TFSA Amendments
Explanatory Notes

ITA
12(1)(z.5)
Paragraph 12(1)(z.5) of the Income Tax Act (the Act) requires a taxpayer to include in income from property amounts that arise from the application of subsection 146.2(9). That subsection, which applies on the death of the last holder of a trusteed tax-free savings account (TFSA), continues the trust's tax-exempt status until the end of the year following the year of death. It also provides for any income earned on, or appreciation in the value of, the trust's property during the post-death exempt period to be included, to the extent paid out during that period, in the income of the recipient and, otherwise, in the trust's income for its first taxable year.

Paragraph 12(1)(z.5) is amended to also require that amounts described in new section 207.061 be included in computing the taxpayer’s income from property. New subsection 207.061 requires that certain distributions from TFSAs, generally related to TFSA advantages or income earned in respect of non-qualified or prohibited investments, be included in the recipient’s income. For more details, readers may refer to the commentary on new section 207.061.

This amendment applies after October 16, 2009.

ITA
146.2(6)
Subsection 146.2(6) of the Act provides that no Part I tax is payable by a trust that is governed by a TFSA (a “TFSA trust”) unless the TFSA trust carries on business or holds non-qualified investments during the year. Subsection 146.2(6) of the Act also provides special rules that apply for the purposes of calculating income of a TFSA trust from those sources. Subsection 146.2(6) is amended to add new paragraph (c). New paragraph 146.2(6)(c) provides that the TFSA trust’s income from carrying on a business or in respect of a non-qualified investment is to be calculated without reference to subsection 104(6). Subsection 104(6) generally permits a trust to deduct, in computing its income for a taxation year, any income payable to a beneficiary in the year under the trust.

This amendment applies to the 2010 and subsequent taxation years.

ITA
207.01(1)
Subsection 207.01(1) provides definitions that apply for the purposes of Part XI.01 of the Act. Pursuant to the October 16, 2009 Department of Finance news release regarding amendments to the TFSA rules, a number of changes are being proposed to existing defined terms and several new defined terms are being introduced.
“advantage”

Section 207.05 imposes a special tax if an advantage in relation to a TFSA is extended to any person who is, or who does not deal at arm's length with, the holder of the TFSA. An advantage is defined to include, in paragraph (a), any benefit, loan or indebtedness that is in any way dependent on the existence of the TFSA, with certain exceptions. Under paragraph (b), an advantage also includes a benefit that is an increase in the fair market value of property held in connection with a TFSA where it is reasonable to conclude that the increased value is attributable to certain events or circumstances. This provision is intended to prevent transactions designed to artificially shift taxable income away from the holder and into the shelter of the TFSA or to circumvent the TFSA contribution limits.

Consequential on technical changes to the TFSA rules proposed in the October 16, 2009 Department of Finance News Release, paragraph (b) is amended to extend its application to several new types of transactions, and new paragraph (c) is being added.

Paragraph (b) is amended so that an increase in the fair market value of property held in connection with a TFSA that is reasonably attributable to a “swap transaction” or to undistributed “specified non-qualified investment income” is specifically included in the definition “advantage”.

New paragraph (c) of the definition “advantage” adds to the definition income (including a capital gain) that is reasonably attributable, directly or indirectly, to a “deliberate over-contribution” or a “prohibited investment” in respect of the TFSA or any other TFSA of the holder.

For more detail, readers may refer to the commentary on the new defined terms “deliberate over-contribution”, “swap transaction” and “specified non-qualified investment income” that are being added to subsection 207.01(1). “Prohibited investment” is already defined in subsection 207.01(1); related rules are found in section 207.04.

Existing paragraph (c) of the definition “advantage” is renumbered as paragraph (d). At this time, it is not anticipated that any amendments will be made to the regulations to prescribe a benefit for the purpose of the definition "advantage".

These amendments apply after October 16, 2009, except that new subparagraph (c)(ii) of the definition "advantage" does not apply in respect of income (including a capital gain) earned before October 17, 2009.

