The Tax-Free Savings Account
Good for pre-retirement and retirement

A Tax-Free Savings Account (TFSA) is a flexible investment account that you can use to meet short and long-term goals. Assets held inside a TFSA can earn interest, dividends or capital gains, but this income is not taxed, even when amounts are withdrawn from the TFSA, unlike a Registered Retirement Savings Plan (RRSP). Therefore, a TFSA can be used for both retirement and preretirement goals.

Unlike an RRSP, a TFSA does not have to be closed when you turn 71. You can continue to contribute to it and take advantage of tax-free growth inside it for the rest of your life.

You can open a TFSA during the year your turn 18, as long as you have a Social Insurance Number. Even if your birthday is late in the year, you will be allowed to contribute up to your full contribution limit that year.

The initial contribution limit when the TFSA was introduced in 2009 was $5,000. In 2013, the limit was set at $5,500. Then in 2015, the limit was raised to $10,000. Subsequently, however, the contribution limit was dropped back to $5,500.

If you don’t contribute fully to your TFSA in any given year, the unused contribution room will be carried forward indefinitely until your death.

A TFSA allows for the purchase of similar qualified investments as an RRSP such as stocks, bonds and mutual funds. You can have more than one TFSA if you like, as long as you don’t exceed your total annual contribution room. If you do, the excess will be taxed at 1% a month — on the highest balance in your account that month — until the excess is withdrawn or subsequently absorbed into unused contribution room in a future year. You can transfer to another or a new TFSA as long as the funds are directly transferred between accounts.

Consider opening a TFSA and the ways you can use it to meet your needs, present and in retirement. Ensure you don’t exceed your contribution room.
Tax treatment of a TFSA

If at some point you become a non-resident of Canada, you will be subject to departure tax rules, which deem you to have disposed of all your property and required it, creating a tax liability. However, certain assets are excluded from these rules, including TFSAs and other registered plans.

You can contribute to your TFSA up to the date your residency status changes. You can also continue to benefit from the tax-deferred treatment of the investments when you are a non-resident. You will not accrue new contribution room while you remain a non-resident. If you do make a contribution, those funds will be taxed 1% for every month they stay in the account, in addition to a 1% penalty for an excess contribution.

There are a few key differences between an RRSP and a TFSA. With an RRSP your contributions reduce your tax payable. Your contributions and investments held in the plan can grow tax-free, but upon withdrawal, you will be taxed.

With a TFSA, you do not get a tax deduction for making a contribution, so you are contributing with after-tax income. You do get the benefit of tax deferral on any investment held within the vehicle. Crucially, when you withdraw the income you will not be taxed.

Any withdrawal creates new TFSA contribution room in the following year.

Finally, when you use up your RRSP contribution room, it can’t be recovered. That’s not true for a TFSA. Any withdrawal creates new TFSA contribution room in the following year. Perhaps you want to withdraw money from your TFSA to make a down-payment on a house, assist in funding your child’s university education, or any personal reason that you choose. This easy accessibility can be an attractive feature of a TFSA.

On the other hand, you may wish to keep the TFSA well into retirement as a source of non-taxable income.

Other uses of a TFSA

Since withdrawals from a TFSA are not taxed, your TFSA can be used as collateral for a loan or line of credit. You can’t do that with your RRSP. If you did, your RRSP would be taxed.

There are no spousal TFSAs, but a spouse or common-law partner can give the other partner funds to contribute to their TFSA. Any income your spouse earns on the money in their TFSA is theirs and will not be attributed back to you.

If your marriage or common-law partnership breaks down, any TFSA amount can be transferred from one partner to the other on a tax-free basis. Official documentation, such as a separation agreement or divorce decree, is required to permit a tax-exempt transfer to facilitate the settlement of property equalization or support. It should be noted that a transfer does not affect the recipient’s contribution room.

The “superficial loss rules” are relevant to TFSAs. These rules apply to defer recognition of a loss you incur by disposing of capital property when that property, or identical property (e.g., a particular stock) is purchased or repurchased by you, or an affiliated person, 30 days before or after the sale. A TFSA of which you are a beneficiary will generally be considered to be an affiliated person for the purpose of this rule.

One of the biggest benefits that a TFSA has over an RRSP is that funds withdrawn from a TFSA are not taxable income. As a result, such withdrawals do not have an impact on income-tested benefits such as Old Age security and Guaranteed Income Supplement or tax credits such as Age Credit or GST/HST credit. For seniors, a TFSA may be a good vehicle for investments that pay dividends. While the tax on dividends is mitigated by the dividend tax credit, dividends earned outside a registered plan will have an impact on income-tested benefits.

