National Post

Investors look to PM to keep TFSA promise; May double limit

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A promise is a promise - at least the investment community hopes the Conservatives see it that way.

Prime Minister Stephen Harper has vowed that before he is re-elected, he will allow Canadians to double what they can contribute to a Tax-Free Savings Account (TFSA), if the budget is balanced.

With the government close to a balanced fiscal position, increased attention is now focused on that pledge, and the possibility that annual limits will climb to $10,000. The TFSA, introduced for the 2009 tax year with a $5,000 limit, does rise by $500 increments based on certain inflation targets and is now $5,500 annually.

"This will make a huge difference. I mean $5,500 [per year] isn't spare change, but in terms of funding a lifetime of retirement, [$5,500] is not that big. But at $10,000, the numbers start to really add up," says Tom Hamza, president of the Investor Education Fund.

One thing it won't do is solve our savings problem, when it comes to retirement. It might even make it worse because people saving in a TFSA know they can withdraw the money at any time without tax consequences, unlike a registered retirement savings plan.

"It's not like people have money on the sidelines waiting for this," said Mr. Hamza. "Our problems with retirement start with our problems with debt and people not contributing enough money."

About 39% of eligible Canadians have opened a TFSA.

"It's extremely beneficial for Canadians, particularly older Canadians," said Jamie Golombek, managing director of estate and tax planning with CIBC, adding for some people RRSPs don't make a ton of sense.

TFSAs are an attractive vehicle for people who run out of RRSP room and seniors over 71 who can no longer contribute to an RRSP but are looking to shelter future income and profits.

Registered Retired Income Fund holders who have to start making withdrawals at 69, and want to move the money to an account that shields them from future tax, would also be eager for the extra contribution space.

The general reason to put money in an RR SP is to lower taxable income, and defer tax, at a time when you have a high marginal rate. The hope is when you retire you'll be at a much lower marginal rate and therefore paying less tax.

Mr. Golombek says his rule of thumb is if you are making under $40,000 per year, you should be maximizing your TFSA before you consider putting money into an RRSP.

A growing TFSA pool might also encourage more Canadians to use that account instead of taking money out of their RRSP to buy their first home. The Home Buyers' Plan allows Canadians to take $25,000 out of their RRSP and pay it back over 15 years, but some planners have complained it slows down retirement savings.

The one thing an expanded TFSA is unlikely to impact is the Registered Education Savings Plan or the Registered Disability Savings Plan, both of which come with generous grants, making them more attractive.

Lorne Zeiler, a wealth advisor with TriDelta Financial, said the changes will mean more to people who are really wealthy and to people on the lower end of the financial spectrum who don't need to lower their taxable income.

"The TFSA is a better savings vehicle for people making $45,000, but if the person is a really bad saver we suggest the RRSP because of the penalty that comes," he says, referring to the fact when you withdraw money from an RRSP, it is taxed.

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National Post

How one man got TFSA balance up over $275K; Creative Approach

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Shafik Hirani has an investing style inside his tax-free savings account that he admits might not work for the average Canadian investor.

But you can't argue with the results the Calgary division director and senior executive financial advisor at Investors Group Financial Services Inc. is getting.

In 2013, the Financial Post first launched its show-usyour-TFSA challenge, a popular bragging contest.

To our knowledge, no one seems to have been able to replicate the success of Mr. Hirani, who about a year ago was able to show a statement that had an incredible $172,382 in it.

That's despite the fact that, as of 2013, the government had only allowed $25,500 in contributions.

As of 2014, total contributions allowed are up to $31,000 and there are rumours the government plans to bump the annual allowable increase in contributions to $10,000.

Mr. Hirani's methods were controversial last year. He made a major investment in the once mighty Fannie Mae that had been reduced to a bulletin board stock. You're not allowed to invest in the bulletin board or over the counter stocks in your TFSA but Mr. Hirani was able to point to the somewhat obscure fact that as long as shares are co-listed on a Canada Revenue Agency recognized exchanged, in this case it was the Stuttgart Stock Exchange, the investments are allowed to be held.

