

TFSA troubles ... and the CRA's administrative solution (July 2010)

When Tax-free savings accounts (TFSAs) first became available to Canadians in January 2009, millions of Canadians—4.7 million, in fact—took advantage of the opportunity to save on a tax-free basis. They also took advantage of the flexibility offered by TFSAs, but it seems that some of those savers (and perhaps a few financial institutions) were not sufficiently familiar with the details of TFSA contribution and withdrawal rules.

The federal government recently sent out about 70,000 letters to Canadians who had opened TFSAs, informing them that they may have gone “offside” with respect to contribution limits and re-contribution rules and that a penalty tax of 1% per month could be assessed on any over-contributions. The trouble, it seems, has arisen for the most part with respect to the re-contribution of amounts withdrawn from a TFSA.

To recap: every Canadian over the age of 17 is entitled to contribute up to \$5,000 to a TFSA in any particular tax year. A taxpayer can have as many TFSAs as he or she wishes, as long as the overall \$5,000 annual contribution limit is not exceeded. Amounts (whether original contributions or investment gains) can be withdrawn from a TFSA at any time, for any purpose, free of tax. As well, where amounts are withdrawn from a TFSA, those amounts can be re-contributed, **but not until the following calendar year**. It is this latter restriction which seems to have caused some problems. As outlined in a recent Canada Revenue Agency (CRA) release, many Canadians seem to have used a TFSA as a kind of day-to-day savings account, withdrawing and depositing funds on a regular, ongoing basis, without necessarily taking into account either the overall \$5,000 annual limit or the re-contribution restrictions

The good news for such Canadians is that the federal government and, in particular, the CRA, have recognized that many of these cases may represent a genuine misunderstanding of the TFSA contribution rules, rather than a deliberate attempt to flout those rules, and it is prepared to deal with such situations on that basis. The CRA's intention, as outlined in its release, available at <http://www.cra-arc.gc.ca/whtsnw/tms/jntsttmnt-eng.html> is to “review each situation on a case-by-case basis and, where appropriate, waive taxes on excess contributions for this year”. In particular, the CRA indicates that “individuals who used their TFSA as a regular banking account in 2009, making deposits and withdrawals on a frequent basis, or who have transferred funds between TFSAs at different institutions, but whose net contributions never exceeded the 2009 limit of \$5000, may not be required to pay the tax on excess contributions for this year.”

The 70,000 or so Canadian who received a letter from the CRA and who may be facing a penalty tax were asked to provide further information about their accounts before June 30, 2010. The government has decided to extend that deadline, and recipients of such letters now have until August 3, 2010 to respond. Anyone who has received such a letter should answer it, providing the CRA with any relevant information about the circumstances in which, and the reasons why, any over-contribution situation may have arisen. If no additional information is provided, or the CRA does not receive a response to its letter, it will proceed on the basis that there is no such explanation and a Notice of

Assessment will be issued for any penalty tax payable. The taxpayer will then, of course, be free to object to the Notice of Assessment or seek relief under the Taxpayer Fairness provisions (information on how to file a Notice of Objection is available on the CRA Web site at http://www.cra-arc.gc.ca/gncy/prgrms_srvcs/dsgr/ncm_tx-eng.html and details of the Taxpayer Fairness provisions can be found at <http://www.cra-arc.gc.ca/gncy/frnss/fr-prv-eng.html>). However, if there is an explanation to be provided, it would be better for the taxpayer to provide it now, before the matter proceeds to the Notice of Assessment stage.

Finally, it's important to note that any administrative flexibility or waiver of penalties extended by the CRA with respect to TFSA over-contributions will be provided only for the 2009 taxation year. The Agency clearly feels that taxpayers should by now be aware of the rules and restrictions associated with contributing to a TFSA, and any contributions which go "offside" in 2010 will almost certainly not be granted similar concessions.