

# TRS

Tax &  
Retirement  
Services



## TAX-FREE SAVINGS ACCOUNT (TFSA)

### THE FACTS

## Everything You Need to Know About Tax-Free Savings Accounts (TFSAs)

Until 2009, most Canadians held their savings in RRSPs, where they could claim a deduction for their contributions and then defer tax on withdrawals until retirement. The newest savings vehicle available to Canadians is called a Tax-Free Savings Account (TFSA). Whether you are saving for the short term (0-5 years) or for the longer term (6 years and beyond) a TFSA can be a valuable addition to your financial plan. When used to its full advantage, a TFSA can be a powerful tool to save money in a tax-free environment.

Manulife Investments has written this booklet to provide you with information you'll need to make the most of your savings. The booklet describes the technical details of TFSAs and offers some tips on how to maximize the tax free investing available with these plans.

### WHAT IS A TFSA?

A TFSA, or Tax-Free Savings Account, is a flexible, general purpose savings vehicle that allows you to make contributions each year and to withdraw funds at any time in the future, similar to an account you would open at your favorite bank. But unlike a typical savings account, a TFSA provides you with a powerful incentive to save by allowing the investment growth to accumulate and be withdrawn tax-free. However, unlike an RRSP, you cannot claim a tax deduction for contributions you make to a TFSA and your withdrawals are added back to your unused contribution room for the following year.

You can open a TFSA at most financial institutions, including banks, trust companies, credit unions, life insurance companies, caisse populaires, mutual fund

and brokerage firms. A TFSA may hold a wide range of qualified investments such as stocks, bonds, and other popular portfolios including mutual funds, segregated funds and GICs.

Once you deposit funds into a TFSA, any growth or income earned on the underlying investment will not be taxed nor will it be taken into account for the purposes of determining your eligibility for federal income-tested benefits and credits such as Old Age Security, the Guaranteed Income Supplement, the Canada Child Tax Benefit, the Employment Insurance benefits, the Goods and Services Tax Credit and the Age Credit.

There is no restriction on how withdrawals can be used. Withdrawals may be made for personal reasons, investment, education or any other purpose.



A 7% rate of return on an investment may sound good, but if the return is fully taxable at a 45% marginal tax rate, you've actually only earned 3.85%.

## WHY SHOULD I CONTRIBUTE TO A TFSA?

Taxation of the investment growth can have a very unfavorable effect on your savings. For example, a 7% rate of return on an investment may sound good, but if the return is fully taxable at a 45% marginal tax rate, you've actually only earned 3.85%.

Let's compare 2 examples. The first assumes you contribute \$3,000 after-tax money at the beginning of each year, your annual rate of return is 7% and your effective tax rate is 40%. In this scenario, your TFSA would accumulate to \$44,350 after 10 years. The second scenario assumes you will save the \$3,000 after-

tax money per year outside a TFSA, in a non-registered account, where the return is taxed in equal amounts as interest, dividends and capital gains. Since this investment does not grow tax free or cannot be withdrawn tax free, you would accumulate \$41,020. On the other hand, in comparison to an RRSP, since the contribution is tax deductible, you could contribute \$5,000 (provided you had sufficient earned income).<sup>1</sup> After 10 years you would have accumulated \$73,920 but if you withdrew the entire amount in that year, you would have \$44,350 after paying taxes, an identical result as the TFSA numbers.

	TFSA (\$)	Non-registered (\$)	RRSP (\$)
<b>Pre-tax income</b>	5,000	5,000	5,000
<b>Tax @ 40%</b>	2,000	2,000	–
<b>Net Contribution</b>	3,000	3,000	5,000
<b>Net investment income 10 years @ 7%</b>	14,350	13,140 <sup>2</sup>	23,920
<b>Value</b>	44,350	43,140	73,920
<b>Tax if withdrawn</b>	–	2,120 <sup>3</sup>	29,570
<b>Net Proceeds</b>	44,350	41,020	44,350

<sup>1</sup>See RRSPs – The Facts, MK1730 for more information on RRSPs

<sup>2</sup>Assumes 25% of investment income is taxed annually at 28% and paid from the account

<sup>3</sup>Capital gains tax at 20% (Adjusted Cost Base is \$32,540)



## SHOULD I CONTRIBUTE TO A TFSA OR AN RRSP?

In general, RRSP savings will generate a net rate of return higher than the TFSA when the effective tax rate at the time of withdrawal is lower than the effective tax rate at the time of contribution. The TFSA will provide a higher return if the reverse occurs.

