Evolving the TFSA to help seniors

Doug Carroll / May 16, 2014
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In his tenure as federal Finance Minister, the late Jim Flaherty oversaw one of the most challenging economies in living memory. He initiated reforms and introduced innovations that will have a long-lasting impact on Canadian society.

While he did not actively court controversy, opinions about his administration's policies were often divided. Still, he was clearly not shy about expressing his personal views, at times irrespective of his political allegiance.

In fact, just before tabling his last budget, he broke ranks with the Conservative Party stance on the touted Family Tax Cut, suggesting that this past election promise may no longer be appropriate—at least not in its current form.

The other key election promise from the 2011 election campaign was about doubling TFSA room. Both this and the income-splitting promise were premised on the Conservatives obtaining a full term in office and reaching a balanced budget. With a majority in power and a surplus projected after this year, the moment of truth will come in next year's budget, to be delivered by Flaherty's successor, Joe Oliver.

Introduced in 2008 (for first use in 2009), the TFSA was greeted with strong consumer uptake. So the promise to provide more of a good thing made for good electioneering. Whether it makes for good economic and social policy is another matter.

On its face—and indeed, by its name—the TFSA is a threat to tax revenue. But as it may alleviate the government from providing future support to some people making use of the program, it may be net revenue positive over the long term.

Still, what does this mean to the individual taxpayer?

Profile of TFSA holders

In the Tax and Expenditures Report 2012, the Department of Finance produced a statistical report on the TFSA over its first three years.Total contributions to TFSAs rose from $19 billion in 2009 to $25 billion in 2010, and to $30 billion in 2011. The average contribution per TFSA holder was fairly consistent—a bit shy of $4,000. But averages can be deceiving.

Many people would not have contributed the maximum, but the fairly high average would tend to indicate that it was driven by those capable of contributing the full amount.

What's more, the legislated maximum is irrelevant to those without enough disposable income to make a full contribution. In fact, the report notes participation by those with incomes under $20,000 was about 20%, compared to 58% usage by $200,000+ income earners.

Presumably the TFSA is not intended to merely be a tax giveaway. So, does it really make sense to double the room? Those with the capacity will contribute more, and those of lesser means will contribute the same amounts.

RRIF vs. TFSA

Part of the rationale for introducing the TFSA was that the RRSP-RRIF savings regime was not effectively serving lower income earners.

Consider this: For those earning the average industrial wage (the CPP year's maximum pensionable earnings of $52,500 in 2014), deductible RRSP contributions may come out in retirement at the same or higher marginal tax rates once the clawback of tax credits (e.g., the age credit) and potential loss of social supports are factored in.

Consider as well that taxpayers lose tax-sheltering room through the forced withdrawal of RRSP-RRIF funds when they reach age 71.

Seniors are using TFSAs in slightly higher numbers than the general population, according to the 2012 report. What's more, Guaranteed Income Supplement recipients contributed 3% more to TFSAs than low-income people. Hopefully these positive trends will continue.

Targeted help for seniors

Presumably, TFSA room will double next year as intended, but it may also be a good idea to encourage more efficient savings for seniors specifically. One change could be as simple as allowing additional TFSA room based on the after-tax value RRIF withdrawals (with appropriate age thresholds and upper income limits). If the procedure includes associated clawbacks, the whole exercise could be tax-neutral.

While such an approach does not automatically mean people will save more, it does create more TFSA room. And even if that larger room is not ultimately used, affected seniors will at least be encouraged to migrate existing savings over to a vehicle that can be more tax-efficient for them in future.