MACKENZIE Investments | CONFIDENCE IN A CHANGING WORLD

Tax-Free Savings Accounts (TFSAs)

Investor Guide

Introduction

Since its introduction in 1957, the Registered Retirement Savings Plan (RRSP) has been one of the best tax shelters available. Aside from RRSPs, there are few ways Canadians can shelter income, which limits the growth potential of an investment portfolio.

The investing landscape changed when the federal government implemented an ambitious agenda to reduce taxes and increase personal savings. In the 2008 Federal Budget, the government introduced the Tax-Free Savings Account (TFSA), a registered account designed to provide tax-free income.

This brochure outlines the main features of the TFSA, along with some investment strategies. It also includes profiles of typical TFSA investors.

To see how you can benefit from a TFSA, speak to a financial advisor.

Is a TFSA right for you?

If you are a Canadian resident age 18 or older, you can contribute up to $5,500 a year to a TFSA – this is your annual contribution limit. This amount is indexed to inflation annually and rounded to the nearest $500. It is possible to have more than one TFSA, but total contributions cannot exceed your annual limit.

Unlike RRSPs, TFSA contribution room will not be tied to earned income. Regardless of income earned, contribution room will accumulate for each year you file a tax return. If you are not able to contribute the maximum amount to your TFSA in a year, the unused amount will carry forward to a future year.

Also, spousal attribution rules – rules designed to ensure spouses and common-law partners do not benefit from splitting income – don't apply to TFSA contributions. This creates an opportunity for couples to gift assets to each other, allowing tax-free growth on TFSA contributions of $11,000 per family per year.

Allan, 52, and Meg, 50, have been married for 10 years. Four years ago, Allan decided to retire and become a volunteer in his community. Meg is a dentist, and primary income earner for the family. Their financial advisor, Fred, introduced them to TFSAs as a way to increase their savings. Meg liked the idea, but was concerned that Allan's lack of income would limit the family's available TFSA contribution room.

Fred explained that TFSA room is not based on earned income. Because both Meg and Allan file annual tax returns (Allan regularly files because of investment income), both are able to contribute $5,500 a year to a TFSA. If at any time Allan does not have the funds to maximize his contributions each year, Meg can give him the money to do so allowing total tax-free growth on $11,000 per year.

As a TFSA holder, although your contributions are not tax deductible, investment income earned and withdrawals are tax-free. As you withdraw amounts from your TFSA, the withdrawals can be re-contributed in a future year in addition to the contribution limit for that future year. Because of the combined effects of the carry forward provision and ability to re-contribute amounts withdrawn, you will generally not lose total TFSA savings room. Note: A withdrawal in a year cannot be re-contributed in the same year unless you have contribution room to absorb it. The ability to re-contribute withdrawals begins the year following the withdrawal.

Audrey has been contributing to a TFSA for 8 years. Over that period, she made contributions of $5,000 per year for 2009–2012, $5,500 for 2013–2014, $10,000 for 2015 and $5,500 for 2016 and realized a return of 3% each year. Details of her plan are as follows:

Contribution	$46,500
Growth	$6,225
Total Value	**$52,725**

Audrey's son Barrett recently qualified to attend university and required $40,000 to fund his education and living costs. Audrey decided to help and redeemed $40,000 from her TFSA.

The following year, Audrey received an inheritance of $60,000 from her grandparents. Because withdrawals restore contribution room, Audrey was able to re-contribute the $40,000 the year following the withdrawal to her TFSA, sheltering most of the future growth on her inheritance from taxes. She also contributed an additional $5,500 for new contribution room received that year.

As indicated, TFSA contributions are restricted to Canadian residents and are subject to a limit of $5,500 per year, indexed annually. If you exceed this limit, or contribute while you are a non-resident, over-contribution penalties of 1% per month generally apply. Contribution room does not accumulate for any year in which you are a non-resident.

Who is the typical TFSA holder?

According to the federal government TFSAs are meant to be "flexible, registered accounts that will help Canadians with different savings needs over their lifetime."

Are there specific types of investors that the TFSA is best suited to?

TFSAs are suited to anyone with money to invest. Regardless of your age or time horizon, TFSAs can fit into a portfolio and should be considered part of any overall investment strategy. Here are four investor profiles.

Flexibility Seeker

Meg is a 50-year-old mother of two. While she earns enough to put money aside each year, she is reluctant to lock up her investments for the long term because she wants cash available for unpredictable expenses like home and vehicle repairs. But, in addition to having easy access to her money, Meg also wants market exposure and a higher rate of return.

Since RRSPs are best used for long-term investing, the consideration for Meg would likely be TFSA versus non-registered investing. Said another way, the question would likely become taxable versus non-taxable investing. Because of the wide selection of investments available in the TFSA, and also because of the tax-free status of TFSA investment income, the TFSA would likely be the better option. As her TFSA increases in value over the years, Meg can use some of the funds to make RRSP contributions if desired.