Whether to save in a TFSA or an RRSP or both will depend on your savings needs as well as your current and expected future financial situation and income level. In addition, the impact of income tested benefits and credits and the flexibility to recontribute TFSA withdrawals will have to be taken into consideration.

Generally, an RRSP is used for saving for retirement, while a TFSA would be used for both saving for retirement and other shorter term purchases. Because TFSA withdrawals are added back to your available TFSA contribution room in the year following the year of withdrawal, there is very little downside to using the assets for mid to large purchases.

If you are in a low tax bracket it will probably be better to save in a TFSA since there is no impact on federal income-tested benefits such as child tax benefits, OAS or GIS when the money is withdrawn. However, if you are in a higher tax bracket, you will probably consider using both types of plans, the RRSP with the higher tax deductible limits for retirement planning and the TFSA for supplementary savings. Your advisor will be able to assist you in determining what is best in your situation.

## HOW MUCH CAN I CONTRIBUTE?

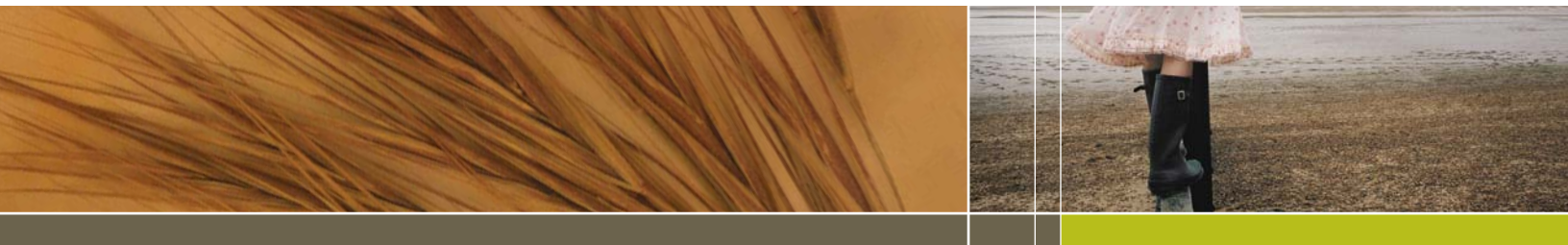
Starting in 2009, if you are a Canadian resident who is 18 years of age or older, you can contribute \$5,000<sup>4</sup> per year. If you do not contribute or do not contribute the full \$5,000, the unused amount will carry forward to the next year. Unused contribution room can be carried forward indefinitely. For example, if you only contributed \$3,000 in 2009, you would be able to contribute up to \$7,000 in 2010.<sup>5</sup>

Also if you withdraw money from your account, the amount will reinstate your TFSA room in the next calendar year. For example, if you made a \$5,000 contribution in each of 2009 and 2010 and the account had grown to \$11,000 and you withdrew that amount in 2010, your contribution limit for 2011 would be the regular \$5,000 (assume there is no indexing) plus the \$11,000 you had withdrawn in the previous year for a total of \$16,000.

Based on information supplied by the various financial institutions issuing TFSAs, the Canada Revenue Agency (CRA) is expected to report your available TFSA contribution room on your notice of assessment each year, similar to the reporting currently done for available RRSP room and/or will allow you to access this information on the CRA website.

<sup>4</sup>Increases, rounded to the nearest \$500, to the yearly contribution limit will be applied as warranted by the consumer price index for years after 2009

<sup>5</sup>Assumes the annual contribution room for 2010 & 2011 is still \$5,000



You cannot hold a TFSA jointly with your spouse.  
A TFSA must be held individually.

### **CAN I CONTRIBUTE TO MY SPOUSE'S TFSA?**

Provided your spouse<sup>6</sup> is a Canadian resident who is at least 18 years of age and has available TFSA contribution room, you can transfer property or funds to your spouse to contribute up to that amount to a TFSA that is in your spouse's name without any tax consequences or income attribution. Unlike a spousal RRSP, the amount that can be contributed is based on the spouse's TFSA contribution room and can only be made by your spouse, the holder of the account. You cannot hold a TFSA jointly with your spouse. A TFSA must be held individually.

### **CAN I SET UP A TFSA FOR MY CHILDREN?**

As with a contribution to your spouse's TFSA, you could transfer property or funds to an adult child to contribute to a TFSA set up in your child's name provided they have available TFSA contribution room. Your child would then make a contribution directly to his/her own TFSA.

