



## TFSA OVERCONTRIBUTIONS

### — When they occur and how to fix them

Many Canadians fall prey to excess contributions to registered plans. Sometimes the excess (or overcontribution) is the result of pre-arranged periodic payments. Other times, windfall payments (eg. bonuses) directed to registered plans are the cause. Regardless, overcontributions to RRSPs and TFSAs can lead to overcontribution penalties, so advisors and investors should be mindful of the rules. This article focuses on excess contributions to TFSAs and discusses options for dealing with excess TFSA amounts.

TFSA contribution room, available to Canadian residents age 18 and older, is calculated as follows:

TFSA dollar limit for the year (\$6,000 for 2021)
+
Unused TFSA contribution room from the previous year
+
Withdrawals made from the TFSA in the previous year

Since 2009, the year the TFSA was launched, the TFSA dollar limit for each year was \$5,000 for each of 2009, 2010, 2011 and 2012. The limit increased to \$5,500 for 2013 and 2014 and \$10,000 in 2015. With the introduction of a new Liberal government in 2016, the TFSA limit was returned to \$5,500 for 2016 through 2018 and increased to \$6,000 for 2019 and subsequent years, a result of indexation.

Unused contribution room carries forward to a future year, but does not accrue for any year throughout which an individual is a non-resident of Canada. Contribution room is available, however, without proration for the years an individual turns age 18, emigrates from or immigrates to Canada or dies. An individual can confirm their TFSA contribution room by accessing the CRA's self-help "My Account", "My CRA", or

"Tax Information Phone" (TIPS) services, or the client can contact the CRA directly to request a TFSA Room Statement or Transaction Summary.

One of the great benefits of the TFSA is its flexibility. When an individual makes a withdrawal from a TFSA, unlike RRSPs, his/her contribution room is not lost. The amount withdrawn is added to the individual's TFSA contribution room as early as the following calendar year. Consider the following example:

Tina regularly contributes to her TFSA. In January 2021, she began the year with TFSA contribution room of \$11,000. On February 10, she made a TFSA contribution of \$10,000. Later in the year, on March 15, she withdrew \$2,000 for home renovations.

Given that Tina had not yet maximized her TFSA for the year, she can contribute another \$1,000 in the current year, 2021. In addition, given the flexibility of TFSAs, her \$2,000 withdrawal would be added to her TFSA contribution room beginning in 2022, allowing her to recontribute the amount withdrawn.

Where an individual exceeds their TFSA contribution limit for the year, the excess amount, referred to as a "TFSA excess amount", is subject to a penalty tax of 1% per month. The tax is calculated based on the highest excess amount for the month and, unlike RRSPs, the TFSA does not allow for a \$2,000 "grace" amount. Where TFSA taxes apply for a year, a special TFSA return (Form RC243) is required to calculate and report the taxes. The return must be filed by June 30 of the following year and any taxes owed must be paid by that date. If the return is filed late, additional penalties and interest may apply.

Where an individual is in an excess contribution position, while penalty taxes would be payable up to that point in

time, the individual can correct their situation and avoid additional taxes by:

- Immediately withdrawing the excess amount, or,
- Waiting for new contribution room to become available the following year.

With the latter option, the 1% tax would apply to excess amounts for each month up to the end of the current year. Thereafter, new contribution room would absorb the excess and, depending on the amount of new room, the tax would cease. Where excess amounts are immediately withdrawn, the timing of withdrawals is important. Consider the following example:

Tina regularly contributes to her TFSA. In January 2021, she began the year with TFSA contribution room of \$11,000. In error, Tina overcontributed to her TFSA for the year. Her 2021 contributions and withdrawals were as follows:

Transaction	Date
\$10,000 contribution	February 10th
\$2,000 withdrawal	March 15th
\$2,000 contribution	April 10th
\$3,500 contribution	July 13th

In speaking with her financial advisor, Tina had the following questions.

- How much was her excess contribution for the year?
- How would the CRA calculate her penalty tax?
- How can Tina correct her excess contribution situation?
- How much contribution room will be available to Tina beginning in 2022?

### HOW MUCH WAS TINA'S EXCESS CONTRIBUTION FOR THE YEAR?

Tina contributed a total of \$15,500, which is more than her \$11,000 contribution limit for the year. But, is her penalty tax based on an excess amount of \$4,500, or, after considering her \$2,000 withdrawal on March 15, \$2,500?

Although Tina withdrew \$2,000 on March 15, because the withdrawal occurred before the creation of an excess amount, she does not receive credit for the withdrawal for 2021 tax purposes. If the withdrawal occurred after her excess

amount was created (ie. after the April 10 contribution), the withdrawal would have been a "qualifying portion of a withdrawal" which would have reduced her excess amount and associated taxes. Because the withdrawal occurred before Tina's excess contribution, it does not factor into her penalty tax calculation for the year. Therefore, her excess contribution for the year was \$1,000 as of April 10 and \$4,500 (\$1,000 + \$3,500) as of July 13.

### HOW WOULD THE CRA CALCULATE TINA'S PENALTY TAX?

There is no issue with the February 10 contribution as it does not exceed Tina's contribution limit for the year. The excess contribution arises on April 10, and Tina's tax is calculated from that point forward. For 2021, the tax would be \$300 calculated as follows:

$$\begin{aligned} & \$1,000 \times 3 \text{ months (Apr - Jun)} \times 1\%, \text{ plus} \\ & \$4,500 \times 6 \text{ months (Jul - Dec)} \times 1\% \end{aligned}$$

### HOW CAN TINA CORRECT HER EXCESS CONTRIBUTION SITUATION?

The above calculation assumes Tina remains in an excess contribution situation for the remainder of the year. If this is the case, new contribution room of \$8,000 (\$6,000 dollar limit + \$2,000 withdrawal from 2021) would become available on January 1, 2022 and overcontribution penalties would cease. However, the monthly penalty tax would remain payable for the remainder of 2021. Alternatively, once the excess amount is created, Tina can immediately withdraw the excess. If she were to do this, the tax would be payable for the month(s) in which there is an excess, but future penalties would cease.

### HOW MUCH CONTRIBUTION ROOM WILL BE AVAILABLE TO TINA BEGINNING IN 2022?

If Tina withdraws her excess contribution before the end of 2021, new contribution room of \$8,000 would be available on January 1, 2022 (\$6,000 + (-\$4,500) + \$6,500)<sup>1</sup>. If Tina does not withdraw the excess before the end of 2021, new contribution room will absorb the excess, allowing Tina to contribute \$3,500 for 2022 (\$6,000 + (-\$4,500) + \$2,000)<sup>1</sup>.

For most Canadians, dealing with excess TFSA amounts is a hassle. When faced with such a situation, however, knowing the rules will help to minimize taxes payable.

<sup>1</sup> 2022 TFSA dollar limit + unused room at end of 2021 + 2021 withdrawals; Unused room at the end of 2021 is calculated as: (unused room at the end of 2020 + 2020 withdrawals + 2021 TFSA dollar limit - 2021 TFSA contributions)

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