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Making the most of your TFSA dollars



Tax Managed Strategy 17

Tax-free savings accounts (TFSAs) can be an excellent savings vehicle; however, consideration should be given to who can best benefit from using them, as well as why and how you could use them. Provided you have no credit card debt, TFSAs may be your first choice for contributions to a non-retirement based account. Here are some things to consider.

Choosing investments

Since TFSAs don't benefit from the tax-efficiency of dividends or capital gains, it's generally a good idea to use them for the least tax-efficient investments, such as those that pay interest. Another consideration, depending on your risk tolerance, would be to put speculative or high-risk investments into a TFSA and hope that a \$6,000 deposit grows, for example, to \$30,000 or \$50,000 which then could be withdrawn tax-free. The risk is that if the investment does poorly, capital losses aren't available to you.

Gradual transfer of other assets

You may want to consider withdrawing funds from other assets, both registered and non-registered and contributing it to your TFSA. Guaranteed interest contracts (GICs), for example, where the tax on the interest is paid on an ongoing basis, may be a good asset to switch to a TFSA and allow future interest to grow tax-free. You may also want to consider transferring market-based assets or even making RRSP withdrawals if you're concerned that you will lose income-tested benefits in retirement. The tax paid now may very well offset the impact of reduced benefits in retirement. Remember that if you're transferring market-based assets in kind to a TFSA, it will trigger a capital gain or capital loss, and a capital loss would be denied. So, if you're in a loss position, it may be better to sell the investment and trigger the loss and then contribute the cash to the TFSA.

Income splitting

Every Canadian age 18 and over will have TFSA room but may not have the means to make a TFSA contribution. Income attribution doesn't apply, so you may want to consider providing the funds to your spouse,¹ so they can make a contribution,

thereby increasing the amount of your combined investments that will grow on a tax-free basis.

Estate planning

Consider naming your spouse as successor holder of your TFSA. By doing this, the tax-free status of the investment earnings can continue after death.

All provinces, except Quebec, have introduced legislation allowing the designation of beneficiaries on a TFSA. If a spouse is named as beneficiary, an amount up to the value of the TFSA at the time of death can be contributed to a TFSA without affecting the TFSA contribution room if the contribution is done prior to 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 the spouse.

It's often suggested that, where permitted, the holder name their spouse as successor holder instead of a beneficiary. On the holder's death, the 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 under the new successor holder. In addition, naming a spouse as successor holder can help avoid the administration and filing requirements necessary to preserve the tax-free status of the TFSA funds when a spouse is named as beneficiary.

Whether naming your spouse as a beneficiary or successor holder of your TFSA, both have the advantage of having the proceeds bypass the estate. In addition, there's the potential for creditor protection on insurance company issued TFSAs.

Wealth transfer

If you have funds earmarked for your children, you may want to consider a gradual transfer of those assets to your adult children now. While this may trigger a capital gain, you can freeze the amount of capital gains paid by having future investment earnings grow tax-free, thereby possibly minimizing taxes in your estate later.

Retirement planning

A TFSA could be used to supplement your retirement savings if you're in a situation where you can't contribute to an RRSP. For example, you may receive dividend income rather than earned income, or you may belong to a pension plan where the pension adjustment limits your RRSP contribution.

Education savings

A TFSA can't replace registered education savings plans (RESPs) for education savings because of the grants and the fact that the holder of a TFSA must be at least 18 years old. However, you could provide education savings for your older children — those in university, for example — by providing dollars to contribute to their own TFSA. Alternatively, you could use your TFSA room to supplement the high cost of education when RESP savings isn't enough.

Strategies by income level

Low Income

A TFSA may be a great savings vehicle if you're in a low-income tax bracket. RRSPs may not be well suited to low-income Canadians. If you previously made RRSP contributions and now find yourself in a lower tax bracket, such as when on maternity leave, you may want to consider making a withdrawal from your RRSP to make a TFSA contribution.

Middle Income

One strategy would be to contribute to your TFSA now and accumulate RRSP room to be used later, when in a higher tax bracket, to help optimize the tax benefits. Rainy day or emergency savings would also be appropriate for a TFSA.

High Income

This is a situation where you may want to maximize both your RRSP and TFSA contributions. In fact, the tax savings or tax refund received from the RRSP contribution could be used to fund the TFSA.

Discretionary income

If you have more income than you need to live on, consider investing the difference in a TFSA. Since you're already paying tax on it and investing the remainder, why not let it grow tax-free? This excess income may be in the form of forced registered retirement income fund (RRIF) minimum withdrawals due to age or taking Canada Pension Plan (CPP) or Quebec Pension Plan (QPP) income but still working. It could also be from receiving excess income from mutual fund distributions or from the many investments that provide an income stream that's primarily a return of capital, such as Series T funds.

Impact on income-tested benefits

Federal income-tested benefits such as Old Age Security (OAS), the Guaranteed Income Supplement (GIS), and child tax benefits won't be impacted by TFSA assets or withdrawals. Other provincial programs such as disability support, student loans, or nursing homes that factor in assets and/or income may be impacted. The impact is likely a reduction of such benefits, but this varies by province and program.

Investment options with Manulife

Manulife and its subsidiaries provide a range of investments and services.

Mutual funds from Manulife Investment Management can help meet your specific financial needs throughout your life. Whether you're just starting out, accumulating wealth, or nearing/in retirement, mutual funds offered by Manulife Investment Management can provide you with solutions to help build a portfolio that meets your needs. Manulife is committed to providing quality investment products and services.

Manulife segregated fund contracts combine the growth potential offered by a broad range of investment funds, with the unique wealth protection features of an insurance contract. Through Manulife segregated fund contracts, investors can help minimize their exposure to risk through income, death, and maturity guarantees; potential creditor protection features; and estate planning benefits — all from a single product or insurance contract.

Manulife Investments guaranteed interest contracts (GICs) offer competitive rates plus investment options. Investors benefit from a guarantee on their principal investment, and from several different investment options that can diversify and add flexibility to their portfolio. Manulife Investments GICs can be a great solution for conservative investors looking to help grow their wealth but are concerned about minimizing risk.

🔗 Important disclosure ▼

¹ Includes a spouse or common-law partner as defined by the *Income Tax Act* (Canada).

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