John Warnke
SENIOR INVESTMENT ADVISOR

TFSA: What's Your Strategy?

With cumulative eligible Tax-Free Savings Account (TFSA) contribution room now standing at $81,500, the TFSA has the potential to be a compelling component in growing your retirement nest egg. How compelling? Consider an investor who maximized annual TFSA contributions since its inception in 2009. With no further contributions, in 45 years, this investor would have over $1,000,000, assuming a 5 percent rate of return per annum (see inset). Most important, any income earned within or withdrawals made from the TFSA are not subject to tax in Canada*.

PLANNING FOR RETIREMENT

Don't overlook the opportunity to grow investments on a tax-free basis within a TFSA. When the TFSA was first introduced, many individuals held cash or low-risk, interest-bearing investments inside the plan — possibly because it was introduced as a "savings account." However, this approach forgoes the opportunity for longer-term, compounded, tax-free growth over time, which can be significant. As such, many longer-term investors may be better served by using their TFSA as part of their broader investment strategy to help build future wealth.

USING THE TFSA IN RETIREMENT

The flexibility of tax-free withdrawals — no limitations on timing or amounts to be withdrawn, as well as the ability to recontribute withdrawn amounts[1] — can make the TFSA a savvy retirement planning tool. Unlike the Registered Retirement Savings Plan (RRSP), contributions can continue beyond the age of 71.[2] If an RRSP is converted into a Registered Retirement Income Fund (RRIF), mandatory annual RRIF withdrawals will generate taxable income; however, TFSA withdrawals will not be considered as taxable income and won't affect income-tested benefits, such as Old Age Security (OAS), or tax credits. As such, the TFSA may be used to help reduce taxable income in retirement. For some individuals, the TFSA may be used to supplement income to allow for the deferral of CPP/QPP benefits, allowing for the flexibility to potentially maximize their value.

FUNDING THE TFSA FOR SENIORS ALREADY IN RETIREMENT

Retirees who are not generating income may find it challenging to fund the maximum annual TFSA dollar amounts. However, even with limited income, two viable options may be considered to fund the TFSA: i) using net (after-tax) RRIF withdrawals; or ii) using non-registered investments.

If an individual has a lower marginal tax rate today than they expect to have in the future (including at death) and RRIF funds will not be needed in the future, drawing down RRIF income above the minimum levels[3] may be one way to potentially lower an overall lifetime tax bill. RRIF withdrawals will be taxed at the current lower tax rate, instead of at the higher-anticipated future marginal tax rate.

If non-registered investments with unrealized gains are used to fund the TFSA, this may result in adverse tax consequences; however, consider that gains realized from non-registered investments could potentially be offset by realized capital losses. As well, potential future tax-free growth within the TFSA may be beneficial.

In both situations, "in-kind" transfers of securities to the TFSA can help ensure continuity in holdings, however there may be tax consequences during the transfer.[4] The effect on income-tested government benefits (OAS, etc.) should also be considered when taking this approach.

TRANSFERRING WEALTH WHILE ALIVE

The TFSA may also be used to gradually transfer wealth to beneficiaries while you are alive. For adult (grand) children, gifted funds can be used to contribute to their own TFSA, subject to available contribution room, which has the potential to grow over time. Transferring wealth while you are alive can help to simplify your estate and minimize future estate taxes. However, keep in mind that once you gift assets, you will no longer have control over how those funds are used.

A VALUABLE ESTATE PLANNING TOOL

The TFSA can play a valuable role in estate planning. Consider that the value of TFSA assets at the time of the holder's death can be transferred tax free to beneficiaries, as opposed to residual RRSP or RRIF funds that are subject to tax, and potentially at high marginal tax rates. In provinces other than Quebec, if the TFSA does not pass through the estate, no probate will be payable in provinces where applicable. Also important, if a surviving spouse/common-law partner is named as a "successor holder," the TFSA can continue to be operated by them on a tax-free basis. Any income or gains earned after the holder's death will continue to be sheltered from tax. For a review or update of your TFSA beneficiary designations, please get in touch.

Are you making the most of your TFSA? We can help to provide perspectives on how you can use the TFSA to your best advantage.

*US Dividends will be subject to US Withholding tax requirement and TFSA income only tax free in Canada.

1. With any TFSA withdrawal, the associated contribution room will be available starting in the next calendar year; 2. RRSP contributions end after the year in which the holder turns 71 years of age, or the youngest spouse turns 71; 3. Note that withholding taxes will be applied to RRIF withdrawals in excess of the minimum amount; 4. Generally, you will be deemed to have sold these investments at fair market value immediately prior to transferring them.

GROWTH POTENTIAL*

	Assuming full contribution to 2022; No further contributions	Assuming full annual contributions to 2022 and continued annual contributions of $6,000 into the future
In 20 years	$314,171	$522,486
In 30 years	$511,751	$930,315
In 40 years	$833,588	$1,594,627

*At a 5% compounded annual rate of return since TFSA inception in 2009. Full annual contribution made at the start of each year.