# Frequently Asked Questions Regarding Tax-Free Savings Accounts (TFSAs)

### What is a TFSA?

The Tax-Free Savings Account is a registered account that allows individuals to earn investment income tax-free inside a savings account.

### Who is eligible to contribute to a TFSA?

Canadian residents aged 18 years of age or older may contribute to a TFSA providing they have a Social Insurance Number.

As the age of majority in some provinces (including British Columbia) is 19, this may delay the opening of a TFSA. However, contribution room begins to accumulate in the year in which an individual turns 18.

### How does a TFSA compare to an RRSP and a non-registered account?

RRSP contributions are tax deductible, and any withdrawals will be taxed when funds are withdrawn.

TFSA contributions are not tax deductible; however any investment income within the account will not be taxed, even when withdrawn.

The decision to contribute to a TFSA, an RRSP, or both, will depend upon an individual's income level, savings and investment objectives, as well as their current and expected future financial situation.

The net after-tax rates of return on a TFSA and an RRSP are equivalent when effective tax rates are the same at the time of contribution and withdrawal. The value of the tax deduction available for RRSP contributions is equivalent to the value of withdrawing funds from a TFSA on a tax-free basis.

However, when an individual's income and tax bracket are expected to increase over time, a higher after-tax rate of return would be earned by contributing to a TFSA during the lower income years and making withdrawals during the higher income years.

The opposite is true with an RRSP. When an individual's income and tax bracket are expected to decrease in retirement, a higher after-tax rate of return would be earned by contributing to an RRSP during the higher income years and making withdrawals during the lower income years.

The after-tax rate of return from investing in either a TFSA or an RRSP is greater than that of a non-registered investment account.

The following table compares the after-tax return of a TFSA, an RRSP and non-registered account for an individual with a 40 per cent tax rate for example. For illustration purposes, annual contributions of $5,000 are assumed.

| | TFSA | RRSP | NON-REGISTERED |
|---|---|---|---|
| Pre-tax Income Available for Investment | $5,000 | $5,000 | $5,000 |
| Tax (40% Rate) | ($2,000) | – | ($2,000) |
| Net Contribution[1] | $3,000 | $5,000 | $3,000 |
| Investment Income (20 Years at 5.5%) | $5,753 | $9,589 | $3,537[2] |
| Gross proceeds (Net Contribution + Investment Income) | $8,753 | $14,589 | $6,537 |
| Tax (40% Rate) | – | ($5,836) | – |
| Net Proceeds | $8,753 | $8,753 | $6,537 |
| Net Annual After-tax Rate of Return[3] | 5.5% | 5.5% | 4.0% |

[1] Savings (foregone consumption) is $3,000 in all cases. In the RRSP account, the individual contributes $5,000 and receives a $2,000 tax reduction, therefore the net consumption remains $3,000.

[2] Tax rate on investment income is 28 per cent, representing a weighted average tax rate on an investment portfolio comprised of 30 per cent dividends, 30 per cent capital gains and 40 per cent interest.

[3] Measured in relation to the savings of $3,000. Based on an annual nominal pre-tax rate of return of 5.5 per cent invested for 20 years.

### How is an individual's TFSA contribution limit determined?

Canadian residents 18 years of age or older began accumulating contribution room at $5,000 per year starting in 2009, indexed to inflation in increments of $500. The first $500 increase (to an annual dollar limit of $5,500) was effective January 1, 2013.

Any withdrawals made in the previous year will be added to the contribution room for the following year. In addition, any unused contribution room from the previous year will be carried forward to the contribution room for the following year.

### Who can contribute to a TFSA?

Only the registered account holder can make a contribution to their account. You may, however, give money to your spouse or common-law partner, who may make a contribution without being subject to income attribution rules.

### How will the TFSA contribution room be reported to individuals for a given tax year?

Information on TFSA contribution room can be accessed through the “My Account” function on the CRA website. It can also be calculated using form RC343 “Worksheet – TFSA contribution room” available on CRA’s website.

