

Tax Free Savings Accounts

Role Reversal Portfolio Strategies



The Critics Agree

Rob Carrick of *The Globe and Mail* calls TFSA,
“An investor’s new best friend.”

“TFSA will shake up investment industry:”
– Jonathan Chevreau, *National Post*

The TFSA is "arguably the most significant change
to Canada’s saving system since the introduction of
RRSPs in 1957."

– Malcolm Hamilton, Mercer Pension Consultants

How TFSA Works

- ◆ Starting in 2009, Canadians aged 18 and older can deposit up to \$5,000 annually in a TFSA. The \$5,000 limit is indexed to the CPI and will increase in multiples of \$500.
- ◆ Unused TFSA contribution room can be carried forward to future years.
- ◆ Contributions to a TFSA will not be deductible for income tax purposes but investment income, including capital gains and dividends, earned in a TFSA will not be taxed, even when withdrawn.
- ◆ Because investment returns are not taxed, it is anticipated that interest on leveraging strategies will not be deductible for money that flows into TFSAs.

How TFSA Works

- ◆ You can withdraw funds from the TFSA at any time for any purpose. The amount withdrawn can be put back in the TFSA at a later date without reducing your contribution room.
- ◆ Neither income earned in a TFSA nor withdrawals will affect your eligibility for federal income-tested benefits and credits.
- ◆ Contributions to a spouse's TFSA will be allowed and TFSA assets can be transferred to a spouse upon death.
- ◆ TFSAs are subject to the same investment restrictions as RRSPs.

Uses

- ◆ A Post Retirement Tax Shelter
- ◆ As a supplement to RESPs
- ◆ For Emergency Savings
- ◆ Income splitting without investment attribution

Who Should Use A TFSA?

- ◆ Canadians with below-average incomes – TFSAs allow them to avoid the heavy claw back rates applicable to modest withdrawals from RRSPs and RPPs after the age of 65;
- ◆ Canadians with high incomes, who need to save more than the current RRSP limit;
- ◆ Senior citizens, wanting to save through their retirement years for medical emergencies, custodial care and / or to accumulate funds destined for charities or their children;
- ◆ Working Canadians who want to set money aside for post-retirement medical costs;
- ◆ Young Canadians accumulating down payments for a first home;
- ◆ Middle-aged Canadians who are debt free and looking for a flexible savings vehicle to save for a major purchase or to supplement their post-retirement income.

Source: Malcolm Hamilton Mercer Pension Consultants

TFFA / RRSP Differences

- ◆ Contributions to an RRSP are deductible and reduce your income for tax purposes. In contrast, your TFSA savings will not be deductible.
- ◆ Withdrawals from an RRSP are added to your income and taxed at current rates. Your TFSA withdrawals and growth within your account will not - they will be tax-free.
- ◆ Example:

Robert withdraws \$20,000 tax-free from his TFSA to renovate his home. Robert will be able to re-contribute the \$20,000 to his TFSA in the future without affecting his other available contribution room.

Had he used his RRSP savings, he would have needed to withdraw up to \$37,000 to pay taxes and cover the cost of the renovation, and this contribution room would have been lost.

TFSA versus RRSP

Comparison Shopping	TFSA	RRSP
Pretax Income	\$ 5,000.00	\$ 5,000.00
Tax paid / owing on contribution ¹	\$ 2,000.00	\$ -
Net Contribution to Plan	\$ 3,000.00	\$ 5,000.00
Value of account after 30 years ²	\$14,951.85	\$24,919.76
Tax on Liquidation ¹	\$ -	\$ 9,967.90
Cash in pocket	\$14,951.85	\$14,951.85

