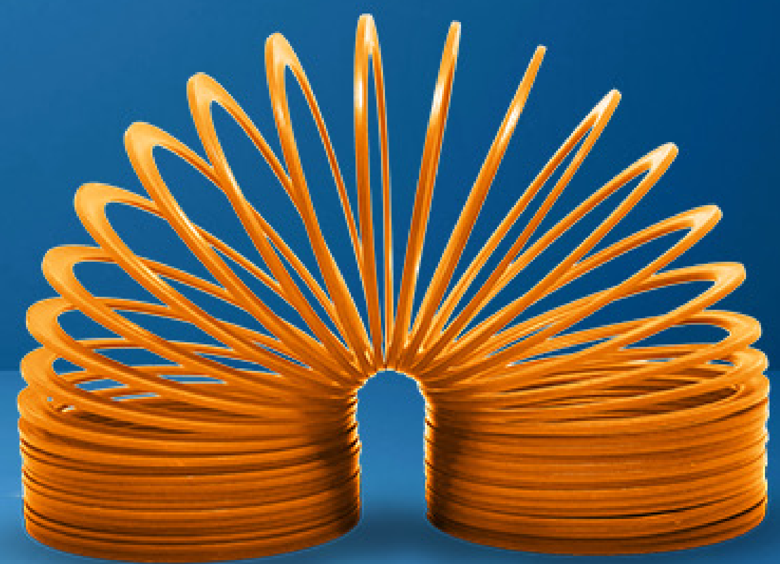
MACKENZIE
Investments

The TFSA: The more flexible investment account



Let's begin

MACKENZIE
Investments

Contents

A flexible, tax-free investment option 3

Should you be investing in a TFSA? 3

Is there a typical TFSA holder? 6

TFSAs can hold more than just cash 7

The best ways to borrow and invest 7

TFSAs offer flexible withdrawals 8

Transferring between accounts may cost you 11

What happens to your TFSA when you die? 12

Make the most out of your TFSA

A flexible, tax-free investment option

While the Registered Retirement Savings Plan (RRSP) has provided Canadians with one of the best tax shelters available since 1957, its sibling, the Tax-Free Savings Account (TFSA), has only been around since 2008. That hasn't stopped it from becoming a favourite among Canadians: almost 15 million of us have a TFSA, with those savings worth around $300 billion[1].

Despite its popularity, many Canadians are still in the dark about the TFSA's advantages. In fact, over a quarter of Canadians don't know the difference between a TFSA and an RRSP.[2]

This brochure aims to shed some light on the differences between the two investment accounts and highlight the TFSA's main advantages. You'll learn ways to make the most out of this tax-saving account, along with some investment strategies and profiles of the different types of TFSA investors.

> **Despite its popularity, many Canadians are still in the dark about the TFSA's advantages.**

Should you be investing in a TFSA?

If you're a Canadian resident aged 18 or older, you can contribute up to $6,500 (for 2023) per year to a TFSA: this is your annual contribution limit. This amount is indexed to inflation annually and periodically rounded to the nearest $500. It is possible to have more than one TFSA, but total contributions cannot exceed your annual limit. If you were eligible to open a TFSA in 2009 but have not, the total contributions you could make in 2023 is $88,000.

Unlike RRSPs, TFSA contribution room is not tied to earned income. Regardless of income earned, contribution room accumulates each year or partial year, even if you don't file an income tax return. If you are not able to contribute the maximum amount to your TFSA in a year, the unused amount will carry forward to the next year.

Also, spousal attribution rules (rules designed to ensure spouses and common-law partners do not benefit from splitting income), don't apply to TFSA contributions. This creates an opportunity for couples to gift assets to each other, allowing tax-free growth on TFSA contributions of $13,000 per family per year. The amount must be gifted, as only the TFSA accountholder can make a contribution.

[1] Financial Post: New data from CRA shows Canadians have nearly 300 billion reasons to love their TFSAs by Jamie Golombek, Jan 1, 2021.
[2] BNN Bloomberg: 1 in 4 Canadians don't know difference between TFSA and RRSP: Survey, Jan 27, 2020

Case study 1

Sharing your contribution room to boost your family's investments

Allan, 52, and Meg, 50, have been married for 10 years.

Four years ago, Allan decided to retire and become a volunteer in his community. Meg is a dentist, and the primary income earner for the family.

Their financial advisor, Fred, introduced them to TFSAs as a way to increase their investments. Meg liked the idea but was concerned that Allan's lack of income would limit the family's available TFSA contribution room.

