

Tax Tip
Week of October 26, 2009

Changes to Tax Free Savings Accounts

The rules concerning Registered Retirement Savings Plans and Tax Free Savings Accounts have a penalty provision to prevent over contributions. The penalty for such contributions is 1% per month, although the RRSP rules have a lifetime over contribution limit of \$2,000. The Department of Finance is concerned that a number of aggressive taxpayers are making deliberate overcontributions to their TFSA because they believe they can generate a rate of return in excess of the approximate 12% per year penalty. To use an extreme example, taxpayers could contribute a million dollars to their Tax Free Savings Account, but if they earn 20% on their investments, they would have a significant gain. Needless to say, earning a rate of return in excess of 12% the penalty tax is no easy feat.

Effective October 19, 2009, the Department of Finance introduced rules that will levy a 100% tax on over contributions to a Tax Free Savings Account. Apparently if a taxpayer believes he or she can earn a rate of return in excess of 12%, they can still attempt this strategy in a RRSP.