different tax characteristics of a TFSA (tax-free), an RSP (tax-deferred), and a non-registered investment account (taxable), you may want to review the types of investments you currently hold in these investment vehicles to ensure that your overall investment portfolio is structured in the most tax-efficient manner. Talk to your TD Wealth advisor about how you can incorporate Tax-Free Savings Accounts into your personal financial plan.

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