TD Wealth

Wealth Insights

TD Wealth Private Investment Advice

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The Power of Time

When ChatGPT reached 100 million active users in just two months, it highlighted the accelerating pace at which technology is transforming the world. Consider that it took the social media platform Instagram 2.5 years to reach the same user base[1] and the internet 7 years to acquire 50 million users.[2]

Why are things moving so quickly? From a broad perspective, the advances we see today have been made possible by the increasing capacity of computer processing power, which has grown exponentially. One way to help conceptualize the power of exponential growth is through the anecdote that folding a paper 42 times can get you to the moon. At the onset, exponential growth yields insignificant results, but over time it creates impressive outcomes. Consider the insignificance of a piece of paper only 1/10th of a millimetre thick: Folding this over seven times will lead to the thickness of a notebook of 128 pages. It takes 24 folds to get you past one kilometre; yet, 30 folds will get you into space — the paper will now be 100 km thick! By 42 folds, it takes you beyond the distance from the Earth to the Moon, which is around 382,500 km.

In investing, the parallel is compounded returns,[3] which can have a profound impact on portfolio values. Similar to the concept of the folding paper, significant outcomes become more likely over time. This is why, as advisors, we often emphasize the principle: *The first rule of compounding is to never interrupt it unnecessarily.* As we show on page 2, if you were to contribute $6,500 each year for 10 years starting at age 20, compounded at 6 percent per year, the $65,000 contribution would grow to $1.7 million by age 80. However, if you were to withdraw funds at age 40, they would have accumulated to just $172,000. As one investment strategist reminds us: "*Time is the exponent that does the heavy lifting. The common denominator of almost all fortunes isn't returns; it's endurance and longevity*."[4]

Ironically, the same technological advances that have enabled growth may be a countervailing force to compounding returns. One of the most difficult parts of investing is the emotional discipline needed to stick to a wealth plan and allow it the time to grow. What appears to be changing in this modern era is that instant communication and social media seem to have created heightened awareness and sensitivity, which can derail investor focus.

Today's narrative is no exception. Despite economic resilience and growth that has exceeded expectations, we may be distracted by the challenges and uncertainties of debt and deleverage, deglobalization, slower growth and higher interest rates, to name a handful. But it's worth a reminder: the world has always been uncertain. Investing is never a smooth road. Even the most respected investors who have delivered outstanding long-term returns have managed through periods of uncertainty and even routinely underperformed the markets. Would you be surprised to learn that over their investing lives, the annual performance of Warren Buffett, John Templeton and Charlie Munger fell short of the markets at least 33 percent of the time?[4] Yet, they endured the short-term bumps and stuck to their approach to outperform the markets over time. The common denominator? Endurance and longevity.

As advisors, we are focused on managing portfolios to navigate the challenges that come with the changing times. As investors, don't overlook the importance of a commitment to the longer term. Let time in the markets be one of your keys to success.

1. www.reuters.com/technology/chatgpt-sets-record-fastest-growing-user-base-analyst-note-2023-02-01/; 2. www.visualcapitalist.com/how-long-does-it-take-to-hit-50-million-users/; 3. It is acknowledged that the folding paper example of 100% compounded returns is not realistic for investing purposes; 4. Morgan Housel, https://collabfund.com/blog/keep-it-going/

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To Our Clients:

With the rise in rates, more investors have been attracted to low-risk, fixed-income investments. Have you thought about the tax implications? There may be opportunities to be more tax efficient, such as "shifting" interest-bearing instruments to registered plans or investing in investments taxed more efficiently than GICs. By saving on taxes, these alternatives may give you a higher yield. Call for ideas.

The return of cooler, shorter days reminds us that the year end fast approaches. Before then, certain actions can support your 2023 tax position, such as tax-loss selling or charitable donations. We can help. Wishing you the best this season.

— Paul and Connie

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Tax-Free Savings Account (TFSA) Benefits: Don't Pass Up

Are You Overlooking the Tax-Free Opportunity...And More?

Many Canadians are not fully contributing to their TFSAs — including the most wealthy Canadians.

