Making the Most of Your TFSA

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Being such a new program, many Canadians do not fully understand the long-term power of the TFSA tax savings opportunities. It is much more than just an opportunity for saving — it can be a powerful and incredibly effective tool for an overall investment strategy. Here are some ways that you can use the TFSA for your long-term benefit and financial empowerment.

While many Canadians consider the TFSA to be nothing more than a savings account, its potential as an ideal account for long-term equity investments is difficult to overstate. Consider the power offered by long-lasting compound growth in a TFSA account above simple cash savings.

For example, if someone in the 40 percent tax bracket were to invest $5000 to earn a one percent return ($50), keeping that money secured in a TFSA would save them roughly $20. That's good, but it's not an enormous level of growth. However, an equity investment in a TFSA growing at 5% would earn about $250 and ultimately save $100 in taxes. We're talking about a 500% increase in saving growth by using the TFSA as an investment account instead of just a savings account.

When thinking about using a TFSA as part of a long term financial strategy, it is important to access the appropriateness of each different investment in terms of an investor's overall risk profile. One time-tested strategy is using a diversified portfolio of high-quality equity investments as opposed to investments that are more volatile or risky.

For example, a balanced fund provides exposure to a variety of different investment categories which reduces the risk inherent when only investing in one type of asset class. Experienced investors with long term horizons can afford to take a more bullish approach within a TFSA as long everything is managed in conjunction with a wise asset allocation strategy.

Remember, a TFSA allows you to avoid dramatically high capital gains and marginal tax rates [1], allowing you to owe the government absolutely nothing even after significant profits. When thinking about retirement savings, estate planning and other long-term strategies the tax-free status of TFSA gains should never be considered lightly.

Let us consider another example. Anyone who was over 18 at the time when the TSFA was introduced would now have TFSA contribution room of $52,000. If that individual wasn't keen on taking big risks with their investments, via their TFSA they could select a group of high-quality equity or balanced funds to create a portfolio with minimized risk. Over 25 years of consistent if unspectacular 4% growth, that investment could increase to over $138,000. And if those investments were managed outside of a TFSA by an individual with a 35% tax rate they would end up with about $40,000 less, which is a large sum that the tax man does not get when investments are managed inside a TFSA account.

While the TFSA can't ever be consider a "magic bullet" for turning every Canadian into a millionaire investor, it is a powerful tool that, if used correctly, can have dramatically positive effects on your financial future. In the few years since they arrived, people are starting to realize that TFSAs are truly the best gift the government has given Canadians in a very long time.

Questions about TFSAs?
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