

Get a TFSA Working For You

January 2023

The benefits and flexibility provided by a Tax-Free Savings Account (“TFSA”) make it an ideal solution to save for multiple financial goals. While TFSA contributions are not tax deductible; they grow tax-free, can be withdrawn tax-free at any time, and there are no restrictions on how you use the funds once they’re withdrawn from your TFSA.

Whether you’re saving for a new car, a home purchase, your child’s education or retirement, a TFSA can help you reach your financial goals sooner.

Contributions and withdrawals

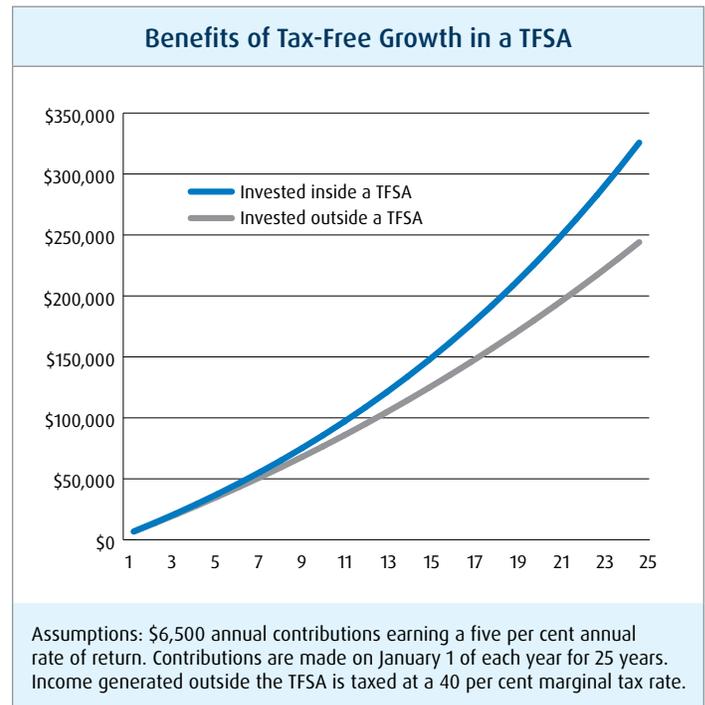
For 2023, the annual TFSA contribution limit is \$6,500¹. Unused contribution room – dating back to 2009 when TFSAs were first introduced, or the year you turned 18 – carries forward and can be used in any future year².

Individuals are responsible for monitoring their TFSA contributions, although this can be confirmed by contacting the Canada Revenue Agency (“CRA”) online through the My Account function on the Canada Revenue Agency web site³.

Withdrawals from your TFSA are tax-free and any amount withdrawn in the current year will be added back to your TFSA contribution room at the beginning of the following calendar year. For example, let’s assume that you have no current unused TFSA contribution room and you withdrew \$15,000 from your TFSA on January 15, 2022. On January 1, 2023, your TFSA contribution limit will increase to \$21,500 (\$15,000 withdrawn in 2022, plus your 2023 TFSA contribution limit of \$6,500). In addition, TFSA withdrawals won’t impact your eligibility for Federal income-tested benefits and credits such as Old Age Security, Guaranteed Income Supplement, employment insurance benefits, child tax benefits and the GST credit.

The chart on the right compares the growth of annual \$6,500 contributions to a TFSA versus saving \$6,500 annually in a non-registered investment account. Assuming a five per cent rate of return, after 25 years the TFSA will grow to \$325,737; while the

non-registered account grows to only \$244,095. As a result of the tax-free growth of the TFSA, you’d have over \$81,642 (or 33 per cent) more to fund your financial goals.



Investment options

Generally, investments that qualify for an RRSP can also be held in a TFSA, including equities, bonds, mutual funds, GICs and Exchange Traded Funds (“ETFs”).

TFSA or RRSP: Determining the best savings option for you

Since the introduction of TFSAs, many Canadians have questioned whether to contribute to a TFSA or RRSP for their retirement savings. While both plans allow your investments to grow tax-free inside the plan, there are major differences in the tax treatment of contributions and withdrawals. TFSA contributions are not tax-deductible and all withdrawals are tax-free. With an RRSP the opposite is true; contributions are tax-deductible and all withdrawals (including any income earned while inside the RRSP) are taxed as ordinary income when withdrawn. As a result, when deciding whether to make a TFSA or RRSP contribution, the most important financial factor is your marginal tax rate today, and your expected marginal tax rate in retirement.

The table below compares three scenarios where a pre-tax \$6,500 contribution is made to both a TFSA and RRSP, and the contribution earns a five per cent rate of return over 25 years.

At the end of 25 years, the funds are withdrawn from each plan. In Scenario 1, the marginal tax rate is 40 per cent at the time of the TFSA/RRSP contributions and withdrawals, resulting in identical after-tax savings. However, in Scenario 2, the individual is in a higher tax bracket when making their TFSA/RRSP contributions than when making their withdrawals, and therefore the RRSP provides more after-tax savings than the TFSA. Conversely, in Scenario 3, the individual is in a lower tax bracket when making their TFSA/RRSP contributions than when making their withdrawals, and as a result, the TFSA provides more after-tax savings than the RRSP.

