Canada Revenue Agency 101: How to Legally Outsmart the CRA With Your TFSA

Description

The Tax-Free Savings Account (TFSA) is a wonderful “no-strings-attached” investment vehicle that was created to help all Canadians to get ahead financially.

The RRSP, RESP and other investment vehicles are “strings-attached” accounts that aren’t worthwhile for many Canadians who aren’t willing to limit their liquidity. RRSPs and RESPs are designed for saving for specific purposes. I believe there is little to no benefit from the use of such accounts.

We live in uncertain times, so the last thing that a young Canadian should seek to do is to “lock down” their money for a particular purpose and risk unnecessary penalties.

Even it’s your goal to save up for retirement, college or a downpayment on a home, you’d probably still be better off using your TFSA as the investment vehicle of choice instead of an RRSP, since financial goals can change.

The next thing you know, interest rates could be substantially higher, housing prices could balloon in the market you’ve been looking at, or you may run into a financial emergency that requires you to raise cash immediately and postpone your plans of buying a home.

In the latter scenario, you could get salt rubbed in your wounds (in the form of withholding taxes) by the CRA if you made a premature withdrawal from your RRSP rather than your TFSA. Similarly, with your RESP, you could face stiff RESP withdrawal penalties if your child decides that post-secondary education isn’t for them.

In short, by putting money in a goal-focused account, you’re limiting your liquidity for tax advantages, which may not even be worthwhile given your circumstances. Thus, contributors to such accounts may not be getting the tax-free edge they’d initially expected and could be setting themselves up for a headache of tax burdens, penalties and other complexities down the road.

Of course, such goal-focused accounts make a tonne of sense for some Canadians. But they’re not built for everyone like the TFSA.

So, what’s the best way to outsmart the CRA?

Keep your options open

Don’t limit yourself to specific financial goals if you are uncertain about your future use of the funds.

While saving for your retirement, a home purchase or college may seem like responsible financial goals, I think it’s best not to commit oneself if there’s a chance that one will use the funds for alternative purposes.

If you're a young investor like a millennial who's still nowhere near reaching peak income, take a rain cheque on goal-based accounts like the RRSP and keep your options open by maxing out your TFSA.

That way, you'll retain the tax-free advantage without reducing your liquidity over the long run. And for full effect, invest your TFSA funds in stocks or ETFs like the **BMO Low Volatility Canadian Equity Fund** to get the most out of your tax-free advantage.

Capital gains and dividends are off-limits for the tax man, so make him envious of the amount of potential taxes you'd be legally avoiding!

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