THE GLOBE AND MAIL

# Couple relying heavily on savings wonder if their investments are allotted in a tax-efficient way

DIANNE MALEY
Special to The Globe and Mail

Published Saturday, April 24, 2021

Seven years ago, when they had their first Financial Facelift, Tess and Lee were starting to wind down their successful consulting business, selling their Toronto house and moving to a luxury apartment. With plans to travel extensively, they liked the idea of "just being able to lock the door and go," Tess said at the time. They were asking how to arrange their investments in the most tax-efficient manner and whether they could afford the lifestyle they wanted without running out of money. They are spending roughly $192,000 a year.

Now in their early 70s and relying heavily on their savings, "I think it's time for a tune-up," Tess writes in an e-mail.

They're happy with their investment portfolio, where they hold exchange-traded funds and some guaranteed investment certificates. Their target asset allocation is 60 per cent stocks and 40 per cent fixed income, spread over various accounts.

"This is where we need a bit of advice," Tess writes. "We're not sure that the allocation is where it should be now that we're drawing funds out of these accounts to cover our expenses," she writes. They want to ensure "that our level of spending can be sustained throughout our lifetime." They wonder, too, whether it's worthwhile to keep contributing to their tax-free savings accounts, and whether it makes sense to keep paying for long-term care insurance.

We asked Ian Calvert, a financial planner and portfolio manager at HighView Investment Group in Toronto, to look at Tess and Lee's situation.

**WHAT THE EXPERT SAYS**

Tess and Lee wonder whether their investments are arranged in the most tax-efficient way now that they are spending their capital rather than saving, Mr. Calvert says. Their investment portfolio mix is currently 35 per cent fixed income and 65 per cent equities, mostly in exchange-traded funds. Of the equity portion, 35 per cent is Canadian, 31 per cent U.S. and 34 per cent overseas.

"Lee and Tess must evaluate what type of income they want to report in each investment account," the planner says. From a tax perspective, the two most favourable types of investment income are Canadian dividends and capital gains. "Canadian dividends get favourable tax treatment through the dividend tax credit, and only half of realized capital gains are taxable," he adds. In the current portfolio, 80 per cent of their Canadian stocks are held in their taxable accounts, "which is desirable."

However, Tess has a TFSA that is 100 per cent Canadian equities. This may be because she wants to avoid the 15-per-cent withholding tax that is lost on U.S. dividends held in a TFSA.

When U.S. dividend-paying investments are held in a registered retirement savings plan or registered retirement income fund they are exempt from this withholding tax. When held in the non-registered portfolio, there is relief through the foreign dividend tax credit. However, the U.S. Internal Revenue Service does not acknowledge TFSA accounts' status as tax-free accounts, the planner says.

This does not mean that U.S. equities should be totally avoided in the TFSA, Mr. Calvert says. "Tax should be an important component of your investment strategy, but not the driver of all decisions." Indeed, investments more suited to TFSAs for tax planning would be lower-yielding global equities, the planner says. One strategy to mitigate the tax liability without losing important exposure to U.S. stocks is to carve up exposure across account types, Mr. Calvert says. "For example, consider keeping higher-yielding U.S. equities in the RRSP/RRIF and more growth-oriented U.S. equities in the TFSAs."

Tess and Lee ask whether they should still be contributing to their TFSAs even though they must take the funds, or the securities, from their non-registered account, triggering a capital gain. The answer is yes, the planner says. "Although they are voluntarily triggering a capital gain, they are moving the asset into a structure where all future gains and income will be exempt from tax," he says. "Having an account with unlimited upside for tax-exempt growth should be part of their financial plan." The TFSA will also provide more flexibility in the long run, he adds.

Another thing to consider is the size of the capital gain. Currently, their taxable income is about $60,000 each. Any capital gain they would trigger by moving $6,000 from their non-registered account to their TFSAs will not have a material effect on their total income, marginal tax rate or Old Age Security benefits, he says.

Next, the planner looks at the couple's long-term care insurance policy. "This type of insurance policy provides protection if you become unable to care for yourself and require the services of a long-term care facility or professional in-home care," he says. The beneficiary of the policy would be provided with a tax-free benefit to help pay for, or reimburse, these costs.

"There is no one-size-fits-all answer," Mr. Calvert says. Canadians are living longer, and the cost of long-term care is increasing. But an LTC policy can be expensive, and there is no certainty they will need it. "Understanding the family's balance sheet is an important item in making this decision," the planner says. Tess and Lee don't own any real estate that they could sell to cover nursing care late in life, he notes.

"Many Canadians when faced with new and expensive long-term care costs, have been able to sell their principal residence," the planner notes. Because Tess and Lee don't have that option, there is a stronger case to keep the long-term care policy.

This forecast assumes they are taking a total of $40,000 of investment income each year from the non-registered portfolio. Their current income also consists of Canada Pension Plan benefits, Old Age Security, prescribed annuity payments, minimum RRIF withdrawals and a small amount of employment income ($8,000 a year for Lee).

"After income splitting, they will have taxable income of about $60,000 each," Mr. Calvert says. "This level of taxable income and marginal tax rate provides good flexibility for additional taxable withdrawals from their RRIF, the planner says. "They could comfortably take an additional $10,000 each from their RRIF without moving into a new tax bracket or jeopardizing their OAS benefit." Any additional funds needed could come from their non-registered portfolio.

The planner's analysis assumes an average annual rate of return of 5 per cent and an inflation rate of 2 per cent. By 2039, when they are age 89 and 90, "we would expect their assets to be reduced to about $1-million," Mr. Calvert says.

## CLIENT SITUATION

**The people:** Tess, 70, and Lee, 71

**The problem:** Are their investments arranged in the most tax-efficient way? Can they sustain their current lifestyle spending? Should they continue contributing to TFSAs and paying for long-term care insurance?

**The plan:** They might want to shift their TFSAs to growth-oriented global equities and keep the blue-chip dividend payers in their non-registered accounts. Keep contributing to TFSAs and long-term care insurance.

**The payoff:** Knowing they've arranged their finances well.

**Monthly net income:** $16,040 or as needed.

**Assets:** Bank accounts $31,850; her non-registered portfolio $952,600; her TFSA $97,430; his TFSA $93,835; her RRIF $385,655; his RRIF $706,415. Total: $2.27-million

**Monthly outlays:** Rent $4,100; home insurance $75; electricity $80; housekeeping $200; home decorating $250; transportation $525; groceries $800; clothing $200; gifts, charity $350; vacation, travel $2,000; other discretionary $3,000 (furnishing, vehicle maintenance, major appliances); dining, drinks, entertainment $850; personal care $300; yoga $250; subscriptions $35; adult education $1,000; dentists, physio, chiropractor $900; drugstore $150; health insurance $310; long-term care insurance $325; phones, TV, internet $340. Total: $16,040

**Liabilities:** None

*Ian Calvert is a Vice President & Principal*

*at HighView Financial Group.*