WOOD GUNDY

WHAT ARE YOU SAVING FOR? THE TAX-FREE SAVINGS ACCOUNT

The Tax-Free Savings Account (TFSA) gives Canadian residents a way to save, tax-free. When you contribute to a TFSA, your investments can grow tax-free and you will not pay tax on income or capital gains earned within the account, even when you make a withdrawal, providing you follow the rules on contribution limits and eligible investments.

The TFSA can play an important role in your financial plan regardless of your stage of life. Whether you are putting money aside for a new home, a child's wedding or a family vacation, or you want to supplement your retirement income, the TFSA can help you save for what matters to you.

Features and benefits of a TFSA

- Annual TFSA dollar limit of $6,500[1]
- Tax-free growth on investments
- Funds can be withdrawn at any time, for any reason
- Withdrawals are not taxable
- Amounts withdrawn are added to next year's contribution room (other than withdrawals to correct over-contributions)
- Unused contribution room can be carried forward indefinitely

TFSA contributions

The TFSA dollar limit, as it is known in the Income Tax Act (Canada), sets out how much Canadian residents 18 years[2] of age and older are allowed to contribute annually. If you do not contribute the maximum TFSA dollar limit to your TFSA, the unused portion of your contribution room will be carried forward and added to your contribution room for future years. If you contribute more than your contribution room, the excess contributions will be subject to a tax of one percent per month on the highest amount of over-contributions for the month[3] and a penalty tax of 100 percent will be applied to any income or gains earned on the over-contributed amount.

Contributions to a TFSA are made with after-tax dollars and cannot be deducted from your income for the year. However, all income including interest, dividends and capital gains earned within your account grow tax-free and you will not pay tax on earnings when you make a withdrawal. Your TFSA contribution room is not determined by earned income and will accumulate even if you do not have any earned income in a year. TFSA contributions can be made in addition to RRSP contributions; your TFSA contribution room is not affected by contributions to your RRSP, and vice-versa.

Withdrawals from a TFSA

You can withdraw funds from your TFSA at any time, for any reason. There are no restrictions on withdrawals from a TFSA and you will not be taxed on the amounts you withdraw from your account. You can also re-contribute the amounts you withdraw from your TFSA in future years as long as you are a Canadian resident. The amount withdrawn will be added back to your contribution room in the following year, provided that the withdrawal was not to correct an over-contribution.

TFSA withdrawals are not added to your income and, as a result, will not affect any federal income-tested benefits, including Old Age Security, the Guaranteed Income Supplement and the Canada Child Tax Benefit.

Transfers between TFSAs

An individual with multiple TFSAs can transfer assets from one of their TFSAs to another without tax consequences, provided that the transfer is done directly between the TFSAs.

However, if the funds are withdrawn from one TFSA and then deposited to another TFSA belonging to the same individual, the deposit will be considered to be a contribution to a TFSA and will reduce the individual's contribution room or potentially create an over-contribution. The TFSA holder may incur penalty taxes on any income earned as a result of the over-contribution, plus a monthly penalty tax.

If you wish to transfer funds between TFSAs in which you are the holder, please ensure that the transfer is made directly from one TFSA to the other without the assets being withdrawn and subsequently contributed.

Transfers due to breakdown of marriage or common law partnership

In the event of a relationship breakdown, assets in TFSAs can be transferred to a former spouse's or common law partner's TFSA, provided the following conditions are met:

- Both parties must be living separate and apart at the time of transfer, and
- The recipient is entitled to receive the amount as part of a court order, decree or written separation agreement relating to division of property between both parties in settlement of rights arising from the relationship breakdown.

Certain specific documentation may be required to transfer from one TFSA to another on breakdown of marriage or common law partnership.

Eligible investments

You can hold many of the same investments in a TFSA that you can hold in your RRSP, including:

- Cash
- Mutual Funds
- Guaranteed Investment Certificates (GICs)
- Segregated Funds
- Stocks and Bonds:

Swap transactions

A swap transaction is an exchange of securities for cash or other securities between accounts that belong to the same holder.

A swap is generally considered to result in an advantage to the holder, results in a penalty tax equal to 100 percent of the benefit. As a result, swaps are generally not permitted.