Fred explained that **TFSA contribution room is not based on earned income**. Because both Meg and Allan file annual tax returns (Allan regularly files because of investment income), both can contribute **$6,500** a year to a TFSA. If at any time Allan does not have the funds to maximize his contributions each year, Meg can give him the money to do so, allowing total tax-free growth on **$13,000** per year.

The best of both worlds: Tax-free growth, tax-free withdrawals

As a TFSA holder, although your contributions are not tax-deductible, investment income earned and withdrawals are tax-free. As you withdraw amounts from your TFSA, the withdrawals can be re-contributed in future years, in addition to the contribution limit for that year.

Because of the combined effects of the carry-forward provision and ability to re-contribute amounts withdrawn, you will generally not lose total TFSA savings room. It's worth noting, however, that a withdrawal cannot be re-contributed in the same year, unless you have contribution room to absorb it. An over-contribution will attract a 1% per month penalty, similar to an RRSP over-contribution. The ability to re-contribute withdrawals begins the year following the withdrawal.

As a TFSA holder, although your contributions are not tax-deductible, investment income earned and withdrawals are tax-free.

Case study 2

Flexible re-contributions

Audrey has made the maximum contributions to her TFSA for 13 years, realizing a return of 5% each year.

Details of her plan are as follows:

Contribution	**$81,500**
Growth	**$36,907**
Total Value	**$118,407**

Audrey's son Barrett recently got into university and needed **$40,000** to fund his education and living costs.

Audrey decided to help and so withdrew **$40,000** from her TFSA.

The following year, Audrey received an inheritance of **$60,000** from her grandparents. Because withdrawals restore contribution room, Audrey was able to re-contribute **$40,000** that year, sheltering most of the future growth on her inheritance from taxes. She also contributed an additional **$6,500** for new contribution room received that year.

As indicated, TFSA contributions are restricted to Canadian residents and are subject to a limit of $6,500 (2023) per year, indexed annually. If you exceed this limit, or contribute while you are a non-resident, over-contribution penalties of 1% per month generally apply. Contribution room does not accumulate for any year in which you are a non-resident. Contribution room however is available in full for partial years. For example, if you moved to Canada and became a resident as of July of 2022, you can contribute $6,000 for 2022 and $6,500 for 2023.

> **TFSA contributions are restricted to Canadian residents and are subject to a limit of $6,500 per year starting in 2023.**

Is there a typical TFSA holder?

TFSAs are meant to be flexible, registered accounts that will help Canadians with different investment needs over their lifetime. Given that TFSAs are geared towards anyone with money to invest, they are well suited to all Canadian investors. Regardless of your age or time horizon, TFSAs can fit into your investment plan and should be considered part of any overall investment strategy. Here are four investor profiles:

1 The flexibility seeker

Maria is a 50-year-old mother of two. While she earns enough to put money aside each year, she is reluctant to lock up her investments for the long term because she wants cash available for unpredictable expenses, such as home and vehicle repairs. Maria also wants market exposure and a higher rate of return.

Since RRSPs are best used for long-term investing, the consideration for Maria would likely be a TFSA rather than a taxable, non-registered investment account. Because of the wide selection of investments available in TFSAs, and also because of the tax-free status of TFSA investment income, the TFSA would be the better option. As her TFSA increases in value over the years, Maria could use some of those funds to make RRSP contributions.

2 The low-income investor

Jimmy, 23, is a new graduate who recently joined the workforce. Like many new graduates, he is currently in the lowest tax bracket, and because Jimmy still lives with his parents, his expenses are low, and he has money to invest.

Now that he is working, Jimmy can consider an RRSP for his long-term investments. Contributions to an RRSP would provide him with a tax-deferral on a portion of his employment income (meaning that he would receive a tax refund). However, if Jimmy thinks he might need the money before he retires (in a year when he is in a higher tax bracket), a TFSA might be a better fit. While a tax deduction would not be available at the time of the TFSA contribution, he could make future withdrawals (including income and capital gains earned) tax-free. With an RRSP withdrawal, however, he would pay more tax than the original tax refund if he is in a higher tax bracket when he makes the withdrawal.

3 The RRSP maximizer

Alex, a business owner, can maximize his RRSP each year. He is a fan of the RRSP primarily because of the annual tax deduction it provides. Because Alex is in the top tax bracket, he wants to shelter as much income from tax as possible. The problem is, other than the RRSP, there are very few tax shelters available in Canada.

The TFSA is another shelter available to Alex and one that can be used in combination with his RRSP. Once he reaches his RRSP contribution limit, excess funds, as well as his tax refund, can be invested in a TFSA for additional tax-saving opportunities.

