

The TFSA Shuttle ... channeling the *Harlem Shuffle*



A catalyst in concert with FHSA, RESP and RRSP tax-sheltered savings

In 1986, the *Rolling Stones* covered the 1963 R&B song *Harlem Shuffle*. While the original from the duo *Bob & Earl* was modestly successful, the *Stones*' cover topped the charts in some places, peaking at #5 in Canada. The self-proclaimed world's greatest rock'n'roll band had put their distinctive spin on something good, and made it even better.

Now, no-one's about to suggest that tax planning is as enticing as a smooth groove, but magic truly can happen when good things come together. To the point, if you take one good thing – FHSA for a home, RESP for education, RRSP for retirement – and combine it with another – the ubiquitous TFSA – you really can produce a whole that is greater than the sum of its parts.

TFSA principles

Introduced in 2009, the tax-free savings account (TFSA) allows after-tax deposits to accumulate tax-sheltered and be drawn out tax-free. By contrast, a registered retirement savings plan (RRSP) is funded by pre-tax deposits that (also) accumulate tax-sheltered, and then are taxed on withdrawal.

Comparison of the two plans was inevitable, often framed as 'TFSA vs. RRSP'. But rather than it being an either-or proposition, a more productive approach is to employ yes-and thinking. Specifically, if the TFSA is used as the entry point into RRSPs or other tax-sheltered plans, that routing can positively exploit a valuable feature unique to TFSAs.

The re-contribution credit

Whereas available room for other tax-sheltered plans is exhausted one-way as contributions are made, the TFSA calculation operates in both directions. For a Canadian resident over 18, annual room has three components:

- 1) The prescribed annual TFSA dollar limit, currently standing at \$7,000, +
- 2) Unused room from previous years, +
- 3) Withdrawals made in the immediately preceding year.

It is the third component that presents the opportunity for the TFSA to be used in concert (pun fully intended) with its tax-sheltered siblings. And whereas a catalyst in the chemical sense remains unchanged after influencing a reaction, not only might a TFSA help another plan, the benefit of that interaction can also echo back to the TFSA.

Start me up! (Assumptions)

Meet 20-something Mick. He's a serial saver for current needs, and is ready to set aside an additional \$100 each week to add to his routine. He intends on using a high-interest savings account (HISA) for this, with the going interest rate in early 2024 being 4%. It's the start of the year and he hasn't yet used any of his annual TFSA room.

Understanding there are 52 weeks in a year, to avoid a 19th nervous breakdown doing the math, we'll use \$5,000 for the annual tally. As well, though his cash flow and the HISA terms are bound to vary, we'll keep them constant here.

FHSA for a home

With the state of house prices, Mick knows he needs to start saving a down payment, for which he wants to use the recently-introduced first home savings account (FHSA). Base annual contribution room is \$8,000, with a lifetime limit of \$40,000. His plan will have him saving about \$5,000 a year, using up his lifetime room in eight years.

Alternatively, Mick could open HISAs for both FHSA and TFSA. Assuming the same terms for each, weekly deposits could be directed to the TFSA, then after 50 weeks in mid-December the balance could be withdrawn and deposited to the FHSA before year-end. It's important to be attentive to dates for two reasons:

- The TFSA re-contribution credit occurs the next January 1st, which could be a 365-day swing if it's missed.
- And though the deduction for FHSA contributions may be carried forward to a later year if desired, it can't be carried back to an earlier year (i.e., there's no 'first 60 days after year-end' rule as there is for RRSPs).

Timing aside, the average TFSA balance over the year will have been \$2,500. At 4% interest, the mid-December balance will be about \$5,100.

- An annual TFSA-out/FHSA-in shuttle of that full amount will allow Mick to max his FHSA in a little less than the eight years. With annual TFSA deposits of \$5,000 and withdrawals of \$5,100, the net re-contribution credit will be \$100 each year, giving Mick \$800 more TFSA room over the full duration by having used the shuttle option.
- If instead, an even \$5,000 is taken out of the TFSA annually, it will again take exactly eight years to fill the FHSA, as if the TFSA had not been involved. However, by using the TFSA as a shuttle, \$800 extra TFSA balance will be created, without making any material change to Mick's investment choices or risk exposure.

RESP for education

Now in his 30's, Mick had been hoping his son Jack would earn an athletic scholarship for his pole-vaulting prowess. But as he's grown, it appears that Jack's jumping skills were just a flash in the sand, and Mick now needs to catch up on contributions to the boy's registered education savings plan (RESP). With carryforward of past unused room, Mick plans to deposit \$5,000 for the next seven years or so, to claim the maximum grant money.

As with the FHSA example above, deposits could go direct to the RESP, or route through a TFSA. The Canada Education Savings Grant (CESG) is the main support program, matching 20% of annual RESP contributions, so \$1,000 in our example. By routing through the TFSA, some of that CESG will be delayed a few months as compared to direct RESP contributions. Even so, that's a small price to pay to obtain the additional TFSA balance or room, which will sum up to just over \$700 across those planned years using the same HISA terms.

Another consideration is that once Jack is enrolled in a qualifying post-secondary program, personal RESP contributions can be withdrawn tax-free. The withdrawn amount could be routed back to Mick's TFSA, assuming there is sufficient room. While the continuing income would be tax-sheltered whether left in the RESP or moved to the TFSA, once again the availability of the re-contribution credit favours use of the TFSA.

If Mick wants to take it a step further, some of those refunded contributions could go to Jack's TFSA. After all, Jack's entry into post-secondary will roughly align with him hitting age 18, when he will start getting TFSA room. This could be a good time to establish the knowledge, tools and behaviours to help him on his own personal finance journey.

RRSP for retirement *accumulation*

As Mick travels through his 40's, 50's & 60's (though some observers feel like he's the picture of eternal youth), his savings efforts will increasingly focus on retirement. The dollars will be larger – from the amounts saved to their accumulation and on to the annual drawdowns – but otherwise the same fundamentals apply. Mick could go direct into RRSP, or use a TFSA-RRSP shuttle, bearing in mind that larger amounts mean larger re-contribution credits.

There is one more effect to consider, being the annual tax refund Mick can expect to receive after deducting those non-workplace RRSP contributions when filing his annual tax return. If that too is routed to and through the TFSA, it will provide an extra lift to the anticipated TFSA re-contribution credit generated each year.

HISA or market investing?

Saving for retirement and being in retirement can each be decades in length. While a HISA may work for shorter-term purposes like a home purchase or education, it's not suitable as the core of retirement savings. Indeed, a diversified investment portfolio is generally more appropriate for RRSP savings. In turn, a parallel TFSA portfolio could be arranged to facilitate the intra-year shuttle. With a higher expected (though variable and not-guaranteed) return relative to a HISA, this could be one more boost to the TFSA re-contribution credit.

Mick should consult with his advisor before undertaking this more advanced version of the shuttle concept, to determine what approach best aligns with his knowledge, personal circumstances and risk tolerance.

RRIF for retirement *decumulation*

Into his 70's, Mick will have migrated his accumulating RRSPs into the decumulating form of a registered retirement income fund (RRIF) with mandatory minimum annual withdrawals. By default, he would probably take a fixed weekly or monthly spending withdrawal. Alternatively, he could take a lump sum early in the year and route it into a TFSA (HISA being most appropriate for this use), still available for spending, while getting one more TFSA room kicker.

TFSA as the others' little helper

Over its 15-year history, the TFSA has progressed from novelty to fixture in our financial landscape. By using it as a shuttle, its built-in flexibility can feed into other tax-sheltered plans, while making itself better in the process.

For more information, please consult your advisor and tax professional.

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