



Tax-Free Savings Account (TFSA)

What is a TFSA?

Starting in 2009, a tax-free savings account (TFSA) is a new way for residents of Canada to set money aside tax free throughout their lifetimes.

Contributions to a TFSA are not deductible for income tax purposes and the income earned in the account (for example, investment income and capital gains) is tax-free, even when it is withdrawn. Interest on money borrowed in order to contribute to a TFSA is also not tax-deductible.

Who is eligible for a TFSA?

Any individual (other than a trust) who is at least 18 years old, who is a resident of Canada, and who has a valid social insurance number (SIN) can be a **holder*** of a TFSA.

How to establish a TFSA

To establish a TFSA, you must contact your financial institution, credit union or insurance company (**issuer***). As the TFSA holder, you will need to provide the issuer with your SIN and date of birth so that the issuer can register your **qualifying arrangement*** as a TFSA. Failing to provide this information or providing incorrect information may cause the registration of the TFSA to be denied, resulting in possible tax consequences.

You can set up a **self-directed TFSA** if you prefer to build and manage your own investment portfolio by buying and selling a variety of different types of investments. If you are considering this type of arrangement, you may want to consult with your financial institution.

Note

An individual can have more than one TFSA at any given time, as long as the total amount contributed to all the accounts during the year does not exceed the individual's available TFSA contribution room for that year.

Types of investments allowed in a TFSA

Generally, the types of investments that will be permitted in a TFSA are the same as those permitted in a registered retirement savings plan (RRSP). This would include mutual funds, securities listed on a designated stock exchange, Guaranteed Investment Certificates (GICs), bonds, and certain shares of small business corporations.

You can also make "in kind" contributions to your TFSA, as long as the property is a **qualified investment***. You will be considered to have disposed of the property at its fair market value (FMV) at the time of the contribution. If the FMV is more than the cost of the property, you will have to report the capital gain on your income tax return. However, if the cost is more than the FMV, the resulting capital loss cannot be claimed. The amount of the contribution will be equal to the FMV of the property.

TFSA dollar limit

As the account holder, you are the only person who can contribute to your TFSA.

For 2009, if you are eligible, you can contribute up to \$5,000 to your TFSA. After 2009, the annual TFSA dollar limit will be indexed to the inflation rate.

The indexed amount will be rounded to the nearest \$500. For example, assuming that the inflation rate is 2%, the TFSA dollar limit would remain at \$5,000, for 2010 and 2011, but would increase to \$5,500 for 2012.

TFSA contribution room

The TFSA contribution room is made up of:

- your annual TFSA dollar limit (\$5,000 per year plus indexation, if applicable);
- any **unused TFSA contribution room*** in the previous year; and
- any withdrawals made from the TFSA in the previous year, excluding **qualifying transfers***.

Based on information provided by the issuers, the Canada Revenue Agency (CRA) will determine the TFSA contribution room for each eligible individual. Your annual contribution room will be indicated on your notice of assessment.

Withdrawals, excluding qualifying transfers, made from your TFSA in the year will be added back to your TFSA contribution room at the beginning of the following year.

You cannot contribute more than your TFSA contribution room in a given year, even if you make withdrawals from the account during the year. If you do, you will be subject to a tax equal to

*see the definitions at the end of this document.

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1% of the highest excess amount in the month, for each month you are in an overcontribution position.

To report any discrepancies in your contribution room limit or excess contributions, please contact your TFSA issuer.

Example 1

In 2009, Sarah invests \$5,000 in a TFSA. Later that year, she withdraws \$3,000 for a trip to Europe. Unfortunately, her plans change and she cannot go. Since Sarah has no unused TFSA contribution room left, she will have to wait until the beginning of 2010 to deposit the \$3,000 in her TFSA. If she does so earlier, she will have overcontributed to her TFSA and will be charged a monthly tax of 1% on the overcontributed amount.

Example 2 (Assuming no indexing)

In 2009, Carl is allowed to contribute \$5,000. He contributes \$2,000 for that year.

2009 TFSA dollar limit:	\$5,000
2009 contributions:.....	- <u>\$2,000</u>
Unused TFSA contribution room available for future years.....	\$3,000

In 2010, Carl does not contribute to his TFSA, but he makes a \$1,000 withdrawal from his account.

