

TAX BULLETIN

ANSWERING YOUR TFSA QUESTIONS

Since the introduction of the Tax-Free Savings Account or TFSA in January 2009, millions of Canadians have opened one or more TFSAs. Clearly, many Canadians are comfortable with including TFSAs as part of their financial plans.

Unlike Registered Retirement Savings Plans (RRSPs), the TFSA is a tax-paid savings vehicle. It allows individuals to save for many purposes, such as buying a home, starting a small business, buying a new car or putting money away for a child's wedding. TFSAs are also a lot more flexible than an RRSP, as you are able to take money out without impacting your ability to use a TFSA again in future years. RRSPs are ill-suited for these shorter term savings goals. And TFSAs can also be used to save for retirement. In fact, for some individuals, having a TFSA at retirement may be more beneficial than an RRSP as TFSA withdrawals won't impact income-tested benefits.

What makes a TFSA significantly different than other tax deferred plans such as an RRSP is how contributions and withdrawals are handled. Unlike an RRSP, contributions to a TFSA will not give rise to a tax deduction (and that's why we say a TFSA represents tax-paid savings). When money is withdrawn, the accumulated contributions and income you receive will not be taxable.

In the rest of this bulletin, we'll address many of the common questions people are asking about the TFSA.

Opening a TFSA

Who can open a TFSA and when?

Any individual (other than a trust) who is resident in Canada and 18 years of age or older can open a TFSA. Like an RRSP, you can hold as many TFSA accounts as you want as long as you do not exceed the contribution limit.

Where can I buy a TFSA?

Many financial institutions offer TFSA accounts, along with traditional RRSPs and non-sheltered marketable securities accounts. You should be able to open a TFSA account at most financial institutions, such as Canadian trust companies, investment dealers, life insurance companies, banks, and credit unions. You will have to provide the institution with your social insurance number when opening an account.

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Contributing to a TFSA

How much can I contribute?

The amount you can contribute annually will be governed by your contribution room for the year. Your TFSA contribution room will be made up of three amounts:

- The annual contribution room for the year. Each year, you will be entitled to a specified contribution limit. The annual TFSA dollar limit is a set limit that is indexed to inflation and rounded to the nearest \$500. For the years 2009 through 2012 the limit was \$5,000. Due to indexing, this annual limit increased for the years 2013 and 2014 to \$5,500. For 2015, the annual TFSA dollar limit increased to \$10,000 due to a measure implemented by the former Conservative government. However, the current Liberal government reversed this increase and the contribution limit is \$5,500 for 2016 to 2018. For 2019, the limit increases to \$6,000 due to indexing.
- Any withdrawals made in the previous year will be added to the contribution room for the year.
- Any unused contribution room from the previous year will be added to the contribution room for the current year.

To illustrate the rules, consider the following example:

Year	Annual Contribution Made	Current Year Dollar Limit to Carry Forward
2009	\$4,000	\$1,000
2010	\$3,000	\$2,000
2011	\$5,000	0
2012	\$4,000	\$1,000
2013	\$5,500	0
2014	\$5,500	0
2015	0	\$10,000
2016	0	\$5,500
2017	\$5,500	0
2018 Total Carry Forward Amount		\$19,500

Based on the annual contributions set out in the chart, you can carry forward the remaining \$19,500 of contribution room to 2018, giving you 2018 contribution room of \$25,000 (the annual limit for 2018 of \$5,500 plus the \$19,500 carried forward).

Next, let's say you withdrew \$1,000 in 2018 (and you didn't make a contribution during 2018). This will give you contribution room in 2019 of \$32,000 (being the annual limit for 2019 of \$6,000 plus the \$25,000 carried forward from 2018 and the \$1,000 you withdrew in 2018).

How will I know what my TFSA contribution room will be?

Calculating the TFSA contribution room may seem complicated; however, there is good news. Although you should keep records about your TFSA transactions to ensure that you do not exceed your TFSA contribution room, the Canada Revenue Agency (CRA) tracks TFSA room similar to the way it tracks RRSP contribution room. Based on information provided by TFSA issuers, the CRA will determine your TFSA contribution room at the beginning of each calendar year.

If you are a registered user of "My Account", you can view your TFSA contribution room. This will generally be based on your balance at the beginning of the calendar year, but keep in mind that TFSA issuers have until the end of February to provide records to the CRA for the previous year, so there may be a lag until your balance is updated early in the year. My Account is a self-service portal offered by the CRA that enables individuals to access their own tax and benefit information in a secure on-line environment. Information about your TFSA contribution room can also be found on "MyCRA", a secure mobile application for individual taxpayers.