As contributions are not tax deductible, receipts will not be issued or necessary for filing an income tax return.

### Can a beneficiary be named on a TFSA account?

Yes. Under BC provincial legislation, the registered owner of a TFSA may designate a successor holder (spouse or common-law partner) and/or other beneficiaries. In the event of death, such a designation would allow for the distribution of TFSA assets to take place outside of the deceased's will and estate.

### Can a TFSA be set up as a Joint Ownership or In-Trust-For account?

No. There can only be one registered owner per TFSA.

### What investments will be allowed in a TFSA?

A TFSA will be permitted to hold the same qualified investments as a Registered Retirement Savings Plan (RRSP). These include mutual funds, publicly-traded securities, government and corporate bonds, GICs and, in certain cases, shares of small business corporations.

However, a TFSA is prohibited from holding investments in any entities with which the account holder does not deal at arm's length and entities of which the account holder is a "specified shareholder[1]."

[1] A "Specified Shareholder" is defined in the Income Tax Act as a shareholder of a corporation who owns directly or indirectly, at any time of the year, 10 per cent or more of the issued shares of any class of the capital stock of the corporation or any other corporation that is related to the corporation.

### Are Asset Transfer Transactions, or "swaps," permitted between TFSA and other accounts?

No. Effective October 17, 2009, Asset Transfer Transactions, also known as "swap" transactions, involving a TFSA are prohibited.

### Will withholding taxes be applied to U.S. sourced income?

Yes.

### If an individual becomes a non-resident, how does that affect the TFSA?

If an individual becomes a non-resident, they will be allowed to maintain the TFSA and not be taxed on any withdrawals or investment earnings in the account; however, they would not be able to contribute, or accrue any contribution room for the entire year(s) for which they are a non-resident.

### Can capital losses be offset against capital gains in other accounts?

No.

### Is there a penalty for over-contributing to a TFSA?

Yes. Excess contributions will be subject to tax in the amount of one per cent per month for each month that the excess remains in the plan.

### Is there a requirement to withdraw funds at a particular age?

No.

### Will contributions and withdrawals affect federal income-tested benefits?

Earnings and withdrawals from a TFSA will not affect income-tested benefits such as Old Age Security (OAS), Guaranteed Income Supplement (GIS), and the Canada Child Tax Benefit.

### Will interest on money borrowed to invest in a TFSA be tax-deductible?

No, interest on money borrowed to invest in a TFSA would not be deductible for tax purposes. Since the investment income and withdrawals from a TFSA are not taxable, interest on money borrowed to invest in a TFSA will not be deductible in computing income for tax purposes.

Note: There is no prohibition in the Income Tax Act on an individual's ability to use their TFSA assets as collateral for a loan.

### What would happen with a TFSA transfer upon a marriage or common-law partnership breakdown?

Upon the breakdown of a marriage or a common-law partnership, an amount may be transferred directly from one spouse or common-law partner's TFSA to the other's TFSA. This type of transfer would not affect either person's contribution room.

Note: There is no prohibition in the Income Tax Act on an individual's ability to use their TFSA assets as collateral for a loan.

### How will a TFSA be treated upon death of an account holder?

Investment income and gains that accrue in the account after the individual's death will be taxable, while those which have accrued before death will remain tax-exempt. However, an individual will be permitted to name his or her spouse or common-law partner as the successor account holder to maintain its tax-exempt status. Alternatively, the assets of a deceased individual's TFSA may be transferred to a TFSA of the surviving spouse or common-law partner, regardless of whether the survivor has available contribution room, and without reducing the survivor's existing room.

Note: There is no prohibition in the Income Tax Act on an individual's ability to use their TFSA assets as collateral for a loan.

### Will there be any restrictions on withdrawals?

No. You can withdraw up to the entire amount within the TFSA, for any reason, without paying taxes on either the contribution or the investment income.

*Information about the Tax-Free Savings Account is based on data available from the Canadian government and is for informational purposes only. The accuracy cannot be guaranteed. Please consult your tax professional.*