2009 unused TFSA contribution room	\$3,000
2010 TFSA dollar limit	+ <u>\$5,000</u>
2010 unused TFSA contribution room available for future years.....	\$8,000

Carl's unused TFSA contribution room for 2011

2010 unused TFSA contribution room	+ \$8,000
2010 withdrawal	+ \$1,000
2011 TFSA dollar limit	+ <u>\$5,000</u>
2011 TFSA contribution room	\$14,000

Non-residents of Canada

If you become non-resident of Canada, you will be allowed to keep your TFSA and you will not be taxed on any earnings in the account or on withdrawals from it. No TFSA contribution room will accrue for any year throughout which you are a non-resident. Any withdrawals made during the period that you were a non-resident will be added back to your unused TFSA contribution room in the following year, but will only be available if you resume your residency status in Canada.

If you make contributions to your TFSA while you are a non-resident, you will be subject to a tax of 1% per month on the amount you contributed for each month, ending at the earliest of:

- when the non-resident contributions are withdrawn from the account **and** designated as a withdrawal in connection with the contribution; or
- when you become resident of Canada.

Even if you do not live in Canada, you may have residential ties which deem you to be a resident of Canada. These ties include where your home and personal property are, and where your spouse or common-law partner or dependants reside. Other ties that may be relevant include social ties, a driver's licence, bank accounts or credit cards, and provincial or territorial hospitalization insurance. For more information, see Interpretation Bulletin IT-221R, *Determination of an Individual's Residence Status*.

Impact on your income-tested benefits

Neither income earned in, nor funds withdrawn from a TFSA will affect your eligibility for federal income-tested benefits and credits, such as the Working Income Tax Benefit (WITB), the Goods and Services Tax Credit (GSTC), the age amount and the Canada Child Tax Benefit (CCTB).

These amounts will also not reduce other benefits that are based on your income level, such as Old Age Security benefits (OAS), the Guaranteed Income Supplement (GIS), or Employment Insurance (EI) benefits.

Example

Denis is retired and receives the GIS as well as OAS and Canada Pension Plan (CPP) benefits. He earns \$500 a year in interest income from his TFSA savings. Neither this income nor any TFSA withdrawals will affect his GIS, or any other federal income-tested benefits and credits he receives. If this \$500 were earned in an unregistered vehicle, it would have to be included on his tax return and could be subject to a social benefit repayment.

Denis' income	Funds in a registered vehicle (TFSA)	Funds in an unregistered vehicle
Total pension income	\$44,822	\$44,822
Total CPP benefits	\$12,017	\$12,017
Total OAS	\$5,933	\$5,933
Total GIS	\$ 3,428	\$ 3,428
Interest income to be reported on the tax return	\$ <u>0</u>	\$ <u>500</u>
Total income	\$66,200	\$66,700
Fictitious base amount for social benefits repayments	\$66,250	\$66,250
Amount over base amount	\$0	\$450
(multiplied by 15%)	x15%	x15%
Amount to be included on the tax return as a social benefit repayment	\$0	\$67.50

Marriage or common-law partnership breakdown

When there is a breakdown in a marriage or common-law partnership, an amount can be transferred directly from one former spouse or common-law partner's TFSA to the other's TFSA in the following situation.

You and your current or former spouse or common-law partner are living separate and apart at the time of the transfer and you are entitled to receive the amount:

- under a decree, order, or judgment of a court, or under a written separation agreement; and
- to settle rights arising out of your relationship on or after the breakdown of your relationship.

The amount of the transfer will not reduce the recipient's eligible contribution room; however, since this transfer is not considered a withdrawal, the transferred amount will not be added back to the transferor's contribution room at the beginning of the following year.

The transfer will not eliminate any excess amount in the TFSA.

Death of the TFSA holder

General rules

When the holder of a deposit or an annuity contract under a TFSA dies, the holder is considered to have received, immediately before death, an amount equal to the fair market value (FMV) of all the property held in the TFSA at the time of death.

After the holder's death, the annuity contract is considered to be a separate contract and is no longer considered as a TFSA. All earnings that accrue after the holder's death will be taxable to the beneficiaries.

Generally, amounts paid from the TFSA that represent the income earned in the TFSA after the date the holder died have to be reported by the holder's beneficiaries. These payments have to be included in the income of the beneficiaries for the year they are received.

A beneficiary will not have to pay tax on any payments made out of the TFSA that do not exceed the FMV of all the property held in the TFSA at the time of death.

Spouse or common-law partner is the sole beneficiary of the TFSA

The deceased holder is **not considered** to have received an amount from the TFSA at the time of death if, in the TFSA **contract**, the holder named his or her spouse or common-law partner as the **sole** beneficiary of the TFSA. In this situation, the TFSA continues and the spouse or common-law partner becomes the **successor holder*** under the plan.

