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Knowing the Rules

Confusion about the rules governing the
Tax-Free Savings Account

Ombudsman special report, June 2011 | J. Paul Dubé, Taxpayers' Ombudsman

Taxpayers'
Ombudsman

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"Knowing the Rules"

TAXPAYER BILL OF RIGHTS

1. You have the right to receive entitlements and to pay no more and no less than what is required by law.
2. You have the right to service in both official languages.
3. You have the right to privacy and confidentiality.
4. You have the right to a formal review and a subsequent appeal.
5. You have the right to be treated professionally, courteously, and fairly.*
6. You have the right to complete, accurate, clear, and timely information.*
7. You have the right, as an individual, not to pay income tax amounts in dispute before you have had an impartial review.
8. You have the right to have the law applied consistently.
9. You have the right to lodge a service complaint and to be provided with an explanation of our findings.*
10. You have the right to have the costs of compliance taken into account when administering tax legislation.*
11. You have the right to expect us to be accountable.*
12. You have the right to relief from penalties and interest under tax legislation because of extraordinary circumstances.
13. You have the right to expect us to publish our service standards and report annually.*
14. You have the right to expect us to warn you about questionable tax schemes in a timely manner.*
15. You have the right to be represented by a person of your choice.*

**Service rights upheld by the Taxpayers' Ombudsman*

Knowing the Rules

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the Tax-Free Savings Account

Introduction

The Tax-Free Savings Account (TFSA) is a flexible, registered, general purpose savings vehicle that allows Canadians to earn tax-free investment income. The TFSA is intended to complement other registered savings plans such as the Registered Retirement Savings Plan (RRSP) and the Registered Educational Savings Plan (RESP). The TFSA was introduced in the 2008 Federal Budget and came into effect on January 1, 2009.

Taxpayers complained to us that TFSA rules regarding withdrawals and over-contributions were confusing.

While a TFSA is a savings vehicle, it is not an ordinary savings account. The rules governing TFSAs state that individuals may contribute a maximum of \$5,000 per year and take the money out any time, tax-free. The rules further provide that individuals can put the money back in, but only up to the limit of \$5,000 for any given year. Unfortunately, many taxpayers have fallen afoul of these rules. In fact, of the 4.8 million Canadians who opened a TFSA, 72,786 (1.5%) received a letter in 2010 from the Canada Revenue Agency (CRA) about possible excess contributions. These letters were intended to either inform Canadians about the tax consequences of over-contributions, or in some cases, to request more information from the taxpayer.

Our office took notice of the numerous media reports on the difficulties experienced by individuals who found themselves in that situation. We also received complaints from taxpayers who had received letters from the CRA advising that they were being penalized for over-contributing to a TFSA. Taxpayers complained to us that TFSA rules regarding withdrawals and over-contributions were confusing. We heard from individuals who claimed that the information they had obtained about the rules governing TFSAs was not clear enough, thus generating mistakes in their use of a TFSA. In June 2010, we began our review of the service and fairness issues that arose in the first year of the TFSA. However, since the CRA was reacting to complaints by continually updating information on its Web site and training its staff on the TFSA, we delayed issuing a report and monitored the situation. At the time of writing this report, there were still stories in the media about the confusion experienced by taxpayers trying to obtain information about TFSAs. Now that the TFSA has been in existence for two tax years, we thought it was an appropriate time to take stock and make our observations public.

Scope of our Review

It is important to note that Canadians who opened TFSAs obtained information about the rules from a variety of sources apart from the CRA, including the financial services sector, the Government of Canada, the media, and advertisements. In fact, it seems that many Canadians did not consult the CRA for information about the tax rules governing TFSAs prior to opening an account. The scope of our review was limited to the CRA's service to, and treatment of, taxpayers with respect to the TFSA. It is beyond our mandate to comment on the adequacy of services provided to Canadians by other government departments or the financial services sector, although we did research this in order to put the CRA's role in proper context.

The Taxpayer Bill of Rights

The mandate of the Taxpayers' Ombudsman is fulfilled by upholding the Taxpayer Bill of Rights, reviewing complaints from taxpayers, and addressing systemic issues that have a negative impact on taxpayers. That means ensuring that taxpayers receive the fair treatment and complete, accurate, clear, and timely information they are entitled to in their dealings with the CRA.

Article 5 of the Taxpayer Bill of Rights reads, "You have the right to be treated professionally, courteously, and fairly."