4 The RRIF maximizer

Juan is a 72-year-old who has transferred his RRSP investments to a RRIF. Because of tax legislation, he has to begin receiving RRIF payments by the end of the year. Juan does not require the extra cash, as his annual expenses are minimal and he is adequately provided for by Old Age Security (OAS), Canada Pension Plan (CPP) and pension income. Juan would like to continue to invest the money received from his RRIF, but is concerned that additional investment income could result in a clawback of income-sensitive OAS benefits.

This is where the TFSA can help. The cash flow received from Juan's RRIF can be reinvested in a TFSA. Unlike RRSPs, there is no maximum age restriction for TFSA contributions, so seniors can benefit from the plan just like other investors. Also, as opposed to being tax-deferred in the RRIF, future investment income will grow tax-free in the TFSA. Should Juan require cash from his TFSA thereafter, withdrawals can be made without affecting his OAS benefits.

TFSAs can hold more than just cash

There is a broad range of investments you can hold in your TFSA, (they are generally the same as those allowed in an RRSP). They include:

- Mutual funds
- Stocks and exchange-traded funds (ETFs) listed on designated stock exchanges
- Guaranteed investment certificates
- Bonds
- Certain shares of small business corporations

Be careful of non-qualified or prohibited investments (such as stocks traded on non-designated stock exchanges). These can result in a tax of 50% of their fair market value. Income earned on these investments may also be taxable.

Non-qualified or prohibited investments are generally those deemed ineligible for registered plans (such as TFSAs, RRSPs, RRIFs and DPSPs). Certain privately-owned corporate shares are an example. It is important to speak to a financial advisor to ensure your investment selections are suitable for TFSAs.

Mackenzie Investments offers a broad variety of investments to help you make the most of your TFSA. Talk to your financial advisor to decide which investments are best for you.

The best ways to borrow and invest

Because your TFSA provides tax-free investment growth, interest on money borrowed to invest in a TFSA is not tax-deductible.

As an alternative, it could make sense to transfer non-registered assets to your TFSA instead of borrowing. Your non-registered assets could then be repurchased with borrowed funds.[3] In this case, a direct link from the borrowed money to an eligible non-registered investment would be established, and interest should be tax-deductible. As with any leveraging strategy, there are risks associated with debt, so this strategy should not be considered without the assistance of a financial advisor. Also, a taxable capital gain may occur when you transfer non-registered assets to a TFSA.

[3] Using borrowed money to finance the purchase of securities involves greater risk than a purchase using cash. If you borrow money to purchase securities, your responsibility to repay the loan and pay interest as required by its terms remains the same even if the value of the securities purchased declines. Please ensure you read the leverage disclosure statement found in the loan application and discuss with your financial advisor the risks and potential benefits of borrowing money to purchase securities.

Case study 3

How to maximize your non-registered investments

Kevin has non-registered investments valued at **$36,500**, which he bought for **$30,000** several years ago.

His financial advisor has since introduced him to TFSAs, and Kevin realizes that he has accumulated **$88,000** in TFSA contribution room over the past 14 years.

Kevin has always been a risk taker and is not opposed to borrowing to invest, if it means potentially better returns. Realizing that interest is not tax-deductible whenever borrowed funds are used to invest in a TFSA, Kevin transfers his non-registered investments to a TFSA and then buys more non-registered assets using a loan.

Although Kevin is subject to capital gains tax on the investments he transfers to his TFSA, interest on his loan is tax-deductible because his new, non-registered investments have the potential to pay income. From now on, all of the investments he moved to his TFSA will grow tax-free.

TFSAs can help you to get a loan

The Income Tax Act (ITA) allows TFSAs to be used as security for a loan: this is not the case for your RRSPs or RRIFs.

TFSA tip

When transferring non-registered investments directly to a TFSA, don't transfer any investment that has taken a loss: current tax rules won't allow you to claim that loss in this situation. For more information on this type of transfer, see the section on Transferring between accounts [see page 11].

TFSAs offer flexible withdrawals

TFSAs are meant to be flexible, general-purpose accounts. You can therefore withdraw from them at any time, for any reason, and they are not considered taxable income (unlike RRSP and RRIF withdrawals). And, as we mentioned, any amounts withdrawn can be re-contributed in future years without affecting future contribution room. This flexibility means your investments are easy to access in case of emergencies and can be used for ad hoc expenses, such as home renovations and vehicle repairs.

Case study 4

Keeping your contribution room

Trevor graduated from college and started work in 2009.