There is some debate over whether your investing focus should be on an RRSP or a TFSA. Your tax rate will be pivotal to this consideration. If your tax rate in
retirement will be lower when you withdraw funds from a registered plan than when you contributed them, the RRSP may be a better focus. However, another way to look at the issue is consider using your RRSP for your retirement needs and a TFSA for supplemental retirement income needs.

Talk with your TD advisor about the multiple uses of a TFSA. Can you afford to contribute the maximum amounts to an RRSP and a TFSA? Given the differences between the two vehicles and the tax implications, your advisor can help you decide where to direct your contributions in the context of your overall retirement plan.

Calculating your TFSA contribution room: an example

Your TFSA contribution room consists of:
- Your current year TFSA dollar limit;
- any unused TSFA contribution room from previous years; and,
- Any withdrawals made from the TFSA in the previous year.

Let’s look at an example:

From 2010 until the end of 2014, Jacob contributed the maximum TFSA dollar limit each year. He did not make any other contributions or withdraw any funds. His TFSA contribution room at the beginning of 2015 was $10,000 (the 2015 TFSA dollar limit).

On June 15, 2015, Josh made a contribution of $500. On October 26, 2015, he withdrew $4,000. His unused TFSA contribution room at the end of 2015 was $9,500 ($10,000 - $500). Jacob will make the following calculation to determine his TFSA contribution room at the beginning of 2016:

Step 1: Unused TFSA contribution room at the end of 2015

TFSA contribution room at the beginning of 2015 ($10,000) minus contributions made in 2015 ($500) = Unused TFSA contribution room at the end of 2015 ($9,500).

Step 2: TFSA contribution room at the beginning of 2016

Unused TFSA contribution room at the end of 2015 ($9,500) + total withdrawal made in 2015 ($4,000) + 2016 TFSA dollar limit ($5,500) = TFSA contribution room at the beginning of 2016 ($19,000).

A TFSA and your beneficiaries

Upon death, only your spouse or common-law partner is considered to be the survivor of your TFSA. A survivor can be named as the successor holder or beneficiary of your TFSA.

A survivor as a successor holder can acquire all the rights to your TFSA and it will continue to exist. The successor holder does not require unused contribution room to facilitate the transfer. However, if your TFSA is in an over-contribution position when you die, your successor will need unused room, or be made to pay over-contribution penalties.

Alternately, a survivor can be designated the beneficiary of your TFSA. The survivor can then transfer the funds in your TFSA into their own TFSA and designate this transfer as an “exempt contribution”. This must be done between the date of death and December 31st in the year following the year of your death. The amount of the exempt contribution cannot generally exceed the value of the plan as of the date of death. Any funds that accrue in the plan after death would require your survivor to have contribution room. The growth between the date of death and the date they receive the funds will be taxed.

A person who is not a survivor and is designated as a beneficiary will acquire the rights to your TFSA funds, but they will need TFSA contribution room in order to receive the funds and not have it taxed as excess. They will not have the ability to designate an exempt contribution. They will also be taxed on any growth in your TFSA between the date of your death and the date they receive the funds.
Please note that successor or beneficiary designations cannot be made on the plan document in Quebec. Instead, the designation must have been made in the deceased's Will.

*If you do not name a successor holder, or designate a beneficiary,* the fair market value of the TFSA will paid tax-free to your estate. Any income that accrues after the transfer will be taxable to your estate.

*Are you naming your spouse or common-law partner as your “successor holder”? Or, will you designate them as your TFSA beneficiary? It will affect how they receive the funds. If you don’t designate a beneficiary, there may be tax implications. Ensure you know what they are. If you have questions about passing on your TFSA, speak with your TD advisor.*

---

**Now are ready to:**

- Consider opening a TFSA account and how you might use it to meet your needs today and down the road
- Consider how you and your spouse or common-law partner can use a TFSA to your advantage
- Appreciate the tax implications for a beneficiary who is neither your spouse, nor your common-law partner

---

The information contained herein has been provided by TD Wealth and is for information purposes only. The information has been drawn from sources believed to be reliable. The information does not provide financial, legal, tax or investment advice. Particular investment, tax, or trading strategies should be evaluated relative to each individual’s objectives and risk tolerance. TD Wealth represents the products and services offered by TD Waterhouse Canada Inc. (Member—Canadian Investor Protection Fund), TD Waterhouse Private Investment Counsel Inc., TD Wealth Private Banking (offered by The Toronto-Dominion Bank) and TD Wealth Private Trust (offered by The Canada Trust Company). © The TD logo and other trademarks are the property of The Toronto-Dominion Bank.