

## Introduction

The Tax-Free Savings Accounts are available beginning January 1, 2009. Many financial institutions are already taking applications to establish the accounts although contributions may not be made until after January 1, 2009.

## Eligibility

Any individual who is resident in Canada and 18 years of age or older will be eligible to establish a TFSA by providing their Social Insurance Number to an eligible issuer<sup>1</sup>.

## Contribution Limits

Effective in 2009, an individual will be able to make annual contributions of up to \$5,000 (indexed to inflation and rounded to the nearest \$500). Unused contribution room may be carried forward indefinitely. Any amounts withdrawn from the TFSA will be added to the individual's contribution room for the following year. This will give individuals who access their TFSA savings the ability to re-contribute an equivalent amount in the future. Excess contributions will be subject to a tax of 1% per month.

## Treatment of TFSA Income for Tax and Income-Tested Benefit Purposes

Contributions to a TFSA will not be deductible in computing taxable income nor subject to income tax when withdrawn. In addition, income and capital gains will not be taxable either while retained inside the TFSA or when withdrawn. Finally, any income earned and any amounts withdrawn will not be taken into account when determining eligibility for income-tested benefits or credits delivered through the income tax system (for example, the Canada Child Tax Benefit, the Goods and Services Tax Credit and the Age Credit). Nor will such amounts be taken into account in determining other benefits that are based on the individual's income level, such as Old Age Security benefits, the Guaranteed Income Supplement or Employment Insurance benefits.

## Qualified Investments

A TFSA will generally be permitted to hold the same investments as a Registered Retirement Savings Plan (RRSP). However, the TFSA will be prohibited from holding investments in any entities with which the account holder does not deal at arm's length.

## Interest Deductibility and Collateralization

Because the investment income within, and withdrawals from a TFSA will not be taxable, interest on money borrowed to invest in a TFSA will not be deductible in computing income for tax purposes. There will be no prohibition in the Income Tax Act on an individual's ability to use their TFSA assets as collateral for a loan.

## Attribution Rules

If an individual transfers property to the individual's spouse or common-law partner, the income tax rules generally treat any income earned on that property as income of the individual. An exception to these "attribution rules" will allow individuals to take advantage of the TFSA contribution room available to them using funds provided by their spouse or common-law partner: the attribution rules will not apply to income earned in a TFSA that is derived from such contributions.

## Treatment Upon Death

Generally, an individual's TFSA will lose its tax-exempt status upon the death of the individual. (That is, investment income and capital gains that accrue in the account after the individual's death will be taxable, while those that accrued before death will remain exempt.) However, an individual will be permitted to name their spouse or common-law partner as the successor account holder, in which case the account will maintain its tax-exempt status. Alternatively, the assets

<sup>1</sup> Provincial legislation may impact the ability of a minor, the definition of which varies by Province, to open an account.

of a deceased individual's TFSA may be transferred to a TFSA of the surviving spouse or common-law partner, regardless of whether the survivor has available contribution room, and without reducing the survivor's existing room.

