

Common TFSA mistakes

Things you might not know about Tax-Free Savings Accounts (TFSAs), but should

Tax-Free Savings Accounts have become a popular savings vehicle. While millions of Canadians have opened a TFSA, many are still making mistakes or missing opportunities that are costing them money.

As a recap, a TFSA 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. A TFSA provides a powerful incentive for you to save by allowing the investment growth to accumulate each year and be withdrawn tax-free. However, unlike a Registered Retirement Savings Plan (RRSP), you cannot claim a tax deduction for contributions made to your TFSA and withdrawals are added back to your contribution room for the following year.

Withdrawal or transfer?

You can transfer from one TFSA to another 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 withdrawal amount will not be reinstated until the *next calendar year*. Recontributing to your TFSA in the same year as the withdrawal may result in an overcontribution and you could be subject to a penalty.

Spouse as beneficiary or successor holder?

If your spouse¹ is named as the beneficiary of your TFSA, an amount up to the value of the TFSA at the time of your death can be contributed to his or her TFSA without affecting his or her TFSA contribution room if the contribution is made before the end of the year following the year of death and is designated as an exempt contribution. However, any income earned between the date of death and the contribution will be taxable to your spouse.

¹All references to spouse include common-law partner as defined in the *Income Tax Act* (Canada). The spouse must designate the contribution as an exempt contribution on Form RC240, Designation of an Exempt Contribution Tax-Free Savings Account (TFSA), and submit the designation within 30 days after the contribution is made.



It's often recommended that, where permitted, you name your spouse as successor holder instead of as beneficiary.² On your death, your spouse will automatically become the new holder of the TFSA. The TFSA continues to exist and both its value at the date of death and any income earned after that date continue to be sheltered from tax, with your spouse as the new holder. In addition, naming your spouse as successor holder avoids the administration and filing requirements necessary to preserve the tax-free status of the TFSA funds when your spouse is named as beneficiary.

U.S. citizens with a TFSA

U.S. citizens, even those living in Canada, or other U.S. persons (e.g., green card holders) are required to report their worldwide income to the Internal Revenue Service (IRS) each year, including any income earned in

their TFSA as there is no treaty relief for TFSAs. Whether U.S. taxes will ultimately have to be paid will depend on the particular facts and whether sufficient foreign tax credits are available. If you are in this situation, speak to a cross-border tax specialist before investing in a TFSA.

Increase in 2013 TFSA contribution limit

Since TFSAs were made available in 2009, you have been able to make contributions of up to \$5,000 per year. Beginning in 2013, you will be able to contribute an additional \$500 to your TFSA, raising the annual contribution limit to \$5,500.

Speak to your advisor

TFSAs are a powerful savings vehicle whose significance will only grow over time. To fully maximize the benefits, and avoid the pitfalls, contact your advisor to understand how they work. ●

EXERCISE YOUR BRAIN!

Solutions (from page 35)

Puzzle by websudoku.com

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|---|---|---|---|---|---|---|---|---|
| 1 | 9 | 6 | 7 | 5 | 8 | 3 | 4 | 2 |
| 2 | 4 | 7 | 1 | 6 | 3 | 8 | 5 | 9 |
| 3 | 5 | 8 | 2 | 4 | 9 | 6 | 7 | 1 |
| 4 | 3 | 1 | 8 | 2 | 7 | 9 | 6 | 5 |
| 8 | 6 | 9 | 4 | 1 | 5 | 7 | 2 | 3 |
| 7 | 2 | 5 | 3 | 9 | 6 | 1 | 8 | 4 |
| 5 | 7 | 2 | 6 | 3 | 1 | 4 | 9 | 8 |
| 9 | 8 | 3 | 5 | 7 | 4 | 2 | 1 | 6 |
| 6 | 1 | 4 | 9 | 8 | 2 | 5 | 3 | 7 |

Medium

Puzzle by websudoku.com

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| 9 | 8 | 3 | 4 | 1 | 5 | 2 | 6 | 7 |
| 7 | 1 | 5 | 6 | 2 | 3 | 4 | 8 | 9 |
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| 8 | 2 | 7 | 5 | 3 | 9 | 1 | 4 | 6 |
| 1 | 3 | 4 | 7 | 8 | 6 | 9 | 2 | 5 |
| 5 | 9 | 6 | 1 | 4 | 2 | 7 | 3 | 8 |
| 6 | 7 | 1 | 8 | 5 | 4 | 3 | 9 | 2 |
| 3 | 5 | 8 | 2 | 9 | 1 | 6 | 7 | 4 |
| 2 | 4 | 9 | 3 | 6 | 7 | 8 | 5 | 1 |

Easy

² Certain contracts may provide that if your spouse is named as the sole beneficiary, he or she will automatically continue the contract as the successor holder and the applicable successor holder rules would apply. In these situations, your spouse may have the option to be treated as a beneficiary of the contract and, in that case, the beneficiary rules would apply.