

Intelligence MEMOS



From: Alexandre Laurin
To: The Finance Department
Date: February 24, 2020
Re: **BUILDING ON THE EARLY SUCCESS: TIME FOR A TFSA TUNE-UP**

Tax-Free Savings Accounts (TFSAs) have had great success over the past decade, but could use a tune-up.

In my new C.D. Howe Institute [paper](#), I show that after a decade in existence, there is now enough data and empirical analysis on TFSA use to assess the extent to which the product is reaching its policy objectives, and how it can be made even more useful.

TFSAs were introduced to improve incentives to save by eliminating taxes on investment incomes – and they have experienced phenomenal growth.

After only eight years of existence, the fair-market value of all investments in TFSAs reached almost \$233 billion by the end of 2016, which is about 20 percent of all assets held in Registered Retirement Savings Plans, Registered Retirement Income Funds and Locked-In Retirement Accounts.

They are particularly popular among younger and older Canadians. Retired seniors make extensive use of TFSAs to tax-effectively decumulate their retirement capital and self-insure against longevity risk.

Also, evidence of RRSP displacement at younger ages and lower withdrawal rates in prime retirement saving years suggests that TFSAs are partly used as a tool for long-term capital accumulation.

Building on these early successes, TFSAs could be made even more useful for lower-income retirement savers and for seniors in their retirement years by making a few changes.

First, permitting annuities to be held in a TFSA. Many new retirees do not have a pension guaranteed for life. With the decline of private-sector defined-benefit pension plans, more and more seniors will rely on accumulated savings to provide for their retirement. But practically no one knows how long they will live. This uncertainty may translate into excess precautionary savings and a lower retirement lifestyle than may have been feasible.

The purchase of an annuity, which provides a guaranteed periodic payout for life or a fixed term, provides income protection for longevity. RRSP funds can be used to purchase annuities, but it is not possible to buy life annuities within a TFSA.

This should change. The federal government should amend the legislation to make it possible to buy annuities within a TFSA.

It should also modify the draft legislation creating advanced deferred life annuities (ALDAs) and variable payment life annuities (VPLAs) to make them both available for purchase within a TFSA.

A second limitation of TFSAs, compared to RRSPs, affects the ability for a surviving spouse to exploit the unused TFSA contribution room of the deceased at the time of death. When an RRSP holder with unutilized contribution room dies, the surviving spouse is permitted to contribute into a spousal RRSP an amount up to the deceased spouse's unused RRSP room and claim a deduction against income in the deceased spouse's terminal return.

No spousal provisions exist for TFSAs. Permitting the surviving spouse, who is the successor or the beneficiary of the deceased's TFSA, to utilize the unused TFSA contribution room would encourage more savings at a critical time for spouses, helping them to financially prepare for living longer than they may anticipate and to face long-term care costs.

Finally, the government should facilitate the use of tax-prepaid vehicles, like the TFSA, for retirement capital accumulation.

Pierlot and Laurin [proposed](#) the creation of a dedicated new Tax-Free Pension Account (TFPA) to complement the use of TFSAs. Analogous to the TFSA, TFPAs would allow for the same tax-free accumulations and withdrawals. Because of its pension nature, this new account would be entirely separate from TFSAs. TFPAs would be available to everyone, although they would be particularly geared to the needs of low- to mid-income workers. Ideally, workplace capital accumulation plans would offer a TFPA option, which would share its savings limit with the existing tax-deferred regimes. This would effectively provide a tax-prepaid option for long-term retirement capital accumulation, benefiting from the same creditor protection as pensions and RRSPs. Governments worried about abuse could impose penalties on early redemptions of funds.

Alexandre Laurin is Director of Research at the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

The views expressed here are those of the author. The C.D. Howe Institute does not take corporate positions on policy matters.