### **WHAT IF I CONTRIBUTE TOO MUCH?**

The *Income Tax Act* imposes a penalty of 1% per month on the highest excess contribution amount at any time during the month. This is unlike RRSPs, where a penalty on excess contributions is imposed on the excess amount at the end of the month. Generally, if you contribute more than your accumulated unused TFSA room in any given year, or withdraw an amount from your TFSA and re-contribute it before the next year and don't have the necessary TFSA room to make the contribution, you may be subject to the 1% penalty per month on the highest excess amount for every month the excess was in the plan. The excess amount can be withdrawn to eliminate the penalty tax for subsequent months.

### **CAN I BORROW TO MAKE A CONTRIBUTION?**

Yes you can borrow to make a contribution and the TFSA can be assigned as collateral for a loan. However, the interest you pay on the loan is not tax deductible.

<sup>6</sup>Spouse includes common-law partner



### **CAN I HAVE MORE THAN ONE PLAN?**

You can have as many TFSAs as you wish. You may prefer to have separate plans to take advantage of different investment options or financial institutions. The disadvantage of having more than one plan is that you may spend more time tracking the various plans and you may pay more in administration fees. Similar to RRSPs, these fees cannot be claimed as a tax deduction.

### **CAN I TRANSFER BETWEEN TFSAs OR TO A NEW TFSA?**

You can transfer from one plan to another plan that is in your name provided the funds go directly to the new plan without having been paid to you first. If the funds are paid to you first, it will be considered a withdrawal and your TFSA room for the withdrawn amount will not be reinstated until the next year. This could result in a penalty situation. See section titled “What if I contribute too much?”

### **WHAT HAPPENS TO MY TFSA WHEN I DIE?**

Generally, the value of the TFSA at the date of death can be paid out tax free. The amount will be paid to your named beneficiary, if applicable, otherwise to your estate.

Any investment growth earned after the date of death on a non-trusteed TFSA will be taxed in the same way as any other non-registered investment contract and reported to the beneficiary or estate as applicable. For trustee TFSAs, the investment growth earned from the time of your death up to the end of the year following the year of death will be reported as “other income” if paid during this period. If the trustee TFSA still exists after this period, it will become a taxable trust.

An exception to this general rule is if you have a spouse, or a common-law partner, at the time of your death. In that case, the TFSA can continue on a tax free basis if your spouse becomes the successor holder or the value of assets at the time of death are transferred to your spouse’s TFSA. The transfer must occur prior to the end of the year following the year of death and the surviving spouse will designate the transferred amount as an exempt contribution so that it does not impact his or her TFSA contribution room.



Except for TFSAs with an insurance company, the successor holder or beneficiary designation would have to be named in your will until the applicable provincial law is in effect.

### **CAN I NAME A BENEFICIARY?**

No, you cannot name a beneficiary or a successor holder under current provincial legislation. Although federal TFSA legislation contemplates the naming of a spouse, including a common-law partner, to become the successor holder following your death, this type of designation as well as any beneficiary designations will require amendments to provincial legislation<sup>7</sup> before a designation could be made directly on your TFSA contract. The successor holder or beneficiary designation would have to be named in your will until the applicable provincial law is in effect.

The exception to this deficiency in provincial legislation is with plans offered by insurance companies. Legislation<sup>8</sup> already exists to allow for beneficiary designations and the naming of a spouse as a successor holder. At death, proceeds would be paid directly to the named beneficiary or transferred to the successor holder, if applicable. In all other cases the proceeds would be paid to your estate.

### **WHAT HAPPENS IN THE EVENT OF MARRIAGE BREAKDOWN?**

The legislation allows TFSA funds to transfer between spouse's plans in the event of marriage breakdown without impacting the recipient's TFSA contribution room. In this circumstance, the transfer will not reinstate contribution room of the transferor.

### **WHAT IF I AM NO LONGER A RESIDENT OF CANADA?**

If you become a non-resident of Canada, you can continue to hold your TFSA on a tax free basis. However, you cannot make subsequent contributions to your plan without incurring a penalty. Also, you will not accrue new contribution room while you are a non-resident. However, based on the current legislation, withdrawals made while you are non-resident can be reinstated as contribution room, in subsequent years, and will be available for use if you become a resident again.

<sup>7</sup>Alberta, British Columbia, Nova Scotia and Prince Edward Island allow beneficiary designations on TFSAs

<sup>8</sup>Provincial Insurance Acts and the Quebec Civil Code



## **WILL TFSAs BE PROTECTED FROM CREDITORS IN THE EVENT OF BANKRUPTCY?**

At the time of this writing, TFSAs are not included in the federal legislation that protects registered plans in the event of bankruptcy. TFSAs offered by insurance companies may provide creditor protection, if your named beneficiary is a spouse, parent, child, or grandchild<sup>9</sup>

## **IS THERE ANYTHING ELSE I SHOULD KNOW?**

There are some unique opportunities available that will make wealth transfer more tax effective than in the past.

