THE GLOBE AND MAIL

TAXES

RRSPs and TFSAs not enough for high-net-worth investors

DALE JACKSON
Special to The Globe and Mail
Published Friday, Feb. 03, 2017 1:17PM EST
Last updated Friday, Feb. 03, 2017 2:42PM EST

Contribution limits on Canada's two most popular tax shelters are a non-issue for the vast majority of Canadians, but wealthy investors with plenty to shelter can be left with their assets exposed.

Once registered retirement savings plans (RRSPs) and tax-free savings accounts (TFSAs) have been tapped, high-net-worth investors need to be creative to save on taxes.

Maximize RRSPs

The first step for investors with more than $1-million in investable assets is to make the most of their RRSPs, says Karen Slezak, tax group partner at Crowe Soberman LLP in Toronto. "For them, it's the tax deferral – how many years of deductions you get before you have to bring in the income," she says.

Most Canadians deduct their contributions from their income during their working lives when they are in a high tax bracket, and withdraw it when they retire in a lower tax bracket. But Ms. Slezak says most high-net-worth investors who contribute in a high tax bracket must also withdraw in a high tax bracket. For them, the only advantage to an RRSP is the tax-free growth.

The RRSP contribution limit for the 2016 tax year is $25,370 plus any allowable space from previous years. Contribution limits are increased with inflation each year, but Ms. Slezak says they will never be high enough to fully shelter high-net-worth investors.

"The RRSPs are being indexed, so the limit is climbing each year," she says. But "it probably isn't enough to pay for retirement on that solely."

The TFSA, for whatever it's worth

Ms. Slezak advises wealthy clients to make the most of their TFSAs, too. The contribution limit, also tied to inflation, is $5,500 for 2017, and the maximum cumulative contribution allowance since inception is $52,000. Contributions cannot be written off against income like RRSPs but gains are never taxed.

"For the high-net-worth group the TFSA is just a complement. It's a great way to shelter the tax on $52,000," she says.

Taxes beyond RRSP and TFSA

Once RRSPs and TFSAs are fully tapped, Ms. Slezak recommends investors give first priority to investments with the best tax treatment outside the shelters.

Only half of the gains from stocks or equity funds are subject to taxation, and dividends on eligible stocks generate a tax credit in non-registered investment accounts. Inside an RRSP they are fully taxed as income, like the interest on bonds.

"People will skew their plans to put more income-earning investments in registered accounts, and leave capital gains and dividends in their non-registered accounts," she says.

She cautions investors not to make investment decisions solely for the tax advantage, however. "You want to talk to an investment adviser about a balanced portfolio, and in doing so you're also going to get a more balanced tax portfolio," she says.

In some cases, Ms. Slezak says splitting the tax burden between spouses or family members can lower the overall family tax bill. Once retirees turn 65, income from a spouse in a high tax bracket can be transferred to a spouse in a lower tax bracket.

Income splitting sometimes requires planning before retirement by having a higher income spouse contribute to a spousal RRSP in the name of a lower income spouse. The higher income spouse receives the tax deduction when the contribution is made and the income is taxed in the hands of the lower income spouse when it is withdrawn at least three years later.

Another income splitting strategy involves a high income spouse lending money to a lower income spouse. The money is taxed in the hands of the lower income spouse, but Canada Revenue Agency has strict conditions.

"You have to charge a prescribed rate that is set by the government, and 1 per cent is the current rate. As long as your spouse pays you back the 1 per cent per year, everything earned above and beyond the 1 per cent is legitimately your spouse's."

Ms. Slezak says income splitting loans can also be made to family members provided they are 18 or older.

"If we're in the field with the high-net-worth family where they may have $1-million or $2-million of extra investable assets they've built up, income splitting is really powerful," she says.

Getting the right mix
Knowing the tax tools available for high-net-worth investors is one thing. Determining how to use them together can be complicated, says Lorn Kutner, a tax partner at Toronto-based Deloitte LLP.

Investors may be reluctant to pay for the advice of a tax expert until they come to realize the immediate savings as well as the advantages of having more money to invest over the long term.

Mr. Kutner says an effective tax strategy, implemented early in life, can boost investment returns by at least 25 per cent without the risk that comes with investing in capital markets.

"With a little bit of initial pain just to set up a tax plan, the benefits are huge," he says. "The key is to get over that initial burden. After you set it up, it runs by itself."