He decided to set aside **$300** a month to save for the down payment on a condominium, which he put into a TFSA. In early 2015, Trevor signed a contract to buy a condominium. At that time, details of his TFSA were as follows:

Contributions	**$25,200** (2016–2021)
Growth (3%)	**$2,831**
Total value	**$28,031**

Trevor took the **$25,000** needed for his down payment from his TFSA and made no further contributions that year. Even though the money consisted of both original contributions and growth, the entire amount was tax-free. Also, given the TFSA's flexibility as an all-purpose account, the **$25,000** was added to his TFSA contribution room for the following year.

The following chart summarizes Trevor's TFSA contribution room for 2022, the year following the year of withdrawal.

Carry-forward room (from 2021)	**$71,900**
[(4 years x $5,000 + 5 years x $5,500 + 1 year x $10,000) + 3 years x $6,000 - (7 years x $3,600)]	
Add: annual TFSA limit (for 2016)	**$6,000**
Add: 2021 withdrawal	**$25,000**
2022 TFSA limit	**$102,900**

Keeping your government benefits

TFSA withdrawals won't affect your eligibility for government tax benefits, such as the Canada child benefit (CCTB), the GST/HST credit and the age amount tax credit. They also have no impact on other income-sensitive benefits, such as OAS, the Guaranteed Income Supplement and Employment Insurance (EI). This a huge benefit compared to RRSP and RRIF withdrawals, which can have a negative impact on these benefits.

Case study 5

How TFSA investments can boost government benefits

Omar worked at a car assembly plant for seven years, investing in his TFSA regularly throughout this time.

When the company experienced difficulties it was forced to close, and Omar was laid off.

Omar applied for EI benefits and began receiving weekly payments. The EI payments were not enough to fund his expenses, so he withdrew funds periodically from his TFSA. Although certain earnings, such as payments from locked-in retirement accounts, affect EI benefits, TFSA payments do not, so Omar could supplement his income without reducing his EI benefits.

What's a qualifying transfer and why does it matter?

Because TFSAs are tax-free accounts, taxes are not normally a concern when you transfer assets from a TFSA to another savings plan (for example, an investment account, RRSP, RRIF and RESP). The amount transferred is considered a withdrawal, and the withdrawal rules discussed earlier apply, including the ability to re-contribute amounts withdrawn.

If the transfer is between multiple TFSAs owned by the same person, the transfer is known as a "qualifying transfer." In this case, contribution room is not affected: you will neither gain nor lose contribution room for the amount transferred. Make sure the transfer between financial institutions is classified as a "qualifying transfer" and not a withdrawal, or the amount transferred could cause you to have an over-contribution in the eyes of the CRA.

When — and how — to avoid qualifying transfers

If you transfer TFSA assets to a former spouse or common-law partner because of a relationship breakdown, a qualifying transfer also occurs. Contribution room to your TFSA is not restored, and your former spouse or common-law partner does not require room to receive the transfer. This type of transfer requires a formal divorce decree or separation agreement.

This may not be the best strategy for you if you are the one who is required to split your TFSA. This is because you would be losing a portion of the assets in your account without the benefit of recouping your contribution room. You may want to consider using assets from another account to split with your former spouse, possibly a non-registered or RRSP account. Otherwise, if your ex-spouse has unused contribution room, it could be better to make a withdrawal and gift the proceeds to your ex-spouse for their TFSA contribution.

Transferring between accounts may cost you

If other savings plans (such as investment accounts, RRSPs, RRIFs and RESPs) are transferred to your TFSA, the amount transferred would normally be taxable in the year of transfer and would require TFSA contribution room.

With regards to investment accounts, for assets that have gone up in value, capital gains tax is generally payable when transferred to a TFSA. Assets that have gone down in value are treated differently. If you transfer depreciated assets directly to your TFSA, you won't be able to claim capital losses.

Offsetting financial advisor fees

If you pay a fee to your financial advisor to help you select your investments within your TFSA, those fees can be paid from your non-registered assets, therefore allowing your TFSA to grow faster. The CRA allows this deductibility strategy for all of your registered accounts.

Case study 6

Why it pays to avoid transferring losses to your TFSA

Kelly owns a mutual fund in an investment account, worth **$30,000**.

She bought this fund for **$40,000**, 10 years earlier, but expects it to do well in the future. She wants to move the fund to her TFSA to enjoy tax-free growth in the future and has the contribution room to allow it.