His latest manoeuvre might have people up in arms again - he shorted the stock market just in time for the latest pullback. The immediate reaction might be that shorts are now allowed in a TFSA, but there are exchange-traded funds that mimic the activity of shorting and do it on a leverage basis making returns even greater during a crash - or losses even larger if the market goes the other way.

In this case, he took almost half his money and had it in something called the Direxion Daily SP Bear 3X shares. He managed to take his TFSA to close to $290,000, but the balance has slipped back to $277,408 after an investment in the Direxion Daily Gold Miners Bulls 3X shares shaved about $11,500 off his total. Both ETFs are heavily leveraged.

"I keep my serious money in other accounts. In the TFSA, I want small cap equities with high beta and volume," Mr. Hirani said.

His philosophy is outside of the mainstream without a doubt, based on a survey from the Bank of Montreal released

Wednesday that shows average Canadians have 60% of their TFSA invested in cash and another 20% are invested in guaranteed investment certificates. There might some room for compromise. Christine Canning, head of everyday banking products for BMO Bank of Montreal, said Canadians could probably come a little out of their comfort zone without investing like Mr. Hirani.

"Most people see their TFSAs as a savings account. It might be fair to say that's too conservative," Ms. Canning said. "In a world where what's tax-free is the investment returns you make, this is a good place to be taking some market risks. Just not that much."

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Do you have a TFSA story? We want to hear about your victories but also your losses. Email Garry Marr with it at gmarr@nationalpost.com. We don't necessarily have to publish your name, as long as you give us a glimpse of your statement.

National Post

Fat TFSAs in taxman's crosshairs; Investors with heavy trading, large gains slapped with 'business' taxes

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Tax-free savings accounts, created just five years ago by the Harper government as a tool that would allow Canadians to grow retirement investments while sheltered from capital gains taxes, are increasingly being challenged by Canada Revenue Agency auditors targeting investors that show large gains in their account.

The CRA is also hitting investors with audits if they trade too frequently for the agency's comfort. The CRA has argued that investors who use their TFSAs for frequent trading and earn large gains are effectively running a trading business, and should be taxed on income.

The sudden growth in CRA scrutiny has triggered concern from the Investment Industry Association of Canada, which recently complained of "insufficient guidelines" for TFSA investors to determine whether they've run afoul of tax rules, in a letter to the Finance Department and the director general of the Canada Revenue Agency (CRA).

In addition, a Calgary law firm says it is readying to fight Ottawa over the growing use of the "business" interpretation.

Sources from the tax and legal sectors confirmed to the Financial Post that the CRA has rolled out a TFSA audit project that has become increasingly active in the past couple of years. However, the amount of activity or balance that will trigger an audit remains unclear and the CRA was unable to offer comment to the Financial Post on Monday.

Auditors have reportedly been using an old tax ruling that disallows Canadians from using their TFSAs to "carry on a business," an interpretation described as vague by critics.

Now a Calgary law firm says it is readying for a legal fight with Ottawa.

"There are a lot of people, day traders, with online brokerage accounts and they sit and buy and sell securities. Maybe 10 to 15 trades a day," says Tim Clarke, a lawyer with Calgary's Moodys Gartner Tax Law LLP, which is preparing to challenge the tax agency's interpretation. "The CRA says that means you are trader in securities and you are carrying on a business."

In the past, the CRA had targeted investors who were undervaluing closely held shares in their TFSA, exploiting the lack of liquidity to understate the equity's likely value. Few people in the industry had argued against that crackdown.

But targeting vigorous - and successful - traders is a different approach by the CRA.

"They have no sense of humour about this. They assume since the maximum contribution you could make [as of 2013 was $31,000], if you've got $10-million in your TFSA something is wrong," said Mr. Clarke.

But often big TFSAs are held by high-risk investors who are simply enjoying their appropriate reward, he maintained.

