Manulife Investments

TRS Tax & Retirement Services

TAX MANAGED STRATEGY 17

MAKING THE MOST OF YOUR TFSA DOLLARS

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Now that we have a new savings vehicle, Tax-Free Savings Accounts (TFSAs), it's time to consider 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 the investment of choice for the first $5,000[1] of any non RRSP savings each year. Following is a list of things to consider.

[1] Or the indexed amount

CHOOSING INVESTMENTS

Since TFSAs do not benefit from the tax-efficiency of dividends or capital gains, it is 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or highly risky investments into a TFSA and hope that a $5,000 deposit grows to $30,000 or $50,000 which then could be withdrawn tax free. The risk is that if the investment does poorly, capital losses are not available to you.

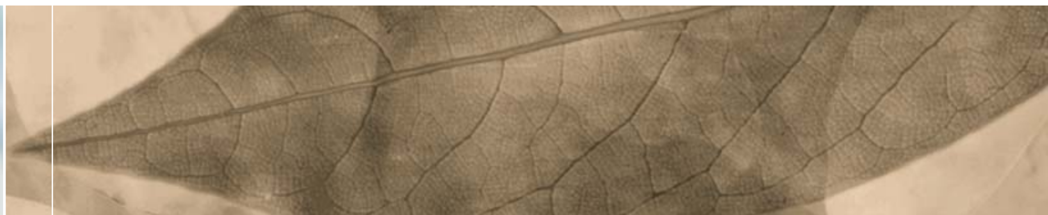
GRADUAL TRANSFER OF OTHER ASSETS

You may want to consider withdrawing $5,000[2] per year 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 an ideal 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 are 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 are transferring market based assets in kind to a TFSA that it will trigger a capital gain or capital loss and that a capital loss would be denied. So, if you are 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 does not apply, so you may want to consider providing the funds to your spouse so they can make a contribution, thereby increasing the amount of your combined investments that will grow on a tax-free basis.

[2]Or the indexed amount



ESTATE PLANNING

Consider naming your spouse or common law partner as sole beneficiary or successor holder of your TFSA. By doing this, the tax-free status of the investment earnings can continue after death. Until provinces amend legislation[3] allowing this type of beneficiary designation on a TFSA, successor holders and beneficiaries can only be named on TFSA contracts offered by an insurance company.

There may be a significant advantage to being able to name a spouse as the sole beneficiary or successor holder directly on an insurance contract. If named in the will, only the market value at the date of death is tax free. Any investment earnings after death will be taxable. If the spouse is named directly on the contract, the TFSA continues tax free, and proceeds may bypass the estate and avoid probate, where applicable. In addition, there is 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 are 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

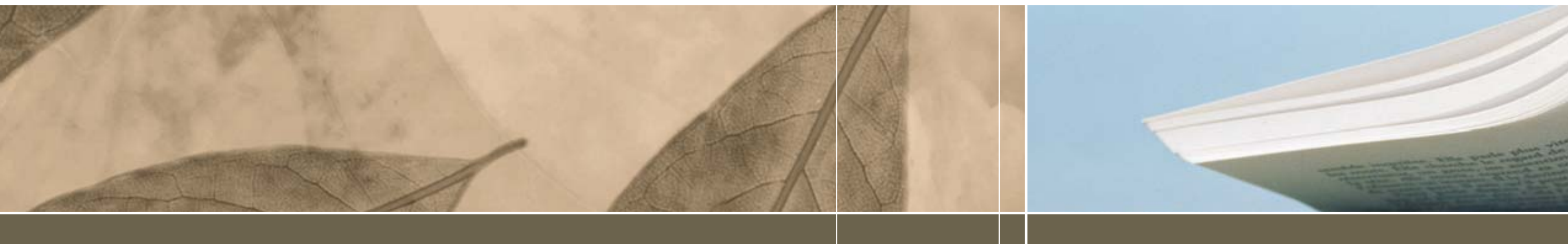
A TFSA may not replace RESPs for education savings because of the grants and the fact that the holder of a TFSA must be at least 18 years old. However, you could provide education savings for your older children, those in university, for example, by providing dollars to contribute to their own TFSA.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

STRATEGIES BY INCOME LEVEL

LOW INCOME

A TFSA may be an ideal savings vehicle if you are 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 withdrawing $5,000 from your RRSP to make a TFSA contribution.

[3]British Colombia, Alberta, Ontario, Nova Scotia and Prince Edward Island allow beneficiary designations on TFSAs



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 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 RRIF minimum withdrawals due to age or taking CPP/QPP at age 65 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 is primarily a return of capital, such as Series T funds.

IMPACT ON INCOME TESTED BENEFITS

Federal income tested benefits such as OAS, GIS and child tax benefits will not be impacted by TFSA assets or withdrawals. Except for Quebec, which has indicated they will follow the federal rules, it is unknown whether other provincial programs such as disability support, student loans, or nursing homes that look at assets and/or income will be impacted.

OUR EXPERTISE

With 30 years of experience in retirement planning and wealth accumulation strategies, Louise Guthrie leads the Manulife Investments Tax and Retirement Services (TRS) team – a group of accountants, lawyers and other specialists skilled in proactively identifying opportunities for clients based on changing regulatory environments and the market.

INVESTMENT OPTIONS WITH MANULIFE INVESTMENTS

Manulife and its subsidiaries provide a range of investments and services including:

Manulife Mutual Funds may be suitable for investors who want to build wealth over time. Manulife Mutual Funds offers a full suite of investment solutions offering access to world-class investment expertise. Both Manulife Funds and Manulife Corporate Classes offer investors access to best-in-class asset managers. To help ensure your investment stays on course, Manulife Mutual Funds leverages iWatch®, Manulife's independent fund manager selection and monitoring process.

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 these contracts, investors can limit their exposure to risk through death and maturity guarantees, potential creditor protection features and the estate planning benefits – all from a single investment.

Manulife Segregated Funds provide an ideal solution for conservative investors looking to grow their wealth yet minimize potential risk.

The Manulife Investments Guaranteed Interest Contract (GIC) offers competitive rates plus investment options that include Basic, Escalating Rate and Laddered GIC Accounts. Tax on interest is deferred for up to one year, and for those 65 years of age or older, the interest will qualify for the pension income tax credit. In the event of death, the entire investment will pass directly and privately to named beneficiaries without surrender, probate, legal or estate fees.

For more information contact your advisor
or visit www.manulife.ca/investments

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