Make the most of your TFSA

If you've maxed out your Registered Retirement Savings Plan (RRSP) contribution room, or need to withdraw funds from an RRSP account and park the money somewhere, a Tax Free Savings Account (TFSA) can be a very good place to start.

"All else being equal, a TFSA can provide a similar return to an RRSP. But there are a few important differences," says Chartered Accountant Camillo Lento, a member of Lakehead University's Faculty of Business Administration in Thunder Bay.

Chartered Accountant Brian Murphy in Whitby thinks the name is a misnomer. "A Tax Free **Investment** Account is more accurate," he says. "For some people and under the right circumstances, these plans can outpace RRSPs, because we can use the money in them to invest in a wide variety of financial products and keep any and all profits, tax-free."

Both agree that knowing and understanding the TFSA contribution rules can mean the difference between money lost and money gained. Here are some of Lento's and Murphy's tips to both help you play by the rules and make money in your TFSA.

Contribute with caution - Anything earned on money in a TFSA is tax-free. But the amount you can contribute is limited to $5,000 per year, not counting recontributions to make up for any withdrawals made in the previous year. Any new contributions that exceed the $5,000 cut-off amount for the year in question are subject to a penalty of one-per-cent per-month until they're withdrawn. That penalty tax must be calculated and filed on the Canada Revenue Agency's (CRA) form RC243, available on their website (www.cra-arc.gc.ca).

Timing is critical - Earnings are tax-free, and you can withdraw them anytime without losing contribution room. But be careful. Once money has been withdrawn, **it cannot be reinvested in the TFSA until the beginning of the following year**. Restocking the TFSA too early was one of the reasons many Canadians were found to be over-contributing in 2008 and 2009. The CRA was lenient with those who simply misunderstood the rules, but it let it be known last year that this excuse won't fly in the future.

Get on track - One of the most common reasons people overcontribute to a TFSA is that they lose track of how much money is already in the account, says Murphy. For the precise status of your TFSA, you can check your Notice of Assessment from last year; call the CRA TIPS line at 1-800-267-6999; log on to the *My Account* feature of the CRA website; or call their main switchboard (1-800-959-8281) and have them direct you from there.

Don't transfer if you can withdraw and recontribute - Transferring funds between TFSAs can be expensive and confusing. Financial institutions often charge to set up or discharge the plans and the CRA charges penalties if you should accidentally overcontribute or incorrectly transfer funds. Lento suggests you avoid the transfer scenario altogether if you can. Instead, withdraw the funds from your TFSA in November or December, and then put them in the new plan early in January.

Pay special attention to in-kind property - Holdings in your TFSA can take many forms, but their worth is based on fair market value at the time they are transferred to the account. This can have important implications in times of market fluctuations or downturns. Specifically, if a loss property is transferred as a contribution or otherwise acquired by the TFSA, the loss will be denied.

The specifics and timing of valuations like these are complicated, so professional advice is strongly recommended if you're considering these kinds of investments in your TFSA.

Prevent penalties - There are other non-qualifiers when it comes to TFSAs. In addition to excess contributions, use the TFSA to contribute to non-qualified or prohibited investments, or in some other way that shields money that would otherwise be taxable under normal circumstances.

Prepare for the inevitable - As with any investment, it's important that beneficiaries be properly named to receive the proceeds of your TFSA when you pass away. Take the time to meet with a lawyer and have your will updated properly. If you detail your wishes in your will, the plan will be sheltered from tax when you die. The recipient(s) will be able to keep their own entitlements and make tax-free withdrawals. A Chartered Accountant can help ensure this is arranged to your best advantage.

Know the rules to win the game. Everything you need to know about TFSAs can be found in publication RC4466 available on the CRA website.

Brought to you by the Institute of Chartered Accountants of Ontario