Have you fully contributed? At last count, only 30 percent of taxpayers earning $250,000 or more had fully contributed, with an average unused amount of around $23,000, or 34 percent of total available contribution room (2020 tax year).[1] Beyond the opportunity to grow funds on a tax-free basis, the TFSA can provide benefits across every stage of life:

Facilitating a "Giving While Living" Strategy — The TFSA may offer an opportunity for a tax-efficient, albeit gradual, transfer of wealth to adult (grand)children while you are still alive. By gifting funds to contribute to their own TFSAs, these assets can grow tax sheltered in their TFSAs over time. Although you lose control over the funds (as with any gift), you can reduce the value of your own estate by the amounts gifted, ultimately reducing potential tax implications upon death.

Approaching Retirement — As retirement nears, if you are in a lower tax bracket now than you anticipate in the future, you can draw down your RRSP/RRIF* funds and contribute them to a TFSA (subject to available room). Funds can then grow tax free in the TFSA and serve as a future tax-free source of income to supplement/replace RRIF withdrawals and other taxable income sources later in retirement. At death, residual TFSA amounts can pass to heirs tax free. In contrast, residual RRSP/RRIF values at death are generally taxable as income to your estate.**

Enhancing Retirement Income — The TFSA can help enhance retirement income and cash-flow streams. TFSA withdrawals are not taxable and won't affect income-tested benefits such as Old Age Security (OAS). The TFSA can also supplement cash flow if a retiree chooses to defer OAS and/or Canada Pension Plan (CPP) benefits. A TFSA may also help with tax planning. If generating RRIF income will push you into a higher tax bracket, you may be able to minimize tax by withdrawing only the required RRIF amount and using TFSA withdrawals to supplement income. On the other hand, if your marginal tax rate is lower than you expect in the future or at death, engaging in a "meltdown strategy" (see above) may help reduce an overall lifetime tax bill.

Your Estate — While income or gains earned in the TFSA at the date of death can pass tax free to beneficiaries, the way beneficiaries are named/structured may impact tax results. For example, if a spouse/partner is named as "successor holder," they can continue operating the account going forward. By naming a spouse as "beneficiary," additional administration may be required to maintain a tax-exempt status.

*Registered Retirement Savings Plan/Registered Retirement Income Fund. **Unless transferred to a surviving spouse, minor/disabled child; 1. www.canada.ca/content/dam/cra-arc/prog-policy/stats/tfsa-celi/2020/table1c-en.pdf

Winning the Retirement "Lottery": A Lesson for the Next Generation

$1.7 million: This is the amount of savings many Canadians believe is needed to retire. And though this figure is large, it is within reach for many younger folks today — and it doesn't involve winning the lottery, though a survey less than 10 years ago suggested that one-third of Canadians hoped to fund retirement through such means![1]

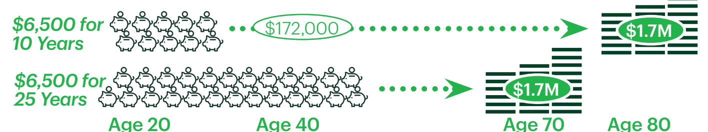
Instead, with a bit of discipline, a consistent savings and investing program that relies on relatively modest contributions each year could steadily progress towards achieving this retirement goal over time. The figures below are just one example of what a commitment to retirement funding can do. The TFSA is one of the best tax-advantaged ways to accumulate assets for the future.

In a TFSA, contributing $6,500 per year at a rate of return of 6 percent...

- *Starting at age 20, contributing for just 10 years, the TFSA will grow to $1.7 million by age 80. If funds are withdrawn at age 40, the TFSA will be worth only $172,000.*
- *Contributing for 25 years, the TFSA will grow to $1.7 million by age 70.*
- *Starting late? Investing a lump sum of $88,000 today, you'll need to contribute $6,500 for 38 years to achieve $1.7 million.*

1. https://www.rcinet.ca/en/2014/02/03/many-canadians-hope-to-win-the-lottery-to-fund-retirement/

Graphic: Investing in a TFSA with a 6% Annual Rate of Return



Canada/Quebec Pension Plan* Reforms: Be Prepared to Pay More

If you earn employment income, you may have noticed more of your paycheque going towards CPP/QPP contributions. For higher-income earners, expect to pay even more.

