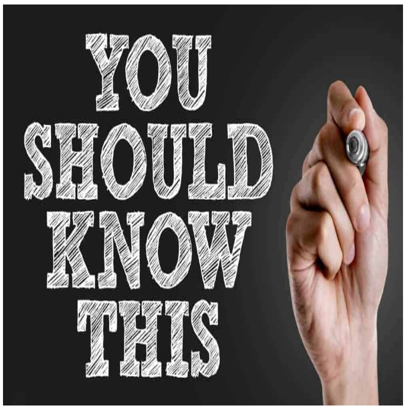

The Best Part About TFSAs You Probably Didn’t Know About

Description

For Canadians, Tax-Free Savings Accounts (TFSAs) are one of the best vehicles available to help them save for retirement.

Not only do returns grow in investors’ TFSAs tax-free (meaning they don’t have to pay any tax on their gains, ever), but TFSA accounts also offer investors the ability to take money out of their accounts any time they’d like.

But unlike the treatment for RRSP accounts, with a TFSA, investors not only don’t have to worry about paying taxes on the money they want to withdraw, but they also don’t have to worry about facing any penalties if they fail to re-deposit the funds back into their account by a specified timeline (as is the case with the RRSP’s Home Buyer’s Plan).

That’s not even my favourite thing about the TFSA.

The TFSA also offers investors what is arguably a lesser-known feature that, in my opinion, has the potential to truly amplify an investors’ wealth creation over time. I’m referring to the ability for TFSA investors to re-contribute amounts that they have previously withdrawn from their accounts without those contributions having any negative implications against their allowable limits.

It will help to illustrate this concept with a fairly straightforward example.

As of January 1, 2019, the maximum amount that a Canadian (born prior to 1991) who has never made any contributions could contribute $63,500 to their TFSA account.

Say that this investor took advantage of this opportunity and made the maximum contribution of $63,500 to fully fund their TFSA account.

Now, let’s imagine that this individual managed to have a reasonably successful year in the markets in 2019, investing Foolishly in high-quality companies with track records of delivering positive returns for their shareholders.

Let’s say that this investor’s portfolio managed to generate a 15% annual return for the year, meaning by the end of the year, that same investor would be showing a balance of $73,025 in their account.

What’s really great about TFSAs is that if the investor wanted to make a withdrawal from their account to make a down payment on a home or car or pay for a child’s college tuition, thanks to the growth in the portfolio, the investor would have effectively permanently raised the ceiling on the available contribution limit for their TFSA account.

Using this example, the investor has effectively just created for themselves an additional $10,000 (or close to) of free contribution room for their TFSA, which they are then free to use to accommodate further contributions and grow those investments tax-free.

Bottom line

This aspect of TFSA accounts is an extremely compelling argument in favour of using your TFSA to hold the investments that you feel offer the best growth prospects.

Since dividends are already taxed at relatively favourable rates by the federal government, high-yield stocks, as great as they may be, simply don’t allow you to leverage the tax shield offered by the TFSA in the same way as a high-growth stock, like, for example, **Shopify** (TSX:SHOP)(NYSE:SHOP).

After all, Shopify stock has done nothing but gain 650% since the company IPO’d in 2015.

Yet for those fortunate individuals who had the foresight to invest their SHOP stock within their TFSA accounts, not only did they get the benefit of those outstanding returns without the associated tax liability, but they also would have been successful in generating more available contribution room for themselves within in their TFSAs, allowing for even larger, future tax-free investments.

CATEGORY

1. Investing
2. Tech Stocks

TICKERS GLOBAL

1. NYSE:SHOP (Shopify Inc.)
2. TSX:SHOP (Shopify Inc.)

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