YEAR-END PLANNING: UTILIZE YOUR TFSA TO LOWER YOUR TOTAL TAXABLE INCOME

2020 has been an interesting year to say the least. A global pandemic, the fastest bear market in history, and increasing unemployment or salary cuts. If you are thinking about topping up your RRSP this year but do not have access to liquid funds other than your TFSA, there may be a strategy that can work in your favour.

The introduction of a Tax-Free Savings Account (TFSA) in 2009 seemed like nothing to bat an eye at. Having an account where you can set aside $5,000 at inception to grow tax-free did not even pop on the radar for many with reasonable sized investment portfolios. However, as of Jan. 1, 2020 the contribution room of a TFSA has reached $69,500 and can be utilized as a great option to lower your total taxable income which is especially beneficial towards the end of the calendar year.

One of the rules of a TFSA is that money withdrawn cannot be returned until January 1st of the following year. If you took out $10,000 on January 15th, 2020 you would have to wait almost an entire year to replenish that $10,000 on January 1st, 2021. Alternatively, if you took that money out on December 15th, you would wait half a month to have access to put the money back in.

Let's look at a real-life example where this may make sense for someone who is looking to drop their taxable income:

Julie is a diligent saver and has money in both her TFSA and RRSP. She makes $200,000 per year from her job and has a rental property. Over the past couple of years, Julie has maxed out her RRSP and TFSA. She has a rough estimate of her total income per year but likes to wait until November to deposit her savings into her RRSP and TFSA accounts. As she approaches the end of the year, she moves the maximum RRSP contribution from her TFSA to her RRSP to decrease her total income-tax down to a lower tax bracket. By doing this, she eliminates the stress of securing an RRSP loan or generating the cash from

Diagram showing how you can use your TFSA to lower your taxable income.

another source. Once tax season rolls around, she receives a healthy return which she rolls back into her TFSA while saving in the next year to replenish the amount taken out.

This strategy can be useful for individuals who have contribution room in their RRSP but no liquid funds other than their TFSA. Typically, an individual or family that is in the growth stage of their lifecycle would use this type of approach, but it can apply to anyone who meets the right requirements. You should consult your advisor if this strategy is beneficial for your individual circumstance.

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