Exceptions include swaps between two TFSAs for the same holder and certain swaps to remove non-qualified investments or prohibited investments.

Non-qualified investments

A TFSA provides you with access to a wide range of investments, from common shares to bonds, as long as they are "qualified investments" for your TFSA. There are, however, certain investments that are considered "non-qualified" when held in a TFSA, such as certain shares in private investment holding companies or foreign private companies and real estate. These investments, whether purchased as a non-qualified investment or, if after purchasing, become non-qualified, may result in certain tax consequences.

Non-qualified investments acquired by your TFSA (or qualified investments acquired that later became non-qualified), will give rise to a penalty tax of 50 percent of the fair market value of the investment on the date of acquisition, or at the time it becomes non-qualified. This tax may be refunded if the position either becomes qualified or is disposed of before December 31st of the calendar year following the year in which the liability for the tax arose.

Annuitants who owe tax for the year as the result of holding non-qualified investments must file Canada Revenue Agency (CRA) form RC243, Tax-Free Savings Account (TFSA) Return, and provide the required documentation outlined within the "Important information" section found within form RC243. The return must be filed, with payment for any balance due, no later than June 30th of the following year.

Investment income earned on a non-qualified investment in a TFSA will remain taxable to the TFSA regardless of when it was acquired or became non-qualified.

Any investment considered both non-qualified and prohibited will be deemed to be a prohibited investment only for tax purposes. See "Prohibited investments" for more information.

Prohibited investments

Even if an investment is a "qualified investment", it may still fall into a category of investments that are not permitted to be held in a TFSA without resulting in penalty taxes; these are known as prohibited investments. A prohibited investment generally includes:

- Debt of the holder
- Investments in which you have a significant interest (you own ten percent or more of the issuer, either individually or as a member of a related group), or where you do not deal at arm's length[4]

If your TFSA acquires property that is a prohibited investment or becomes a prohibited investment, a tax equal to 50 percent of the fair market value of the investment will apply as at the date of acquisition (or the date it becomes a prohibited investment). This tax may be refunded if the investment is removed from your TFSA by the end of the year following the year in which the tax was applied or if the property ceases to be a prohibited investment before the end of the calendar year in which the tax arose. Annuitants who owe tax for the year as the result of holding prohibited investments must file CRA form RC243, TFSA Return, and provide the required documentation outlined within the "Important information" section found within form RC243. The return must be filed, with payment for any balance due, no later than June 30th of the following year.

Any investment income earned on the prohibited investment while held in the TFSA will be treated as an "advantage" and may be subject to a 100 percent penalty tax.

Any investment considered both non-qualified and prohibited will be deemed to be a prohibited investment only for tax purposes. See "Non-Qualified investments" for more information.

Non-resident status

If you become a non-resident of Canada, you can continue to hold your TFSA, and your savings will continue to grow tax-free within your account, from a Canadian tax perspective. During the time that you are a non-resident, you will not be permitted to make TFSA contributions without penalty taxes applying and you will not accumulate TFSA contribution room.

The tax and trading laws of the country in which you reside will determine if you may continue to place trades in a TFSA while you are a non-resident of Canada. Currently, there is no exemption that would permit United States residents to continue to place trades in a brokerage TFSA.

Although the income earned in a TFSA is tax-free for Canadian tax purposes, may be taxable for foreign income tax purposes (e.g. US tax purposes).[5]

Contributions	TFSA	RRSP	RESP	Non-registered
Are contributions tax-deductible?	No	Yes	No	No
Is there a maximum annual contribution amount?	Yes	Yes	No[6]	No
Are annual contribution amounts based on income?	No	Yes	No	–
Is investment income tax-sheltered within the account?	Yes	Yes	Yes	No
Do contributions attract federal or provincial grant?	No	No	Yes	No
Is contribution room carried forward?	Yes	Yes	–	–

Withdrawals	TFSA	RRSP	RESP	Non-registered
Are withdrawals taxable?	No	Yes	Yes[7]	No
Do withholding taxes apply to withdrawals?	No	Yes	No[8]	No
Do amounts withdrawn affect federal income-tested benefits?	No	Yes	Yes	No[9]
Do withdrawals have to be added to income?	No	Yes	Yes	No
Are there any restrictions on withdrawals?	No	No	Yes	No

TFSAs vs. RRSPs

As an RRSP and TFSA offer different tax advantages, it will generally be most beneficial to contribute to both accounts. If you can only contribute to one account, you should consider your tax rate assumptions before deciding whether to direct your funds to an RRSP or to a TFSA. If you expect to withdraw funds after retirement, when you may be in a lower tax bracket, you may wish to contribute to an RRSP to take advantage of the immediate tax deduction. If you expect to be in a higher tax bracket when you withdraw funds, a TFSA may be more beneficial, because of the tax-free treatment of withdrawals.