“deliberate over-contribution”

Under this new definition, a “deliberate over-contribution” means any contribution made under a TFSA by the individual that results in, or increases, an “excess TFSA amount” unless it is reasonable to conclude that the individual neither knew nor ought to have known that the contribution could result in liability for a penalty, tax or similar consequence under this Act. Under the amended definition “advantage”, income that is reasonably attributable, directly or indirectly, to a “deliberate over-contribution” constitutes an advantage subject to the special tax on advantages under section 207.05.
The new definition “deliberate over-contribution” is introduced in subsection 207.01(1) of the Act.

This amendment applies to contributions made after October 16, 2009.

“excess TFSA amount”

The expression “excess TFSA amount” is relevant primarily for the special tax imposed under section 207.02 on excess TFSA contributions. It is also relevant for the purposes of paragraph 74.5(12)(c), subparagraph (d)(iii) of the definition “exempt contribution” in subsection 207.01(1), and subsection 207.01(3), which all depend on whether an individual has an excess TFSA amount at a particular time. For the purpose of applying these provisions, it is important to note that the inclusion of the words “if any” in the preamble of the existing definition indicates that an individual is not considered to have an “excess TFSA amount” where the amount determined by the formula in the definition is nil (either in fact or because of the application of section 257).

The amount of the tax under section 207.02 is determined on the basis of an individual's highest “excess TFSA amount” in a particular month. “Excess TFSA amount” is determined by a formula. Amounts included in variable C of the formula result in a reduction of an individual’s “excess TFSA amount”. Variable C reflects distributions from the individual’s TFSA in the preceding year, subject to certain exclusions. Variable C is amended to replace the reference to the exclusion of a “prescribed distribution” with a reference to the new defined term “specified distribution”. As a result of this amendment, a distribution from a TFSA in the preceding year that is a “specified distribution” is not included in variable C and so cannot reduce an individual’s “excess TFSA amount”. For more detail, readers may refer to the commentary on the new defined term “specified distribution” that is being added to subsection 207.01(1).

Amounts included in Variable E of the formula result in a reduction of an individual’s “excess TFSA amount” for the qualifying portion of distributions from the individual’s TFSA in the year. The qualifying portion is described in paragraphs (a) and (b) of Variable E. Paragraph (a) is amended to specify that no amount of a “specified distribution” may be included in the qualifying portion of a distribution in the year under Variable E. A “specified distribution” in the year therefore cannot reduce an individual’s “excess TFA amount”. For more detail, readers may refer to the commentary on the new defined term “specified distribution” that is being added to subsection 207.01(1).

This amendment applies after October 16, 2009.

“specified distribution”

Unlike regular distributions, under the amended definition “unused TFSA contribution room”, “specified distributions” do not create or increase “unused TFSA contribution room”. Similarly, unlike regular distributions, under the amended definition “excess TFSA amount”, “specified distributions” do not reduce or eliminate an “excess TFSA amount”. If specified distributions were not treated in this manner, amounts that gave
rise to specified distributions would inappropriately increase a taxpayer’s unused TFSA contribution room or inappropriately reduce the taxpayer’s excess TFSA amounts.

The new definition “specified distribution” generally means a distribution from a TFSA that is reasonably attributable to certain TFSA amounts that are subject to taxes. In particular, a distribution of an amount attributable to any of

- an “advantage”,
- “specified non-qualified investment income”,
- income that is taxable in a TFSA trust under Part I of the Act (generally income earned from non-qualified investments or from a business carried on by the TFSA), or
- income earned on excess contributions or non-resident contributions.

The definition “specified distribution” also includes a “prescribed distribution”. At this time, no distributions are prescribed by regulation.

This amendment applies to distributions that occur after October 16, 2009, other than the portion of a distribution that is, or is reasonably attributable to, an advantage that was extended, or income earned, before October 17, 2009.