### **Second Generation – Wealth Transfer Now**

If you have assets specifically earmarked as a legacy for your adult children, you may want to consider allocating \$5,000 to them each year to put into their TFSA so it can grow tax free.

Also, if you have three adult children, for example, and a spouse who are not making TFSA contributions on their own, you could be tax sheltering up to \$25,000 per year among yourself, your spouse and the three children.

### **Second Generation – Wealth Transfer Later**

Unlike an RRSP or other assets held outside of your RRSP, which cause a tax liability in your estate at death due to the deemed disposition, a transfer of TFSA assets to your children will not cause a tax liability for your estate. The assets will transfer to them tax free. Only investment income earned on the TFSA assets after your death will become taxable. If your child has sufficient TFSA room, the amount could be contributed to their own TFSA.

<sup>9</sup>In Quebec, the applicable beneficiary designations are your married or civil-union spouse, ascendants or descendants



When used to its full advantage, a TFSA can be a powerful tool to save money in a tax free environment.

## Comparison of Saving Options

	Non-registered (\$)	RRSP (\$)	TFSA (\$)
<b>Annual contribution limit</b>	Unlimited	Y – based on earned income	Y – no earnings requirement
<b>Carry forward of unused room</b>	n/a	Y	Y
<b>Monthly penalty on excess contribution</b>	n/a	Y – at month end	Y – on highest excess during month
<b>Tax deductible contribution</b>	N	Y	N
<b>Tax deferred/free investment growth</b>	N	Y – tax deferred	Y – tax free
<b>Taxable on withdrawal</b>	Taxable disposition	Fully taxable	Tax free – except for growth after death if no spouse/successor holder
<b>Withdrawals added to contribution room</b>	n/a	N	Y – following year
<b>Impacts income-tested benefits/credits</b>	Y	Y	N
<b>Minimum age to contribute</b>	N	N	Y – age 18
<b>Maximum age to contribute</b>	N	Y – end of year age 71	N
<b>Interest deductible on loan to invest</b>	Y	N	N
<b>Assets used as collateral for loan</b>	Y	N	Y
<b>Tax free/deferred transfer to spouse on death</b>	Y	Y	Y – if successor holder or value at date of death
<b>Tax free/deferred transfer to second generation at death</b>	N – deemed disposition	N – fully taxable unless financially dependent	Y – investment income after date of death is taxable
<b>Loss denied on transfer-in-kind to plan</b>	Y	Y	Y

## TFSA OPTIONS WITH MANULIFE INVESTMENTS

Investment Options	GIF & GIF encore <sup>10</sup>	GIF Select 75 Series	MLIP
Contract Minimum	\$2500 or \$100/mth. PAC	\$2500 or \$100/mth. PAC	\$1000
Account/Fund Minimum	\$500	\$500	\$500
PAC	\$100/mth. minimum	\$100/mth. minimum	\$100/mth. minimum
Contract Maturity Date	December 31 age 100 of annuitant		Chosen by client (latest is Dec. 31 age 100 of annuitant)
Scheduled Payment Option	\$100 a month per fund per sales option		
Rate Guarantee Programs	N/A	N/A	N/A
Cashability	Can withdraw Market Value less applicable Deferred Sales Charges (DSC) any time		
Investment Options	Full suite of funds available; refer to respective "Funds & Products at a Glance" (MK2197/98/99)		
Application	NN1565E/F	NN1565E/F	NN1565E/F

Investment Options	CAP	Manulife Investments GIC <sup>11</sup>	Manulife Mutual Funds
Contract Minimum	\$500	\$5000	N/A
Account/Fund Minimum	\$500	\$1000	\$500
PAC	\$30/mth. minimum	Minimum \$100 (contract minimum must be met)	\$25/mth. for Mutual Funds \$100/mth. for Simplicity Portfolios
Contract Maturity Date	Chosen by client (latest is Dec. 31 age 100 of annuitant)	Annuitant's 100th birthday	N/A
Scheduled Payment Option	\$100 a month per fund per sales option	Interest only	\$50/mth. for Mutual Funds \$100/mth. for Simplicity Portfolios
Rate Guarantee Programs	N/A	30-day for new money 30-day "better of" for reinvestments	N/A
Cashability	Can withdraw Market Value less applicable Deferred Sales Charges (DSC) any time	Surrender charges may apply if withdrawn prior to the maturity date of the account	Can withdraw Market Value less applicable Deferred Sales Charge (DSC) any time
Investment Options	Full suite of funds available; refer to respective "Funds & Products at a Glance" (MK2197/98/99)	Basic (cashable), Escalating Rate, Laddered Account, Daily Interest	Full suite of funds (Refer to MK1885E)
Application	NN1565E/F	NN1566E/F	NN1570E/F

<sup>10</sup>The GIF Manulife Investment Account (MLIA) will not be eligible for TFSA until later in 2009.