In reference to this Article, the CRA states in its *Guide to the Taxpayer Bill of Rights* (RC17):

You can [...] expect us to listen to you, take your circumstances into account, and treat you fairly to make fair and impartial decisions according to the law.

Article 6 of the Taxpayer Bill of Rights provides that, "You have the right to complete, accurate, clear, and timely information."

The CRA's *Guide to the Taxpayer Bill of Rights* (RC17) states that:

You can expect us to provide you with complete, accurate and timely information in plain language that explains the laws and policies that apply to your situation.

We test our publications to make sure they are accurate, complete, and use plain language.



As a result of the media reports and complaints received from taxpayers who had difficulties with the rules governing the TFSA, our office looked into whether the CRA's administration of this new savings vehicle respected taxpayers' service rights. Was it easy for taxpayers to be properly informed? Were people who mistakenly over-contributed to a TFSA treated fairly by the CRA?

Analysis and Findings

Informing CRA telephone agents

Many Canadians who attempt to obtain advice and information from the CRA do so by telephone. The quality, accuracy, and consistency of that information depend largely on the training and information provided to CRA agents who respond to telephone enquiries from taxpayers.

We reviewed the training and instructions provided to CRA Individual Income Tax Enquiries telephone agents on how to respond to questions from taxpayers about the TFSA. We noted that a guide used by the CRA employees called *Individual Services Technical Help Guide* (ISTHG) first contained information on the TFSA in its annual update on November 17, 2008. This guide did contain information on the taxation of a TFSA, but the focus was on contributing to a TFSA. Throughout 2009, minor additions were made to this guide as information became available. A new page, which focuses on the taxation of a TFSA, was added during the annual update of the guide on December 16, 2009. The TFSA pages of the guide were revised numerous times throughout 2010 as new information became available.

The CRA telephone agents were made aware of additions to the guide through a "What's New?" forum on InfoZone, an internal Web site available exclusively to CRA employees.

As of February 15, 2010, telephone agents were required to use a new computer system to perform a number of activities. The new system allows these agents to view taxpayers' accounts in order to provide answers to questions about contribution room, statements, over-contribution status, and other TFSA related items.

After the *Tax-Free Savings Account (TFSA) Return* (RC243) was implemented in December 2009 and more information became available about the taxation of TFSAs, the CRA designed a training course for its employees specifically for the completion of this return.

Informing the financial services sector

In April 2008, the CRA began consultations with umbrella organizations from the financial services sector including the Canadian Bankers Association, the Investment Industry Association of Canada, and the Investment Funds Institute of Canada. The organizations involved met on a regular basis to share information regarding the TFSA. We were advised at the time of writing this report that the CRA and the financial services sector continue to meet on a regular basis to discuss the TFSA.

Joint public outreach sessions were presented by the CRA and members of the financial services sector before and after the TFSA came into effect with a view to educating financial advisors and institutions about their responsibilities and filing processes.

The CRA also made a page on its Web site available for the benefit of the financial services sector, which contained information about the application and approval processes, transfers to and from TFSAs, electronic records forms, and tips for explaining how TFSA monetary values are calculated. This site also provided illustrative examples.

Informing the public

On January 2, 2009, the Government of Canada launched a dedicated Web site for the TFSA¹. This Web site provided information on the rules governing TFSAs. Although the Web site did not provide any explanations on the tax consequences of over-contributions and withdrawals paid back in the same year, the site included links to the CRA Web site which did provide this information.

The CRA Web site also offered comprehensive information explaining in detail the rules and the limitations regarding the TFSA. It presented examples of situations to better help Canadians understand how it could apply to them. A page dedicated to the rules of withdrawals has been available on the CRA Web site since the inception of the TFSA. It includes an example of a person contributing \$5,000 for each of the 2009 and 2010 tax years, and later withdrawing \$3,000 for a trip that eventually fell through. The rules state that the person has to wait until 2011 to put the \$3,000 back into the TFSA. If the person re-contributes before 2011, then a 1% per month tax will apply on the over-contribution.

¹ <http://www.tfsa.gc.ca/>

On December 10, 2008, the CRA posted an information sheet about the TFSA on its Web site, which was also available to Canadians in print. This information sheet later evolved to become the *Tax-Free Savings Account (TFSA) Guide for Individuals (RC4466)*, and was made available on January 30, 2009, in both print and electronic formats.

When the TFSA was first introduced, the Government did not anticipate the possibility that it might be used as an aggressive tax-planning scheme.

