

UNDERSTANDING TFSA ATTRIBUTION RULES

Can an individual contribute to their spouse or common-law partner's TFSA? Where an amount is gifted or transferred from an individual to their spouse for contribution to the spouse's TFSA, are there attribution rules that would see future income or capital gains taxed to the transferring spouse?

Section 146.2(2)(c) of the federal Income Tax Act (ITA) is clear that a TFSA "prohibits anyone other than the holder from making contributions under the arrangement." In other words, only a TFSA holder can contribute to their own TFSA. Having said that, the ITA does not prevent an individual from gifting assets to their spouse, assets of which the spouse can then contribute to their own TFSA.

Normally though, whenever an individual gifts or transfers assets to a spouse or common-law partner, unless the transferring spouse receives fair market value consideration in exchange, future income and capital gains earned from the gift would be taxed to the transferor and not the recipient spouse, assuming the transferor remains a resident of Canada. These attribution rules, which are in place to prevent the simplest forms of income-splitting, cease on death or relationship breakdown, and are defined by sections 74.1(1) and 74.2(1) of the ITA.

Do 74.1(1) and 74.2(1) apply to a gift to a spouse where the spouse will contribute the gift to their own TFSA? Effective 2009, the year the TFSA was introduced, an exception to this attribution rule was also introduced. Specifically, under section 74.5(12)(c), attribution will not apply to a gift to a spouse while the gift is held in a TFSA in the name of the spouse. Also, for attribution not to apply, the contribution of the gift to the TFSA must not have created or added to a TFSA excess (or over) contribution. In other words, where a gift received by a spouse is contributed to a TFSA in their own name, and while the gift is held in the TFSA, any income or capital gains earned from the gift will not be subject to attribution rules, provided the contribution did not create (or add to) an excess contribution.

EXAMPLE:

Earlier this year, Camille contributed the maximum amount allowed to her TFSA. Her husband, Jeff, still has \$10,000 of contribution room available. To take advantage of Jeff's room, Camille transfers \$10,000 to Jeff, which he promptly contributes to his TFSA. Shortly thereafter, later in the year, Jeff withdraws the \$10,000 from his TFSA. Is the \$10,000 withdrawal taxable? If yes, to whom?

The \$10,000 withdrawal is not taxable, as amounts withdrawn from a TFSA are tax-free. Also, any income or gains earned in the TFSA are exempt from the attribution rules discussed above and are also tax-free on withdrawal. But let's take this a step further. What if Jeff were to reinvest the \$10,000 in a non-registered account and subsequently earn income or capital gains from the reinvested amount? Would a tax issue arise in this case?

According to CRA technical interpretation #2010-0354491E5, the attribution rules apply when money given to a spouse to contribute to a TFSA is subsequently withdrawn from the TFSA. So, if Jeff were to withdraw from his TFSA the \$10,000 given to him from Camille, the withdrawal would be subject to the 74.1(1) and 74.2(1) attribution rules meaning, if



reinvested, future income and capital gains earned from the gift would be taxable to Camille.

There are questions that remain unanswered in the technical interpretation:

- If Jeff's TFSA was funded with money that came from both himself and Camille, would his withdrawal be considered sourced from his own contributions or from the gift from Camille?
- If Jeff's TFSA increased in value from the time of contribution to the time of withdrawal, what portion of the withdrawal would be considered growth versus the original gift from Camille?

Answers to these questions would help determine what portion of the withdrawal would be subject to attribution, but guidance in this area is not yet clear.

WHAT CLIENTS CAN DO:

TFSA holders who have received gifted money from a spouse intended for their TFSA, but who wish to stay clear of the attribution rules, should consider:

- Using TFSA withdrawals for personal, non-income producing purposes (e.g., personal use mortgage payments, car purchase, etc.),
- Using gifts from a spouse for non-income producing purposes and funding TFSAs with the holder's own money; and/or
- Setting up a second TFSA for gifts from a spouse to allow for better tracking of source of funds.

The TFSA is flexible, easy to use and efficient as an investment vehicle. Like most things in life though, there are some details to consider to achieve its maximum value.

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Published September 18, 2021

21-08-420476_E (09/21)