"If you buy penny stocks and you're an initial investor, you are taking a huge risk," he said.

The TFSA, introduced in the 2009 tax year, is widely seen as a place to better take risks with investments, since all income including windfall gains, are tax-free forever, whereas in a registered retirement savings plan the money is taxed on withdrawal.

"There is a no case law on this business of carrying on a business in a TFSA," said Lauchlin MacEachern, another lawyer with Moodys Gartner, who says he can't comment on specific cases. "In the next year or two we expect there to be a case that goes to court and we'll know whether carrying on a business in your TFSA means trading securities actively. We say that's a question of fact and we also disagree with their legal interpretation."

In all of these cases, the CRA has only to declare a "balance of probabilities" burden of proof has been met, leaving the onus on the taxpayer to prove that he or she should not be taxed as a business.

The Investment Industry Association of Canada seems to agree there needs to be some clear-cut rules and is also concerned about liability its members may have if a taxpayer were to withdraw all their money out of a TFSA before the tax bill arrives.

"The IIAC requests comfort that TFSA trustees will not be liable for any shortfall in taxes should funds within a TFSA be insufficient to cover off any liability arising by virtue of a TFSA being found to have carried on as a business," the group wrote, in its submission to Ottawa.

Some taxpayers report that the CR A has offered them a deal where, if they agree to pay taxes on income within a TFSA, it will not demand additional penalties. That tactic has resulted in settlements, according to sources.

That's what happened to one Quebec investment advisor, who says he was called a "pirate" by a CRA auditor. The advisor - who did not want to be identified due to his clash with the tax agency - was told he must pay income tax on all the gains inside his TFSA or face his wages being garnished along with interest penalties. The CRA says someone operating a "business" pays income tax on earnings, which is an even higher rate than the capital gains tax usually charged on investment income.

The Quebec investment advisor says he was flagged after making about 200 trades in his TFSA, manoeuvring his account to a value of about $180,000. He has since taken all the money out and paid taxes on it.

"I've already paid the $35,000 and now I'm sure the province is going to come after me for their money," he said, referring to provincial taxes he'll owe based on the federal assessment. "The accountants and lawyers have told me to shut up."

He claims he was able to make all this money because he has some expertise in resource stocks.

"I could have lost that money," he says, adding when he filled out forms for his TFSA under the know-yourclient rule he said his profile was "100% risk and 100% speculation."

He said the idea that he is a "professional trader" makes no sense because he's never taken any specific trading courses and doesn't execute trades for clients. "I can tell you what caught their eye. It was the amount. The [auditor] told me 'you're not allowed to make $180,000 in there.' You know what? I think they're jealous."

Mr. Clarke thinks this would not be happening if not for some of the high balances seen from a bullish stock market.

"To have a portfolio that increases in value, you need a run up in shares and the value of the stock market, which is what we've had, and you need the CRA to be scrutinizing it," said the lawyer. "In my view, what we need is a black line test, if you put a qualified investment into a TFSA, as long as it's within the categories of qualified investment, it shouldn't matter how you earn or lose money. The income should not be taxable and the losses not deducted."

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Investors locked out of TFSAs under audit; Dealers fear getting stuck with tax bills

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Tax-free savings account holders audited by the Canada Revenue Agency are being banned from withdrawals by dealers who fear being left on the hook for a major tax bill.

The Investment Industry Association of Canada confirmed to the Financial Post that a member has been stuck with a bill because a TFSA holder withdrew all the money in advance of an audit.

The Canada Revenue Agency has been conducting an audit project aimed at people who it feels are operating a trading business within their TFSA, basing their suspicions on signs such as high balances and frequent transactions.

"It's rare that [preventing withdrawals] will happen but we have heard this has happened in the case of the TFSA issue," said Barbara Amsden, director of special projects for the Investment Industry Association. "The reason this can happen is because the CRA can come back to the dealer even after the client has left and dealer is on the hook for unpaid taxes."

