Wealth Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

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Tax-free savings account (TFSA)

How the TFSA can help you reach your financial goals

The TFSA is a flexible savings vehicle. Investment income earned in this account is tax-free, which may help you reach your financial goals more quickly. The TFSA complements existing registered savings plans, such as registered retirement savings plans (RRSPs) and registered education savings plans (RESPs). This article describes how the TFSA may benefit you, as well as some pitfalls and anti-avoidance rules you should be aware of. This article covers the following topics:

- What is a TFSA?
- Opening your TFSA
- Contributions
- Over-contributions
- Withdrawals
- Fees related to your TFSA
- Breakdown of marriage or common-law partnership
- U.S. citizens resident in Canada
- Non-residents
- Carrying on a business
- Appendix: Anti-avoidance rules

Any reference to a spouse in this article also includes a common-law partner.

What is a TFSA?

The TFSA was introduced in 2009 as a way for individuals to save and grow their savings in a tax-free manner.

Here are some key details about this account:

- Any income and capital gains earned in a TFSA is exempt from tax.
- Any interest paid on money borrowed to contribute to a TFSA is not tax-deductible.
- Contributions to a TFSA are not tax-deductible.
- If capital losses are realized in a TFSA, they can't be used to offset capital gains realized outside the TFSA.
- Any withdrawal made (whether from capital or income) is generally tax-free and the amount withdrawn is added to an individual's contribution room in the following year.
- If someone contributes less than their annual TFSA contribution limit, they can carry forward any unused contribution room indefinitely.

Opening your TFSA

There are three different types of TFSAs:

- A deposit;
- An annuity contract; and
- A trust arrangement.

If your TFSA is a trust arrangement, it can be self-directed. This allows you to develop and manage your own portfolio. The other differences between the types of TFSAs are more pronounced upon death. For more details on the tax implications of TFSAs at death, please ask your RBC advisor for the article on that topic.

If you're a Canadian resident, have reached the age of majority in your province or territory of residence and have a valid social insurance number, you're eligible to open a TFSA. In the year you turn age 18, you'll accrue the full TFSA dollar limit for that year. Note that certain provinces and territories, including Newfoundland and Labrador, New Brunswick, Nova Scotia, British Columbia, Northwest Territories, Yukon and Nunavut have set the age of majority to 19. If the age of majority is over 18 in your province or territory of residence, you'll still accumulate contribution room for the year you turned 18 and be able to carry it forward to any future year.

Contributions

Your contribution room

The maximum amount you can contribute is limited to your TFSA contribution room. The total TFSA contribution limit from 2009 to 2026 is $109,000. The annual TFSA dollar limits from 2009 to 2026 are as follows:

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Year	TFSA annual dollar limit
2009 to 2012	$5,000
2013 to 2014	$5,500
2015	$10,000
2016 to 2018	$5,500
2019 to 2022	$6,000
2023	$6,500
2024 to 2026	$7,000

The annual contribution limit is indexed to inflation and rounded to the nearest $500.

You automatically accumulate contribution room each year (starting in 2009) if you were a resident of Canada at any time during the year and you were at least 18 years of age. You don't have to open a TFSA or file an income tax return to earn contribution room. Your income level also has no bearing on your contribution room. Although the Canada Revenue Agency (CRA) will track your contribution room, you should also maintain your own records to keep track of your TFSA transactions.

Keep in mind that your contribution room decreases with any contributions you make, including re-contributions of funds you've withdrawn in previous years. Any investment income earned within your TFSA or the value of your investments held within your TFSA will not affect your contribution room.

If there's a situation where you don't use your contribution room in a particular year, you can carry forward the unused room throughout your lifetime to any future year. An attractive feature of the TFSA is that there's no age limit that restricts your ability to continue making contributions. There's also no lifetime limit on the amount you can contribute.

Who can contribute?

Only the holder of a TFSA can make contributions to their own TFSA. This means a corporation owned by you, or a trust of which you're a beneficiary, can't make a direct contribution to your TFSA. In general, if a third party

wants to make a contribution to your TFSA, they'll first need to gift the funds to you. You can then contribute these funds to your TFSA.

Multiple TFSAs

You can maintain more than one TFSA at a time, as long as your total annual contributions don't exceed your contribution limit. You can transfer funds from one TFSA account to another or from one financial institution to another without tax consequences if your financial institution completes a **direct transfer** for you.

