Manulife

Tax, Retirement & Estate Planning Services

INVESTMENT INSIGHT

Common Tax-Free Savings Account Mistakes

Things you might not know about Tax-Free Savings Accounts, but should

Tax-Free Savings Accounts (TFSAs) have become a popular savings vehicle. While millions of Canadians have opened a TFSA, many are still making mistakes or missing opportunities that are costing them money.

As a recap, a TFSA is a flexible, general purpose savings vehicle that allows individuals to make contributions each year and to withdraw funds at any time in the future. A TFSA provides a powerful incentive to save by allowing the investment growth to accumulate each year and be withdrawn tax-free. However, unlike a Registered Retirement Savings Plan (RRSP), investors cannot claim a tax deduction for contributions made to their TFSA and withdrawals are added back to their contribution room for the following year.

WITHDRAWAL OR TRANSFER?

An individual can transfer from one TFSA to another provided the funds go **directly** to the new plan without having been paid to them first. If the funds are paid to the investor first, it will be considered a withdrawal and their TFSA room for the withdrawal amount will not be reinstated until the **next calendar year**. Recontributing to a TFSA in the same year as the withdrawal may result in an overcontribution and the investor could be subject to a penalty fee.

The Income Tax Act (Canada) imposes a penalty of one per cent per month on the highest excess contribution amount at any time during the month. The excess amount can be withdrawn to eliminate the penalty tax for subsequent months.

SPOUSE AS BENEFICIARY OR SUCCESSOR HOLDER?

If a spouse[1] is named as the beneficiary of the TFSA, an amount up to the value of the TFSA at the time of death can be contributed to his or her TFSA without affecting his or her TFSA contribution room if the contribution is made before the end of the year following the year of death and is designated as an exempt contribution. However, any income earned between the date of death and the contribution will be taxable to the spouse.

[1] All references to spouse includes common-law partner as defined in the Income Tax Act (Canada). The spouse must designate the contribution as an exempt contribution on Form RC240, Designation of an Exempt Contribution Tax-Free Savings Account (TFSA), and submit the designation within 30 days after the contribution is made.

It's often recommended that, where permitted, the holder names their spouse as successor holder instead of as beneficiary.[2] On the holder's death, his or her spouse will automatically become the new holder of the TFSA. The TFSA continues to exist and both its value at the date of death and any income earned after that date continue to be sheltered from tax under the new successor holder. In addition, naming a spouse as successor holder avoids the administration and filing requirements necessary to preserve the tax-free status of the TFSA funds when a spouse is named as beneficiary.

U.S. CITIZENS WITH A TFSA

U.S. citizens, even those living in Canada, or other U.S. persons (e.g., green card holders) are required to report their worldwide income to the Internal Revenue Service (IRS) each year, including any income earned in their TFSA as there is no treaty relief for TFSAs. Whether U.S. taxes will ultimately have to be paid will depend on the particular facts and whether sufficient foreign tax credits are available. Such individuals should speak to a cross-border tax specialist before investing in a TFSA.

TFSA CONTRIBUTION LIMIT

Since TFSAs were made available in 2009, individuals have been able to make contributions of up the legislative dollar maximum per year. If you do not contribute or do not contriubte the full amount, the unused amount will carry forward to the next year. Unused contribution room can be carried forward indefinitely.

Annual contribution limits for TFSAs

Year	TFSA ($)
2009	5,000
2010	5,000
2011	5,000
2012	5,000
2013	5,500
2014	5,500
2015	10,000
2016	5,500
2017	5,500
2018	Indexed to inflation
2019	Indexed to inflation

SUMMARY

TFSAs are a powerful savings vehicle whose significance will only grow over time. However, to fully maximize the benefits, and avoid the pitfalls, it is important to speak to your advisor to understand how they work.

[2] In Quebec, the equivalent of a successor holder can be named only on a deferred annuity or segregated fund contract which has a life insured (the "measuring life") different than the owner of the contract. Our contracts do not allow this option on a TFSA. Outside Quebec, certain contracts may provide that if a spouse is named as the sole beneficiary, he or she will automatically continue the contract as the successor holder and the applicable successor holder rules would apply (It is possible this stipulation would not be applicable in Quebec. Speak to your advisor concerning this topic. In addition, in Quebec, it is possible to designate a beneficiary on a TFSA only if the product in which the TFSA invests is a deferred annuity or a segregated fund contract.). In these situations, the investor's spouse may have the option to be treated as a beneficiary of the contract and, in that case, the beneficiary rules would apply.

For more information contact your advisor or visit manulife.ca/investments

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