Your savings goals are also an important factor when deciding which account is best for you. If your goal is to save for retirement, an RRSP may be the better option as the tax payable on withdrawals may serve to deter early withdrawals.

You can also consider contributing to your RRSP and using any tax refund to contribute to your TFSA, thereby maximizing the benefits available from both accounts.

TFSAs vs. RESPs

One of the primary benefits of a Registered Education Savings Plan (RESP) is the Canada Education Savings Grant (CESG) and other federal and provincial government grants and bonds available.

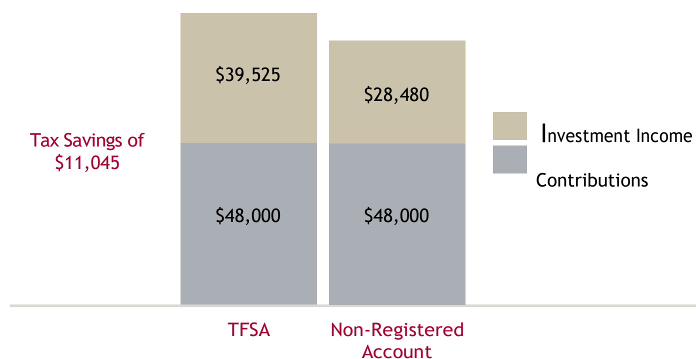
While contributions to a TFSA are not eligible for government grants and assistance, there are no restrictions on withdrawals and you will not be taxed on income or capital gains earned within the account. A withdrawal of earnings from an RESP, where the withdrawal is taxed in the hands of the beneficiary, is generally permitted only when the RESP beneficiary is attending a post-secondary institution and the withdrawal qualifies as an Educational Assistance Payment (EAP). Specific rules apply for other types of RESP withdrawals. For more information, refer to our special report titled **Making RESP withdrawals**.

You can contribute to both an RESP and a TFSA to take advantage of the benefits offered by both accounts. One option to consider is contributing the maximum amount that will attract grant to an RESP and directing the remainder of your education savings to a TFSA.

TFSAs vs. non-registered accounts

A non-registered account has no restrictions on contributions or withdrawals other than based on the specific investment characteristics. Investments in a non-registered account are not tax-sheltered and you must pay tax on all income including interest, dividends, and realized capital gains each year. The tax treatment of investment earnings and the annual dollar limit on TFSAs are the most significant differences between a non-registered account and a TFSA. When you invest in a TFSA, your earnings are tax-sheltered and will not be taxed upon withdrawal.

The chart illustrates the tax savings resulting from a $200 per month contribution to a TFSA over 20 years compared to the same contribution made to a non-registered account. In the example, by contributing to a TFSA rather than a non-registered account, you would earn an additional $11,045 in investment income.



Note: Combined federal and provincial tax savings based on a $200 monthly contribution for 20 years and a 5.5 percent rate of return. For non-registered accounts, a 21 percent average tax rate on investment income is assumed, based on 40 percent interest, 30 percent dividends and 30 percent capital gains, and a middle-income earning account holder.
Department of Finance Canada, Tax-Free Savings Account – www.budget.gc.ca

Family income splitting

You can gift funds to your spouse/common law partner and adult family members so they can contribute those funds to their own TFSA. Spousal/common law partner attribution rules do not apply to income earned within a TFSA. Family income splitting with a TFSA may be an effective strategy for avoiding probate and related fees on the gifted assets, by allowing parents to transfer an intended inheritance prior to death, thereby avoiding applicable probate and taxes on the gifted amount and anything earned prior to their death.

