

Tax Tip

Week of September 5, 2011

Withdrawals from TFSAs

There has been a considerable amount of confusion on withdrawals from Tax Free Savings Accounts. There are no income tax consequences of withdrawing funds from the account. However, contributions in excess of \$5,000 per annum are subject to a penalty tax of 1% per month.

As there are no restrictions on withdrawals, it would appear that a taxpayer who withdrew \$4,000 on March 1, 2011 and repaid the amount two months later and did not exceed the \$5,000 contribution limit would not have any tax issues. Unfortunately, the rules are drafted in such a manner that the taxpayer is offside and may be subject to a 1% per month penalty on the May 1 contribution. If a taxpayer makes a withdrawal, in this case \$4,000 on March 1, 2011, it does not reduce the amount of the previous contribution. Therefore from CRA's perspective, the taxpayer made a \$5,000 contribution on March 1 and an additional \$4,000 on May 1, for a total contribution of \$9,000 in 2011. This level of contribution gives rise to a penalty tax. The penalty will continue to accumulate until either the excess contributions are withdrawn or additional contribution room becomes available because a new calendar year has started.

According to CRA, approximately 4.7 million Canadians opened Tax Free Savings Accounts in 2009 and 70,000 of these taxpayers have been advised by the tax department that they were offside on their contributions. There is obviously a problem, perhaps CRA did not properly explain the excess contribution rules or financial institutions may be culpable for not explaining the rules to their customers. The government issued a press release stating that taxpayers who have inadvertently made an over contribution have until August 3, 2010 to provide CRA with the necessary information so the government can consider waiving the penalty. The penalty will only be waived if the total contributions for the year do not exceed \$5,000.

The relief offered by CRA will assist some taxpayers who were offside in 2009 and were able to meet this August 3, 2010 deadline. However, those who missed the deadline or erroneously over contributed in 2010 will not qualify.

In June 2011, the Taxpayers Ombudsman criticized CRA for not advising taxpayers of the rules. The Department of Finance issued a press release on August

19, 2011 that CRA will be flexible when there was a genuine misunderstanding of the tax rules. Therefore, if one receives a letter from CRA concerning such an overcontribution, the taxpayer should contact CRA to determine if they will waive the penalty.