CPP/QPP reforms were put in place to address the decline in workplace pension plans, amending the CPP/QPP in two ways: i) increasing the income replacement level to 33.33 percent from 25 percent of eligible earnings, and ii) increasing the upper limit for eligible earnings. The first phase began in 2019, when the contribution rate gradually increased by one percentage point from 2019 to 2023 on earnings between $3,500 and the maximum pensionable earnings (MPE) limit. The second phase, which will affect higher-income earners, will begin on January 1, 2024. Employees and employers will each be required to contribute an additional four percent on earnings between the MPE and a new ceiling. Based on the 2023 MPE of $66,600, the new ceiling will be $71,200 in 2024 and $75,900 in 2025.[1]

The good news is that these reforms are expected to make material changes to the benefits Canadians receive at the end of their working lives. However, it will take time before this becomes noticeable. Those retiring in the near term will only see modest enhancements since CPP/QPP is generally based on an average of the best 40 years of earnings.

What is the potential impact of the reforms? Under the old rules, those retiring in 2023 at age 65 could receive a maximum amount of around $15,460[2] per year. Under the enhanced benefit, that same individual could receive around $23,490,[3] an increase of almost 52 percent compared to today.

Consider also that these outcomes don't account for the 0.7 percent per month enhancement for those who defer payments beyond age 65, which would further increase the benefit. Fewer than one percent of retirees delay benefits despite actuarial studies showing that deferring CPP/QPP to the age of 70 may be one of the more financially prudent decisions if you live beyond average life expectancy.[4]

For more information, please see the following — for CPP: https://www.canada.ca/en/services/benefits/publicpensions/cpp/cpp-enhancement.html or for QPP: https://www.rrq.gouv.qc.ca/en/programmes/regime_rentes/Pages/regime-supplementaire.aspx

*CPP/QPP; 1. For 2024, it will be 107% of MPE; for 2025, it will be 114% of MPE; 2. For Q1 2023, $1,306.57 under the old regime less $18.24 enhanced benefit = $1,288.83. www.advisor.ca/tax/tax-strategies/what-clients-should-know-about-the-cpp-reforms/; www.canada.ca/en/revenue-agency/news/2023/05/the-canada-pension-plan-enhancement--businesses-individuals-and-self-employed-what-it-means-for-you.html; 3. www.rrq.gouv.qc.ca/en/programmes/regime_rentes/Pages/regime-supplementaire.aspx; 4. www.fpcanada.ca/docs/default-source/default-document-library/fpw/globe-article-delay-cpp.pdf

■ Back-to-School Season

The RESP: Would You Turn Down "Free Money"?

Education Costs by the Numbers

$30,000	Estimate annual cost for undergraduate university study: tuition, supplies, room & board[1] (higher end of estimate)
$28,000	Average student debt at graduation (university, bachelor's)[2]
$7,076	Average Canadian undergraduate university tuition[3]
$2,023	Average tuition cost 30 years ago in 1993/1994[4]
250%	% Increase in tuition since 1993
+47% to 58%	Additional annual earnings for those with a tertiary degree[5]

1. "Sample budgets" single dorm: www.queensu.ca/registrar/tuition-fees/expenses-budgets; 2. www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=3710003601; 3. Statistics Canada Table: 37-10-0003-01; 4. Statistics Canada Table: 37-10-0150-01; 5. Average, www12.statcan.gc.ca/census-recensement/2016/as-sa/98-200-x/2016024/98-200-x2016024-eng.cfm, Table 1, bachelor's degree.

There are many reasons to consider a Registered Education Savings Plan (RESP) to help save for a child's future education: tax-deferred growth within the plan, earnings taxed at the child's tax rate when eventually withdrawn and, of course, the Canada Education Savings Grant (CESG). The CESG consists of funds paid into the plan by the federal government in the form of a 20 percent matching grant, to an annual maximum of $500 ($1,000 if there's unused grant room from a previous year) and a lifetime maximum of $7,200 per beneficiary. There are no annual limits on RESP contributions but the lifetime limit is $50,000.

Conventional wisdom suggests that we should try and take advantage of the CESG — after all, it is essentially 'free' money. But, is this always the right decision? One way to maximize the CESG involves contributing $2,500 per year over 15 years to receive the full $7,200 in grants. However, will this achieve the greatest outcome for the RESP?

To answer this question, let's compare Investor 1, who gradually contributes and maximizes the CESG, and Investor 2, who contributes a lump sum amount and doesn't maximize the CESG. The outcome may be surprising. Both investors are assumed to earn an annual rate of return of 5 percent. Investor 1 contributes $2,500 each year starting in the first year of the child's life, until year 20, to a maximum contribution of $50,000, and receives the full $7,200 CESG grant. After 20 years, the RESP produces $43,655 of growth, resulting in a value of $100,855.

