

More TFSA room in 2023

The frequency of annual increases is accelerating¹

As expected, the annual allotment of tax-free savings account (TFSA) room rises to \$6,500 beginning in 2023, after four years at \$6,000.

The figure would have risen if the consumer price index (CPI) had been as little as 1.5%. But with the kind of inflation we've been experiencing this past year, the indexation factor came in at over 6%. That contrasts sharply with the sub-2% annual average for the last 15 years since the TFSA was launched.

This is more than just a walk down economic memory lane. The way that the indexing formula is structured, it's an arithmetic inevitability that we'll see more frequent annual increases in TFSA room, with the next one possibly coming as early as next year.

The TFSA indexing formula

One of the distinguishing features of the TFSA is how it is designed to keep up with inflation. Like many other elements of our tax system, it makes use of an indexing formula, but one that operates unlike those others in that changes in annual TFSA room don't necessarily happen annually.

The indexation factor is in section 117 of the Income Tax Act. For a coming year, it is the average of the CPI for the 12-month period that ended on September 30 of the current year, divided by the average of the CPI for the 12-month period that ended on September 30 of the preceding year.

For things like income tax brackets and RRSP room, that factor applies directly to increase the respective element every year. That same factor is used for the TFSA, but it's an indirect calculation, such that changes to TFSA room only occur every few years. The factor augments a background reference figure, and only once that figure rounds to the next \$500 level does actual TFSA room rise by that amount.

Leaving aside the one-time doubling to \$10,000 in the 2015 election year, that \$500 prescribed increment has been applied three times to take us from the original \$5,000 room in 2009 to \$6,500 today. That's about five years on average, bearing in mind that the first move required just a half-step of \$250 for the reference figure to cross \$5,250 and round up to the next actual room of \$5,500.

Historical annual TFSA room			
2009 – 2012	2013 – 2018*	2019 – 2022	2023 – ????
4 years	6 years	4 years	? years
\$5,000	\$5,500	\$6,000	\$6,500
* \$10,000 room for 2015 only			

A beneficial byproduct of this two-stage process is that TFSA room is always a round figure. While being careful not to overstate the case, this simpler expression may make TFSA's more understandable and accessible for those who may feel intimidated by tax minutia.

¹ Tax and Estate Specialist Doug Carroll. A version of this article appears in *Advocis Forum* December 2022.

Frequency of future increases

Now consider that at the beginning, that \$500 increment was 10% of the original \$5,000 room. That same \$500 is now just 7.7% of the current \$6,500 room. With an ever-higher base upon which to apply the indexation factor, the number of years required to reach future levels will continue to compress.

We can observe this with an example that applies a consistent 2% indexation factor. Assuming a current reference figure of \$6,275 (just enough to round to \$6,500 room), it will take four years to step up to \$7,000, another four years to hit \$7,500, and then three years to get to \$8,000, with continuing narrowing in following years.

On the other hand, if the recent 6% jump is the harbinger of a period of sustained higher inflation (hopefully not!), then those times could be compressed even further. By my calculation, the current reference figure is already well past \$6,500, and if inflation continues to be in line with recent history, next year's indexation factor will push the annual TFSA room to \$7,000 in 2024.

Accumulated unused room

Though the original \$5,000 of annual TFSA room may have seemed modest, there is now momentum to its indexed increases. And with the benefit of unlimited carryforward of unused room, the TFSA is likely to become an even more prominent financial tool for many people.

In fact, another way to look at indexing is to consider how the addition of room each year effectively indexes accumulated unused TFSA room. With the \$6,500 of annual room credited for 2023, accumulated unused room stands at \$88,000. For someone who has not yet taken advantage of their TFSA capacity, that's an 8% increase to their waiting tax sheltering room.

One cohort for whom this could be especially apropos is couples who were early homeowners when the TFSA was introduced. Mortgage payments will have dominated their monthly budgeting in the intervening years, but now they're likely seeing light at the end of that tunnel. Through accelerated bi-weekly payments they will have been able to reduce the amortization of a 25-year mortgage by almost eight years. Give it a couple more years and that extra household cash flow will align nicely with the combined \$200,000+ TFSA room waiting to be exploited.

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

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