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Liberals detail how they will roll back TFSA contribution limits

By CLARE O'HARA

While the drop was expected, many investors were left wondering if unused contribution room would be allowed to be carried forward into 2016

Federal Finance Minister Bill Morneau confirmed Monday that the contribution limit on the tax-free savings account will drop back to $5,500 from $10,000 effective Jan. 1, 2016, but that the limit for 2015 will remain untouched. Mr. Morneau also announced that contributions will be indexed to inflation as of next year.

The Conservative government increased the annual contribution limit to $10,000 from $5,500 in the 2015 budget, but that increase has now been reversed going forward.

The TFSA currently provides up to $41,000 of cumulative contribution room to allow investment income to grow tax-free.

The rollback to $5,500 in contribution room was not unexpected in the investment community, as it was one of the key campaign promises made by Prime Minister Justin Trudeau.

"It's unfortunate when we are given a tool to provide better investment planning and now it's being taken back from people who want to work towards having their own financial independence," said Darren Coleman, senior vice-president and portfolio manager with Raymond James Ltd. in Toronto.

"There is this misconception that the TFSA is only for the wealthy and that, unfortunately, is not necessarily true. For a lot of middle-income taxpayers – who the Liberals are really trying to favour in their budgeting – can benefit from using a TFSA rather than a RRSP."

While the decision was anticipated, the big question for many investors was whether unused contribution room from this year's $10,000 limit would be allowed to be carried forward into 2016. Because the limit for 2015 remains untouched, investors who maxed out their TFSA in previous years but did not make any contribution in 2015 would be allowed to contribute $15,500 in 2016.

But those who have no additional room should start considering alternatives for any extra savings.

"The TFSA offers no deduction as the money goes in, but it offers tax-free income going forward so what you are now losing is $4,500 of tax-free savings room annually beginning in 2016," says Aurèle Courcelles, assistant vice-president of tax and estate planning at Investors Group. "If you had $10,000 available to contribute in 2016, you should be looking at alternatives of where you can put that extra $4,500 that can no longer go into the TFSA."

Depending on risk tolerance, financial objectives and time horizon, Mr. Courcelles suggests that investors consider redirecting their contribution of $4,500 to a registered retirement savings plan, or to stocks, corporate-class mutual funds or, for shorter time horizons, a high-interest savings account.

Ian Russell, chief executive officer of the Investment Industry Association of Canada (IIAC), says the rollback of the annual TFSA contribution limit will provide Canadians with fewer retirement-income planning options, particularly those Canadians 65 years and older who account for roughly one-quarter of TFSA holders – and especially those 71 and older who can no longer contribute to a RRSP.

"Presumably, this was undertaken in anticipation of a mandatory expansion of the [Canada Pension Plan]. However, any change to the CPP will require the support of seven provinces representing two-thirds of the country's population, which may not be forthcoming or may take considerable time to achieve," Mr. Russell said in an e-mail to The Globe and Mail.

In addition, the IIAC has proposed a number of measures for the government to consider, such as extending the eligible age for RRSP contributions beyond age 71, eliminating the rules mandating minimum yearly drawdowns from registered retirement income funds, and relieving employers' and employees' contributions to group RRSPs from payroll tax.