News

Tax-Free Savings Accounts: Potential Opportunities for Employer-Sponsored Retirement and Savings Plans

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In the February 2008 Budget, the federal Minister of Finance announced a new initiative – tax free savings accounts (TFSAs). If the proposed legislation is passed, these new savings vehicles will be available to Canadian taxpayers starting in 2009.

Key Features of a TFSA

- Canadian taxpayers will be allowed to contribute up to $5000 each year to a TFSA. The contribution limit is scheduled to increase over time based on yearly increases in inflation.
- Like a Registered Retirement Savings Plan (RRSP), contribution room can be carried forward to a following year. Unlike a RRSP, contributions will not be tax deductible.
- All income earned on monies held in a TFSA, be it interest, capital gains, or dividends, will grow tax free in the account.
- Tax free withdrawals from a TFSA can be made at any time. The amount of a withdrawal can be re contributed at a later date without affecting an individual's overall TFSA contribution room.
- Income earned in a TFSA, or withdrawals made from a TFSA, will not affect other income tested benefits and credits (such as the Canada Child Tax Benefit, the GST credit, the Age credit, and Old Age Security and Guaranteed Income Supplement benefits).

Integration of TFSAs Into Existing Employee Savings and Retirement Programs

Employers may want to consider integrating a "group TFSA" (similar to a group RRSP) into their existing employee retirement and savings programs. For example, many employers now maintain retirement/savings programs that include both a registered component (e.g., a DC registered pension plan or a group RRSP) and a non registered (non tax sheltered) component for "spill over" contributions (e.g., an employee profit sharing plan (EPSP) or an employee benefit plan). Adding a TFSA component to such programs to replace or supplement the existing non registered component of the program may be beneficial to employees. By way of illustration, although contributions to both TFSAs and EPSPs are made on an after tax basis, investment earnings on amounts held in a TFSA will grow tax free whereas investment earnings on amounts held in an EPSP are taxed yearly.

Considerations

Most DC retirement and savings plans are administered by third party service providers. It may take service providers some time before they are able to offer group TFSAs – recordkeeping systems will need to be reprogrammed in order to add TFSAs into existing retirement/savings programs. Further, integrating a group TFSA into an existing employee savings program will need to be carefully planned and implemented by an employer and its service provider. For example, plan design terms will need to be settled, employee communications and election forms will need to be prepared and distributed, and service provider contracts may need to be updated.

By maintaining a group TFSA, employers will likely be assuming additional fiduciary responsibilities. Therefore, employers will want to ensure that they exercise the requisite level of diligence and skill when administering a group TFSA. Further, as group TFSAs will most likely be considered a capital accumulation plan (CAP), the plan sponsor (the employer) will need to ensure that its duties and responsibilities under the CAP Guidelines are fulfilled.

TFSAs are an exciting addition to the established regime of registered and non registered plans. Although it may take some time for them to reach their full potential, it is not too early for employers to start thinking about whether, and how, TFSAs should be integrated into their existing compensation programs.