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Update

# Estates and Trusts Law

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# Tax Free Savings Account

As the economy spirals downward and our worries spiral upward, a new planning option involving registered accounts is being launched by the federal government. The concept of the tax-free savings account ("TFSA") was introduced in the 2008 federal budget, effective January 1, 2009. The TFSA allows individuals to earn investment income, including interest, dividends and capital gains, on a tax-free basis. Unlike other registered savings accounts such as RRSPs, contributions to the TFSA are not deductible. However, income in the account is not subject to Part I tax while in the account nor upon withdrawal. Examples of the qualified investments are mutual funds, segregated funds, stocks, bonds, and GICs.

## Eligibility

Anyone who is of the age of majority (in Ontario, 18) and legally capable to transact may contribute to an account. An adult may contribute to a TFSA of a spouse or common-law partner, so long as contribution room in the account of the recipient spouse or common-law partner has not been used up for that taxation year.

## Contribution Limits

The annual contribution limit for a TFSA begins at $5,000 for 2009, and will be increased annually for inflation and rounded to the nearest $500. Withdrawals from the account will not trigger tax on the amount withdrawn, and will free up more TFSA room for contribution in that taxation year equal to the amount withdrawn. Unused contribution room can be carried forward indefinitely.

Excess contributions to a TFSA are subject to a penalty tax of 1% per month. Other potential penalties apply if a non-resident contributes to the TFSA, the TFSA acquires a non-qualified investment, or the TSFA confers a prohibited advantage on the holder or a person not at arm's length with the holder.

## Advantages

In addition to providing the opportunity for tax-free saving, an advantage of a TFSA is that withdrawals from the TFSA will not be included in income for the purpose of determining eligibility for various income-based credits and benefits, including the Age Credit (Guaranteed Income Supplement), Child Tax Credit and Old Age Security ("OAS") benefits. In other words, unlike withdrawals from an RRSP or RRIF, which can reduce the individual's Age Credit or serve to claw back the individual's OAS benefits, withdrawals from the TFSA will have no effect on such credits or benefits. Furthermore, unlike an RRSP, there is no time limit at which the TFSA must be wound up or converted into another investment vehicle. Thus, the TFSA can be used to fund pre-retirement years or post-retirement years, and there are no limits on withdrawals or the use of the withdrawn funds.

## No Attribution of Income

It is possible to contribute to a spouse's or common-law partner's TFSA without attribution of income to the transferor while the property or substituted property is held in the spouse's or common-law partner's TFSA. This exception from the attribution rules applies only where the recipient spouse's or common-law partner's TFSA has available contribution room at the time of the transfer.

## Beneficiary Designation

As is the case with respect to registered accounts such as RRSPs and RRIFs, a holder may designate a beneficiary of his or her TFSA.

### TFSA and RRSP/RRIF Comparison

Simply put, the TFSA regime works well as a supplement to the RRSP/RRIF regime. Firstly, RRSP contributions are deductible where TFSA contributions are not, and, RRSP/RRIF withdrawals trigger income tax payable where withdrawals from TFSAs do not. Each holder should determine the optimal use of the TFSA on advice from his or her financial planner.

For information or answers to questions about the best way to deal with the new TFSA or any other aspects of your estate plan, contact the trusts and estates lawyers at Goodmans LLP, Patricia Robinson at (416) 597-4144, or Janice Dubiansky at (416) 849-6894.