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Budget 2008: How should advisors handle the TFSA?

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As people digest the news about the new tax-free savings account, advisors are already coming up with ways to incorporate this tax-savings vehicle into their clients' financial plans.

"We're already talking to them," says Rick Wood, an advisor at TD Waterhouse Private Client Services in Toronto. "We're looking at opportunities that we have for clients and trying to maximize what we can."

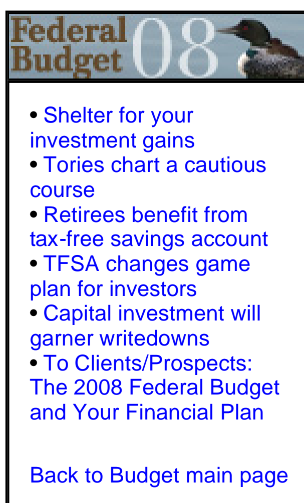
"I'm going to market this to clients as an additional tool to use to reduce the overall tax bill," adds Frank Wiginton, a senior financial planner with TriDelta Financial Partners in Toronto. "It's definitely something that can be used when people are looking for additional sheltering of income."

Since the TFSA was just announced yesterday, advisors are still wrapping their heads around the fine details, but Wood already has a few thoughts as to how his clients might use the account.

He says it could come in handy for clients who unexpectedly need an influx of cash. "Say you need emergency funds. Now there's a way we can put money aside [in case that need arises]," he explains. "We can be conservative with it. We don't have to worry about taxation."

Scott Plaskett, founder and CEO of IRONSHIELD Financial Planning in Toronto, says the new account is useful for short-term planning as clients can remove money tax-free and then reinvest what they removed down the road. "We will discuss with clients whether or not it makes sense to use this from a long-term planning perspective, but it makes a lot of sense to redirect short-term investments into the tax-free savings account. It's a more tax-effective way of saving for the short term."

While clients can add to the TFSA from scratch, Christopher Hatherly, a Vancouver-based financial planner with IPC, suggests moving investments from a non-registered portfolio into the TFSA. "That's the big win," he says. "The non-registered portfolio is going to generate income that will be taxed. By moving it into the tax-free account, you won't have to pay on that going forward."



However, it's unclear if the government will allow investors to switch between accounts without getting penalized for withdrawing. "You have to be aware too of the tax implication on moving the non-registered portfolio," he explains. "All the details aren't out yet, but let's say you had a $5,000 GIC and you wanted to move it. Do you have to sell it? What would you have to do?"

But just because there are still unanswered questions surrounding the new account doesn't mean advisors aren't trying to figure out which type of investments would work best for it.

Wiginton says in the first few years of the account's existence, some clients will use it as a way to play with the market by investing in speculative stocks. Ultimately, though, this is "just going to be another account for them to put a portion of their overall portfolio in," he says.

Using it for GICs is another option that advisors are thinking about. "Anything that's going

to generate income, like a GIC, where interest is fully taxable, you put that inside a plan like this and a client can avoid paying tax on it."

John McGuire, vice-president and product manager for registered products and pensions at BMO Nesbitt Burns, says it makes sense to put conservative interest bearing investments in the TFSA "because they are going to grow tax-free."

He says aggressive investors should put money in products outside this account — and away from their RRSPs — as dividend and capital gains income are taxed more favourably.

Wiginton points out that for some people, it might actually be better to invest in the TFSA than in an RRSP. He says low-income earners making about $30,000 a year will get back about .16 cents on every dollar they contribute to an RRSP. When it comes time to take that money out, they'll have to pay a bundle of tax. If they put their cash into a TFSA instead, clients can build up savings without there being a tax burden in the end.

But RRSPs allow for an immediate tax deferral, which, Hatherly says, could be more useful for people than making a contribution to a TFSA.

Wealthier clients will definitely want to use RRSPs over TFSAs for their retirement savings needs, adds McGuire. "For an individual whose income is large, they are going to want to get the tax deduction the RRSP represents," he explains. "Obviously, when they retire, they are going to have to pay money on the tax withdrawn, whereas the money in the TFSA they are not going to have to pay tax on. But the likelihood is these individuals who earn a lower income now, their income in retirement is going to be lower than it is now, so in that context, the RRSP makes sense."

Some younger people might not even be able to take advantage of the TFSA right now since they don't have enough to save. But because the annual contribution amount accumulates — if you don't contribute $5,000 next year, you can add $10,000 the next — the account could be a boon to an investor, or to an inheritor later in life. "For the first 10 years, you don't have money to be put away, but you accumulate $50,000 worth of room," says Wiginton. "Then you can put a large amount in later."

In terms of estate planning, an unused TFSA could be a benefit. If your client has never used the account, he or she could rack up $150,000 worth of room. Then, if a loved one passes away and leaves your client $200,000, he or she could put it in the TFSA, where it will grow tax free.

Of course, what to do with a client's portfolio is just speculation right now. The budget must be passed first, and then financial institutions have to be set up to handle the new accounts. When that happens, advisors might find that they have more work to do than normal.

"Administratively, it'll be more challenging," says Hatherly, "because it encourages people to move money from their current portfolio into the savings account."

But beyond that, it'll probably be business as usual. "Advisors aren't going to be getting a lot of calls from people," says Plaskett, who plans to start talking to clients about the account once the budget is passed. "RRSPs didn't do that. It just gives advisors more tools in developing a comprehensive financial plan."

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