If you gift funds to your spouse/common law partner, who then contributes them to their own TFSA, and your spouse/common law partner subsequently withdraws them, the attribution rules may apply to income earned on the funds once they are no longer held inside a TFSA.

Estate planning with TFSAs

Without a valid beneficiary designation, assets held within a TFSA upon death will flow through the account holder's estate, and may therefore be subject to probate costs and fees. The fair market value of the TFSA as at the date of death will be received by the estate on a tax-free basis, but any income or gains accrued after the date of death will be taxable to the estate.

Holders of TFSAs can designate a successor holder or beneficiary for their TFSA.[10] Appointing a beneficiary or successor holder allows TFSA assets to pass outside the estate.

Spouse/common law partner as successor holder

Where a successor holder is appointed, the successor holder can take over the TFSA and this eliminates tax on income or gains accrued after the original holder's death. Only a spouse/ common law partner of the deceased holder can be designated and become a successor holder.

Spouse/common law partner as beneficiary

Where a spouse/common law partner is entitled to the proceeds as a consequence of the holder's death (but not designated as the successor holder), the spouse/common law partner may be able to contribute up to the date of death value to his or her own TFSA without infringing on their regular TFSA contribution room limits. To qualify, the contribution must be made before the end of the year following the year the TFSA holder died (known as the exemption end time) and a prescribed form must be filed with the CRA by the spouse/ common law partner within 30 days of this contribution.

Beneficiary designation other than spouse/ common law partner or to estate

Where a beneficiary other then a spouse/common law partner is designated, or the proceeds are payable to the estate, the full amount of the TFSA (date of death value, including any increase after death to date of payment) will be paid to the named beneficiary or estate. For a trusteed TFSA, such as those offered by CIBC Wood Gundy, the beneficiary or estate receives the date of death value tax-free and any increase in the fair market value of the TFSA from the date of death to the date of payment will be taxable to the beneficiary or estate as other income, with no differentiation between interest, dividends or capital gains so long as payment is received by the exemption end time.

Taxable inter-vivos trust after death of holder

If a beneficiary or estate representative does not claim the TFSA proceeds before the exemption end time, the TFSA becomes a taxable inter-vivos trust.

Any increase in the value of the TFSA between the date of death and the exemption end time must be included in the trust's income for the first taxation year after the end of the exemption period. The trust is deemed to have disposed of all property immediately before the end of the exemption end time at fair market value and to have re-acquired the property at a cost equal to the fair market value. Should this occur, the trust will pay tax on the increase at the "Other Income" rate, with no differentiation between interest, dividends or capital gains. Going forward, an annual T3 Return will be required to be filed until the assets are claimed.

Making a TFSA part of your investment portfolio

TFSAs can be a valuable addition to your investment portfolio. The tax-free growth of income and capital gains earned within the account may provide you with additional savings when compared to investments held in a non-registered account, and the tax-free withdrawal of funds from your TFSA will allow you to use your savings when you need without tax consequences.

For more information on TFSAs, please speak to your CIBC Wood Gundy Investment Advisor today.

[1] The annual dollar limit between 2009 and 2012 was $5,000. In 2013 and 2014 the annual dollar limit was $5,500. In 2015 it increased to $10,000, and reduced back to $5,500 2016 – 2018/$6,000 in 2019 -2022 and $6,500 in 2023.

[2] Individual must be age of majority to open a CIBC Wood Gundy brokerage account. Age of majority is based on the province the client resides in at the time of account open. Please note contribution room for Canadian residents accumulates from age 18 onwards regardless of whether or not a TFSA is opened.

[3] Deliberate over-contributions will be subject to additional taxes.

[4] A non-arm's length transaction is one where parties are related in some capacity, or the parties do not deal at arm's length for another reason such as acting in concert without separate interests.

[5] CIBC Wood Gundy is not a tax advisor for US tax purposes and it is strongly advised that you consult with a US tax advisor based on your personal situation.

[6] Individual beneficiary cumulative limit is $50,000.

[7] EAP withdrawals are generally taxed in the beneficiary's hands.

[8] Withholding taxes are generally applied on AIPs that are not directly transferred into the subscriber's (or spouse's/common-law partner's) RRSP.

[9] Income within an account does affect federal income-tested benefits.

[10] Quebec does not allow beneficiary designation on certain types of TFSAs.

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