Education Library

Tax-Free Savings Account

TAX & FINANCIAL PLANNING

A Tax-Free Savings Account (TFSA) is a flexible savings vehicle that allows Canadians to save for short- and long-term goals while earning tax-free investment income and growth. All income and withdrawals from a TFSA are generally tax free. A TFSA may be used in conjunction with your existing savings plans like Registered Retirement Savings Plans (RRSP), Registered Education Savings Plans (RESP), Registered Disability Savings Plans (RDSP) as well as your non-registered savings.

The annual TFSA dollar limit for the year 2025 is $7,000.

Overview of the TFSA

- Available for Canadian residents, 18 years of age and older.
- Contributions are not tax deductible.
- Unused contribution room may be carried forward indefinitely.
- Investment income and growth earned is tax free.
- Withdrawals are tax free.
- Amount of withdrawal in one year can be re-contributed in future years.
- Wide range of investment options with certain restrictions on prohibited and non-qualified investments.
- Income earned and withdrawals do not affect eligibility for federal income-tested benefits and credits.
- Attribution does not apply where funds are given to a spouse to invest in their TFSA.
- The TFSA of a deceased spouse can generally be transferred to a surviving spouse's TFSA tax free.

Since 2009, Canadian residents who have reached the age of majority, and have a valid Social Insurance Number have been eligible to open a TFSA and make contributions up to a specified annual limit. In provinces or territories where the age of majority is 19, individuals will accumulate contribution room beginning the year they turn 18 and will be able to contribute that amount the following year. Unused contribution amounts can be carried forward indefinitely.

Contributions to a TFSA are not tax deductible and are not subject to tax on withdrawal from the account. Further, income and capital gains are not taxable while retained within the TFSA nor when withdrawn. Any amounts withdrawn from a TFSA will be added to your contribution room in the following taxation year. This gives you access to your TFSA savings in the short term, with the ability to re-contribute an equivalent amount in the future. Excess contributions are subject to a tax of 1% per month.

Planning tip:

If you withdraw funds from your TFSA in the year, it is important to wait until the following taxation year to re-contribute this amount to your TFSA.

Investment rules

Qualified investments in a TFSA generally include publicly traded Canadian stocks, bonds and mutual funds.

Consistent with the rules for RRSPs, investments in the following are considered **prohibited investments** for TFSAs:

- Shares of a corporation in which you have a significant interest because you own 10% or more of the shares of any class of the corporation
- An interest in a partnership or trust and you own 10% or more of the fair market value of all interests in the partnership or trust
- A share in a corporation that does not deal at arm's length with you or with a corporation, partnership, or trust in which you have significant interest
- Some private corporations, e.g., Canadian Controlled Private Corporations, Small Business and Venture Capital Corporations which do not qualify under the *Income Tax Act (Canada)*

Shares in foreign private companies, real property and any other investment that are not permitted under the Income Tax Act are also considered **non-qualified investments**. Investing in a prohibited or non-qualified investment within a TFSA can result in large penalty taxes.

Taxation of a TFSA

Because investment income and withdrawals from a TFSA are not taxable, interest on money borrowed to invest in a TFSA is not deductible for income tax purposes. However, you may use your TFSA as collateral for a loan.

A TFSA also allows you to gift funds to your spouse and/or adult child to facilitate their annual TFSA contribution. The attribution rules that usually attribute income earned on property transferred to a spouse as taxable to the transferor do not apply in this case.

What are the differences between TFSAs and RRSPs?

- An RRSP is primarily for your retirement savings, while a TFSA is for other investments and savings.
- Contributions to an RRSP are tax deductible and reduce your taxable income, while contributions to a TFSA are not tax deductible.
- Withdrawals from an RRSP are added to your income and taxed at your current marginal income tax rate, while TFSA withdrawals are tax free.
- You must convert your RRSP to a RRIF by age 71 and withdrawals after that time are mandated according to a schedule based on your age. There is no similar requirement for TFSAs.
- For RRSPs, once a contribution is made, that contribution room is "used up." With TFSAs, the amount of a withdrawal is automatically added back to the contribution room in the following taxation year.

Also, any income earned and any amounts withdrawn will not be taken into account when determining eligibility for income-tested benefits or credits delivered through the Canadian income tax system (for example the *Goods and Services Tax Credit* and the *Age Credit*). Nor will such amounts be considered in determining other benefits that are based on the individual's income level, such as *Old Age Security benefits*, the *Guaranteed Income Supplement* or E*mployment Insurance benefits*.

Non-Residents

A n individual who becomes a non-resident of Canada will be allowed to maintain their TFSA; however, no contributions will be permitted while the individual is non-resident, and no contribution room will accrue for any year throughout which the individual is non-resident. Any contributions made during non-residency will be subject to a 1% penalty tax per month for each month these funds remain in the plan.