If you withdraw funds from one TFSA and contribute those funds to another TFSA, it will be treated as a withdrawal and a contribution (instead of a direct transfer), which will affect your contribution room for the year. If you don't have sufficient contribution room, you'll be subject to tax on any excess contributions. For more information regarding excess contributions, please refer to the later section in this article on "Over-contributions."

Foreign funds and investments

If your financial institution allows, you can contribute foreign funds to your TFSA. Your financial institution will have to convert the contribution amount to Canadian dollars (using the exchange rate on the date of the transaction) when reporting the contribution to the CRA. The total amount of the contribution, in Canadian dollars, should not exceed your available contribution room. Otherwise, you may be subject to a penalty tax.

If you hold foreign investments within your TFSA, keep in mind that distributions may be subject to foreign withholding tax. You can't claim this withholding tax as a foreign tax credit on your personal income tax return.

In-kind contributions

When you transfer assets in-kind to your TFSA from your non-registered account, the transfer is a taxable disposition. You will be considered to have disposed of the assets for their fair market value (FMV) at the time of transfer. If the assets are in a gain position, you'll have to report the resulting capital gain on your income tax return for that year. If the investment is in a loss position, you can't claim the resulting capital loss. The amount of the contribution to your TFSA will be equal to the FMV of the investment at the time it's contributed.

Transfers from your RRSP

"Swap transactions" occur when you exchange securities in your TFSA for cash, or other securities of equal value, between your registered or non-registered accounts. Swap transactions are not allowed and are discussed in more detail in the Appendix on "Anti-avoidance rules."

You can generally withdraw any amount from your TFSA at any time, without tax consequences. However, depending on the type of investments you hold within your TFSA, you may need to time your withdrawals accordingly.

You can't directly transfer an investment from your RRSP to your TFSA. You can, however, make a taxable withdrawal from your RRSP (withholding tax may apply on the withdrawal), and make a contribution to your TFSA if you have sufficient TFSA room.

Income splitting using a TFSA

As an income splitting strategy, you can make a gift to your spouse or adult child to contribute to their TFSA. Any income earned or capital gains generated within the TFSA will not attribute back to you. If you have a lower-income adult family member, this strategy may help them earn tax-free investment income and save for retirement or other goals.

Over-contributions

An over-contribution occurs when your contributions to your TFSA exceed your TFSA contribution room. You will be subject to a tax of 1% on the highest excess amount in the month, for each month you're in an over-contribution position. You will need to file Form RC243, *Tax-Free Savings Account (TFSA) Return*, with the CRA by June 30 of the year following the year in which you made the over-contribution and pay any taxes you owe by that date. You'll also need to complete and file RC243-SCH-A, *Schedule A – Excess TFSA Amounts*, to help you calculate the amount of taxes you owe. Speak with a qualified tax advisor if you're in an over-contribution position.

The 1% tax will continue to apply for each month the excess amount remains in your TFSA. To stop the tax from accruing, you need to either withdraw the excess amount from your TFSA or receive new contribution room to absorb the over-contribution, which occurs on January 1 of the following year. There's no CRA form that needs to be completed to withdraw the excess amount.

Withdrawals

You can generally withdraw any amount from your TFSA at any time, without tax consequences. However, depending on the type of investments you hold within your TFSA, you may need to time your withdrawals accordingly. For example, if you invested in a non-redeemable guaranteed investment certificate (GIC), you may have to wait until it matures.

It's important to note that withdrawals do not reduce the amount of any contributions you've made for the current year. Instead, the full FMV of the withdrawal will be added to your contribution room at the beginning of the following year. For example, an amount you withdraw in 2025 can be re-contributed to your TFSA starting January 1, 2026. This means you can withdraw funds from your TFSA as needed and re-contribute them in a later year. If you re-contribute an amount withdrawn in the same year (without having unused contribution room), you may have over-contributed and be subject to penalties.

How much you can re-contribute depends on how much you withdraw from your TFSA. For example, let's say you invested $10,000 five years ago and your investment increased to $25,000 in 2025. If you withdrew the full $25,000 in 2025, then starting January 1, 2026, you can re-contribute $25,000 plus the $7,000 of new contribution room for 2026 for a total of $32,000. Additionally, you can contribute any unused TFSA contribution room you accrued from previous years. On the other hand, suppose you'd invested $10,000 but the investment decreased to $2,000. If you withdrew this amount in 2025, starting January 1, 2026, you can re-contribute only $2,000 plus the $7,000 of new contribution room for 2026 for a total of $9,000. Again, you'll also be able to contribute any unused TFSA contribution room you accrued from previous years.