Low-Income Investor

Jimmy, 23, is a new graduate who recently joined the workforce. Like many new graduates he is currently in the lowest tax bracket, and because Jimmy still lives with his parents, his expenses are low and he has money to invest.

Jimmy can consider an RRSP for his long-term investments. Contributions to an RRSP would provide him with a tax-deferral on a portion of his employment income. However, if Jimmy thinks he may require the assets in a year when he is in a higher tax bracket, the TFSA might be a better fit. Although a tax deduction would not be available at the time of contribution, future withdrawals (including income and capital gains earned) would be received tax-free. This is in contrast to a fully taxable RRSP withdrawal – a withdrawal that would be taxed at the higher tax bracket he finds himself in at the time of withdrawal.

RRSP Maximizer

Alex, a business owner, is able to maximize his RRSP each year. He is a fan of the RRSP primarily because of the annual tax deduction it provides. Because Alex is in the top tax bracket, he wants to shelter as much income from tax as possible. The problem is, other than the RRSP, there are very few tax shelters available in Canada.

The TFSA is another shelter available to Alex and one that can be used in combination with his RRSP. Because he is in the top tax bracket, tax deductions achieved by his annual RRSP contributions would likely continue to be of value. However, once his RRSP contribution limit is reached, excess funds can be invested in a TFSA for additional tax-saving opportunities. Furthermore, the tax refund generated from his RRSP contributions can be used to fund TFSA contributions.

Satisfied Senior

Allen is a 72-year-old RRIF annuitant who, because of tax legislation, must begin to receive RRIF payments by the end of the year. Allen does not require the extra cash as his annual expenses are minimal and he is adequately provided for by Old Age Security (OAS), Canada Pension Plan (CPP) and pension income. Allen would like to continue to invest the money received from his RRIF, but is concerned that additional investment income could result in a clawback of income-sensitive OAS benefits.

The TFSA can help. The cash flow received from Allen’s RRIF can be reinvested in a TFSA. Unlike RRSPs, there is no maximum age restriction for TFSA contributions, so seniors can benefit from the plan the same as any other investor. Also, as opposed to being tax-deferred in the RRIF, future investment income will grow tax-free in the TFSA. Should Allen require cash from his TFSA thereafter, withdrawals can be made without affecting his OAS benefits.

TFSA investment options

There is a broad range of investments you can use in your TFSA, and they are generally the same as those you would include in your RRSP. Be careful of "non-qualified" or "prohibited" investments – if held, these investments may be subject to a tax of 50% of their fair market value. Income earned on these investments may also be taxable.

Non-qualified or prohibited investments are generally those deemed ineligible for all registered plans (e.g., RRSPs, RRIFs, DPSPs). Certain privately-owned corporate shares are an example. It is important to speak to a financial advisor to ensure your investment selections are suitable for TFSAs.

TFSAs and interest deductibility

Because your TFSA provides tax-free income, interest on money borrowed to invest in a TFSA is not tax-deductible.

As an alternative, it could make sense to transfer non-registered assets to your TFSA instead of borrowing. Your non-registered assets could then be repurchased with borrowed funds[1]. In this case, a direct link from the borrowed money to an eligible non-registered investment would be established, and interest should be tax-deductible. As with any leveraging strategy, there are risks associated with debt, so this strategy should not be considered without the assistance of a financial advisor. Also, a taxable disposition may occur on transfer of non-registered assets to a TFSA, resulting in possible capital gains tax.

Kevin has non-registered investments valued at $36,500 that he purchased for $30,000 several years ago. His financial advisor introduced him to TFSAs and he realized that he had accumulated $46,500 in TFSA contribution room over the past 8 years.

Kevin has always been a risk taker, and is not opposed to leveraging for potentially better returns. Realizing that interest is not deductible where borrowed funds are used to invest in a TFSA, Kevin transfers his non-registered investments to his TFSA, and repurchases his non-registered assets with borrowed funds.

Although Kevin is subject to capital gains tax on transfer to his TFSA, interest on his loan is tax-deductible because his repurchased investments have the potential to pay income.

Here's another TFSA advantage

The *Income Tax Act (ITA)* permits TFSAs to be used as security for a loan. This is not the case for your RRSPs or RRIFs.

TFSA tip:

When transferring non-registered investments directly to a TFSA, don't transfer an investment that is in a loss position – current tax rules won't allow you to claim the loss. For more information on this type of transfer, see *Transferring between accounts* on page 9.

[1] Using borrowed money to finance the purchase of securities involves greater risk than a purchase using cash resources only. If you borrow money to purchase securities, your responsibility to repay the loan and pay interest as required by its terms remains the same even if the value of the securities purchased declines. Please ensure you read the Leverage Disclosure Statement found in the loan application and discuss with your financial advisor the actual risks and potential benefits of borrowing money to purchase securities.

