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# Eight things you need to know about your TFSA to maximize your money

By Garry Marr

*'I remember when you just had $5,000 and you really couldn't do anything with them'*

The tax-free savings account is starting to grow up.

Introduced in the 2008 federal budget and coming into effect on Jan. 1, 2009, the TFSA has become an integral part of financial planning in Canada, with the lifetime contribution limit set to reach $52,000 in 2017, provided you were 18 at the time it came into existence.

Clay Gillespie, a financial advisor and managing director of Vancouver-based Rogers Financial, says the TFSAs have become portfolios unto themselves and that's changed everything in his world.

"I remember when you just had $5,000 and you really couldn't do anything with them. Now you see portfolios with $60,000 to $70,000 for each husband and wife if they have been maximizing their contribution," he said, referring to some of the gains clients have made beyond their contributions.

Gillespie is now using the TFSA to draw an income for some of his retired clients. All the gains made in the TFSA are tax-free, and so are withdrawals - but more importantly the money coming out of the account does not count as income in terms of the clawback for Old Age Security, which starts at $74,780 in 2017.

He says the TFSA has also become a great vehicle for dealing with a sudden influx of wealth. "We've had people who all they had was registered money (like in an RRSP) and then they sell their house or they get an inheritance," says Gillespie.

The advisor says one of the biggest problems with the accounts is that Canadians don't actively invest in their TFSAs.

"It was marketed as a savings account," he says, which is how too many people treat them, thereby missing out on the potential for tax-free compounding.

With that in mind, and the new year limit increase upon us, here are eight things Canadians need to know about TFSAs.

**How did we get to $52,000?**

The first four years of the program, the annual contribution limit was $5,000 but that increased to $5,500 in 2013 and 2014 under a formula that indexes contributions to inflation. The Tories increased the annual contribution limit to $10,000 in 2015 but the Liberals quickly repealed that when they came into power and reduced annual contributions to $5,500 for 2016, still indexed to inflation. The annual number increases in increments of $500 but inflation was not riding high enough to boost the annual figure to $6,000 for 2017 so we are stuck at $5,500. That brings us to the current $52,000. The good news is even if you've never contributed before, that contribution room kept growing based on the year in which you turned 18.

**Eligible investments**

For the most part, whatever is permitted in a RRSP, can go into a TFSA. That includes cash, mutual funds, securities listed on a designated stock exchange, guaranteed investment certificates, bonds and certain shares of small business corporations. You can contribute foreign funds but they will be converted to Canadian dollars which cannot exceed your TFSA contribution room.

**Unused room**

As the TFSA limit has grown, so has the unused room in Canadians' accounts. A poll from Tangerine Bank in 2014 found that even after the Tories increased the annual limit, a move that ended up as one-time annual bump, 56 per cent of people were still unaware of the larger contribution limit. In 2015, only about one in five Canadians with a TFSA had maximized the contribution room in their account, according to documents from the Canada Revenue Agency.

**Withdrawal and redeposit rules**

For the most part, you can withdraw any amount from the TFSA at any time and it will not reduce the total amount of contributions you have already made for the year. The tricky part is the repayment rules. If you decide to replace or re-contribute all or a portion of your withdrawals into your TFSA in the same year, you can only do so if you have available TFSA contribution room. Otherwise you must wait until Jan. 1 of the next year. The penalty for over-contributing is 1 per cent of the highest excess TFSA amount in the month, for each month that the excess amount remains in your account. "The scary part is if you withdraw on Jan. 1 and give it back Jan. 2 and forget all year you'd be over-contributing at one per cent all year," says Rocco Mocella, head of network for Quebec and Atlantic Canada, retail banking wealth management, HSBC Bank Canada

**Is the Canada Revenue Agency still auditing TFSAs?**

The Canada Revenue Agency continues to investigate some Canadians - less than one per cent - who have very high balances in their accounts. Active traders in speculative products seem to be the main trigger. Tim Clarke, a Vancouver-based lawyer, is litigating a case with Moodys Gartner and expects his appeal of the current rules regarding TFSA investments to be heard in February.

**Be careful on foreign investments**

If a stock pays foreign dividends, you could find yourself subject to a withholding tax. Jamie Golombek, managing director, tax & estate planning with CIBC, said while in a non-registered account you get a foreign tax credit for the amount of foreign taxes withheld, if the dividends are paid to your TFSA, no foreign tax credit is available. "For U.S. stocks, while, there is an exemption from withholding tax under the Canada-U.S. tax treaty for U.S. dividends paid to an RRSP or RRIF, this exemption does not apply to U.S. dividends paid to a TFSA," he says.

**What are people investing their TFSA in?**

Gillespie says people are still heavily into cash and close to cash holdings. A study from the Royal Bank of Canada two years ago, found 44 per cent of holdings in TFSAs were in a high interest savings accounts. Another 21 per cent were in guaranteed investment certificates. "You want to see your money grow but you also have to respect your risk tolerance," said Mocella. "You want to look at your investment horizon."

**TFSA vs RRSP**

"It's hard to generalize" says Mocella, about which is better for a typical Canadian. RRSPs are generally geared towards reducing your taxable income when your marginal rate is high and then withdrawing the money in retirement when your income will theoretically be much lower. The answer is easy if you make $10,000 a year and you're a young person - the TFSA is better - but Mocella says salaries and the deduction you get from RRSP contributions are only part of the equation. "It also depends on the flexibility that you are looking for. Once you get to the higher marginal rate that deduction is attractive but nothing stops you from taking that deduction and putting it in a TFSA and getting the benefit of both."

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