The Globe and Mail - November 18, 2022

TFSAs to the rescue: How to use the higher 2023 limit to play both offence and defence in your finances

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The increase in the TFSA contribution limit to $6,500 in 2023 is much more than an opportunity to put an extra $500 to work. We're having a moment in personal finance and investing right now. There are buy-low opportunities to buy stocks and bonds, but the risk of recession is rising and the affordability of daily life is under pressure from inflation and rising interest rates. With all these conflicting realities in mind, here are six ideas on how to use tax-free savings accounts to improve your finances:

Do: Consider a TFSA for your emergency savings if you're not ready for investing just now

Personal finance experts sometimes mock people who use TFSAs for savings instead of hunting for bigger returns from investing. It's true that there's more to be gained from a TFSA's tax-sheltering if you do well with stocks than if you use a savings account.

But a recession may be on the way and stockpiling money in a savings account is a smart thing to do right now. If you're saving as opposed to investing in 2023, consider a TFSA.

Go to HighInterestSavings.ca/chart to compare rates on savings account TFSAs. As of mid-month, six alternative banks offered a savings rate of 3 per cent or slightly more. If you enable transfers to your chequing account, your TFSA will be easily accessible if you need to tap your savings.

Don’t: Make a TFSA contribution if you’re carrying a lot of debt

One of the ways we stress ourselves out in managing money is trying to do everything – manage rising living costs, pay down debt, save, invest. If you’re struggling with all of this, simplify by taking a TFSA contribution hiatus.

One of the nice features of TFSAs is that you catch up on unused contribution room later on. Total accumulated room since the inception of TFSAs in 2009 is $88,000, if you include the $6,500 limit for next year.

You do lose out on the benefit of compounding if you delay contributions to TFSAs. A $10,000 investment in a fund that rises 7 per cent in 2023 gives you $10,700 to earn future gains with. Also, rates on mortgages and home equity lines of credit are in the 5 to 6 per cent range these days – you could do better investing in a TFSA if stocks and bonds rebound next year.

Debt repayment is guaranteed, though. Stocks, bonds and funds could fall or eke out minimal gains next year, but the benefit of reducing debt cannot be taken away unless you borrow more.

Do: Withdraw from an existing TFSA to get out of debt with a high rate

Have a balance on your credit card? Consider taking money out of your TFSA to eliminate your card debt.

As great as they are, TFSAs are subject to the limits of investment returns. Expect 5 to 7 per cent on an average annual basis after fees if you diversify prudently with stocks from Canada and the rest of the world and some bonds. Credit cards have an interest rate of 13 per cent for low-rate cards and 20 per cent and up for others.

Rising interest rates have pushed up the cost of almost all debt to a point where there’s arguably a clear case for paying it down instead of investing. Are you sure your investments beat the rates on your debt?

Don’t: Write off stocks and bonds for your TFSA because of the hard year they’ve had

Booming GIC sales tell us some investors feel done with stocks and bonds right now. But trying times like these are an ideal time to invest. Stocks have rebounded somewhat lately, but they were still down for the year as of mid-week. Bond prices are down by double-digit amounts, a huge shock for investors who hold them to add stability to their portfolios.

Putting money into a diversified balanced fund, mixing stocks and bonds, makes good sense right now if you’re willing to wait at least five to 10 years to see maximum benefit. If your main concern is getting good results in the next 12 months, see below.

Do: Think about GICs

Interest rates on guaranteed investment certificates are as high as 4.5 to 5 per cent or more for terms of one through five years, higher than we’ve seen in decades. GIC returns lag inflation, but offer value in that they’re virtually risk-free. Record levels of GIC sales attest to the appeal of low-drama investing right now.

Two negatives with GICs: They’re illiquid unless you settle for the lower rate offered by a redeemable GIC, and the interest they pay is taxed as regular income in non-registered accounts. Outside registered accounts, there’s a dividend tax credit for dividends paid by Canadian companies and a 50-per-cent inclusion rate on capital gains. With GIC and bond interest, you take the full tax hit.

A solution to this tax issue is to shield your GICs from tax by putting them in a TFSA. Many of the alternative banks that offer high GIC rates have a TFSA account option, as do big banks. Online brokers typically offer a variety of third-party GICs you could add to a TFSA.

Don’t: Hesitate to put a small amount in a TFSA

Some is better than none with TFSAs. The only minimums that apply will be on the investments you choose for your TFSA – maybe $500 or $1,000 for mutual funds and GICs. There’s no dollar minimum for exchange-traded funds, but you may have to pay brokerage commissions to buy and sell them.

A quick way to invest small amounts cheaply: Set up an account with the stock-trading apps TD Easy Trade or Wealthsimple Trade, and then buy asset allocation ETFs. These exchange-traded funds offer a diversified portfolio wrapped into a single product. Pick the fund that works for your needs and buy with whatever amount you have. There’s no commission to buy or sell at Wealthsimple Trade, while TD Easy Trade gives you 50 free trades a year and unlimited free trades of TD ETF products, which include some asset allocation ETFs.