

The Tax-Free Saving Account (TFSA) was introduced in the 2008 federal budget. Possibly one of the most significant changes to Canada's savings system since the introduction of the Registered Retirement Savings Plan (RSP) in 1957, the TFSA is a new tax-efficient and flexible savings option which will complement any financial plan.

Starting in 2009, Canadian residents who are 18 years of age or older with a valid Social Insurance Number will be permitted to contribute to a TFSA. Note that residents of provinces and territories where the age of majority is 19 (British Columbia, New Brunswick, Newfoundland and Labrador, Northwest Territories, Nova Scotia, Nunavut and Yukon) will not be able to open a TFSA with TD Waterhouse until they reach age 19; however, the accumulation of contribution room will start at age 18.

The TFSA will allow individuals to contribute up to \$5,000 in the first year for any savings goal. The annual TFSA dollar limit will be indexed to inflation and rounded to the nearest \$500.

For those who do not have funds to invest in a TFSA in any given year, it should be noted that any unused contribution room from the previous years and any withdrawals made in the previous years will be added to the annual TFSA dollar limit which can be carried forward indefinitely on a cumulative basis.

The factors that distinguish the TFSA are that contributions are not tax-deductible and that income and gains accumulate tax-free within the TFSA. Furthermore, any amounts withdrawn from the TFSA will be received tax-free. Since TFSA withdrawals are treated as non-taxable income, withdrawals will not affect federal income-tested benefits such as the Guaranteed Income Supplement, Old Age Security, Canada Child Tax Benefit and the Age Credit.

Other Characteristics of the TFSA

- You can use the TFSA to split income with your spouse or common-law partner by giving them funds to contribute to their TFSA and not have income attributed back to you.
- On death, your TFSA can
 - be paid out to your beneficiaries tax-free, subject to certain conditions; or
 - be transferred to your spouse or common-law partner's TFSA if he/she is the beneficiary; or
 - continue with your spouse or common-law partner as the successor holder.

Note that provincial law governs beneficiary designations and those laws have not yet been amended to cover TFSAs. Consequently, beneficiary designations can be made through a will (or in Quebec, through a Will or a marriage contract), but at this time they cannot be made through the plan.

- In the case of a marriage or relationship breakdown, the TFSA assets can be transferred tax-free between spouses or common-law partners without affecting either party's contribution room.
- There is a penalty tax of 1% per month on excess contributions.
- You will not be able to deduct interest on money borrowed to invest in a TFSA.
- TFSA assets can be used as collateral for a loan.
- If you cease being a Canadian resident any contributions made while you are a non-resident will be subject to a 1% per month special tax until you withdraw the amount and designate it as a withdrawal of a non-resident contribution. In addition, no contribution room will accrue for any year in which you are a non-resident. Your TFSA will continue to grow on a tax-free basis in Canada and you will not be subject to any Canadian withholding taxes on withdrawals. (To determine the tax treatment of the TFSA in your new jurisdiction you should consult a tax advisor in your new country of residence).

Registered Savings Plan or Tax-Free Savings Account?

You may wonder whether you should put your money into a RSP or a TFSA. The answer will depend on a number of factors including whether you will need to access the money on a short-term basis and your expected tax rates both at the time of contribution and withdrawal. If you expect your tax rate to be lower in retirement than when you make your contribution, then a RSP strategy may be preferable. Conversely, if you expect your tax rate to increase in retirement then contributing to a TFSA may be more advantageous. If you expect your tax rate to remain the same at the time of RSP contribution and withdrawal, then the TFSA and RSP strategy may produce the same result. Please consult your tax advisor to discuss your personal circumstances.

While the RSP is intended to be a retirement savings vehicle, the TFSA is intended to encourage savings in general. The RSP provides immediate tax savings and has higher contribution limits than the TFSA; however, the TFSA provides a tax-free savings vehicle for people who have limited access to RSPs, namely:

- individuals who do not generate earned income (e.g. young adults and homemakers);
- seniors who want to shelter investment income;
- individuals who have maximized their RSP contribution room; and
- individuals with large pension plans that generate large pension adjustments.

As the two options are not mutually exclusive, and the TFSA is offered in addition to the current RSP limits, you may choose to have a combination of RSPs and TFSAs for different savings goals. In addition, you can use the tax savings from the RSP contribution to contribute to the TFSA. A table comparing the two options is provided below:

	RSP	TFSA
Contribution limit	18% of previous year's earned income, maximum \$21,000 (2009) adjusted for certain amounts (e.g. pension adjustment (PA), past service pension adjustment (PSPA), pension adjustment reversal (PAR))	The total of: <ul style="list-style-type: none"> • \$5,000 (indexed) • Withdrawals made in the previous year, plus • Unused contribution room from previous year
Contributions	Tax-deductible	After-tax
Income & Growth	Tax-deferred	Tax-free
Withdrawals	Taxable: affects income-tested amounts. Amount withdrawn cannot be re-contributed.	Tax-free: does not affect federal income-tested amounts. Amount withdrawn is added to contribution room in following year.
Primary purpose	Retirement savings	Savings for any purpose
Plan maturity	End of year when you turn 71	None. There is no upper age limit on contributions.
Spousal plan	Permitted	Not permitted
Creditor protected	Creditor protected in the event of bankruptcy (other than contributions in the previous 12 months). Some provinces may provide additional creditor protection.	Not protected

Given the different tax characteristics of a TFSA (tax-free), an RSP (tax-deferred), and a non-registered account (taxable), you may want to review the types of investments you currently hold in these investment vehicles to ensure your overall investment portfolio is structured in the most tax efficient manner.

Although the annual contribution limit to a TFSA is initially small, over time it will no doubt become an integral part of the overall savings strategy for many Canadians.

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