There are some cases where certain withdrawals may not be added back to your contribution room for the following year. These include withdrawals of deliberate over-contributions, prohibited investments, non-qualified investments, amounts attributable to swap transactions, and income or capital gains earned on any of these items.

Impact of withdrawals on your government benefits and credits

Any income earned in your TFSA or withdrawals you make from the account will not affect your federal income-tested benefits such as old age security benefits, the guaranteed income supplement and employment insurance benefits. The income earned or withdrawal you make from your TFSA will also not impact your entitlement to federal tax credits such as the age amount, the GST/HST credit, the working income tax benefit or the Canada child benefit.

Fees related to your TFSA

If you incur any fees in relation to your TFSA, such as account maintenance, administration, transaction fees and management fees, these are not tax-deductible, regardless of where the fees are paid from.

When fees are charged to your TFSA, they're not considered withdrawals that can be recontributed the following year. Currently, if TFSA fees are paid directly from your non-registered account, they're not considered contributions to your TFSA. However, if you contribute funds into your TFSA from your non-registered account to pay the fees, that transfer will be considered a contribution.

If you become a non-resident of Canada, you are allowed to keep your TFSA. You will not need to pay Canadian taxes on any income earned or capital gains generated in the account.

Breakdown of marriage or common-law partnership

If there's been a breakdown in your marriage or common-law partnership, it may be possible for you to transfer an amount directly from your TFSA to your former spouse's TFSA without tax consequences. For a direct transfer to take place, you and your former spouse must be living separate and apart at the time of the transfer, and the transfer must be made under a decree, order or judgment of a court, or under a written separation agreement to settle rights arising out of your relationship on or after the breakdown of your relationship. Your financial institution must complete a direct transfer for you.

If you directly transfer TFSA assets to your former spouse's TFSA, your contribution room would not be reinstated, and your former spouse would not need contribution room to accept the transfer.

Alternatively, you may withdraw assets from your TFSA and give these assets to your former spouse. In this case, the amount of the withdrawal will be added back to your contribution room in the following year. Your former spouse, however, will only be able to contribute these assets to their own TFSA if they have unused TFSA contribution room.

U.S. citizens resident in Canada

If you're a U.S. citizen or green-card holder who's required to file U.S. income tax returns, you may not benefit from a TFSA. Income earned in your TFSA will be taxable for U.S. purposes in the year it's earned. There may also be additional reporting requirements depending on the type of TFSA you own. Speak with a qualified cross-border tax advisor to determine if having a TFSA makes sense for your circumstances.

Non-residents of Canada

If you become a non-resident of Canada, you are allowed to keep your TFSA. You will not need to pay Canadian taxes on any income earned or capital gains generated in

the account. You also won't need to pay Canadian taxes on any withdrawals you make. You may want to consider obtaining tax advice from a qualified professional in your country of residence to determine how the funds in your TFSA will be treated for tax purposes in that jurisdiction.

The TFSA contribution limit is not pro-rated for the year you move from or to Canada. You're entitled to the full amount of contribution room in either of those years. If you're a non-resident for an entire calendar year, you will not accrue contribution room for that year.

You can make a TFSA contribution up until the date you become a non-resident of Canada. If you contribute to your TFSA while you're a non-resident, you will be subject to a 1% penalty tax for each month the contribution stays in your account. The penalty will continue to apply until you withdraw the full amount of the contribution from your account (and designate it as a withdrawal of non-resident contributions) or become a resident of Canada. If the 1% penalty tax applies to you as a non-resident, you'll need to file Form RC243, *Tax-Free Savings Account (TFSA) Return*, and Form RC243-SCH-B, *Schedule B – Non-Resident Contributions to a Tax-Free Savings Account (TFSA)*. If the contribution you made while you were a non-resident is also in excess of your TFSA contribution room, you may be subject to an additional penalty tax of 1% per month and have to file Form RC243-SCH-A, *Schedule A – Excess TFSA Amounts*.

Generally, withdrawals (that are not excess contributions or contributions made while a non-resident) you make while you're a non-resident will be added back to your TFSA contribution room for the following year. Keep in mind that this contribution room will not be available to you until you become a Canadian resident again.

