Taking advantage of the TFSA

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Canadians can grow their savings much faster because income and growth from a Tax-Free Savings Account (TFSA) are completely tax-free. For seniors, withdrawals from a TFSA will not affect eligibility for federal income-tested benefits such as Old Age Security (OAS). Furthermore, amounts withdrawn will be added back as available contribution room starting the year following the withdrawal. For example, a $2,000 withdrawal this year can be replaced next year without affecting next year's $5,500 contribution room. Therefore, you can deposit $7,500 next year without causing an over-contribution (assuming no unused room).

Saving for retirement: RRSP or TFSA?

Deciding between a Registered Retirement Savings Plan (RRSP) and TFSA will depend on your savings need, as well as your current and future financial situation. Generally, if you expect to be in a lower tax bracket during retirement, then RRSP contributions provide a benefit in deferring tax until those years. Should the reverse be true, TFSA contributions may be more attractive.

An RRSP must be converted to a Registered Retirement Income Fund (RRIF), an annuity, or withdrawn by the end of the year you turn age 71. TFSAs have no such requirement, and can continue to accept contributions to shelter income indefinitely. The minimum annual withdrawal requirements for RRIFs and annuities are considered taxable income. TFSAs can benefit pensioners looking to minimize that amount, especially if they are receiving income from part-time or consulting work.

TFSA contribution limits are the same for everyone regardless of how much you earn or contribute to your pension. If you are already contributing to your RRSP, it might be a good option to save the refund generated into your TFSA.

Ultimately, there may be no need to choose one over the other. A TFSA complements your RRSP as a strategy for retirement savings, as well as for other objectives described below. Using TFSAs and RRSPs together can bring you closer to your goals as part of your overall financial plan.

TFSAs are not just for retirement

Short and medium term goals

TFSAs are useful in providing for an emergency, major purchase, or vacation since there are no restrictions on removing funds and amounts received will have no tax owing. By contrast, withholding tax will apply on RRSP withdrawals. Therefore, you will need to remove more from your RRSP than is needed to cover the incurred expense amount. In most cases, TFSAs will offer the flexibility and tax efficiency needed for short-term needs.

Income-splitting opportunity

TFSAs allow an effective way to split income among family members such as your spouse and adult children. You may provide a gift to help them make a contribution to their TFSA. They are responsible for their own account and contribution room. Income tax attribution does not apply on earnings as they are tax-free.

Education savings

Normally, a Registered Education Savings Plan (RESP) is the standard vehicle to save for a child's education. It offers tax-deferred growth plus the Canada Education Savings Grant (CESG) of up to $7,200 lifetime while contributions are made before age 18. A child beneficiary receives, and is taxed on, payments made from the RESP. One potential drawback is the loss of certain RESP benefits if your child does not pursue post-secondary education. Consequently, the use of TFSA savings allows for flexibility in this case and may be considered a desirable compliment to RESPs in saving for a child's education.

Investment transfer

You may want to consider transferring investments held in a non-registered (taxable) account to your TFSA, known as an 'in-kind' contribution. If the investments have appreciated in value, this transfer would trigger a taxable capital gain. However, be aware that you will not be allowed to claim a capital loss for tax purposes if your investments have depreciated in value. Consult your tax advisor for more information.

Estate planning

TFSAs can help minimize taxes upon your death towards maximizing your estate. If you name your spouse as successor holder, he or she will inherit and maintain its tax-free status without affecting his or her own contribution room. Naming children as beneficiaries allow them to inherit the account directly, avoiding probate fees. Note the tax-free status is lost on death when the account passes to a beneficiary. Your children could use inherited TFSA funds to contribute to their own TFSA as a tax-free method of inter-generational wealth transfer.

TFSAs are significant savings vehicles for Canadians 18 years or older. Take the time now to consider using it as part of your overall savings and investment strategy. Contact your Scotia Wealth Management relationship manager today to explore these opportunities.

The following table summarizes several features of a TFSA:

About TFSAs	Feature	Note
Eligibility	Age 18	Canadian Resident (e.g. TFSAs not tax-free for US taxpayers)
Contribution	$5,500 per year	Starting January 1, 2016
Tax deduction	No	After-tax funds used for contributions
Over contributions	1% penalty per month	Penalty is on the amount of over contribution
Unused Room	Cumulative	Carried forward indefinitely
Accumulation	Tax Free	No income tax on interest, dividends, capital gains
Withdrawals	Tax Free	Can be replaced the year following withdrawals
Withdrawal Requirements	None	No requirement to withdraw funds at a certain age; no minimum withdrawal required
Income-Tested Benefits	Not Affected	Earnings & withdrawals do not affect eligibility for OAS, GIS, age credits, and assistance
Plans	Offered by banks, insurance companies, credit unions	Self-directed plans available
Investments	Many	Same as RRSP/RRIF qualified investments
Creditor Protection	No	Subject to claims by spouse, creditors
Estate	Successor Holder/Beneficiary Designation	No probate if a beneficiary is named (Quebec –N/A)
Collateral for Loans	Yes	Can be used as collateral for a loan
Joint Account	No	Must be an individual, but not a trust or company
Borrow to Invest	Yes	Interest on loan is NOT tax deductible
Tax Return	No	Income is not reported
Power of Attorney (POA)	Yes	Attorney can transact on behalf of the TFSA holder