**Transfers**

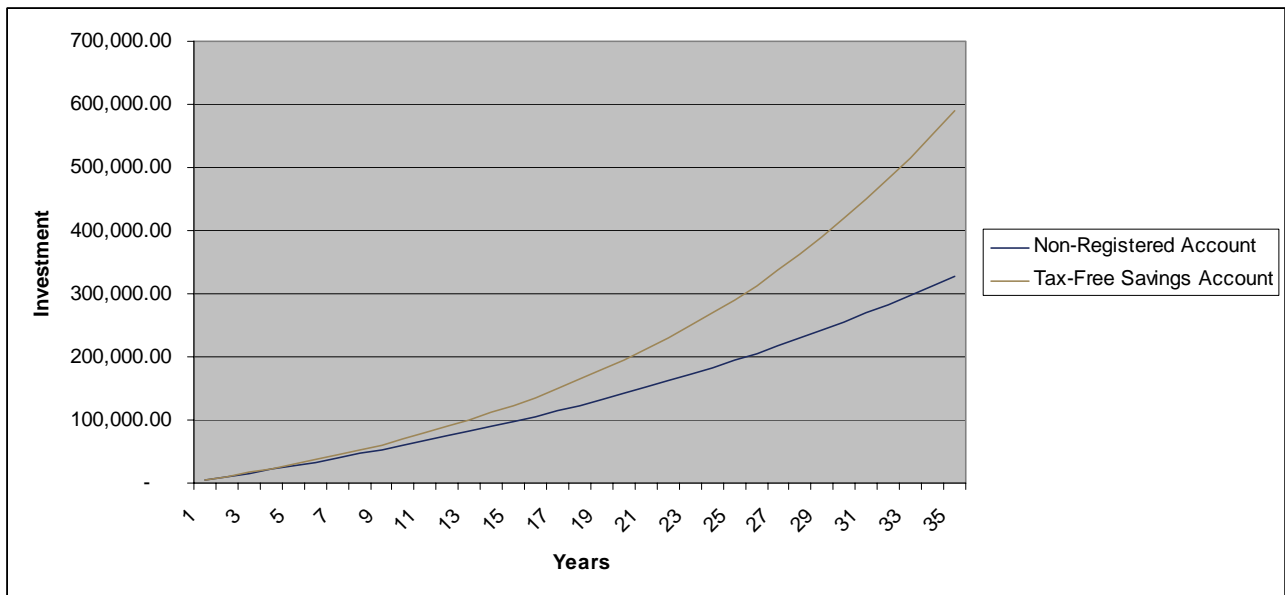
On the breakdown of a marriage or a common-law partnership, an amount may be transferred directly from the TFSA of one party to the TFSA of the other. In this circumstance, the transfer will not re-instate contribution room of the transferor, and will not reduce the contribution room of the transferee.

**Non-Residents**

An individual who becomes non-resident 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 per month for each month these funds remain in the plan.

**Financial Benefits**

The graph below compares investing \$5,000 per year in a non-registered investment account versus a Tax-Free Savings Account. In 35 years the non-registered account will have grown to over \$300,000 while the TFSA will have grown to almost \$600,000.



Assuming interest of 6% for an investor at a marginal tax rate of 46%.

## Summary

Characteristic	TFSA	RRSP
Contribution Room - amount	\$5,000 each year (indexed annually and rounded to the nearest \$500)	Based on earned income subject to maximum annual limits
Contribution Room – carryforward amount	Indefinitely	Up to age limit (71 years)
Contributions to Account	Not tax deductible	Tax deductible
Income Earned Inside Account	Tax-Free	Tax-Free
Withdrawal of Funds	Tax-free, amounts withdrawn are added to contribution room	Taxed on withdrawal
Excess Contributions	Penalty tax of 1%/month	Penalty of 1%/month in excess of \$2,000
Qualified Investments	Same as RRSP, except investments in non-arm's length entities are not permitted	Broad range to include mutual funds, publicly traded securities, government & corporate bonds, GIC's, and certain shares of small business corporations
Interest on Borrowed Funds to Invest in Account	Not deductible but TFSA's may be used as collateral for other borrowing	Not deductible and cannot be used as collateral
Attribution Rules	Do not apply to funds transferred to spouses or common-law partners to contribute to TFSA's	Spousal RRSP allowed
Treatment Upon Death	TFSA can be transferred tax-free to a spouse or common-law partner	RRSP can be transferred tax-free to a spouse or common-law partner

## Conclusion

The introduction of Tax-Free Savings Accounts represents a significant opportunity for Canadian investors. In addition to reducing taxes on savings for the investor there are income splitting opportunities as well as opportunities to minimize social benefit clawbacks, TFSA's can significantly enhance your wealth if properly implemented as part of your overall plan. For additional planning opportunities please contact your Richardson GMP Investment Advisor.

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