In summary, if you expect your marginal tax rate to be lower (including the possible clawback of government benefits, such as Old Age Security) when you retire, an RRSP is generally more beneficial. However, if you expect your marginal tax rate to be higher in retirement than it is today, then contributing to a TFSA may be the better option.

It's also important to note that for many, an RRSP offers a higher contribution limit than a TFSA. For 2023, the RRSP contribution limit can be as high as \$30,780, whereas the TFSA contribution limit is \$6,500. Ideally, investors should maximize contributions to both plans to take advantage of the tax savings benefits. However, from a financial standpoint, this may not always be possible. While everyone's situation is unique, the following guidelines can assist you in deciding between a TFSA or RRSP contribution:

- If you're in the top marginal tax bracket, maximize your RRSP contribution first and then contribute excess funds to your TFSA to build your retirement assets. Use any income tax refund to top-up your TFSA for continued tax-free growth.
- If you're just starting your career, you may want to consider delaying your RRSP contributions until you're in a higher tax bracket, since the RRSP tax deduction won't save you as much tax today as it might in the future. Instead, contribute to a TFSA for tax-free growth and later, when you're in a higher tax bracket, consider withdrawing funds from your TFSA to make an RRSP contribution and capitalize on the larger tax deduction. You can then use your income tax refund to make a TFSA contribution.

TFSA vs. RRSP Comparison						
	Scenario 1		Scenario 2		Scenario 3	
	Marginal Rate 40% when contributed; 40% when withdrawn		Marginal Rate 40% when contributed; 20% when withdrawn		Marginal Rate 20% when contributed; 40% when withdrawn	
Plan	TFSA	RRSP	TFSA	RRSP	TFSA	RRSP
Pre-tax Income	\$6,500	\$6,500	\$6,500	\$6,500	\$6,500	\$6,500
Income Tax Payable	\$2,600	n/a	\$2,600	n/a	\$1,300	n/a
Net Contribution	\$3,900	\$6,500	\$3,900	\$6,500	\$5,200	\$6,500
Value 25 Years Later @ 5% Growth	\$13,207	\$22,011	\$13,207	\$22,011	\$17,609	\$22,011
Income Tax Payable Upon Withdrawal	n/a	\$8,804	n/a	\$4,402	n/a	\$8,804
Net Withdrawal	\$13,207	\$13,207	\$13,207	\$17,609	\$17,609	\$13,207

Please note: The RRSP withdrawal is for comparison purposes only, as actual withdrawals would generally occur after the RRSP is converted to a Registered Retirement Income Fund ("RRIF").

Other important factors to consider include:

- Most people are hesitant to make RRSP withdrawals due to the tax consequences. Except for amounts qualifying for the Home Buyers' Plan or Lifelong Learning Plan (or the new Tax-Free First Home Savings Account - expected to be available in mid-2023), a withdrawal from your RRSP will generally result in the amount being added to your taxable income for the year – and you will lose the contribution room forever. Since TFSA withdrawals are tax-free and easy to make, you may be more inclined to make a withdrawal from your TFSA when you need funds.
- In retirement, RRSP/RRIF withdrawals will be added to your income – along with your pension and other income – and could put you in a higher tax bracket, triggering the claw back of Old Age Security ("OAS") payments. In 2023, OAS benefits start being clawed back when your net income exceeds \$86,912. A TFSA may be advantageous as withdrawals do not affect federal income benefits including the OAS.
- While the plan you choose to contribute to may change from time-to-time, depending on your income and financial goals, a general rule of thumb is that if you contribute to an RRSP, use the resulting tax refund wisely, and if you contribute to a TFSA, try not to withdraw funds unless necessary – especially if you are using the account to save for retirement.

Planning opportunities

TFSA's are ideal for implementing a variety of planning strategies, including:

- Income-splitting – You may gift funds to your spouse/common-law partner ("spouse/partner") or adult child to allow them to contribute to their own TFSA (subject to their personal TFSA contribution limit). Income earned within a spouse's/partner's or adult child's TFSA will not be attributed back to you.⁴
- Consider holding investments in your TFSA that would otherwise be taxed at high rates outside of a registered account, such as interest income-producing investments.

Open your TFSA today

With a TFSA you benefit from a plan that provides tax-free growth and offers the flexibility you need to meet multiple financial priorities over your lifetime.

For more information, please speak with your BMO financial professional.



¹ The TFSA annual contribution limit is indexed to inflation, and rounded to the nearest \$500 based on the consumer price index provided by Statistics Canada.

² If you've never contributed to a TFSA and were at least 18 years of age in 2009 and have been a Canadian resident since then, your 2023 contribution limit will be \$88,000.

³ The Canada Revenue Agency ("CRA") will track your contribution room. CRA reports this amount to individuals through the My Account function on the CRA web site: <https://www.canada.ca/en/revenue-agency/services/e-services/cra-login-services.html>

⁴ However, the Canada Revenue Agency takes the position that the attribution rules could apply when the funds gifted to contribute to a TFSA are subsequently withdrawn, i.e., where future income and/or capital gains are realized on funds withdrawn that are subsequently re-invested (outside of the TFSA).

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