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Maximize Your RRSP Return Through Asset Location

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Do you know the real rate of return on your investments? Generally, Canadians measure the success of their investments based only on the rate of return. While it provides a good snapshot of whether an investment is doing well or not, it is not the only criterion for a true picture of success. A good portfolio is based not only on the return, but also by the tax implications of the investments.

Investors can optimize their real rate of return by utilizing ***effective asset location strategies to reduce tax exposure***. Carefully dividing your investments between registered and non-registered portfolios will help to maximize your overall return. Keep in mind, investments inside your RRSP are tax deferred and a TFSA (Tax Free Savings Account) is not taxable. But everything outside of these investments will have a tax implication.

Understanding how your investments are taxed goes a long way in determining where to invest your money.

Investment income has three main types. Each has different tax levels when held outside your registered investments.

- **Interest income** has the highest tax rate of the three regardless of your income. Whether you receive the interest or decide to reinvest it, it is fully taxable and accrued annually.
- **Income from Canadian dividends** are taxed more favourably than interest income but it is important to remember that there are exclusions in the form of income from rent, royalties and foreign dividends which are taxed at the same rate of interest income.
- **Capital gains** income is taxed on only 50 percent of the total and the gains are included in your income when the gains are realized.

Although every province varies, an Ontario resident who sits at the highest marginal income tax bracket would pay over 53 percent* tax on interest income, over 39 percent* on eligible dividends and over 26 percent* on capital gains if these investments are in a non-registered account.

If these three incomes are within a registered portfolio such as RRSP or RRIF (Registered Retirement Income Fund), the taxes are deferred until you begin to make withdrawals. The withdrawals are then considered income' and the entire amount is taxed at your marginal rate of tax.

It would be great to funnel your entire portfolio into an RRSP or TFSA but each carries certain limits of contribution. If your portfolio includes fixed income securities, you should take maximum advantage of keeping these within an RRSP or TFSA for tax shelter purposes. If you have reached the limits of your tax-sheltered investments, any equity investments that produce 'tax-preferred' income (capital gains and dividends) would be suitable to include in a non-registered account.

Don't let the tax implications be your sole motivating factor when choosing your investments. Try to gear your investments such that they are suitable for your specific situation and risk implications. Once you have accomplished this, you can then focus on the best tax efficiency.

* CRA Income Tax Rates for 2019

Questions about tax planning?

Contact our office! [2]

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