Tax-Free Savings Accounts a good product with a bad name, experts say

TFSAs still aren't being used to potential 6 years after their creation. Experts blame the name

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What's in a name, financially speaking?

Tax Free Savings Accounts, or TFSAs, have been available to Canadians since 2009, but they're not being used to their full potential, say financial experts, who put a large part of the blame on the name.

"The name is huge," said Rubina Ahmed-Haq, a personal finance expert in Toronto. "You've got to call things what they are."

- **After 6 years, TFSAs still a source of confusion**
- **Special report: RRSP season 2016**

"It is a misnomer to call it a TFSA," said Peter Bowen, vice-president of tax research and solutions at Fidelity Investments Canada. "That was a mistake made by the government when these were launched, I would argue."

Money experts say the name leads people to believe it's a standard savings account, meant for short-term savings and frequent withdrawals.

"They kind of dip in and dip out whenever they want, but that's not really what it's meant for," said Ayana Forward, a certified financial planner at Ryan Lamontagne Inc. in Ottawa.

In fact, TFSAs allow users to invest large sums of money tax-free using almost any investment possibility, giving Canadians a key place to save money medium- and long-term.

Here are some key things to know about TFSAs:

TFSAs are flexible

Several of the experts who spoke to CBC News said the TFSA would be better named an "investment account" rather than a "savings account," since the TFSA can shelter myriad investment possibilities: high-interest savings accounts, mutual funds, guaranteed investment certificates, listed securities and other types of qualified investment products.

- **5 reasons why TFSAs are a smart retirement investment**
- **RRSPs vs. TFSAs: Comparing Canada's 2 great savings plans**

And unlike RRSPs, you pay no income tax when you withdraw funds. (Conversely, deposits aren't tax-deductible either.)

"They're very flexible," Bowen said of TFSAs. "They can benefit Canadians across all age groups and all income levels. They can be used for short-term savings, but also for mid-term [such as for a house] and most importantly for long-term."

Bowen said it's "wrong" to use a TFSA as a typical savings account.

"The asset allocation should be considered with a very long-term view," he said. "We hope people are sitting down with their financial advisers to really make that work for themselves."

Dipping can get you dinged

Ahmed-Haq said a sure sign that people don't understand how TFSAs are supposed to work are the annual stories about tens of thousands of people who have paid fines because they overcontribute.

- **TFSA withdrawal rule keeps catching unwitting Canadians**

Canada Revenue Agency charges one per cent per month on the amount over your contribution limit. If you overcontributed by $1,000 for a year, you'd lose $120.

Why are people overcontributing? Because they're taking money out of the account and putting new money in, not realizing that every dollar deposited counts towards the contribution limit no matter how much you take out.

"If you took the same $1,000 and put it in seven times and took it out seven times, you've gone over, even though you still have $1,000," Ahmed-Haq said.

Limits lower, but you'll always have contribution room

A fresh bit of confusion was in the offing this year, because for the first time since TFSAs were created the contribution limit has dropped.

- **TFSA limits lower, but past contribution room remains**

However, "the Liberal government made the changes in a manner that was relatively straightforward," Bowen said, noting that several more complicated approaches had been bandied about in the media.

On Jan. 1, the annual contribution limit for tax-free savings accounts shrunk to $5,500, instead of the $10,000 the previous government had implemented for 2015.

Which brings up another blind spot in some Canadians' knowledge: Ahmed-Haq said many people don't realize that the contribution room in a TFSA is retroactive to when they were created, even if you're starting one today.

The rules around the accounts allow the contribution limits to accumulate starting from 2009 for each year during which a person turned or was over 18 years of age, held a social insurance number and was a resident of Canada.

The limit for anyone opening an account for the first time today would be $46,500.

Sometimes TFSAs trump RRSPs

TFSAs are more than just an add-on to Canadians' life savings. In several cases, a TFSA actually makes more sense than a registered retirement savings plan.

Someone with a lucrative pension might consider a TFSA, because the money in it isn't considered income the way an RRSP withdrawal is.

"You don't really want to have an RRSP and a pension at the same time," Forward explained. "You don't want to put yourself in that higher tax bracket. So a TFSA is really good for someone who has a good, solid pension ... so that they can have some savings without really worrying about the tax implications of those withdrawals later on in life.

"They're also good for low-income learners who might not get the most bang for their buck for an RRSP deduction, or someone saving for the short-term, like for a house."

TFSAs are better than debt

Warren MacKenzie, president and CEO of Weigh House Investor Services in Toronto, said he deals with mostly high-net worth clients who understand the subtleties of a TFSA.

- **RRSP vs. TFSA vs. mortgage vs. credit card debt**

But he disagreed with the idea that the accounts shouldn't ever be used for short-term savings.

MacKenzie said there are no good reasons aside from lack of funds for not using a TFSA.

It's better to use a TFSA for long-term savings, but if you want to use it as a short-term bank account that's a good strategy too, because you're saving, not going into debt, he said.

"Even if you're using it not to its full advantage, it's better to save the money than to [spend] it on a credit card," he said.
