TFSA Time Bomb !

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The Tax-Free Savings Account (TFSA) was introduced in 2009 as a new way for Canadians to build assets and wealth on a tax-advantaged basis. Any capital gains, dividends or interest income are tax-free upon redemption from the account. The initial contribution amount was $5,000 with annual increases of $5,000. This has been increased to $5,500 in 2013 to offset inflation. This brings the maximum contribution amount for a new subscriber, in 2013, to $25,500.

You can have more than one TFSA as long as the total contributions do not exceed the above limits. And like RRSPs, you can carry forward, to future years, unused TFSA contribution room if you do not make the full contribution in any one year.

What looks simple on paper is in reality much more complex than many Canadians realize now that the program has been in operation for a few years. There are multiple reports now that some Canadians are getting notices from the Canada Revenue Agency (CRA) with fines and penalties due to activity in their TFSA account. This is a ticking time bomb that will trap many unwary Canadians in future years. Given the initial confusion about this the new program, CRA forgave penalties incurred for 2009 as long as people applied for forgiveness by August 3, 2010. CRA is now enforcing the collection of any fines and penalties.

This situation was highlighted at a recent investment conference. During a lunch break, one advisor explained how his 30-year old daughter had received a penalty notice from CRA regarding the use of her bank TFSA. It took him and his daughter several hours and multiple conversations with the bank branch to understand how these penalties were incurred.

A second situation involved another financial planner whose 24-year old daughter recently went to the bank to get a chequing account. She had her first job out of university and was looking to set up an account to handle her day-to-day cash management needs. She left the bank branch with a TFSA instead, with the understanding that it was similar to a chequing account and would meet her needs.

Upon further discussion, she believed that she would be able to use the TFSA as a savings and/or emergency account for use for items such as travel or any other extra expenses. It turns out she did make a withdrawal and a deposit in 2013 that exceeded her contribution limits. They needed to discontinue the monthly contribution to her TFSA to avoid future penalties.

The problem is the misuse and misunderstanding of how TFSAs work and how the rules are inadvertently catching Canadians in a web of future fines and penalties. As discussed with the CRA helpline, TFSAs are not to be used for daily or ongoing transactions. Problems often arise when an account holder has already contributed the maximum to their TFSA, makes a withdrawal and then makes another contribution in the same calendar year for example.

CRA will assess penalties for over contributions at 1% per month. Call us today to discuss your TFSA account needs and goals. If in doubt about your contribution room, you and your Advisor can call CRA at 1-800-959-8281 to determine your limits before making any new contributions.

Questions about TFSA strategies?

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