If you don't have access to CRA's online services, you can use CRA's automated Tax Information Phone Service (TIPS) to access your individual contribution limit. Keep in mind that this information is available from mid-February to the end of December. It is also possible to request a *TFSA Room Statement* or *TFSA Transaction Summary* by contacting the CRA's general enquiries line for individuals at 1-800-959-8281. The *TFSA Transaction Summary* shows the information

that the CRA received from your TFSA issuer(s) about your contributions and withdrawals.

As previously mentioned, the CRA's information is generally updated to provide your room balance at the beginning of the year. Therefore, if you have any transactions in your TFSA in the current year, you may be able to use form [RC343, Worksheet – TFSA Contribution Room](#), to determine your current contribution room balance.

When can I re-contribute funds that I have withdrawn?

This is a very important consideration. When funds have been withdrawn from the TFSA, and the maximum amount allowed per year has already been contributed, it is very important that the re-contribution not happen until the next calendar year. This is because the contribution room does not “re-set” until the start of the following calendar year. Withdrawals do not get added back to your available contribution room until January 1st of the following year. If amounts withdrawn are re-contributed in the same calendar year, and there is not enough contribution room, then you will be penalized for making an over-contribution.

What if I over-contribute to a TFSA?

TFSA over-contributions are subject to a 1% penalty tax on the highest excess TFSA amount for each month in which an excess remains. Take note that the 1% penalty tax applies for a particular month even if an excess amount was contributed and withdrawn later during the same month. The penalty tax is calculated in the same manner as RRSP over-contributions. However, in the case of the TFSA, there is no \$2,000 margin for error which is available for RRSP over-contributions – the first dollar of TFSA over-contributions will be penalized. So, you will have to track your TFSA limit and carefully compare it to the contributions you make during the year. The CRA may notify TFSA holders of over-contributions.

If you notice that you have over-contributed, you should contact your financial institution as soon as possible to arrange for the amount of over-contribution to be withdrawn from your account. You will also be required to complete and file forms [RC243 – Tax-Free Savings Account \(TFSA\)](#)

[Return](#) and [RC243-SCH-A – Excess TFSA Amounts](#) and pay the over-contribution penalty tax by June 30th of the year following the calendar year in which the tax arose.

What if I want to make a transfer from one TFSA to another TFSA?

A direct transfer between your TFSAs is not considered a contribution or withdrawal and is allowed by the CRA as a qualifying transfer. All qualifying transfers must be completed by a financial institution. In other words, you can't personally withdraw the funds from your TFSA and immediately re-contribute those funds to another TFSA that you hold, as you will be considered to have made a separate contribution which will impact your contribution room and can result in an over-contribution.

Note that if the CRA charges you a TFSA over-contribution penalty tax on a qualifying transfer, it is possible that the transfer was incorrectly recorded by one or both of the financial institutions involved in the transfer. In this case, you should contact them to correct the reporting of the transfer with the CRA.

I'm a U.S. citizen living in Canada. Should I make a TFSA contribution?

The main issue that has to be considered here is that U.S. citizens and other “U.S. persons”, such as green card holders, are subject to U.S. tax on their worldwide income. Under the Canada-U.S. Tax Treaty, U.S. persons in Canada can elect to defer the taxation of income earned in certain plans, such as RRSPs, registered retirement income funds or deferred profit sharing plans, for U.S. tax purposes. This income is deferred until it is withdrawn from the plan.

This deferral applies because current income in these plans is exempt from tax in Canada and each such plan is “operated exclusively to provide pension or employee benefits”. As TFSA contributions and withdrawals are not linked to employment or retirement, treaty relief will not apply to TFSAs. This means that TFSAs will be treated as an ordinary investment account for a U.S. person and TFSA earnings will be part of a U.S. person's taxable income for U.S. purposes.

TFSAs are also “foreign financial accounts” for U.S. tax purposes. As such, they are subject to U.S. foreign reporting requirements on an annual basis. Where TFSAs are operated as a trust, further annual reporting will be required. Penalties may be charged by the U.S. government where TFSAs owned by U.S. persons are not disclosed as required.

For further information regarding U.S. foreign information reporting and TFSAs, see our Tax Bulletin [Tax Consequences for U.S. Citizens and Other U.S. Persons Living in Canada](#). If you’re a U.S. person, the best advice is to consult with your BDO advisor before purchasing a TFSA.

Can I gift or loan funds to a spouse or other family members to make TFSA contributions?

Yes. Generally, if you make an interest-free loan or gift funds to a spouse to invest, the income on the investment will be attributed to you and taxed in your hands. In the case of funds used by your spouse to make a TFSA contribution, there will be no taxable income, and therefore, the attribution rules will not be a concern. The same will be true where you make an interest-free loan or a monetary gift to an adult child so that they can invest in a TFSA. Loaning or gifting money to family members to buy a TFSA can be an important personal tax planning consideration, depending on your situation. It will be important, however, that you not make a contribution directly to anyone’s TFSA except your own. Such a contribution is not in keeping with the TFSA rules.