“specified non-qualified investment income”

Under the existing TFSA rules, income earned by a TFSA trust on non-qualified investments is subject to tax under Part I of the Act because of subsection 146.2(6). An additional tax based on the fair market value of the investment is also payable under subsection 207.04(2). However, there was no requirement that such income, or income earned on such income, be removed from a TFSA.

The new definition “specified non-qualified investment income” in respect of a TFSA generally means income that is reasonably attributable, directly or indirectly, to an amount that is taxable under Part I for a TFSA trust. For this purpose, income includes capital gains. Amounts that are taxable under Part I for a TFSA trust are generally income earned from non-qualified investments or from a business carried on by the TFSA. Therefore, the new definition “specified non-qualified investment income” refers to second and subsequent generation income earned on non-qualified investment income or on income from a business carried on by a TFSA.

“Specified non-qualified investment income” may be subject to a Ministerial requirement to remove it from a TFSA pursuant to new subsection 207.06(4). If it is not removed within 90 days of receipt of the requirement to remove, it will be considered an “advantage” in respect of the TFSA under the amended definition “advantage” and subject to the tax on advantages under section 207.05.

This amendment applies to the 2010 and subsequent taxation years.

“swap transaction”
Under the amended definition “advantage”, an increase in fair market value of property held in connection with a TFSA that is reasonably attributable to a “swap transaction” is an “advantage” and subject to the tax on advantages under section 207.05.

The new definition “swap transaction”, in relation to a TFSA trust, generally means any transfer of property occurring between the trust and the holder of the TFSA or a person with whom the holder does not deal at arm’s length, other than a transfer that is a distribution from, or a contribution to, a TFSA trust.

This amendment applies to transfers of property occurring after October 16, 2009.

“unused TFSA contribution room”

An individual's “unused TFSA contribution room” is used to determine how much an individual may contribute to a TFSA. Under the existing definition, an individual's “unused TFSA contribution room” (at the end of a particular calendar year after 2008) is the amount, which can be positive or negative, determined by the formula

\[ A + B + C - D \]

where

- \( A \) is the individual's “unused TFSA contribution room” at the end of the year preceding the particular year;
- \( B \) is the total amount of distributions made in that preceding year under TFSAs of the individual, but excluding qualifying transfers and prescribed distributions;
- \( C \) is the TFSA dollar limit for the particular year if, at any time in the particular year, the individual is at least 18 years of age and resident in Canada. If the individual is under 18 years old, or is non-resident, throughout the year, the \( C \) amount is nil; and
- \( D \) is the total of all TFSA contributions made by the individual in the particular year, but excluding contributions made by way of a qualifying transfer or an exempt contribution.

The definition “unused TFSA contribution room” is amended in two respects. First, new paragraph \((a.1)\) provides that, where the Minister of National Revenue has waived or cancelled all or part of an individual’s liability under sections 207.02, 207.03, 207.04 or 207.05 (respectively, taxes on excess TFSA amounts, non-resident contributions, prohibited or non-qualified investments, and advantages) an individual’s “unused TFSA contribution room” will be the amount determined by the Minister of National Revenue. In these circumstances, the formula will not be used to calculate “unused TFSA contribution room”. This will allow the particular circumstances that gave rise to the special tax, the steps taken by the individual to address the situation, and the conditions surrounding the waiver to be properly taken into consideration in re-setting the individual’s “unused TFSA contribution room”.

Second, the reference to a “prescribed distribution” in subparagraph (ii) of the description of variable \( B \) in the definition is replaced by a reference to a “specified distribution” consequential on the introduction of that new definition. For more detail, readers may refer to the commentary on the new defined term “specified distribution” that is being added to subsection 207.01(1).

These amendments apply after October 16, 2009.
Existing subsections 207.04(6) and (7) impose a special tax in relation to “prohibited investments”. Subsections 207.04(6) and (7) of the Act are repealed, consequential on the amendments to the definition “advantage” which result in income earned on prohibited investments being subject to the tax on advantages under section 207.05.

This amendment applies after October 16, 2009.

