FINANCIAL POST

TFSAs are wildly popular but they could be even more so with a few changes

Jamie Golombek: The immense popularity of TFSAs suggests that many Canadians may be substituting TFSA contributions for what used to be RRSP contributions

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The Tax-Free Savings Account is set to celebrate its 11th anniversary on Jan. 1, 2020, so let's review the contribution limit for next year, share some stats on the wildly popular take-up of this relatively new plan and look at a couple of suggestions for reform courtesy of a new report by the C.D. Howe Institute.

CONTRIBUTION LIMITS

Let's start with the TFSA limit for 2020. In late November, the Canada Revenue Agency confirmed that the TFSA dollar limit would remain at $6,000. This comes as no surprise to those familiar with the somewhat unusual indexation rules used to determine this amount.

The TFSA was formally introduced in the 2008 federal budget and Canadians could initially contribute up to $5,000 for the 2009 calendar year. The TFSA dollar limit remained at $5,000 for 2010, 2011 and 2012, before it was increased to

$5,500 for 2013 and 2014. In 2015, it was increased to $10,000, before being dropped back to $5,500 for 2016.

At that point, the annual TFSA dollar limit was indexed to inflation, retroactive to 2009’s $5,000 limit, but rounded to the nearest $500 to make the annual limits easy to remember. Each fall, the CRA announces the indexation increase for the following calendar year. The indexation factor of 1.9 per cent, which is the rate used to increase the federal tax brackets from 2019 to 2020 and most federal credits, isn’t enough to push the TFSA dollar limit for 2020 to the next $500, which is why it will remain at $6,000.
Fortunately, unused TFSA contribution room can be carried forward to future years so that the cumulative limit in 2020 for someone who has never contributed could be as high as $69,500. In other words, if you were at least 18 years of age in 2009, a resident of Canada throughout that period and have never opened up a TFSA before, you could contribute the entire $69,500 to your TFSA as of Jan. 1.

Contributions to a TFSA are with after-tax dollars, so they grow tax-free for life once the funds have been contributed. TFSA funds may be withdrawn, tax free, at any time, for any reason, and they don’t negatively impact income-tested benefits and credits, such as the Guaranteed Income Supplement, Old Age Security payments or age credit because the withdrawals aren’t considered to be income. Any amounts withdrawn from your TFSA can be recontributed, beginning the following calendar year, without using up TFSA room. This flexibility is one of the reasons TFSAs have become so popular.

POPULARITY OF TFSAS

TFSAs have experienced “phenomenal growth in popularity since their inception in 2009,” said Alexandre Laurin, C.D. Howe’s director of research, in his newly-

released report, TFSAs: Time for a Tune-Up. The fair-market value of all investments in TFSAs reached nearly $233 billion by the end of 2016, which, by comparison, is approximately 20 per cent of all the assets held in Registered Retirement Savings Plans, Registered Retirement Income Funds and Locked-In Retirement Accounts. Considering that TFSAs had only been around for eight years at the time, while RRSPs have been around since 1957 (and RRIFs since 1978), this demonstrates quite a remarkable take-up by Canadians.
The value of contributions to TFSAs in 2016 by individuals less than 65 years old represented almost four per cent of all gross wages and salaries earned in that year, according to the report. In particular, TFSAs have become extremely popular with younger Canadians. Today, half of the 25-to-34-year-old cohort holds a TFSA, which is almost as high as the 65-and-over set, the most popular age category at 57 per cent.

Indeed, the immense popularity of TFSAs suggests that many Canadians may be substituting TFSA contributions for what used to be RRSP contributions. In 2016, a total of $55 billion was contributed to TFSAs, compared to $42 billion to RRSPs. Since 2013, annual TFSA contributions have exceeded those made to RRSPs.

POSSIBLE REFORMS

In light of the TFSA's popularity, Laurin said the government could make TFSAs even more useful by making some changes. Let's review a couple of them.

First, Laurin said the federal government should amend the tax rules to make it possible to buy life annuities within a TFSA. A life annuity, which provides a guaranteed periodic payout for life, provides income protection for longevity in retirement.

Laurin said many seniors are relying on accumulated savings in registered plans to provide for their retirement, given the decline of private-sector defined-benefit pension plans. But since most people don’t know how long they will live, seniors who otherwise don’t have a guaranteed source of income for life need to protect themselves from running out of money. This can lead to “excess precautionary savings and a lower retirement lifestyle than may have been feasible.”

Under current rules, an individual with a TFSA who wishes to buy an annuity to insure against the risk of living a long life would have to withdraw the funds and purchase an annuity contract in which the interest portion of the payouts is taxable. The tax on the interest portion reduces the benefit of the annuity contract, making the alternative of leaving the funds within the TFSA — negating the benefits of longevity pooling — more tax-effective.

Another suggestion in Laurin’s report has to do with unused TFSA contribution room at death. Currently, if someone dies with unused TFSA contribution room, that room is lost. But if an individual dies with unused RRSP contribution room, the deceased’s surviving spouse or partner is permitted to contribute to a spousal RRSP up to the deceased spouse’s unused RRSP room and claim a deduction from income on the deceased spouse’s terminal tax return.

With a TFSA, however, there is currently no way to utilize unused TFSA room upon death — it is simply lost. Laurin wants the government to change the rules to permit a surviving spouse (or partner) who is named as the beneficiary or successor of their late spouse’s TFSA to be able to “top-up” the deceased’s TFSA, based on the unused TFSA contribution room of the deceased spouse.

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