If at the time of death there was an **excess TFSA amount***, the successor holder is deemed to have made, at the beginning of the month following the date of death, a contribution to their TFSA equal to the amount of the excess TFSA amount. If that contribution creates an excess contribution to the successor holder's TFSA, they will be subject to a 1% tax per month on the highest amount for each month they are in an overcontribution position.

If, in the TFSA **contract**, the holder named his or her **spouse** or **common-law partner** and **someone else** as beneficiaries of the TFSA, we consider that there is no successor holder. The spouse or common-law partner would be considered a survivor.

Other beneficiaries

When no spouse or common-law partner is named in the TFSA contract, the deceased holder's estate becomes entitled to receive the TFSA property. If the deceased's **will** states that the spouse or common-law partner is entitled to the amounts paid under the TFSA, or that the spouse or common-law partner is the sole beneficiary of the estate, the spouse or common-law partner becomes the survivor.

Under proposed changes, the TFSA that becomes a trusted arrangement is deemed to continue to be a TFSA until the end of the exempt period which is the end of the calendar year following the year in which the holder dies, or when the trust ceases to exist, if earlier.

All income earned during the exempt period and paid to the beneficiaries, including a survivor, will be included in their income, while earnings that accrued before death would remain exempt.

The survivor may contribute payments made within the exempt period from a deceased holder's TFSA into their own TFSA without affecting their **unused TFSA contribution room*** limit. Such survivor payments become an **exempt contribution***.

In order for the survivor to designate an exempt contribution, the survivor must designate their survivor payments as an exempt contribution on Form RC240, *Designating an Exempt Contribution to a Survivor Tax-Free Savings Account (TFSA)* within 30 days after the day on which the contribution is made.

An exempt contribution cannot exceed the payment received during the exempt period and the FMV of the deceased holder's TFSA at the time of death.

Donation upon death

If a **qualified donee*** was named as a beneficiary of the deceased holder's TFSA, the transfer of funds to the qualified donee must generally occur within the 36-month period following the holder's death.

Termination of the TFSA

The TFSA ceases to exist at the earliest of when:

- the last account holder dies;
- the account ceases to be a qualifying arrangement; or
- the account is not being administered according to the *Income Tax Act*.

Taxation

All amounts in the account are not taxable, except in the following cases:

- If, at any time in a calendar month, there is an excess TFSA amount in your account, you will be subject to a tax of 1% of the highest such amount in that month.
- If you, while a non-resident of Canada, make contributions to a TFSA, you will be subject to tax of 1% per month on the amount you contributed. This will continue to apply for each month that the amount contributed remains in the TFSA and will continue to apply until the earlier of:
 - when the total amount is withdrawn **and designated** as a withdrawal in connection with the contribution from the account; or
 - when you become a resident of Canada.
- If property that is considered to be a **prohibited investment*** or a **non-qualified investment*** is acquired, or if property held in the account becomes such, a tax of 50% of the FMV of the property, at the time it was acquired or that it became a non-qualified or prohibited investment is payable by the holder. When a TFSA holds a prohibited investment, the holder will also be subject to an additional tax that is based on income earned from the prohibited investment.
- In the case of a trustee TFSA, the income earned in the account and paid to a beneficiary during the **exempt period*** will be included in that beneficiary's income.

Note

If the income earned in the account during the exempt period is not paid out to a beneficiary during that period, it will be included on the trust's income tax return.

- If an annuity contract or a deposit ceases to be a TFSA, the account holder is deemed to have disposed of the contract or the deposit at FMV immediately before the contract or the deposit terminated. Earnings that accrue in the account after the holder's death will be taxable to the beneficiary of the account.
- When, for a calendar year, an **advantage*** in relation to the TFSA is extended to the holder of the TFSA or someone who does not deal at **arm's length*** with the holder, the amount of tax payable by the holder is:
 - in the case of a benefit, the FMV of the benefit; and
 - in the case of a loan or a debt, the amount of the loan or debt.

Return and payment of tax

A person who is liable to pay tax must file a return in prescribed form within 90 days after the end of the year and pay to the Receiver General the amount that is owed for the year.

Refund of taxes paid

The TFSA holder may be entitled to a refund of taxes paid on **non-qualified investments*** or **prohibited investments*** held in the account if:

- the TFSA trust sells the property in question before the end of the calendar year following the calendar year in which the tax arose;
- if the property ceases to be a non-qualified or prohibited investment before the end of the calendar year following the calendar year in which the tax arose; or
- such later time permitted by the Minister.

However, no refund will be issued if it is reasonable to expect that the holder knew, or should have known, at the time the property was obtained by the TFSA trust, that the property was, or would become, a non-qualified investment or a prohibited investment.

