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Financial Focus

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Three Tips to Get the Most from Your TFSA

By Clinton Orr

At the beginning of the year contributing to a Tax Free Savings Account is usually near the top of the financial to do list. For good reason, it is a phenomenal tax saving tool. According to a recent survey, however, there is still some confusion surrounding the TFSA. The survey was commissioned by BMO and conducted in November 2020; the results show that most folks are not getting full value out their TFSAs. We will pass along three tips to help turn that around, but first a quick review of the basics.

The Tax Free Savings Account was introduced in 2009. Anyone with a valid Social Insurance Number who is over the age of 18 can open a TFSA. In 2009 the contribution limit was capped at $5,000 a year. The contribution limit has fluctuated over the years, for 2021 the limit is $6,000. If you do not contribute the full amount to a TFSA in a given year, you do not lose the contribution room; it rolls to the next year. If you have never contributed to a TFSA, your total contribution room is $75,500. Once the money is in the account a wide array of investments are permitted. Stocks, bonds, GICs, mutual funds, alternative investments, there is a large selection of acceptable TFSA investments. I believe the name is misleading, it is called a Tax Free Savings Account, however there is such a large selection of permitted investments, it is not really a savings account it is more of an investment account.

Invest in your TFSA: The survey found that cash is the primary choice for most Canadians, meaning most Canadians are using the TFSA for savings rather than investing. You do not receive a tax deduction for your TFSA contribution, however once the money is in the account any growth on the investment is tax free. That's the main benefit, the growth is tax free. Whether your investment grows by 2% or 7%, all of the growth is tax free. If you use the TFSA as a savings account, you will earn 1% maybe 2% on your money. Emergency funds and short-term savings are important; however, I would not put that money in a TFSA. Use a different account for your savings. Put your long-term investments in your TFSA, overtime they will likely earn a much better return.

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Since you are limited to the amount of money you can contribute to your TFSA, it makes sense to invest that money and receive a higher tax-free return.

Contribute in January: Ideally, if possible, you would do a lump sum contribution to your TFSA near the beginning of the year. That way the money will be in the account, and invested, early in the year and have the rest of the year to grow and compound tax free. A full contribution in January, means the money has the remaining 11 months of the year to grow tax-free. A full contribution early in the year allows you to get the most out of the TFSA, however if that's not possible, it is still worthwhile to contribute, and invest, what you can to your TFSA.

Invest for Growth: It is important that you are comfortable with the risk in your investment portfolio and that your overall mix allows you to achieve your goals. Do not change that mix simply to take advantage of the TFSA. However, if your portfolio already contains some growth investments, for example stocks, do not add more to that category, but simply shift those investments into your TFSA. That way the money in your TFSA has the potential to achieve a higher rate of return and all of that growth will be tax free.

The tips above are listed in order of importance, shifting the objective of your TFSA from savings to investing will have the largest impact. The additional tax-free growth will compound and provide a boost to your overall financial plan. It is important to remember that any financial changes need to be a fit with your overall financial plan. Chat with your financial profession and ensure you are getting the most bang for your tax free buck.

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