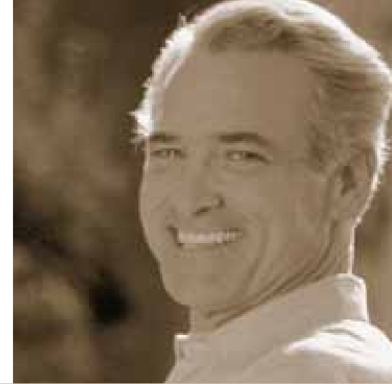
TFSA Case Study

High income earner and income splitting



The situation:

James, age 51, has an earned income of $200,000. He also has a generous defined benefit company pension plan, which will provide him with a financially secure retirement at age 65. James has a pension adjustment of $15,000 a year. This means he can contribute only $5,000 annually to his RRSP. As a result, he has been investing primarily in a non-registered account where he has accumulated $950,000. James has three grown children, ages 19 to 24, and a spouse. He is considering using a tax-free savings account to shelter more of his income and to split some of his accumulated wealth with his family.

The challenge:

To find a tax-effective way to shelter as much of James' income as possible and split some of his investments with his family.

James needs to keep in mind:

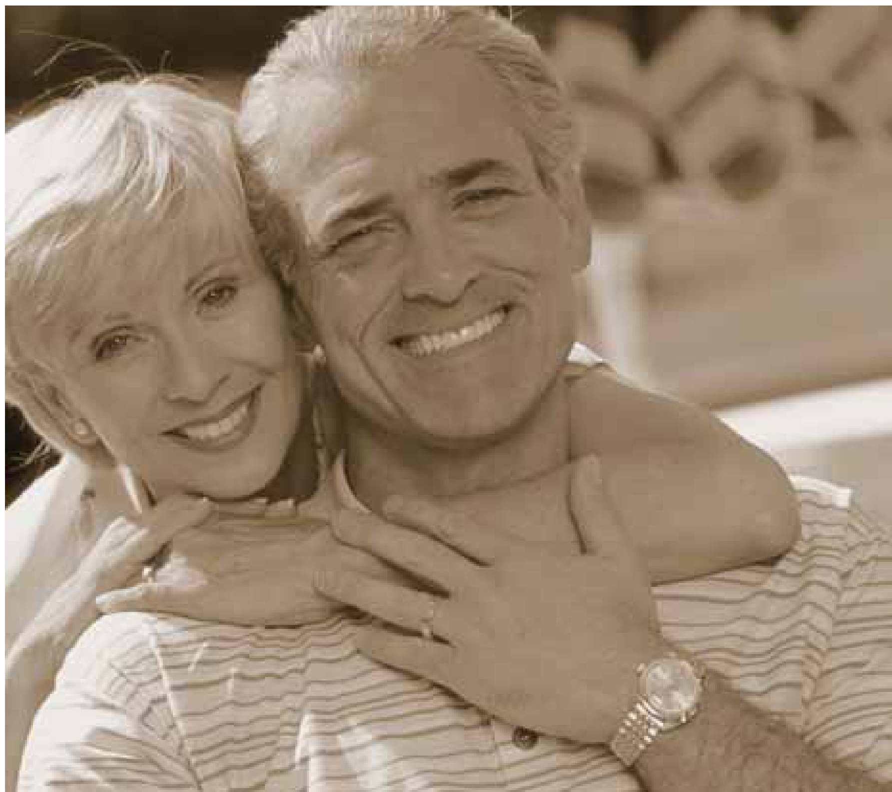
- his annual contribution limits for his RRSP
- his family's total TFSA contribution limits,

and

- the tax status of his non-registered investments.

The strategy:

James continues to maximize his RRSP contributions. Every year, he has $25,000 available in combined contribution room in TFSAs – $5,000 for himself, his wife and each of his children. James decides to use TFSAs to shelter as much income as possible and to share some of his current investments with his family so they can maximize the growth potential of their investments tax free.



Maximum RRSP contribution room*

The allowable RRSP contribution is the lower of:

- 18% of earned income from the previous year, or
- The maximum annual contribution limit for the taxation year:

  2008 – $20,000

  2009 – $21,000

  2010 – $22,000, or

- The remaining limit after any company sponsored pension plan contributions.

**Canada Revenue Agency 2008*

United Financial

The result:

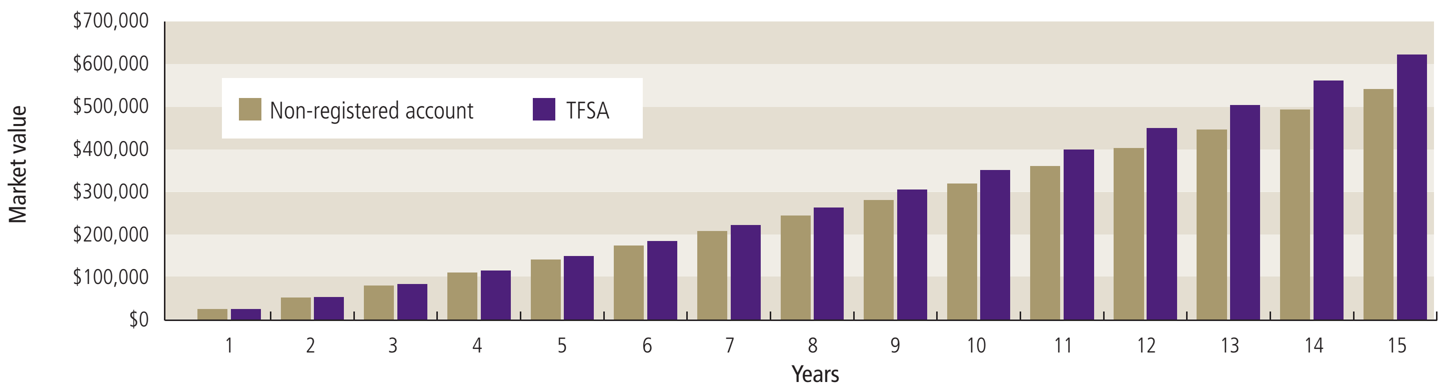
James cannot invest directly in a family member's TFSA. Instead, he must provide them with the money for their contributions. He rebalances his investments to take advantage of capital losses, which he uses against his capital gains. In order to transfer his investments to his family, James must crystallize the gains – and pay tax on them – and sell his investments that have a capital loss.

James continues to use this strategy over the next 15 years. He maximizes his RRSP and TFSA contributions, and transfers $20,000 a year to his family for their TFSAs. During the period he is able to shelter over $375,000 in principal, along with the future growth of the investments, in TFSAs. James realizes that once he gifts the investments to his family, he no longer has control over the assets, but he sees this as an opportunity for his children to benefit during his lifetime. Over the years, his children are able to use their TFSAs for a variety of purposes. Every time they withdraw money, that amount is available as contribution room in future years.

James was able to use TFSAs to shelter as much income as possible for himself and his family. Over the years, the accounts provided $81,078 in additional growth for his family's investments. In choosing a TFSA, it should be kept in mind that every individual will face different circumstances and financial needs throughout his or her lifetime.

TFSAs offer additional growth

This chart shows the combined growth in TFSAs for James and his family compared with a non-registered account. Over the years, James was able to shelter annual contributions of $25,000 a year for himself and his family.



Assumes annual return of 6.1% with a 30% income/70% equity portfolio and a 45% marginal tax rate for the non-registered account. Contributions assumed to be made at the beginning of each year.

The table shown here is used only to illustrate the effects of the compound growth rate and is not intended to reflect future values of invested contributions. The rate of return used is for illustrative purposes only.

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