Ms. Amsden said a member had a case where the client left and three years later the CRA sent a request to the trustee for $134,000. The interest and penalties brought the bill to $154,000.

She has written to the Finance Department and the director general of the CRA complaining of "insufficient guidelines" for TFSA investors to determine whether they've run afoul of tax rules and outlining the concerns her members have over liability.

"TFSAs are new but the reason it doesn't happen on the RR SP side is because at some point the money is coming out, the money will be taxed. In the case of TFSA, it will never be taxed," said Ms. Amsden.

Philippe Brideau, a spokesman for the CRA, did confirm some TFSAs are being scrutinized more closely but said it represents less than 0.0001% of all account holders.

"While the vast majority of those who use the TFSA as an investment vehicle do so in accordance with the law, some may use this tool implemented to help Canadians with their lifelong savings needs in a manner contrary to the spirit of the legislation in order to significantly reduce the amount of tax they owe. Individuals that have used TFSA provisions to avoid taxes on otherwise taxable income will be challenged," he said in an email.

Ms. Amsden said the controversy started in the West where there is more investment in oil and gas stocks that are considered highly speculative.

Another factor in the enforcement, she said, is that CRA is relying on 1984 decision that dealt with RRSPs - a time when people didn't make a ton of trades.

"We want the rules applied in a consistent fashion by the CRA. We just want a one page document that lets clients know who are getting into trading because they are interested in it, like retirees who might have this as a hobby, that they could be at risk," she said.

In the interim, dealers will continue to let TFSA holders trade but not withdraw.

That's what a Toronto man says has happened with his current account. The man who runs a consultant business in the trade industry, who asked that his named not be used, said his account is well above $200,000.

"My broker told me I couldn't withdraw any money because the CRA is auditing me," he says. "I had just bought a house and I needed the down payment."

He ended up borrowing the money from friends to close his home sale but the case has been going on since February with no resolution.

"I bought some penny mining stocks and now I can't get my money," he says, referring to all the gains he's made.

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National Post

Let's be braver with our TFSA thinking

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The headlines in a Financial Post series on taxfree savings accounts point to some big winners, but Canadians are mostly losers.

"Losers" may be too strong a word - describing them as boring investors barely keeping ahead of inflation sounds about right.

There are some decent teaser rates on TFSAs, but after the initial special expires most of the time you are left with a rate below October's 2.4% inflation rate.

More than a few readers have reacted angrily to the Post's annual contest encouraging Canadians to show us who has the most money in their TFSA, the savings product launched in 2009.

Canadians can put up to $5,500 annually in a TFSA, the cumulative total since 2009 is $31,000. One Calgary adviser has managed to push his initial investment to more than $275,000 by purchasing leverage exchange-traded funds and other investments many would call risky.

"Why don't you just encourage people to play the lottery," one angry reader emailed.

A high-risk bet on an obscure mining stock - as one investor made - may seem like gambling, but what do you call the opposite strategy of doing absolutely nothing in your TFSA. How about a guaranteed loss?

A Bank of Montreal study released last month found on average Canadians have $17,490 in their TFSAs and 60% of the money is in cash. In this case, cash isn't king; it's more akin to a pawn on a chess board about to be taken.

"Most people are investing in cash, mutual funds or GICs and they are seeing it as a [regular] savings account," says Christine Canning, head of everyday banking products for BM O Financial Group. "It's almost too conservative. In a world where the returns are tax-free, this is a good place to be taking some market risks."

There has to be a middle ground between the penny stock and the boring savings account, and Canadians probably need to readjust their thinking.

Author Talbot Stevens says the TFSA is the one investment play in which you should take a shot at a big win. "If you are ever going to shoot for a 10-bagger, what way should you shelter it? In your RRSP? Outside your RRSP? Or in your TFSA? It's clearly TFSA because it's all sheltered," he says.

The obvious downside is if you miss big in your TFSA, you can't claim a capital loss and that investment room is gone forever.