Treatment Upon Death

Generally, your TFSA will lose its tax-exempt status upon your death. That is, investment income and capital gains that accrue in the account after death will be taxable, while those that accrued before death will remain tax exempt. Most provinces allow you to name a beneficiary on a TFSA such that the funds will transfer to the beneficiary on your death, outside of your will. This can reduce probate taxes (in those provinces where probate applies) that would otherwise be payable by your estate. In Quebec, a beneficiary designation can only be made through a will.

If certain conditions are met and the named beneficiary is your spouse or common law partner, your TFSA may be transferred to your spouse's TFSA after your death, regardless of whether the survivor has available contribution room and without reducing the survivor's existing room. The conditions require that the transfer be made from the deceased's TFSA to the surviving spouse within the first calendar year after death (rollover period) and that an election form is filed with Canada Revenue Agency within 30 days of the transfer.

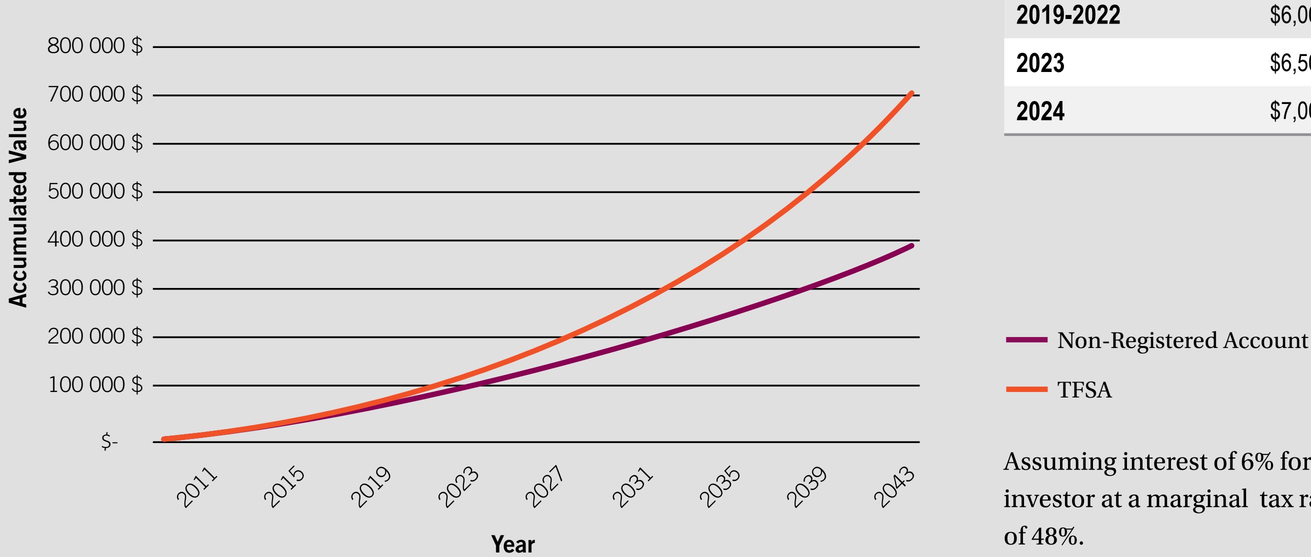
As a further planning opportunity, in some provinces you can name your spouse or common-law partner as the "successor holder" of your TFSA. This is a specific type of beneficiary designation where the surviving spouse will take over ownership of the account, maintaining its tax-exempt status from the date of death onwards.

Case Study

The graph below compares investing in a non-registered investment account versus a TFSA. We have assumed annual contributions to each plan equal the annual TFSA dollar limits up to and including 2023 (refer to table on the right). We have also assumed annual contributions to each plan going forward remain at the most recent TFSA dollar limit based on current legislation.

If annual contributions continued for 35 years (until 2043 in this example), the non-registered account will have grown to over $390,000 while the TFSA will have grown to over $710,000.

Annual TFSA Dollar Limits:	
2009-2012	$5,000
2013-2014	$5,500
2015	$10,000
2016-2018	$5,500
2019-2022	$6,000
2023	$6,500
2024	$7,000



Assuming interest of 6% for an investor at a marginal tax rate of 48%.

Transfers

On the breakdown of a marriage or a common-law relationship, an amount may be transferred directly from the TFSA of one party to the TFSA of the other. In this circumstance, the transfer will not reinstate contribution room of the transferor and will not reduce the contribution room of the transferee.

Conclusion

In addition to reducing taxes on investment income and growth for the investor, TFSAs offer income splitting opportunities as well as the ability to minimize social benefit clawbacks. TFSAs can significantly enhance your wealth if properly implemented as part of your overall wealth plan. For more planning opportunities, please contact your Richardson Wealth Investment Advisor.

Tax & Estate Planning

As an individual investor or a business owner you have unique objectives and priorities that need to be considered. At Richardson Wealth, your Investment Advisor collaborates with our in-house Tax & Estate Planning professionals to deliver customized wealth management solutions designed to address tax, estate, insurance, philanthropic and succession needs.

Our approach. Our expertise. Our experience.
Our difference.