Withdrawals from your TFSA

TFSAs are meant to be flexible, general-purpose accounts. As such, withdrawals are permitted at any time for any purpose, and are not included in taxable income. Also, as previously stated, amounts withdrawn can be re-contributed to your TFSA in a future year without affecting future contribution room. This flexibility provides ease of access in the case of emergencies, and provides funds for ad hoc expenses such as home renovations and vehicle repairs.

Trevor, age 22, recently graduated from college and started work in 2009. He decided to set aside $300 a month to save for the down payment on a condominium. While he wasn't making a lot of money, living at home with his parents allowed him to save aggressively and he contributed the $300 to his TFSA each month.

Early in 2015, Trevor signed a contract to purchase his condominium. At that time, details of his TFSA were as follows:

Contributions	$25,200 (2009–2015)
Growth (3%)	$2,831
Total Value	**$28,031**

Needing $25,000 for his down payment, Trevor redeemed this amount from his TFSA and made no further contributions that year. Even though the redemption consisted of both original contributions and growth, the entire amount was received tax-free. Also, because the TFSA is meant to be a flexible all-purpose account, after Trevor's financial institution notified the Canada Revenue Agency (CRA) of the withdrawal, the $25,000 redemption was added to his TFSA contribution room for the following year ensuring that total savings room was not lost. The following chart summarizes Trevor's TFSA contribution room for 2016, the year following the year of withdrawal.

Carry forward room (from 2015)	$15,800
[(4 years x $5,000 + 2 years x $5,500 + 1 year x $10,000) - (7 years x $3,600)]	
Add: annual TFSA limit (for 2016)	$5,500
Add: 2015 withdrawal	$25,000
2016 TFSA limit	$46,300

The Federal Government has also instructed that TFSA withdrawals not be taken into account in determining eligibility for federally sponsored income-tested benefits delivered through the tax system – e.g., Canada Child Tax Benefit (CCTB), the GST/HST Credit and the Age Credit. Nor will it affect other income-sensitive benefits such as OAS, the Guaranteed Income Supplement or Employment Insurance (EI) benefits. This provides some unique opportunities because TFSA withdrawals can be used without triggering a loss in benefits.

Omar worked at a car assembly plant for 7 years. Throughout this time he invested regularly in his TFSA. When the company recently experienced difficulties it was forced to close and Omar was laid off.

Shortly after, Omar applied for EI benefits and began receiving weekly payments. Realizing the EI payments were not enough to fund his expenses, he withdrew funds periodically from his TFSA. Although certain earnings received while on EI affect EI benefits, (e.g., payments from locked-in retirement accounts), TFSA payments do not. Therefore, Omar was able to supplement his income without reduction to his EI benefits.

Transferring between accounts

Because TFSAs are tax-free accounts, taxes are not normally a concern when transferring assets from a TFSA to another savings plan (e.g., investment account, RRSP, RRIF, RESP). The amount transferred is considered a withdrawal and the withdrawal rules discussed earlier apply, including the ability to re-contribute amounts withdrawn.

If the transfer is between multiple TFSAs owned by the same person, the transfer is known as a "qualifying transfer." In this case, contribution room is not affected – you will neither gain nor lose contribution room for the amount transferred.

If you transfer TFSA assets to a former spouse or common-law partner because of a relationship breakdown, a qualifying transfer also occurs. Contribution room to your TFSA is not restored, and your former spouse or common-law partner does not require room to receive the transfer. This type of transfer requires a formal divorce decree or separation agreement.

This may not be the best strategy for you if you are the one who is required to split your TFSA. This is because you would be losing a portion of the assets in your account without the benefit of recouping your contribution room. You may want to consider using assets from another account to split with your former spouse, possibly a non-registered or RRSP account.

If other savings plans (e.g., investment accounts, RRSPs, RRIFs, RESPs) are transferred to your TFSA, the amount transferred would normally be taxable in the year of transfer and would require TFSA contribution room.

A point on investment accounts: For assets that have gone up in value, capital gains tax is generally payable when transferred to a TFSA. Assets that have gone down in value are treated differently. Because of specific rules in the ITA, if you transfer depreciated assets directly to your TFSA, your capital losses will be denied.

Kelly owns ABC mutual fund in her investment account with a value of $30,000. She purchased this fund 10 years earlier at a cost of $40,000, but still expects the fund to do well in the future. Kelly would love to realize future growth in her TFSA and has the contribution room to allow it.

Kelly's financial advisor told her that a direct transfer of ABC fund to her TFSA would trigger a disposition – a capital loss in this case. However, because of special rules in the ITA, her loss would be denied and not available to offset capital gains.

For this reason, it is generally suggested that capital losses be triggered outside of the TFSA before TFSA contributions are made.