Lorne Zeiler, a wealth adviser with TriDelta Financial, says there is a compromise and thinks the TFSA is a great place to put high-yield income products.

"You really need to look at your total portfolio," says Mr. Zeiler, adding some clients who keep a certain portion of their wealth in growth-oriented stocks earmark those holdings for the TFSA. "If it pays off, they don't want the huge capital gain associated. We look at the asset allocation first and then determine where it makes sense to put different assets."

Tom Hamza, president of the Investor Education Fund, says the TFSA is still in its infancy so that may be one of the reasons Canadians are still coming to grips with investing styles.

"Some of the issue is a lot of the times the TFSA is being used for short-term savings and purchases," says Mr. Hamza. "As time goes on, and the ceiling increases, it's going to be probably reflected in more people using it for retirement savings."

Ottawa has pledged to double the annual contribution limit once the budget is balanced and, long-term, that has the potential to grow TFSA balances very quickly.

The federal department of finance, in its most up-to-date statistics, said 8.2 million Canadians had invested $62 billion by the end of 2011.

"I think some of the [investing style] has to do with a low balance. When you have a low balance, you don't pay much attention to your account," says Mr. Hamza. Maybe it's time to take a look at those TFSA investments. Or at least stop complaining about the people who are actually making money.

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Should you give TFSA money to adult kids?

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If you are looking to stash even more cash in a tax-free savings account than the government allows, there might be some free space hanging around your house doing nothing. That free space could come in the form of adult children who don't have the money to contribute to a TFSA.

Canadians, who can contribute up to $5,500 annually to a TFSA, are still waiting for the Conservatives to go ahead with a promise to double annual contributions once the budget is balanced. Now that Jan. 1 has passed, you can at least kick in your annual limit again, which brings the total allowable contributions to date to $36,500. The TFSA also applies to your adult children, who are allowed to start making annual contributions in the year they turn 18. You can't actually directly contribute to someone else's TFSA account, but what's to stop you from gifting something to your kids and having them start making contributions as soon as they are eligible?

Cindy Crean, managing director of private client for Sun Life Global Investments (Canada) Inc., is doing just that with her children, who are now 22 and 20.

"If you are intending on gifting your adult child money anyway, this is a good way to do it because it will grow tax-free," said Ms. Crean. She has power of attorney over both their accounts, which allows her to control the trading there while teaching her adult children about investing.

The risk? There is absolutely nothing legally that prevents either child from withdrawing money right after the deposit has been made.

"Both of our kids handle money well and we've said to them 'this money is if you decide to do another degree or for if you get married and buy a home' but it's not money for some ski trip," said Ms. Crean.

"They've agreed to it as longterm savings."

Jamie Golombek, managing director of tax and estate planning at CIBC, can't say for sure how prevalent this practice of gifting TFSA money is, but "I know we talk about it in every client meeting. It's a great way to do inter-generational tax planning," he said. He pointed out that it might not mean much for the average Canadian, as many people are struggling to maximize their own TFSA and RRSP holdings.

Mr. Golombek said grandparents are often behind some of the "TFSA gifting" going on these days.

"You can't control if they go out and buy a car or something. There is just no way," said Mr. Golombek, adding that on a practical level parents can control the investment by refusing to make further gifts if children are just spending the TFSA money.

Raymond Leclair, vicepresident of public affairs at Lawyers' Professional Indemnity Company, said in general you can't put parameters on a gift. "If you are concerned about control, you want to set up a living trust [not a TFSA]," said Mr. Leclair. "You contribute to a trust that you create, make yourself the administrator. It may be for the kids but you reserve the right to withdraw it completely if something goes wrong." This depends on how much you trust your children. If you can think of your entire family in terms of wealth management, planning becomes easier.

But Toronto fee-based planer Jason Heath warns parents really need to make sure they have their own house in order before helping out children, lest they run out of money.

"You need to have more than enough money to fund your own retirement. It's not a bad idea, in that case, to advance some of money," says Mr. Heath. "But technically, this is now their money."