Existing subsection 207.05(1) imposes a tax for a calendar year if, in the year, an advantage (defined in subsection 207.01(1)) in relation to a TFSA is extended to any person who is, or who does not deal at arm's length with, the holder of the TFSA. Subsection 207.05(1) is amended to expand the description of the manner in which an advantage may be acquired, and the list of possible recipients. Amended subsection 207.05(1) imposes a tax if an advantage is “extended to, or received or receivable by” any of a TFSA holder, the TFSA itself, or any other person who does not deal at arm’s length with the TFSA holder. These amendments are consequential on the October 16, 2009 Department of Finance announcement of proposed changes to the TFSA rules, which have broadened the “advantage” concept.

This amendment applies after October 16, 2009.

Section 207.06 of the Act provides the Minister of National Revenue with the authority to waive taxes payable under Part XI.01 (Taxes in Respect of TFSAs) under certain conditions.

Subsection 207.06(1)(b) of the Act provides the Minister of National Revenue with the authority to waive taxes payable under section 207.02 (tax on excess TFSA amount) or 207.03 (tax on non-resident TFSA contributions) under certain conditions. In this regard, paragraph (b) contains a condition requiring the removal from a TFSA of the amount that gave rise to the tax under section 207.02 or 207.03. Paragraph (b) is amended, consequential on the October 16, 2009 Department of Finance announcement of proposed TFSA changes, to also require the removal of any income earned on the excess TFSA contribution, or the non-resident TFSA contribution, as the case may be. Paragraph (b) is
also amended to clarify that, as long as the required distributions are made without delay, it is not material whether or not they were made through the action of the individual TFSA holder. For example, an over-contribution could be discovered by a financial institution, with steps taken to address it at that time.

This amendment applies after October 16, 2009.

ITA

207.06(3)

New subsection 207.06(3) imposes conditions that must be satisfied if the Minister of National Revenue intends to waive or cancel a liability for tax under subsection 207.05(3). Subsection 207.05(3) imposes liability for taxes on advantages. Under new subsection 207.06(3), the Minister shall not waive or cancel such a liability unless one or more distributions are made without delay from the relevant TFSA or TFSA(s), the total amount of which is equal to or greater than the amount of the liability being waived or cancelled.

This amendment applies after October 16, 2009.

ITA

207.06(4)

New subsection 207.06(4) allows the Minister of National Revenue to issue a notice requiring a TFSA holder to remove “specified non-qualified investment income” (as defined in subsection 207.01(1)) from his or her TFSA within 90 days. Failure to comply with this requirement will result in the amount of the “specified non-qualified investment income” being considered an “advantage” and subject to the special tax on advantages under section 207.05. For more information, please refer to the commentary on those definitions.

This amendment applies after October 16, 2009.

ITA

207.061

New section 207.061 of the Act requires a holder of a TFSA to include in computing the holder’s income certain TFSA distributions of amounts related to transactions that are subject to tax under Part XI.01. These amounts are amounts described in

(a) subparagraph 207.06(1)(b)(ii) (income earned on excess TFSA contributions or non-resident TFSA contributions);
(b) subsection 207.06(3) (distributions required in relation to the waiver or cancellation of a tax on an advantage); or
(c) subparagraph (a)(ii) of the definition “specified distribution” (generally, first or subsequent generation income in respect of non-qualified investments for a TFSA).
This amendment applies after October 16, 2009.

ITA
207.062

New section 207.062 applies in situations where two taxes under Part XI.01 would otherwise apply in respect of the same TFSA contribution for the same calendar year. Specifically, where an individual is liable to pay tax under section 207.05 (tax on advantages) and under sections 207.02 or 207.03 (tax on excess TFSA contributions and tax on non-resident TFSA contributions, respectively) in respect of the same contribution for the same calendar year, the tax on the advantage payable under section 207.05 for the year shall be reduced by the amount of the tax payable under section 207.02 or 207.03, as the case may be, for the year.

This amendment applies after October 16, 2009.