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Brad Brain: Maximize your TFSA

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Smart Money

Brad Brain: "More Canadians now own TFSAs than own RRSPs. The problem is, the majority of TFSAs are invested in savings accounts or term deposits. Sometimes that will be completely appropriate. But it can also be a squandered opportunity."
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With the Tax Free Savings Account you will pay less tax. I'm a big fan. Who doesn't want to pay less tax? I just think that a lot of people are not using Tax Free Savings Accounts as effectively as they could.

TFSAs are more than just bank accounts. With a TFSA you can invest your money consistent with your financial objectives. Short term or long term, there are lots of investment options; mutual funds, stocks, exchange traded funds, daily interest accounts, etc.

Regardless of whether the investment earns interest, receives dividends, or grows with capital gains, there is no tax on the growth of the investment when it is held in a TFSA.

It gets even more interesting. There is also no tax on any withdrawals from the TFSA. You can access the funds for whatever you want, whenever you want, and you can do it without triggering any tax.

Tax free growth plus tax-free access to your money creates some nice planning opportunities. TFSAs have been become very popular. So popular that they have even overtaken the cherished Registered Retirement Savings Plan. More Canadians now own TFSAs than own RRSPs.

The problem is, the majority of TFSAs are invested in savings accounts or term deposits. Sometimes that will be completely appropriate. But it can also be a squandered opportunity.

I say this because daily interest accounts and GICs are consistent with short-term needs. And while the TFSA will certainly do a wonderful job of holding short-term assets, they can do so much more.

Let's look at the numbers, and I'll show you what I mean. Let's say that you have $10,000 in a GIC and its paying you 2% per year. Hold that GIC in a TFSA and you will see $200 in tax-free interest each year. This doesn't mean that you save $200 per year, mind you. It means you save the tax on $200. If you are in a 30% tax bracket, that works out to $60 per year in savings.

Alternatively, let's say that you invested the money for something long-term, with better growth potential. Since you can put in $6,000 per year, it is not unrealistic to think that over time, with deposits and growth on your money, that you might have a significant sum of money in a TFSA. We are starting to see people with $100,000 accumulated in their TFSA.

So what's better? Saving $60 per year in tax, or being able to lay your hands on $100,000 tax free?

There are so many wonderful things that you can do with a TFSA that go beyond simply a savings account paying 2%. Invest in products with long-term returns that exceed inflation. Utilize a tax-free withdrawal strategy to preserve income-tested government benefits. Buy a blue chip stock with a 5% dividend and set up a dividend reinvestment plan. Put the money in a Guaranteed Minimum Withdrawal Benefit fund, and have tax-free income for life. The list goes on.

With so many interesting options for your TFSA money, why would you constrain your thinking to mere bank accounts? That's fine for any short-term objectives, but if your TFSA is long-term money it's a lousy use of a great opportunity.

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