Your TFSA and death

When you set up a TFSA, you have the opportunity to name a "successor holder" who will continue as holder of your plan on your death. Under rules in the ITA, when a successor holder is named, your TFSA will not terminate on your death – your successor simply replaces you as plan holder, and the plan will continue with all rights passing to the successor.

The ITA restricts the naming of a successor holder to your spouse or common-law partner. TFSA over-contributions existing at the time of your death will be deemed contributions made by your successor in the month following your death. If your successor has sufficient TFSA contribution room to absorb the over-contributions, over-contribution penalties will cease.

Melanie passed away in May. In March she had over-contributed to her TFSA by $1,000. This resulted in an over-contribution penalty of 1% per month for the months of March, April and May. Because her husband, Phil, was named successor holder, he became holder of the plan and inherited all rights associated with the plan. Phil was deemed to make a contribution of $1,000 – the amount of Melanie's over-contribution – to the plan the month following Melanie's death. Because Phil had sufficient TFSA contribution room to absorb the $1,000 contribution, over-contribution penalties ceased.

When a successor holder is not named, but your spouse or common-law partner inherits your TFSA, he or she can transfer the assets to their TFSA as long as the transfer occurs during the "rollover period." This allows for continued tax sheltering. The rollover period is defined as the period that begins at the date of death and ends on December 31st of the following year. If a transfer occurs during this rollover period, the transfer is defined as an "exempt contribution" and does not require TFSA contribution room.

However, exempt contributions are generally limited to the fair market value of the transferring TFSA at the time of death. TFSA growth after death would require new contribution room. To ensure exempt contributions do not affect contribution room of a receiving spouse or common-law partner, the contribution must be designated on CRA form RC240, *Designation of an Exempt Contribution Tax-Free Savings Account (TFSA)*, which must be sent to the CRA within 30 days of contribution.

After a long illness, Jessie passed away. At the time of death, his TFSA was worth $60,000. Although his wife, Jenny, was not a successor holder, she was beneficiary of his estate and inherited the TFSA through his will. Six months after Jessie's death, during the rollover period, Jenny transferred Jessie's TFSA to her TFSA. Although her contribution room at the time of transfer was only $10,000, Jessie's account – $62,000 at the time of transfer – was fully contributed to her account. $60,000 was an exempt contribution (which did not require contribution room) with the remaining $2,000 being absorbed by Jenny's available contribution room. Jenny completed CRA form RC240 within 30 days of transfer to ensure that her exempt contribution did not affect her contribution limit.

Individuals other than spouses and common-law partners can inherit TFSAs, but exempt contributions are not available to them. While TFSA assets can be transferred to these beneficiaries tax-free (for amounts up to the date of death), TFSA contribution room is required to shelter future income from tax.

In the absence of a successor holder, income earned in a TFSA after the date of death is subject to tax – a tax normally payable by the recipient of the TFSA. This is the case regardless of whether or not a spouse or common-law partner is beneficiary.

Continuing the previous example, even though Jenny's contribution room allowed her to contribute the $2,000 earned after Jessie's death to her TFSA, this amount was taxable to Jenny. The $2,000 was fully included in her income for the year of transfer.

Federal legislation does not specify whether or not a beneficiary can be named directly on a TFSA application (an application designation can be effective in reducing estate administration fees and avoiding complex estate settlements). This is not unusual as the transfer of assets at death is governed by provincial and territorial legislation. In order to transfer TFSAs to beneficiaries by way of a plan application (as opposed to a transfer by way of will), provincial or territorial legislation must allow for it.

All provinces and territories (other than Quebec), have updated their respective legislations to allow for beneficiary designations on TFSA applications. For Quebec, TFSA transfers at death continue to pass through the deceased's estate and are governed by the deceased's will[2]. For this reason, will designations continue to be of importance in Quebec.

Meant to complement, not compete

The TFSA is designed to complement, not compete with, existing savings plans. Each of the RRSP, RRIF, RESP, Registered Pension Plan and Registered Disability Savings Plan has a role in investment planning, and each is designed to satisfy a specific objective. TFSAs bridge the gap between registered and non-registered investing by allowing the tax-efficiency of registered accounts coupled with the flexibility of non-registered investments.

To determine how to make the best use of a TFSA, you are encouraged to speak to a financial advisor.

[2] It is expected in Quebec that TFSA assets will always be subject to the terms of a deceased's will regardless of successor holder and/or beneficiary designations made on the TFSA contract.

GENERAL INQUIRIES

For all of your general inquiries and account information please call:

ENGLISH	1-800-387-0614
BILINGUAL	1-800-387-0615
ASIAN INVESTOR SERVICES	1-888-465-1668
TTY	1-855-325-7030 416-922-4186
FAX	1-866-766-6623 416-922-5660
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