Tax-free savings account (TFSA) Q&A

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Invesco Canada Ltd. ("Invesco") began offering TFSAs as of January 2, 2009. There are tax benefits to using a TFSA as a short-term savings plan; however, these benefits can be much greater if the TFSA is used as a long-term investment plan. Why? It's all about the power of tax-free compound growth.

Plan overview

Q: What is the TFSA?

A: The TFSA is a flexible, registered account that allows Canadians to earn tax-free investment income. Invesco believes the TFSA is most effective when used as a long-term investment account because investors will benefit from tax-free compound growth.

Q: Who can invest in a TFSA?

A: In order to be eligible to invest in a TFSA an individual must:

- Be 18 years of age or older
- Be a Canadian resident taxpayer
- Have a valid Social Insurance Number

Q: How much can I contribute to my TFSA?

A: TFSA contribution room is based on an individual's allocated annual TFSA dollar amount and his/her unused TFSA carryforward amount. As per the 2015 Federal Budget, the annual TFSA dollar amount has been increased to $10,000 starting in 2015. The annual dollar amount will no longer be indexed to inflation. Prior to 2015, the annual allocated dollar amount was indexed to inflation and rounded to the nearest $500. From 2009 to 2012, the annual TFSA contribution limit was $5,000. In 2013 and 2014, due to indexation, the annual allocated dollar amounts were $5,500.

Q: When does TFSA contribution room begin to accumulate?

A: TFSA contribution room will begin to accumulate in any year after 2008 provided the individual is a Canadian resident and at least 18 years of age in the year.

Q: How does the carryforward of unused contribution room work?

A: An investor can calculate TFSA contribution room at the beginning of each calendar year. The calculation considers the investor's unused TFSA contribution room at the end of the preceding calendar year plus any TFSA withdrawals made in that year. That figure is added to the TFSA dollar limit for the current year minus all contributions made in the current year.

Note that certain qualifying transfers and prescribed withdrawals are excluded from the evaluation.

Q: How much can be redeemed tax-free from a TFSA?

A: You can redeem the entire value of the TFSA without paying tax on the investment income.

Q: Are contributions in a TFSA tax-deductible?

A: No.

Q: Do withdrawals have an impact on contribution room?

A: Yes. If a withdrawal is made from a TFSA in a year, the amount withdrawn is added to the individual's TFSA contribution room calculation for the next year and can be re-contributed in subsequent years.

Q: What happens if I overcontribute to my TFSA?

A: Any excess contribution will be subject to a 1% penalty tax per month.

Q: Can I name a beneficiary or successor holder directly on a TFSA?

A: Yes. Beneficiary and successor holder designations may be made directly on the TFSA plan, unless you are a resident of Quebec.

Q: Is the interest expense incurred on money borrowed to invest in a TFSA plan tax-deductible?

A: No.

Q: Can I use my TFSA as collateral for a loan?

A: Yes. TFSA assets can be used as collateral and will have no negative tax consequences.

Q: Can I transfer securities from my non-registered account into my TFSA?

A: Yes. However, if these securities have unrealized capital losses, the losses will be denied and cannot be used for tax purposes. Any capital gains realized on the transfer will be reportable on your income tax return.

Q: Can I contribute to my TFSA as a non-resident of Canada?

A: While there is nothing preventing a TFSA accountholder from contributing to a TFSA while being a non-resident of Canada, any contributions made during non-residency will be subject to a 1% penalty per month for each month these funds remain in the plan. Also, the annual TFSA dollar amount will not be allocated during years of non-residence.

Q: Can anyone else make contributions into my TFSA?

A: Third-party contributions are allowed into a TFSA as long as they are a gift to the TFSA accountholder. Please contact Invesco and/or your financial advisor for more information.

Q: Can I hold a TFSA in joint ownership with my spouse or adult children?

A: No.

Q: Can I open a TFSA in-trust for my minor children?

A: No.

Q: What happens to the TFSA upon death of the accountholder?

A: The full account value becomes an asset of the accountholder's estate. While no tax is incurred on passing into the estate, any income after death will be taxable. However, if there is a surviving spouse who is named as successor holder, that spouse may maintain that account as a TFSA without any reduction in the spouse's contribution room. For further information, please see our *Tax & Estate InfoPage* titled "Death and taxes."

Q: What would happen to a TFSA in the event a marriage or common-law partnership is dissolved?

A: A transfer could be made directly from an accountholder's TFSA to his/her former spouse's or common-law partner's TFSA without any taxable situation. The amount of the transfer would not affect either spouse's or common-law partner's TFSA contribution room.

Q: How is a TFSA different from a registered retirement savings plan (RRSP)?

A: An RRSP is primarily intended for retirement. The TFSA can be used for pre-retirement, retirement and estate-planning goals. Both plans offer tax advantages, but they have key differences:

- RRSP contributions are deductible from income
- Although growth and income generated in an RRSP is not taxable, withdrawals from the plan are taxable, except in certain circumstances
- TFSA contributions are not tax-deductible, are likewise not taxed on any income generated in the plan and are completely tax-free on withdrawal
- Withdrawals from an RRSP or registered retirement income fund (RRIF) may affect other seniors' benefits, such as Old Age Security and the Guaranteed Income Supplement, whereas withdrawals from a TFSA will not

Q: Should I make a contribution to my RRSP or TFSA this year? Which one should I maximize first if I don't have enough extra cash to contribute to both?

A: While plans are meant to be tax-neutral where a person has the same marginal tax rate (MTR) at all times (see chart below), RRSPs will tend to make more sense when the tax rate upon withdrawal is expected to be lower than your tax rate upon original contribution. Conversely, TFSAs will work out better if your tax rate (including the effect of RRSP withdrawals on reduced income-tested benefits) will be higher upon ultimate withdrawal than it was when you contributed.

TFSAs compared to RRSPs at a constant MTR

		RRSP	**TFSA**
Pre-tax income		$1,000	$1,000
Tax on contribution	(40% MTR)	N/A	$(400)
Net contribution		$1,000	$600
Growth at 6% over 20 years		$3,207	$1,924
Tax on withdrawal	(40% MTR)	$(1,283)	N/A
Net cash		$1,924	$1,924