The Institute for Advanced Financial Education

COMMENT

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TAX-FREE SAVINGS ACCOUNTS: UNDERSTANDING CONTRIBUTION LIMITS

Introduced in 2009, Tax-Free Savings Accounts (TFSAs) have experienced a steady upward trend in contributions. It is estimated about 11.7 million individuals held TFSA accounts at the end of 2014. While contributions are not tax deductible, the big advantage of this savings vehicle is the opportunity for individuals to accumulate growth on plan assets on a tax-free basis. The design of the TFSA makes it an excellent savings vehicle for many types of needs. While the TFSA can only hold qualified investments, there are plenty of choices available.

Contribution room is created each year based on the annual contribution limit plus the amount of any withdrawals in the prior calendar year. Unused room is carried forward so, as time passes, it is easy for individuals to lose track of their available contribution limit. The Canada Revenue Agency (CRA) does not report contribution room to taxpayers although they do track the amounts and monitor overcontributions.

Year	Annual Limit	Year	Annual Limit
2009	$5,000	2014	$5,500
2010	$5,000	2015	$10,000
2011	$5,000	2016	$5,500
2012	$5,000	2017	$5,500
2013	$5,500		

Annual Contribution Limits

While contribution limits experienced a short-term bump to $10,000 in 2015, the limit was readjusted to $5,500 beginning in 2016, with this amount indexed to inflation and rounded to the nearest $500.

EXAMPLE ONE

Thirty-eight-year-old Sarah made maximum contributions to her TFSA between 2009 to 2013 inclusive (a total of $25,500) and experienced substantial growth on the assets held within the TFSA. At the beginning of 2014, the value of Sarah's TFSA had grown to $63,000. In 2014, she was out of work for eight months so used the opportunity to withdraw $45,000 from her TFSA to cover her living expenses. Sarah opted not to make any TFSA contributions in 2015 and contributed only $3,000 in 2016, as she worked to get her financial affairs back in order.

While the $45,000 withdrawn is $19,500 more than Sarah had contributed at the time of the withdrawal, the tremendous growth in the plan provided Sarah with access to substantially more assets than her actual contributions. The opportunity to replace assets withdrawn from the plan is an incredibly valuable feature of a TFSA.

In 2017, Sarah has re-established her financial stability and is ready to begin contributing larger amounts to her TFSA. Her 2017 contribution room is determined as follows:

• Total unused contribution room at the end of 2016	$63,000(1)
• Total withdrawals made in 2016	nil
• 2017 annual dollar limit	$ 5,500
TOTAL	**$68,500**

Note:

(1) The $63,000 is comprised of $5,500 (2014 annual dollar limit) + $10,000 (2015 annual dollar limit) + $45,000 (total amount withdrawn in 2014 that can be re-contributed in 2015) + $2,500 (2016 dollar limit of $5,500 less her $3,000 contribution).

EXAMPLE TWO

Chris, age forty-two, has contributed the maximum annual amount to his TFSA for each of the years 2009 to 2016 inclusive. This puts his total contributions at $46,500. Unlike Sarah from the previous example, Chris has experienced a substantial loss and has a total TFSA balance of $22,000. Since the $24,500 loss has taken place within a TFSA account, it cannot be offset against any other gains that Chris may have had in any non-registered investment accounts.

In example one, Sarah parlays her TFSA contributions into a substantial amount of investment income that helps fund her financial emergency and can, later, re-contribute the amount withdrawn. In example two, because Chris used the TFSA, the loss on his investment earnings cannot be offset against non-registered gains in other products. All income, losses and gains within a TFSA occur without any tax consequences to the plan holder. This can be particularly beneficial as investment income or plan withdrawals are not included in income for tax purposes when determining eligibility for federal income-tested benefits and credits. For example, TFSA withdrawals will not increase a senior's net income for Old Age Security clawback purposes.

It is important to carefully monitor a taxpayer's contribution limits because overcontributions attract a penalty of one percent per month until the excess is withdrawn. An inadvertent overcontribution could result in penalties that far exceed the investment earnings for that period. Take, for example, the situation where a taxpayer overcontributes $5,000 and does not correct this until 14 months after making the contribution. The penalty for this period is $700 (14% of $5,000) and, if the contributions earned $175 assuming a three percent earnings on an annualized basis, the overall cost is $525.

Eligibility for opening a TFSA account begins at age 18 and requires the individual to hold a valid social insurance number. Contribution room begins to accumulate in the year the individual turns age 18 so even if an individual opts not to open or contribute to a TFSA, the benefits arising from accumulating contribution room accrue on a go-forward basis.

Unlike an RRSP, which requires the plan to move into a payout mode when the annuitant reaches age 71, a TFSA has no mandatory maturity date or withdrawal age. Individuals continue to accrue annual contribution room, regardless of their age. Assets within a TFSA can be transferred to a surviving spouse or common-law partner and, provided the funds remain in the surviving spouse's TFSA, continue to accrue on a tax-sheltered basis without impacting the recipient's contribution limits.

The following chart illustrates the accumulation of the TFSA limits based on an individual's year of birth. Since individuals begin accumulating contribution room in the year they reach age 18, the annual contribution limit is date sensitive. Individuals born in 1999 begin accumulating contribution room and can open a TFSA in 2017 because they will turn age 18 in that year.

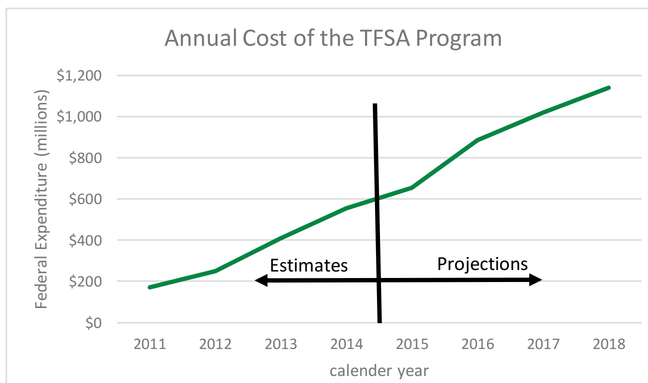
Individuals born before 1992 have been at least age 18 since 2009 and are therefore entitled to the total of the annual TFSAs annual contribution limits since inception.

Total Annual Contribution Limits

Year of birth	Total of Annual Contribution Limits 2009 to 2017 inclusive
Before 1992	$52,000
1992	$47,000
1993	$42,000
1994	$37,000
1995	$32,000
1996	$26,500
1997	$21,000
1998	$11,000
1999	$5,500
2000 or later	0

Based on Year of Birth

By the end of 2018, the federal government estimates the accumulated cost of TFSAs to be about $5.1 billion in tax revenues forgone on the investment earnings in the Tax-Free Savings Accounts.



Source: 2017 Report on Federal Tax Expenditures

In a short period, the TFSA has become an important element of many individuals' financial plans. It is important that individuals track their limits and understand how best to incorporate this savings vehicle into their overall financial strategies.