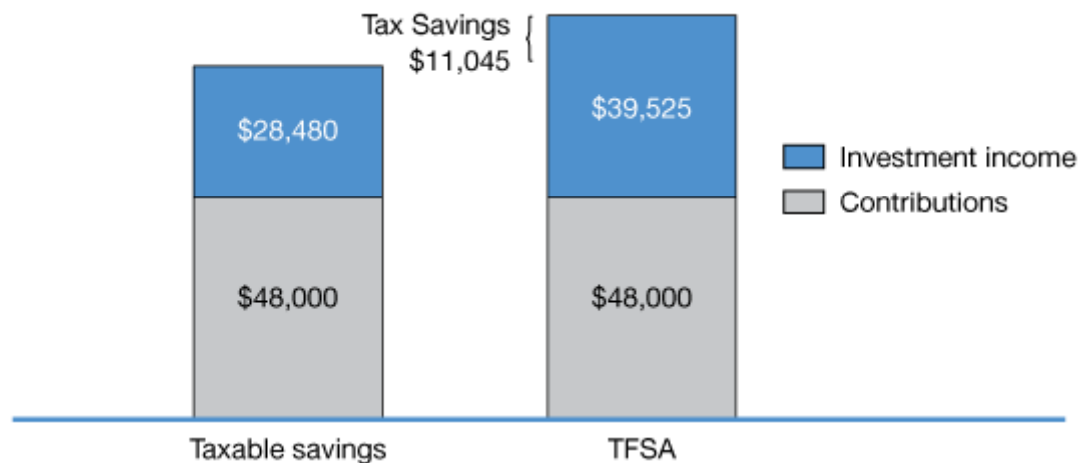
1. Assumes a 40% marginal tax rate

2. Value is a calculation on the initial deposit and assumes not further contributions

Assumes a 5.5% rate of return on investable assets.

TFSA versus Taxable Savings

Because capital gains and other investment income earned in a TFSA will not be taxed, a person contributing \$200 a month to a TFSA for 20 years will enjoy additional savings of \$11,045 compared to saving in an unregistered account.



Notes: Combined federal and provincial tax savings based on a \$200 monthly contribution for 20 years and a 5.5 per cent rate of return. For unregistered savings, a 21 per cent average tax rate on investment income is assumed (based on 40 per cent interest, 30 per cent dividends and 30 per cent capital gains, and a middle-income earning account holder).

Source: Canada Customs and Revenue Agency

Lifetime Flexibility



- ◆ Not everyone is able to save each and every year.
Those who cannot contribute \$5,000 in a given year will be able to carry forward their unused contribution room to future years.
- ◆ Canadians may want to use their savings - to buy a new car or a cottage, or start a small business - and the full amount of withdrawals can be put back into the TFSA in the future. Without impacting contribution room.
- ◆ Couples often save and plan together, so Canadians can contribute to their spouse's or common-law partner's TFSA, depending on the spouse's or partner's available room.

Contribution Carry Forward

Period	Contribution Room	Contribution	Withdrawals	Contribution Carry Forward
2009	\$ 5,000.00	\$ 3,000.00	\$ -	\$ 2,000.00
2010	\$ 5,000.00	\$ 5,000.00		\$ 2,000.00
2011	\$ 5,000.00	\$ 3,500.00		\$ 3,500.00
2012	\$ 5,000.00	\$ 2,500.00	\$ 7,500.00	\$ 13,500.00
2013	\$ 5,000.00	\$ 3,500.00		\$ 15,000.00
2014	\$ 5,000.00	\$ 5,000.00		\$ 15,000.00
2015	\$ 5,000.00	\$ 7,500.00		\$ 12,500.00
2016	\$ 5,000.00	\$ 12,500.00		\$ 5,000.00
2017	\$ 5,000.00	\$ 10,000.00		\$ -
2018	\$ 5,000.00		\$ 7,000.00	\$ 12,000.00
2019	\$ 5,000.00	\$ 12,000.00		\$ 5,000.00
2020	\$ 5,000.00		\$ 35,000.00	\$ 45,000.00

Source: Canada Customs and Revenue Agency

No Impact on Income-Tested Benefits

- ◆ Neither income earned in a TFSA nor withdrawals will affect your eligibility for federal income-tested benefits and credits, such as the Guaranteed Income Supplement and the Canada Child Tax Benefit. This will improve incentives for people with low and modest incomes to save.
- ◆ It is estimated that, in the first five years, over 75 per cent of the benefits of TFSA savings will go to individuals in the two lowest income tax brackets.

TFSA Pitfalls

- ◆ No ability to write off capital losses on assets inside TFSA
- ◆ No dividend tax credits
- ◆ No tax deduction on contributions
- ◆ May not be creditor proof
 - ◆ Although segregated mutual funds are eligible investments

Portfolio Strategy

- ◆ Role reversal
 - ◆ Main factor is time
 - ◆ Secondary issue is tax efficiency
- ◆ Longer time frame
 - ◆ Suggests lower return assumption
 - ◆ Lower risk
- ◆ Shorter time frame
 - ◆ Suggests higher return assumption
 - ◆ Higher risk (depending on client's risk tolerance)
 - ◆ Assuming client has ample assets
 - ◆ And RSPs / RIFs for withdrawal