<sup>11</sup>Manulife Investments Guaranteed Interest Contract (GIC) Basic Non-Cashable Account is not eligible.

## MANULIFE BANK OFFERS TWO TAX-FREE SAVINGS ACCOUNTS

	Tax-Free Advantage Account	Tax-Free GIC
<b>Product Summary</b>	High-interest, fully liquid Tax-Free Savings Account	Long-term interest-bearing investment
<b>Tax Status</b>	Tax-Free Savings Account (TFSA)	Tax-Free Savings Account (TFSA)
<b>Availability</b>	Client name (off-book)	Client name (off-book)
<b>Minimum Deposit</b>	None	\$2,500
<b>Interest Structure</b>	Variable rate. Full rate paid on every dollar. No tiers	Annual compound interest paid at maturity
<b>Liquidity</b>	Fully liquid – no penalty for withdrawal	Can be redeemed prior to maturity, subject to market value adjustment and expense recovery fees
<b>Deposit Options</b>	Deposit cheque by mail, local deposit via advisor, funds transfer	Cheque, local deposit via advisor
<b>Deposit Fees</b>	None	None
<b>Withdrawal Options &amp; Fees</b>	Official Cheque, transfer to another bank account, transfer to other TFSA account of same account holder no withdrawal fees	Can be redeemed prior to maturity, subject to market value adjustment and expense recovery fees
<b>Statements</b>	Quarterly	Deposit confirmation and renewal notice
<b>CDIC Eligibility</b>	May be eligible	May be eligible

### TOP 10 THINGS TO KNOW ABOUT THE TAX-FREE SAVINGS ACCOUNT FROM MANULIFE INVESTMENTS

- 1 The Tax-free Savings Account (TFSA) is available in Canada on January 1, 2009.
- 2 You can open a TFSA if you're 18 years of age and are a Canadian resident.
- 3 The TFSA lets you invest while not being taxed on interest or any investment earnings.
- 4 In 2009, you are able to contribute up to \$5,000.
- 5 The Government will determine the amount remaining for you to contribute to your TFSA the following year. Any unused contribution room gets carried over to the next year.
- 6 If you make a withdrawal, the amount withdrawn will be added to the contribution room available for the following year.
- 7 You can have more than one TFSA, including TFSAs with other financial institutions. The important thing is to remember how much you've contributed. You can only contribute a total of \$5,000 among all TFSA accounts.
- 8 Unlike an RRSP, you don't pay tax on any money you withdraw from the TFSA. Withdrawals also don't affect your ability to qualify for Federal Benefits such as the Child Tax Benefit or Old-age Security.
- 9 With Manulife Investments, you'll be able to invest in Segregated Fund contracts,<sup>12</sup> Guaranteed Interest Contracts<sup>13</sup> and Mutual Funds.
- 10 Money invested in a TFSA cannot be deducted from your income on your tax return; only contributions to a RRSP qualify as a deduction.

<sup>12</sup>The GIF Manulife Investment Account (MLIA) will not be eligible for TFSA until later in 2009. <sup>13</sup>Manulife Investments GIC Basic non-cashable account is not eligible

For more information, please contact your advisor or visit [www.manulife.ca/investments](http://www.manulife.ca/investments)

 **Manulife Investments**  
With you every step of the way<sup>®</sup>

Tax-Free Advantage Account and Tax-Free GIC are offered through Manulife Bank of Canada. Interest on the Tax-Free Advantage Account is calculated daily on the total closing balance and paid monthly. Manulife Investments is the brand name identifying the personal wealth management lines of business offered by Manulife Financial and its subsidiaries in Canada. As one of Canada's largest integrated financial services providers, Manulife Investments offers a variety of products and services including: segregated fund contracts, mutual funds, annuities and guaranteed interest contracts. The commentary in this publication is for general information only and should not be considered investment or tax advice to any party. Individuals should seek the advice of professionals to ensure that any action taken with respect to this information is appropriate to their specific situation. Manulife and the block design are registered service marks and trademarks of The Manufacturers Life Insurance Company and are used by it and its affiliates including Manulife Financial Corporation and Manulife Bank of Canada. Manulife Funds, Manulife Corporate Classes and Manulife Simplicity Portfolios are managed by Manulife Mutual Funds, a division of Elliott & Page Limited.