Investor 2 contributes a lump sum of $50,000 — the full RESP limit — in the first year of the child's life, so the RESP receives only $500 of the CESG. Yet, the RESP will grow to $133,992 over the same period.

This demonstrates the impact that compounding can have over time. Front loading the initial RESP contribution yields a greater outcome, even though the full CESG is not received, all else being equal. Despite lower contributions for Investor 2 over the life of the RESP, or $6,700 less, Investor 2 still ends up with around $33,000 more after 20 years.

A Lesson for the RESP — And, Investing in General

Of course, not many investors have $50,000 of discretionary funds at the start of a child's life. As such, maximizing the CESG where possible is a prudent strategy. However, this example illustrates why, as advisors, we often remind investors not to overlook the impact that compounding can have on any investment, not just the RESP, over time. One takeaway? The sooner you start, the more time funds have to grow and, when it comes to growth, the larger the initial investment, the better!

Illustrative: RESP Gradual vs. Lump Sum Contribution

	Investor 1 – Gradual Contributions			Investor 2 – Lump Sum Contribution		
Year	Annual Contribution	CESG Received	RESP End Amount	Annual Contribution	CESG Received	RESP End Amount
1	$2,500	$500	$3,150	$50,000	$500	$53,025
2-20	$2,500	$6,700	$100,855	--	--	$133,992
Total	$50,000	$7,200	$100,855	$50,000	$500	$133,992

*Assumes 5 percent annual compounded growth.

RESP Changes as a Result of Budget 2023

Planning a first withdrawal from the RESP? The federal budget increased the limit on allowable educational assistance payments (EAPs) from $5,000 to $8,000 in the first 13-week period (full-time programs; $2,500 to $4,000 for part-time programs). If you are planning to open the RESP, budget changes now permit divorced/separated parents to open joint RESPs for children or move an existing joint RESP to another promoter.

RRIF Withdrawals: Planning Ahead Can Have Benefits

The final months of the year are when many retirees take RRIF withdrawals. Don't forget that an "in-kind withdrawal" can satisfy part or all of the minimum requirement. A common misconception is that shares must be sold.

There may be good reasons for an in-kind withdrawal, which involves transferring investments directly to a non-registered account or TFSA. Most apparent, you will maintain ownership of the shares and it may minimize trading costs. Consider that an in-kind withdrawal from the RRIF to a TFSA, subject to available TFSA contribution room, could allow for the future tax-free growth of the securities transferred. If you do an in-kind withdrawal from the RRIF, the fair market value (FMV) of the shares at the time of the transfer will be added to your taxable income and the adjusted cost base (ACB) of the transferred shares will become the FMV at that time. For example, for an in-kind withdrawal and transfer of 100 shares of XYZ stock trading at $50, the RRIF withdrawal will be valued at the FMV of the shares, which is $5,000. This amount will be added to your taxable income. The ACB of the transferred shares will now be $5,000, regardless of the price paid when originally acquired. If transferred to a non-registered account, the ACB will be used when the shares are sold to calculate the capital gain/loss. Keep in mind that if the transfer value is greater than the minimum withdrawal requirement, the excess amount will be subject to withholding tax.

If you have yet to open the RRIF, consider planning ahead. Here are four withdrawal practices that may require forethought.

1. Waiting to make withdrawals to allow greater potential tax-deferred compounding. Making the required withdrawals closer to year end may allow for greater potential tax-deferred compounding within the plan. For those who convert the RRSP to the RRIF at age 71, mandatory withdrawals aren't required until the year after the plan is opened.

2. Varying RRIF withdrawals with your tax bracket. For years in which you will be in a lower income tax bracket, consider the opportunity to make greater withdrawals than the minimum requirement to take advantage of the lower tax rate (subject to withholding tax).

3. Converting a small portion of the RRSP to the RRIF before age 71. The pension income tax credit generally begins at age 65, so this may be one way to take advantage of this non-refundable credit. You may also be able to split pension income with a spouse/partner, which can reduce taxes or improve access to income-tested government benefits.