Investing and managing your TFSA

What kind of investments can I hold in my TFSA?

A TFSA is generally permitted to hold similar investments to those of an RRSP, including mutual funds, publicly traded securities, GICs, bonds, and certain shares of small business corporations. There are specific rules that will limit the types of investments that can be held in a TFSA. In particular, the rules on private company investments are quite restrictive. As the ability to accumulate growth on a tax-free basis is a significant advantage, the government has implemented rules which are designed to block investments that provide a return or other features

that would generally not be available in a normal commercial or investment context between arm’s length parties. For example, if you hold an investment where the nature of the investment is such that it would only be available in special circumstances, then that investment may be problematic. As a specific example, the CRA has said that this would be the case where a business owner completes an estate freeze so that key employees can buy shares of a private company.

The rules for investments that do not trade publicly are complicated and you will be subject to significant penalties on any investments which are not permitted to be held in your TFSA.

The specific investments available to you could also be governed by the terms of your TFSA agreement with your financial institution.

Are there concerns with frequent trading in a TFSA?

If it is determined that income in a TFSA is earned from a business, the related income will be taxable. Generally, it is a question of fact whether frequent trading of investments by an individual would be considered a trading business. There have been cases where the CRA has questioned whether an individual is carrying on a business when there have been high investment returns and/or frequent trading of securities in their TFSA. There is not a clear set of rules that dictates when a business is considered to be carried on in a TFSA, although some guidance on this matter is provided in the [CRA’s Income Tax Folio S3-F10-C1](#) which deals with qualified investments. If you are a frequent trader, we would suggest restricting that activity to non-registered accounts. If you have questions concerning trading in your TFSA, contact your BDO advisor.

What are the tax consequences of paying investment management fees on my TFSA from an open account?

Investment management fees relate to the services provided by an investment manager on behalf of the owner of the investments. In the case of registered plans, such as TFSAs, investment management fees represent an expense of the registered plan trust, and generally, it would be expected that such fees would be paid by the

trustee using funds from within the plan. However, it is not uncommon for the plan annuitant or holder (referred to as the “controlling individual”) to redirect their investment management fees to an open account, which results in the fees being paid with funds outside of their TFSA. The CRA had a long-standing administrative policy that allowed the payment of these expenses from outside of the registered plan by the controlling individual without adverse tax consequences.

However, in late 2016, the CRA indicated that they will apply a new position where the controlling individual could be subject to tax of 100% of the amount of the fees on their registered plans that are paid from an open account. The CRA had originally stated that this change would be effective on January 1, 2018; however, implementation of this new position has been deferred as it is now under review by the Department of Finance.

The CRA’s change in position is based on their view that individuals who have their registered plan’s fees paid from outside the plan obtain a benefit because the value of their registered plan is higher than it would be had the investment management fees been paid from within the registered plan. As such, the CRA believes the controlling individual should be subject to an advantage tax of 100% of the amount of investment management fees paid outside of the plan. After 2018 and once the Department of Finance has completed its review of the issue, the CRA will provide further guidance on the treatment of such investment management fees.

Remember also that investment management fees for registered plans are not deductible whether paid outside or inside of a registered plan.

I’m putting money aside for a cottage. If I take out the funds from a TFSA this year, will that mean I can’t use a new plan later to save for a new car?

No. As discussed earlier, your TFSA contribution room will include amounts withdrawn in a previous year from any of your TFSAs. Therefore, if you fully used your TFSA room from 2009 to 2018 of \$57,500, and collapse your TFSA when it is worth \$65,000, you’ll be able to put the entire withdrawal of

\$65,000 back into a new TFSA in a subsequent year when you begin to save for a new car (plus an amount up to the annual TFSA contribution room that accumulates by then). So, you will be able to use a TFSA repeatedly over the course of your lifetime to save for different purposes.

I have RRSP contribution room and I still owe money on a recent home purchase. Should I invest in a TFSA, make an RRSP contribution or pay off my mortgage?

This is definitely a difficult question to answer as there was never a “one size fits all” answer on the RRSP contribution vs. mortgage repayment issue. So, the answer will vary even more now that TFSAs have been added to the mix. That said, there are a number of observations that can be made:

- If you make an RRSP contribution, this will, for most employed individuals, create a tax refund that you can use to pay down your mortgage. Many financial advisors suggest this approach as you are making progress toward both paying off your mortgage and saving for your retirement. A TFSA contribution will not produce a tax refund.
- The issue of whether an RRSP or TFSA is better for you will really depend on what your marginal income tax rate is now and what it will be in retirement.
 - If you are in a high tax bracket now, and will be in a lower bracket later, RRSP contributions effectively move income that would be taxed at a high rate now into a lower tax bracket later. This produces both a tax deferral and a tax saving.
 - If you are in a lower tax bracket now, and expect to be in the same lower tax bracket later in retirement, a TFSA might make more sense than an RRSP, as the use of an RRSP could put you into a higher bracket in retirement while a deduction arises now at a low marginal rate. Also, having lower income in retirement may allow you to keep more of your government benefits that are income-tested such as Old Age Security, Guaranteed Income Supplements,

GST/HST credits and other benefits/credits such as the age credit.