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National Post

Tax-free savings account friend or foe?; Men who wrote the book on TFSA disagree on its use

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The two men who might be considered the fathers of taxfree savings accounts in Canada, now worth more than $132 billion, appear to be in disagreement over what happens next to their baby.

Jonathan Rhys Kesselman, who wrote a report back in 2001 with Finn Poschmann, vice-president of policy analysis at the C.D. Howe Institute, is suggesting it's time to rein in the accounts and not increase allowable contributions.

The ruling Tories have pledged to double annual limits once the budget is balanced. The annual allowable TFSA contribution was $5,000 when introduced in 2009, but it is indexed to inflation and is now $5,500.

Speculation is growing an announcement will be made in the next budget, expected in April. It's unclear whether the Tories' previous pledge means the annual limit would climb to $10,000 or $11,000.

Mr. Kesselman, a professor in the School of Public Policy at Simon Fraser University, says increasing annual limits will benefit only the wealthy and end up costing Ottawa billions of dollars more than anticipated.

"Like a little baby who looks cuddly and cute, this proposed initiative would grow up to be the hulking teenager who eats everyone out of house and home," he writes in a report titled Double Trouble: The Case Against Expanding Tax-Free Savings Accounts, published Tuesday by the left-leaning Broadbent Institute.

His stand pits him against Mr. Poschmann, who remains at the right-leaning C.D. Howe Institute, where the two resided when they wrote their original paper. At the time, they argued the tax-free accounts would be of chief benefit to low- and moderate-income workers. Mr. Poschmann points out two-thirds of TFSAs are held by people with incomes of less than $60,000.

"One of the reasons that we wanted TFSAs in the first place was to make it easier for more people of different types and different income levels to save and have flexibility of how they went about saving," he said. "The fact that some highincome earners are able to take advantage of the same program doesn't mean it's a bad program." He believes doubling contributions will only encourage Canadians to save more.

"Savings add up. Add $5,000 a year, give it a few years and a few decades, and it makes a huge difference," said Mr. Poschmann, who would stop at $11,000 annually for now.

Mr. Kesselman says even at existing contribution levels, within 40 years, TFSAs could cost Ottawa $15.5 billion annually in lost revenue and the provinces $9 billion, figures that would be "inflated" by doubling contribution limits.

TFSA contributions grew to $33.5 billion in 2012, surpassing registered retirement savings plan deductions of $32.4 billion for that year. While the market value of TFSAs was $18 billion at the end of 2009, the year the investment product was introduced, money held in accounts had ballooned to $132 billion as of mid-2014.

Mr. Kesselman suggests pressuring the government now might force it to scale down the plan. "The Conservatives do pride themselves on doing everything that's in their [2011] campaign platform. They sharply changed their package on income splitting," said Mr. Kesselman about a measure the Tories announced in October that provides a non-refundable credit of up to $2,000 for couples with children under 18.

This time, he thinks the Tories can be convinced to make changes, in addition to not increasing the annual contribution limit. These could include setting a lifetime limit on holdings that would be tax free and making sure withdrawals count against income-tested programs, like old age security and the guaranteed income supplement.

Mr. Poschmann doesn't agree with the idea of a lifetime limit. "Why don't we impose limits on asset accumulation within RRSPs? We don't, because the withdrawals are going to be taxed anyway. And withdrawals count as income toward eligibility for income-tested benefits like OAS/GIS, which have big clawbacks," he said.

Current rules do not call for the same clawback for TFSA redemptions. "That is one of the reasons, the main reason, we wanted TFSAs - so that low-income people, and especially seniors, wouldn't be made to look like financial fools for trying to save," said Mr. Poschmann.

He might be convinced to accept Mr. Kesselman's contention TFSA money counts toward calculating eligibility for OAS and GIS.

"There is a longer-term policy question about rules for OAS/GIS eligibility: Are we comfortable paying such benefits to people who have significant assets?" Mr. Poschmann asked.

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