Service Canada also made information available to the public on its Web site². In addition, it provided a link to the Government of Canada's dedicated TFSA Web site.

The CRA's treatment of Canadians who over-contributed to TFSAs

When the TFSA was first introduced, the Government did not anticipate the possibility that it might be used as an aggressive tax-planning scheme. However, the Department of Finance soon became aware that some Canadians were deliberately over-contributing to their TFSAs beyond the \$5,000 limit in order to achieve a rate of return greater than the 1% monthly tax that would be assessed on the over-contribution.

In October 2009, the Minister of Finance announced changes to the TFSA rules to make any income attributable to deliberate over-contribution subject to the existing anti-avoidance measures in the *Income Tax Act*. At the same time, the Minister of National Revenue directed the CRA to apply the TFSA rules to challenge aggressive tax planning where appropriate.

By June 2010, the Government recognized that there was some genuine confusion over the rules and that, in addition to those who had deliberately exceeded the contribution limits, thousands of Canadians were claiming to have over-contributed to their TFSAs inadvertently. The Minister of Finance and the Minister of National Revenue announced that, for the 2009 filing year only, each case of over-contribution would be examined on its own merit and taxes on excess contributions waived in cases where a genuine misunderstanding of the rules occurred.

Thus for the 2009 filing year, the Minister of National Revenue encouraged taxpayers who over-contributed to a TFSA to explain the circumstances of that over-contribution. In cases of genuine misunderstanding of the rules, the Minister indicated that the tax resulting from that over-contribution could be waived. This is a commitment to the fair treatment of taxpayers who inadvertently over-contributed to a TFSA, which is consistent with Article 5 of the Taxpayer Bill of Rights.

² <http://www.servicecanada.gc.ca/eng/goc/tfsa.shtml>

Conclusion

The TFSA has been promoted since its inception as complementing existing registered savings plans (RRSP and RESP). Since the TFSA is not a simple savings account, Canadians need to know and understand the tax consequences of this new type of account. In response to the particular questions we raised about the accuracy and availability of information from the CRA, our research concluded that sufficient information was readily available on the CRA's Web site for anyone wanting to know the TFSA rules. However, the question remains: why, despite the availability of accurate and timely information, did so many taxpayers misunderstand the rules?

Our investigation revealed that the CRA began meeting with the financial services sector to provide them with relevant information by April 2008, and that the CRA had information regarding TFSAs available to the public on its Web site as early as December 2008. We also found that the CRA took the necessary steps in informing its own employees about the taxation of the TFSA as early as November 2008 by providing telephone agents with training material and courses. The information that the CRA provided was continuously updated as new information became available.

We conclude that as the CRA became aware of the confusion experienced by some Canadians about the TFSA rules, it reacted by making more information available. The CRA, in its role of administering and ensuring compliance with the *Income Tax Act*, has the responsibility to anticipate, to some degree, the challenges that taxpayers could likely face when dealing with a new tax program. So while other government departments, the financial services sector, and the media publicized the benefits of the new tax saving vehicle, the CRA should have been more proactive in informing Canadians about the tax consequences of the TFSA. The TFSA is tax-free only if you follow the rules. Although information about the rules of withdrawals and re-contributions was available on the CRA Web site all along, it is clear that many Canadians did not know that this valuable information about the TFSA could be found on the CRA Web site.

Recommendations

While my office recognizes that the CRA has already taken steps to address the issues, and continues to do so, recent comments from taxpayers as well as current media reports suggest that some confusion still exists about the tax rules governing the TFSA.

Canadians rely largely upon the CRA for the information they need to meet their tax obligations and obtain what they are entitled to from their government. In addition to ensuring that its Web site and publications inform Canadians of the tax obligations that come with a new tax program, the CRA should take steps to inform Canadians on where to find that information.

In light of the foregoing, I make the following recommendations:

1. That the CRA take steps to make Canadians more aware of the information it provides about the TFSA on its Web site, in print, and elsewhere;
2. That the CRA continue to update the information available on the TFSA and be proactive in informing Canadians about how to find the tax rules governing the TFSA;
3. That the CRA continue to work with the financial services sector to ensure that the CRA's information products about the TFSA are widely available.

The CRA should have been more proactive in informing Canadians about the tax consequences of the TFSA.

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RC243, *Tax-Free Savings Account (TFSA) Return*

RC4466, *Tax-Free Savings Account (TFSA) Guide for Individuals*