Kelly's financial advisor tells her that a direct transfer of the fund to her TFSA would trigger a disposition (a capital loss). However, tax rules would not allow her to use the loss to offset capital gains if she switched the fund directly to her TFSA. Kelly was therefore advised to trigger capital losses by moving the fund to a non-registered account, before switching it to her TFSA.

What happens to your TFSA when you die?

When you set up a TFSA, you can name a successor holder, who will take over ownership of your account after you die. This means that your successor holder will simply replace you as the plan holder, with all rights passing to them. Alternatively, you can also name a beneficiary (the person you want to receive your TFSA investments when you die). These rules do not apply in Quebec.

You can only name your spouse (including common-law partner) as your successor holder. If you made any TFSA over-contributions, they will be considered to be contributions made by your successor in the month after your death. If your successor has sufficient TFSA contribution room to absorb the over- contributions, there will be no over-contribution penalties.

Case study 7

Over-contributions after death

Melanie passed away in May, after over-contributing to her TFSA by **$1,000** in March.

This resulted in an over-contribution penalty of 1% per month for the months of March, April and May. Because her husband, Phil, was named successor holder, he became holder of the plan and inherited the plan's rights.

Phil was therefore deemed to make a contribution of **$1,000** (Melanie's over-contribution) the month following Melanie's death. Because Phil had sufficient TFSA contribution room, he did not have to pay over-contribution penalties.

If no successor holder is named, but your spouse or common-law partner inherits your TFSA, they can transfer the assets to their own TFSA, as long as the transfer occurs during the rollover period (which begins at the date of death and ends on December 31 the following year). In this instance, the transfer will be defined as an exempt contribution, which means it won't require TFSA contribution room from your spouse or common-law partner.

However, exempt contributions are generally limited to the fair market value of the transferring TFSA at the time of death: **any growth after death would require new contribution room**. To ensure exempt contributions do not affect your spouse's contribution room, the contribution must be designated on CRA form **RC240**, and sent to the CRA within 30 days of contribution.

Case study 8

How exempt contributions work

After a long illness, Jessie passed away. At the time of death, his TFSA was worth **$60,000**.

Although his wife, Sofia, was not a successor holder, she was the beneficiary of his estate and inherited the TFSA through his will. Six months after Jessie's death, during the rollover period, Sofia transferred Jessie's TFSA to her own. Although her contribution room at the time of transfer was only **$10,000**, Jessie's account (**$62,000** at the time of transfer) was fully contributed to her account.

There was an exempt contribution of **$60,000** (which did not require contribution room), with the remaining **$2,000** being absorbed by Sofia's available contribution room. Sofia completed CRA form RC240 within 30 days of transfer, to ensure that her exempt contribution did not affect her contribution limit.

Other TFSA inheritors

If someone other than a spouse or common-law partner inherit TFSAs, exempt contributions will not apply. While TFSA assets can be transferred to these beneficiaries tax- free (for amounts up to the date of death), TFSA contribution room is required to shelter future income from tax.

If there is no named successor holder, income earned in a TFSA after the date of death is subject to tax, which is normally paid by the beneficiary, even if that beneficiary is the spouse or common-law partner.

Continuing the previous example, even though Sofia's contribution room allowed her to contribute the $2,000 earned after Jessie's death to her TFSA, that, amount would be taxable and should be included in Sofia's income for the year of transfer.

All provinces and territories (other than Quebec), have updated their respective legislations to allow for beneficiary designations on TFSA applications. For Quebec, TFSA transfers at death continue to pass through the deceased's estate and are governed by the deceased's will.[4] For this reason, will designations continue to be of importance in Quebec.

Designed to complement, not compete

The TFSA is designed to complement existing investment plans. RRSPs, RRIFs, RESPs, RDSPs and Registered Pension Plans all have a role in investment planning, and each is designed to satisfy a specific objective. TFSAs bridge the gap between registered and non-registered investing by providing the tax-efficiency of registered accounts along with the flexibility of non- registered investments.

[4] It is expected in Quebec that TFSA assets will always be subject to the terms of a deceased's will, regardless of successor holder and/or beneficiary designations made on the TFSA contract.

General Inquiries

For all of your general inquiries and account information please call:

English: 1-800-387-0614
Bilingual: 1-800-387-0615
Asian Investor Services: 1-888-465-1668
TTY: 1-855-325-7030
Fax: 1-866-766-6623
E-mail: service@mackenzieinvestments.com
Web: mackenzieinvestments.com

**Find fund and account information online through Mackenzie Investments' secure InvestorAccess.
Visit mackenzieinvestments.com for more information.**

To find out how to make the best use of your TFSA, speak to your financial advisor.

2616119 11/22