RBC Wealth Management Services

THE NAVIGATOR

Strategies to Incorporate the Tax-Free Savings Account (TFSA) into Your Financial Plan

Maximizing the benefits of your TFSA

This article discusses some potential financial planning strategies that may help you maximize the benefits of the TFSA. Depending on your stage of life and your financial priorities, there are ways you may be able to integrate this additional source of tax-free investment income into your overall financial plan.

Note: The information provided is based on the current and proposed tax law in effect as of the date of this article. The article is for information purposes only and should not be construed as offering tax or legal advice. Individuals should consult a qualified tax and legal advisor before taking any action based upon the information contained in this article.

Income-Splitting Opportunities

Gifts to a spouse

If there is a higher-income spouse and a lower-income spouse in your household, you may be able to benefit from some potential income-splitting opportunities using the TFSA.

When a higher-income spouse provides funds to their lower-income spouse to contribute to their TFSA, the lower-income account holder will not pay tax on the investment income and capital gains they earn in the account. Consequently, unlike a non-registered account, the income attribution rules will not apply to the spouse who provided the funds.

This may help achieve family income-splitting, plus, as the funds in the account accumulate tax-free, there is no impact on any spousal tax credits that the higher-income spouse may be able to claim for the lower-income spouse.

Conventional income-splitting strategies consider the source of the funds being invested to determine the tax consequences. In contrast, when you gift funds to your spouse to invest in their TFSA, both you and your spouse can earn tax-free investment income, irrespective of which spouse contributed the funds. The TFSA allows tax-free growth on the funds in the account, so there is greater potential for investment growth as the contribution made by each spouse builds over time.

It is also worth noting that if you have a lower-income spouse who has little or no earned income with which to build registered retirement savings plan (RRSP) contribution room, they may still be able to accumulate some additional retirement savings using their annual TFSA contribution room. The TFSA contribution room will continue to accrue throughout their lifetime whether or not they have earned income.

Gifts to Adult Children

You can use the TFSA, in addition to a registered education savings plan (RESP), as another tax-sheltered way to save for a child's education. If you gift funds to a child who is over the age of 18, they can contribute to a

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TFSA and they will not pay tax on the investment income they withdraw from the account as they would with RESP withdrawals. Note however that contributions to a TFSA will not attract the Canada Education Savings Grant.

Opportunities for Retirees

Retirees may be one of the major groups to benefit from the TFSA. Here's a summary of some of the potential opportunities:

- If you are no longer working but still have cash flow that is surplus to your needs, for example investment income or an inheritance, you may wish to continue building your savings even though you no longer have earned income with which to generate RRSP contribution room. The TFSA may provide a way to save for the future in a tax-free environment.
- You can contribute to this tax-free savings vehicle even after the end of the year you turn 71 when you are no longer able to contribute to your RRSP. If you are receiving either the required annual minimum registered retirement income fund (RRIF) income or pension income that is in excess of your current needs, then consider contributing the excess to your TFSA to preserve some tax-free growth. This may prove useful for your future needs and you will not be required to convert it to an income vehicle at any time in the future.
- If you anticipate being in the same or a higher marginal tax bracket in retirement, a TFSA could provide another source of tax-efficient retirement income. Unlike withdrawing funds from a registered plan, which would be fully taxed at a higher future tax rate, withdrawals from a TFSA are not taxable.
- Another advantage of using a TFSA to complement your existing sources of retirement income is that, as withdrawals from the account are not taxable income, they do not have an impact on any federal income-tested benefits and credits you may receive. For example, Employment Insurance benefits, the Guaranteed Income Supplement, the Canada Child Tax Benefit and the Age Credit. The fact that TFSA withdrawals are not taxable also reduces the possibility that Old Age Security (OAS) will be clawed back.

The TFSA can Complement Your Existing Registered Savings Plans

Depending on your financial circumstances and your stage of life, you may be able to use the TFSA to complement your existing registered savings plans in the following ways:

- If you have RRSP contribution room, consider making a contribution and using the tax refund you receive to contribute to a TFSA. This could be a way to save for various goals, for example, a home, a car or travel, while sheltering income from taxation.
- If you have maximized your RRSP contributions based on your available contribution room or if you can no longer make RRSP contributions due to your age, you could use your TFSA to earn additional tax-sheltered investment income. You can withdraw funds from the account when you need them and re-contribute them without tax consequences.
- You may wish to consider using your TFSA to accumulate funds in addition to an RESP. This could be another tax-sheltered way to save for a child's education. By using your own TFSA, you can start investing

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long before your child is 18 and able to open their own account, and you can withdraw funds tax-free when they are needed.

- If you are still building your wealth for the future, consider transferring $5,500 of non-registered assets to your TFSA every year. Note that if you choose to transfer assets in-kind to your TFSA, instead of cash, this could potentially trigger unrealized capital gains, which would result in an immediate tax liability. During your peak earning years when you are in a higher tax bracket, contributing to your RRSP may make sense to give you the benefit of the income tax deduction. Then you could withdraw the funds from your RRSP when you are in a lower tax bracket, possibly in retirement, and contribute to a TFSA to generate tax-free investment income that you can access whenever you need it.
- If you are able to make contributions to your TFSA and are looking for an additional source of retirement income in future years, you may enjoy the flexibility of being able to withdraw funds from the account without tax consequences when you need them. Then in future years you can re-contribute the funds you have withdrawn without losing your contribution room.

Create an Emergency Fund

You may wish to use the TFSA to help create an emergency fund. As these funds may be needed urgently and have to hold their value, more secure, less volatile interest-earning securities may typically be used. As interest in a non-registered account is not favourably taxed, compared with dividend income and capital gains, the TFSA may be a great place to accumulate a portion of your salary every month, which is often suggested for this type of fund. You could earn interest income on the funds tax-free and have access to them when you need them. Consider using your TFSA as a complement to a line of credit as another way to meet unexpected expenses.

If you are considering borrowing funds to invest in a TFSA as part of your overall financial plan, note that you will not be able to deduct the interest you pay on the borrowed funds. However, if you have short-term borrowing needs and don’t want to withdraw funds from your TFSA, you can use the assets in your TFSA as collateral for a loan. Using your RRSP as collateral in this way is not permitted.

Summary

The TFSA may help you achieve greater flexibility in saving and investing throughout your lifetime and can provide more sources of income on which you can draw in retirement. If you make the maximum contribution to your RRSP every year and are looking for additional ways to shelter investment income and capital gains from taxation, a TFSA can be a great complement even though you will not receive a deduction for the amount of your contribution.

Please contact us for more information about the topics discussed in this article.

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