Carrying on a business

TFSAs are generally intended to hold passive investments. If the CRA determines a TFSA is "carrying on a business" of trading securities, the income from that business may be taxable. Whether the TFSA is carrying on a business depends on many different factors, including how frequently the securities are traded, the length of time the securities are owned, the holder's knowledge or experience in the securities markets and whether the securities are considered speculative in nature. A key trigger for the CRA seems to be where the FMV of the account is significantly higher than the total maximum TFSA contributions that can be made to date. If the CRA determines a TFSA is carrying on a business of trading in securities, taxes are imposed on the income earned by the TFSA. Income that's subject to tax within the TFSA includes dividends and interest and the full amount of gains net of any realized losses.

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In addition, it's possible that second- and subsequent-generation income earned on the income from a business carried on by the TFSA may have to be distributed to the TFSA holder and taxed in their hands.

The TFSA holder and the trustee of the TFSA are jointly and severally liable with the TFSA for any tax payable on income earned from carrying on a business in the TFSA.

Conclusion

The TFSA may help you achieve greater flexibility in saving and investing throughout your lifetime. Speak to your RBC advisor about how a TFSA can be incorporated into your financial plan.

This article may contain strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal and/or insurance advisor before acting on any of the information in this article.

Appendix: Anti-avoidance rules

The qualifying investments you're permitted to hold in your TFSA are the same as those permitted in your RRSP. These include (but are not limited to): cash, mutual funds, securities listed on a designated stock exchange, GICs, bonds and certain shares of small business corporations. Holding non-qualified and prohibited investments in your TFSA will result in penalties and filing requirements.

Non-qualified investments are investments that don't meet the definition of a "qualified investment" under the Income Tax Act. Examples of non-qualified investments include shares in private investment holding companies or foreign private companies, shares that become delisted from a designated stock exchange and real estate. Prohibited investments include debt or shares of, or an interest in, entities in which the TFSA holder or a non-arm's length person has a "significant interest" (generally 10% or more ownership) or entities with which the TFSA holder does not deal at arm's length (for example, individuals who are related by blood, marriage, adoption or otherwise).

The consequences of investing in a non-qualified or prohibited investment inside your TFSA can be quite harsh. In the year you purchase the non-qualified or prohibited investment inside your TFSA or in the year an investment becomes non-qualified or prohibited, you may incur a one-time penalty tax of 50% of the FMV of the investment.

If you didn't know, and could not have known, at the time the investment was obtained that the investment was or would become non-qualified or prohibited, and you dispose of the investment from the TFSA or the investment ceases to be non-qualified or prohibited by the end of the year following the year in which the tax applied (or at a later time as permitted by the Minister of National Revenue), this penalty tax may be refunded to you.

If you earn any income or capital gains on the non-qualified investment, the trustee of your TFSA is required to file a T3, *Trust Income Tax and Information Return*. Your TFSA will have to pay tax at the top marginal tax rate on this income and will not get the benefit of the lower inclusion rate for capital gains.

Any income or capital gains that a prohibited investment earns will be considered an "advantage" and subject to a 100% penalty tax.

A "swap transaction" is a transfer of assets (other than a contribution or withdrawal) between your TFSA and yourself (or a person with whom you do not deal at arm's length). Swap transactions are generally not allowed. If you engage in a swap transaction, the increase in the total FMV of the TFSA as a result of the swap transaction is considered an "advantage" and is subject to a 100% penalty tax. In addition, all future increases in the FMV of the TFSA that are reasonably attributable to the initial swap transaction will be considered an advantage. Therefore, any dividends, interest or other amounts paid on the swapped security, any appreciation in value of the swapped security or on any substituted property, and any income earned on income, would be subject to the advantage tax.

There is an exception to these rules. You can swap a non-qualified or prohibited investment from your TFSA with cash or other property of equal value that you hold outside of your TFSA, provided you're entitled to the refund of the 50% penalty tax on the non-qualified or prohibited investment.

If you're required to pay any of these penalty taxes associated with non-qualified investments, prohibited investments or advantages, you must complete and file Form RC243, *Tax-Free Savings Account (TFSA) Return*, by June 30 of the year following the year in which the tax arose. Dealing with these penalty taxes is quite complex, so you should consult with a qualified tax advisor if you find yourself in this situation.



Wealth Management

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NAV0071 (12/2025)