Definitions

Advantage: any benefit, loan or debt that is conditional in any way on the existence of the TFSA, other than:

- a benefit that comes from administrative or investment service; or
- a loan or debt (including the use of the TFSA as security for a loan or a debt) that persons dealing at arm's length with each other would have entered into.

Arm's length: at arm's length is a concept describing a relationship in which the parties are acting independently of each other. The opposite, **not at arm's length**, includes individuals who are related to each other by blood, marriage, adoption, and common-law relationships. Not at arm's length also covers people acting in concert without separate interests, such as those with close business ties.

Excess TFSA amount: the total of all contributions made by the holder to all their TFSAs at a particular time in the calendar year, **other** than a qualifying transfer or an exempt contribution

MINUS

- the unused TFSA contribution room at the end of the preceding calendar year;
- the total of all withdrawals made under the holder's TFSA in the preceding calendar year, **other** than a qualifying transfer;
- for a resident of Canada, the TFSA dollar limit for the calendar year; for any other case, nil; and
- the total of all withdrawals made in the calendar year under all TFSAs of the holder, **other** than a qualifying transfer or withdrawals that are more than the excess TFSA amount determined at that time.

Exempt contribution: a designated contribution made by a TFSA holder's survivor in connection with a payment received from the deceased holder's TFSA.

Exempt period: under proposed changes, the end of the calendar year following the year of death, or when the trust ceases to exist, if earlier.

Holder: the individual who entered into the arrangement, and after their death, the individual's successor holder named in the TFSA contract.

Issuer: a trust company, a licensed annuities provider, a member of the Canadian Payments Association or a credit union with which an individual has an arrangement.

Non-qualified investment: property that is not a qualified investment for the trust.

Prohibited investment: any property of a trust governed by a TFSA, other than prescribed excluded property in relation to the trust, that is at any time:

- a debt of the holder of the TFSA;
- a share of a capital stock of, an interest in, or a debt of a corporation, partnership or trust in which the holder has significant interest;
- a person or partnership that does not deal at arm's length with the holder or with a person or partnership in which the holder has significant interest; **or**
- an interest in, or a right to acquire a share, interest or debt described above.

Qualified donee: the *Income Tax Act* permits qualified donees to issue official tax receipts for donations they receive from individuals or corporations. Some examples of qualified donees are registered charities, Canadian municipalities, registered Canadian amateur athletic associations, the United Nations or one of their agencies, or a university outside Canada that accepts Canadian students.

Qualified investment: some types of qualified investments are: money, interest that is paid, or payable, on a bond, mortgage, a note, debenture, or other debt obligations, Guaranteed Investment Certificates (GICs), and investment contracts (investments are generally the same as those found in an RRSP).

Qualifying arrangement: an arrangement that is entered into after 2008 between an issuer and an individual (other than a trust) who is at least 18 years of age, that is:

- an arrangement in trust with an issuer that is authorized in Canada to offer to the public its services as a trustee;
- an annuity contract with an issuer that is a licensed annuities provider; or
- a deposit with an issuer that is a person who is a member of the Canadian Payments Association, or a credit union that is a shareholder or member of a "central" for the purposes of the *Canadian Payments Act*.

Qualifying transfer: a direct transfer between TFSAs of the same holder, or the amount that is transferred directly to a spouse or common-law partner or former spouse or common-law partner if the transfer relates to a division of property due to the breakdown of their marriage or common-law partnership.

Successor holder: a spouse or common-law partner named in the TFSA contract by the deceased as the successor of the TFSA. The spouse or common-law partner becomes the new account holder.

Survivor: an individual who is, immediately before the holder's death, a spouse or common-law partner of the holder.

Unused TFSA contribution room: the amount, either positive or negative, at the end of a particular calendar year after 2008, determined by the holder's unused TFSA contribution room at the end of the year preceding the particular year.

PLUS

- the total amount of all withdrawals made under the holder's TFSA in the preceding calendar year, **other** than a qualifying transfer.
- the TFSA dollar limit for the particular year if, at some point in that year, the individual is at least 18 years old and a resident of Canada. In all other cases, the amount is nil.

MINUS

- the total of all TFSA contributions made by the individual in the particular year **other** than a qualifying transfer or an exempt contribution.

Forms and Publications

- IT-110R *Gifts and Official Donation Receipts*
- IT-221R *Determination of an individual's Residence Status*
- IT-320R *Qualified Investments-Trusts Governed by Registered Retirement Savings Plans, Registered Education Savings Plans and Registered Retirement Income Funds*
- IT-419R *Meaning of Arm's Length*
- RC240 *Designating an Exempt Contribution to a Survivor Tax-Free Savings Account (TFSA)*

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Canada Revenue Agency
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