

What is a TFSA? Only 1 in 5 knows the answer

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What is the **best** way to describe a Tax-Free Savings Account or TFSA? It sounds like such a simple question, but only one in five people taking [our online quiz](#) knows the answer.

Our query about TFSAs was of 20 questions we put to readers in [an online quiz aimed at beginners](#) in January. More than 2,600 attempted this question, but only 21% got it right. To put that in context the average score on our beginner quiz was 76%. No other question scored lower than 55%. What's most surprising—at least to us—is that it wasn't meant to be a trick question.



The result supports what the financial advisors have long said about the TFSA: that a large number of people still don't fully understand what they are or how to use it.

What's in a name?

MoneySense [has long argued that TFSA is a lousy name](#). A better name would be TFIA—a Tax-Free Investment Account—because it's designed to shelter interest, dividends, and other investment earnings from tax.

The whole way the TFSA was introduced to the market was incorrect, says Scott Plaskett, senior financial planner and CEO of Ironshield Financial Planning. People heard savings in the name and they came to their own conclusions as to the purpose of the accounts. "It's such a misleading name," he says. "Most just think it must just be a savings account that you can get through a bank."

That's precisely how most people responded to our question. More than half of the respondents thought it was

similar to a regular savings account, except that the interest on the deposits are tax free. While there is some truth to that statement, it wasn't the best answer available. And if you unpack that response you'll know that a TFSA isn't really all that similar to a savings account.

TFSA vs. a regular savings account

For starters, unlike a regular savings account, there are limits governing how much you can put in and take out of a TFSA. The current maximum contribution is \$52,000, which grows every year. Go over these limits and you will trigger significant tax penalties.

If you over contribute to your TFSA the excess will be taxed 1% each month those extra funds stay in your TFSA. For instance, if you only have \$1,000 of contribution room remaining in your TFSA and you put in \$5,000 then you would pay \$40 a month in penalties until you corrected your error.

And unlike a regular savings account you also have to be mindful if you're taking money out of the account. While you can withdraw funds from a TFSA any time you want, you have to wait until January of the following year before you can contribute back into the plan, unless you still have unused contribution room.

The differences don't end there. Unlike your typical bank savings account, most TFSA accounts don't pay a cent of interest on deposits. There are exceptions of course, PC Financial and Tangerine both offer them with introductory interest rates of 2.25% and 2.4% respectively. And yes, some of the banks also have "high-interest" TFSAs (if you consider 0.45% high interest).

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Wasted opportunity

But if you think this is the **best** way to use a TFSA then you've missed the point. If you're signing up for a TFSA where your deposits are earning 1% then you're really only giving your financial institution a low-interest loan, says Plaskett. A TFSA is just a plan that you put something into, it doesn't guarantee a return, he says. Plaskett says he chuckles at the idea of opening a TFSA that pays 1% interest. "So they are not going to have to pay tax on 1% on a small balance; there's not much interest income to pay tax on anyway."

To the best of our knowledge there is no one account that will allow you to earn tax-free interest on your deposits and have the choice to make investment decisions. You can create one, but it won't be simple.

In order get the benefits of earning tax-free interest on deposits and make investment decisions that can grow tax-free you would need to have two accounts and transfer funds between them. It's doable, but not very practical.

To transfer funds between the two TFSA account types, TD customers for instance, would have to visit a local branch to fill out the paperwork and then wait up to two business days before the funds show. Not ideal if you decide you want to make a trade.

Despite the continued confusion about what a TFSA really is don't expect the name to change anytime soon. But for now, we'll ask again. What's the best way to describe a TFSA? Next time, call it what it is: an investment account.