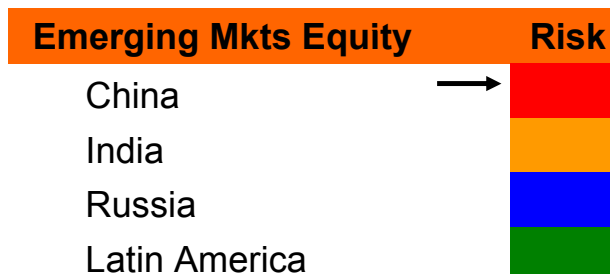
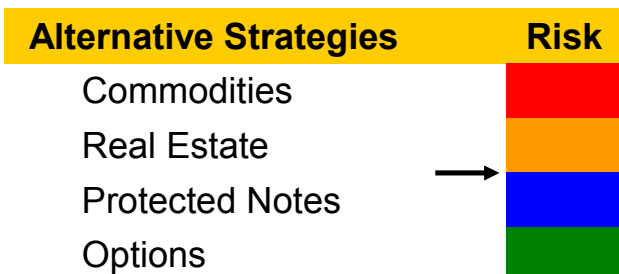
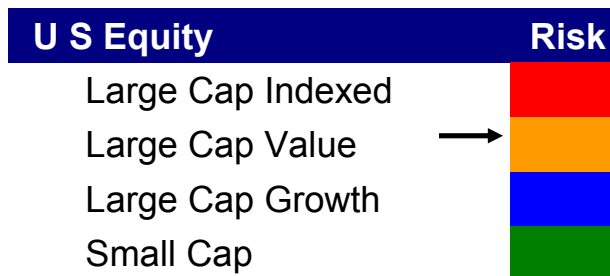
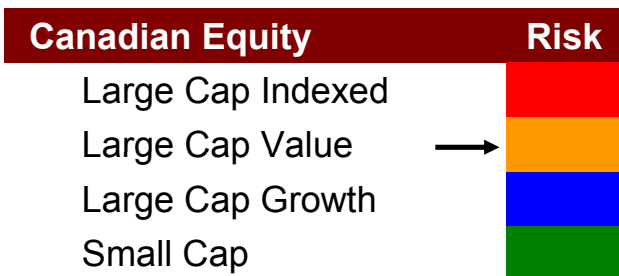
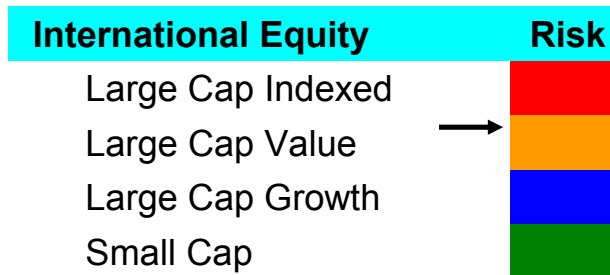
Effects of Compounding

Assumptions

Annual Contribution
\$5,000

Return on Investment
5.5% annually

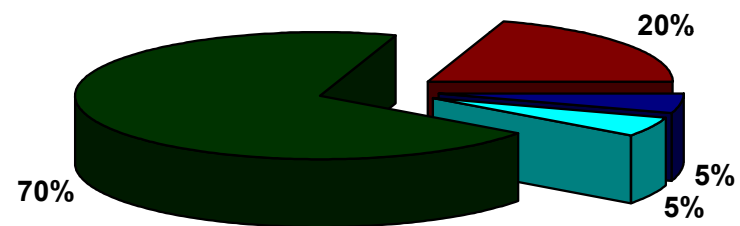
Portfolio Asset Classes



Starting In Early Years

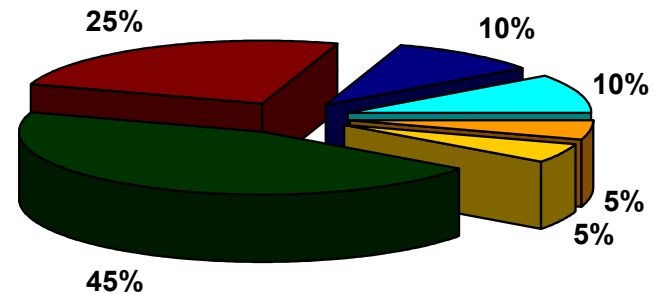
More than 20 years Weight

Income	■	70%
Canadian Equity	■	20%
US Equity	■	5%
International Equity	■	5%
Emerging Markets Equity	■	0%
Alternative Strategies	■	0%



Starting In Mid Life

Between 10 and 20 years		Weight
Income	■	45%
Canadian Equity	■	25%
US Equity	■	10%
International Equity	■	10%
Emerging Markets Equity	■	5%
Alternative Strategies	■	5%



Mature Portfolio *

* Assuming client has ample assets and RSP / RIF for withdrawals

Less than 10 years

Weight

Income	■	20%
Canadian Equity	■	35%
US Equity	■	15%
International Equity	■	10%
Emerging Markets Equity	■	10%
Alternative Strategies	■	10%

