TD Wealth

Wealth Insights

TD Wealth Private Investment Advice

Monthly Perspectives From The Daley Group Wealth Management

Did You Know? The TFSA May Not Always Be Tax Free

The Tax-Free Savings Account (TFSA) has become known as a great account in which to invest and not have to worry about funds going to the tax collector. But, just when you thought you could get off "scot-free", did you know that there may be instances in which TFSA funds may be subject to tax?*

Not all investments held within a TFSA are free of tax. Foreign dividend-paying shares held in the TFSA may be subject to a withholding tax on dividends paid. The U.S. imposes a 15 percent withholding tax on the dividends paid to Canadians by U.S. corporations. Registered Retirement Savings Plan (RSP) and registered Retirement Income Fund (RIF) accounts are exempt from this tax under the Canada-U.S. tax treaty. For non-registered accounts, this withholding tax can potentially be recovered by claiming a foreign tax credit. However, you can't recover this withholding tax within a TFSA.

Takeaway: Certain assets may be taxed differently based on where they are held (registered or non-registered investment accounts). Consider holding foreign dividend-paying stocks outside of a TFSA. Also, be aware that eligible Canadian dividend payments held within a TFSA will forgo the dividend tax credit.

A beneficiary could be subject to tax on a TFSA. While the TFSA can be transferred to a beneficiary on a tax-free basis at fair market value at the time of death, any gains after the holder's death would be subject to tax.

Takeaway: If the intended beneficiary is a spouse/partner, consider designating them as a "successor holder." A successor holder can continue to operate the TFSA after a spouse's death relatively seamlessly, with assets remaining in the TFSA. If a spouse is, instead, named as a beneficiary, they need to complete a transfer to their own TFSA and file certain forms with the CRA, within specific time frames. Otherwise, any gains earned after death may not necessarily be tax-sheltered.

Transfers between your own TFSA accounts can be subject to tax. Unless a "direct transfer" is completed by the financial institution, any TFSA withdrawals will only reset contribution room in the following calendar year. If no contribution room is available and these funds are deposited into another TFSA account, the amount may be subject to a penalty tax of one percent per month until contribution room becomes available.

Takeaway: If you are consolidating TFSAs, consider having the financial institution complete a direct transfer. With any TFSA contribution, ensure you have available contribution room. Information is available on your Canada Revenue Agency (CRA) online account "My Account". You can also contact the CRA to request a TFSA Room Statement.

The cumulative TFSA contribution limit for an individual who has been eligible to contribute since 2009 is $75,500 (for 2021), making the TFSA a potentially compelling investment tool. Have you fully contributed?

*This article is intended for Canadian residents who are not subject to U.S. income taxes as a U.S. person including Canadian resident U.S. citizens and green card holders.

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