- When comparing a TFSA contribution to making a mortgage repayment, your mortgage is really just another TFSA. That is, any non-deductible interest that you don't have to pay due to the mortgage repayment is effectively tax-free income earned with a fairly good return on your money. Therefore, in terms of limiting risk, many individuals will concentrate on repaying their mortgage first, especially since the accumulated TFSA room should still be there when they finish paying off their mortgage. If the investment rate of return in your TFSA is less than the mortgage rate, then paying down your mortgage will definitely be more beneficial.
- If you have funds now, but you may need them again later, using a TFSA temporarily could make sense. Contributing money to an RRSP now and withdrawing it soon after is usually not a good idea. Although the income and deduction may offset each other (i.e. if the contribution and withdrawal fall within the same year), this eliminates RRSP room. If you're in this situation, a better plan could be to put the money into a TFSA and then later withdraw and contribute the funds to an RRSP once you're sure you won't need the money until retirement (assuming of course using an RRSP makes sense for you in general).
- Finally, many financial advisors recommend that individuals keep a reserve fund for a rainy day. The TFSA is perfectly suited to this as your reserve fund will not be taxed, and if you do have to draw on it, then you can put the money back in a later year when financial resources permit.

Rules on death, marriage breakdown and emigration

How will a TFSA be handled on death or marital breakdown?

Generally, earnings that accrue before your death will remain tax-exempt, while earnings that accrue after your death will be taxable.

It is possible to maintain the tax-exempt status of earnings. In the case of a surviving spouse (including a common-law partner), it will be possible to transfer a TFSA to the spouse without affecting the spouse's TFSA contribution room. This can be accomplished by simply designating the spouse as the successor holder as part of the plan. A successor holder designation is effective only if it is recognized under applicable provincial and territorial law.

If a spouse is not designated as a successor holder, but is designated as a beneficiary, payments out of a deceased individual's TFSA can be transferred to that surviving spouse's TFSA without affecting their own unused TFSA contribution room, subject to certain conditions and limits. In particular, this contribution cannot exceed the fair market value of the deceased individual's TFSA at the time of death.

If there is a breakdown in a marriage or common-law partnership, TFSA property can be transferred between spouses or common-law partners and, if certain conditions are met, the TFSA property will be eligible for TFSA treatment in the hands of the transferee without affecting their TFSA room. Note that the transfer must be made directly between the TFSAs.

What happens if I emigrate from Canada?

If you become a non-resident of Canada, you will be allowed to maintain your TFSA, and you will not be taxed on any earnings in the account or on withdrawals in Canada. However, no contribution room will accrue for any year throughout which you are a non-resident and any contributions you make as a non-resident will be subject to a penalty tax. You will also need to determine how the TFSA will be treated under the tax laws of the country you immigrate to. As mentioned previously, the U.S. will treat your TFSA as a regular investment account.

Borrowing considerations

Should I borrow to make a TFSA contribution?

Probably not. In the case of an RRSP, it has been suggested that borrowing money for an RRSP contribution and paying non-deductible interest for

a few months can make sense if you borrow just before the RRSP contribution deadline and you will pay off the loan quickly. This is because a last minute RRSP contribution will provide a tax reduction now that you wouldn't otherwise get until next year. In the case of a TFSA contribution, it will not generate a tax deduction and any interest paid will also be non-deductible. In the case of either a terminally ill individual with a spouse or an individual who will emigrate from Canada, it could make sense to borrow money to make a TFSA contribution.

In the case of death, a TFSA account can be transferred to a surviving spouse while TFSA room cannot. The surviving spouse can pay off the loan with other funds that arise after death or even simply collapse the TFSA (as the withdrawal will be added to the surviving spouse's TFSA room for future years).

For an emigrant, they will not be able to make a contribution after emigration even though they can keep the TFSA and any unused TFSA room should they resume their Canadian residency in the future. Therefore, borrowing funds for a contribution before emigration may be worthwhile, especially where the TFSA will not be subject to tax in the country in which the emigrant is resident.

Consult your BDO advisor about your particular situation.

Summary

The TFSA is an important part of Canadian personal tax planning as taxpayers realize the flexibility that can arise from holding investments in a TFSA. If you have any questions on these rules, contact your BDO advisor.

The information in this publication is current as of December 10, 2018.

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