4. Using a younger spouse's age to determine the minimum. A younger spouse's age can minimize withdrawal amounts and maximize flexibility since you can always withdraw more than the required minimum if you need it (subject to withholding tax). However, you must elect to use a spouse's age when first setting up the RRIF.

Think Later Rather Than Sooner: The Power of Deferring Taxes

Tax implications play an important role in wealth and investment planning, which includes using tax-advantaged accounts and implementing tax-efficient strategies to optimize after-tax returns. Here is how taxes can impact capital accumulation.

There are few benefits to procrastination unless you're talking about paying taxes. And, of course, this isn't referring to filing your tax return or making tax payments past their deadline (for which, incidentally, the penalties have increased substantially with rising rates — consider that the interest rate charged on overdue taxes currently stands at 9 percent![1]). Rather, this refers to the concept of tax deferral.

Deferring taxes is one of the most important features of registered plans like the Registered Retirement Savings Plan (RRSP) and Registered Retirement Income Fund (RRIF) for long-term growth. When it comes to investing, tax deferral can be beneficial, all other factors being equal. By paying tax later rather than sooner, you can invest 100 percent of your pre-tax dollars, instead of a lesser amount of after-tax dollars. Through the benefit of compounded growth, there is potential for greater wealth to accumulate over time.

Just how much of a difference can this make? The table illustrates the impact of tax deferral on capital accumulation. Four investors each invest $88,000 in Year 0. Each is assumed to earn 6 percent annually, compounded over 25 years. Investors A and B pay tax each year at different rates based on the type of income earned: interest and dividends. Investor C pays no annual tax, but will pay tax at the end of year 25 when capital gains are realized. Investor D invests in a Tax-Free Savings Account (TFSA) so no taxes will apply. After 25 years, the difference is significant.

This is why we should not overlook the importance of maximizing tax-efficient accounts where possible, including TFSAs and RRSPs. Here are some other possible ways to defer tax:

Investments that provide a return of capital (ROC) — ROC comprises a return of all or a portion of your original invested capital, which is a non-taxable payment. Mutual funds, REITs, limited partnerships and certain other investments may provide ROC distributions that are not taxable in the year received. The ROC distribution can generally allow you to defer tax until your investment is sold, or the adjusted cost base of the investment becomes negative.

Spousal Rollover — Upon death, capital property is deemed to be sold at fair market value (FMV), which can trigger unrealized capital gains. If you have a spouse/common-law partner, the use of the spousal rollover may permit the transfer of assets at cost rather than FMV, which can defer taxes until they are eventually sold.[2]

Individual Pension Plan (IPP) — For business owners or executives, an IPP could be set up to allow tax-deferred contributions into the plan and build retirement income. In some cases, the maximum contribution to an IPP can be greater than the maximum contribution to the RRSP, allowing for greater tax-sheltered investing.

Estate Freeze — For business owners looking to pass their company to the next generation, an estate freeze could lock in the tax liability at death based on today's value of the business and transfer any future growth (and the related tax liability) to the business' successor, such as a child.

This is not intended to be an in-depth discussion or provide tax-planning advice. For more information, please contact the office or seek assistance from a tax-planning specialist.

1. https://www.canada.ca/en/revenue-agency/services/tax/prescribed-interest-rates/2023-q3.html; 2. Or deemed to be sold.

Table: The Power of Deferring Tax (Illustrative Only)

Year	A: Interest	B: Dividends	C: Capital Gains	D: Tax Free
	Taxed Annually		*Tax Deferred*	*No Taxation*
Tax Rate	*50.25%*	*35.02%*	*25.13%*	*—*
0	$88,000	$88,000	$88,000	$88,000
1	90,627	91,431	93,280	93,280
5	101,942	106,545	117,764	117,764
10	118,092	128,998	157,595	157,595
15	136,801	156,183	210,897	210,897
20	158,474	189,097	282,228	282,228
25	183,581	228,948	377,685	377,685
After-Tax Value	183,581	228,948	304,900	377,685
Amount Paid in Tax	96,544	75,967	72,784	—
Difference (% of D)	49%	61%	81%	100%

Assumes 6% compounded annual growth. Tax rates are based on the average of 2023 combined federal, provincial and territorial personal marginal tax bracket at $250,000 of ordinary income, eligible dividends or capital gains: 50.25%, 35.02% and 25.13%, respectively.

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