Investing in Registered Accounts: Risks and Rewards

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Agenda

- What is a registered investment account?
- Review of registered account types
- Considerations for investing
- Qualified and prohibited investments
- Non-qualified investment tax
- Advantage tax and swap transactions
- Overcontribution tax and other cautions
- CRA Audits

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What is a registered investment account?

- RRSP – Registered Retirement Savings Plan
- RRIF – Registered Retirement Income Fund
- TFSA – Tax Free Savings Account
- RDSP – Registered Disability Savings Plan
- RESP – Registered Education Savings Plan
- For this presentation: “Reg Acc”

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RRSP

- Contributions are deductible, assuming adequate contribution room available
- Spousal contributions create possibility to income split
- Contributions limited based on % of earned income
- Withdrawals taxable as ordinary income
- Home Buyer’s Plan and Lifelong Learning Plan available for use

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RRIF

- RRSP automatically converts into RRIF at 71
- 7% minimum withdrawal every year
  - Possible to pension split with spouse
- Additional withdrawals beyond 7% per year cannot benefit from pension splitting
- Withdrawals are taxable as ordinary income
- Otherwise very similar to RRSPs

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TFSA

- Contributions non-deductible
- Income, capital gains, withdrawals non-taxable
- Contributions limited by per-year limit ($5,500)
- Withdrawals are only added to the <u>following</u> year’s contribution room

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RDSP

- Requires disability credit eligible beneficiary
- Contributions not deductible, lifetime limit of $200,000 per individual
- Gov’t matches contributions depending on adjusted family income
- Lifetime limit of $70,000 benefit
- No limitations on spending by beneficiary

RESP

- Contributions non-deductible
- Lifetime contribution limit ($50,000)
- Income and capital gains accrue tax deferred
- Canada Education Savings Grant (20% added to contributions of up to $2,500 per year)
- Taxable to beneficiary for use in post-secondary purposes
- CESG repayable if RESP reverts to contributor

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Other considerations

- Income and capital gains accrue on a tax deferred basis—can mean faster growth
- Withdrawals / income lose tax character
- TFSA – Highest income investments
- Non-TFSA – Interest-bearing investments

What can you invest in a registered account?

- Must <u>be</u> a *Qualified Investment*
  - Often relates to the type or nature of the investment
- Must <u>not be</u> a *Prohibited Investment*
  - Often deals with the relationship between planholder and investment
- <u>Any point in time test</u>

Qualified Investment

- Money, deposits, GICs (no cryptocurrency)
- Most public company shares, warrants, options
- Mutual funds and segregated funds
- Canada or provincial savings bonds
- Debt obligations of public companies
- Insured mortgages
- Other more uncommon investments

Prohibited Investment

- Personal debts
- Debt, shares, or interest in:
  - A corporation, trust or partnership in which the planholder has a significant interest
  - A person or partnership with which the planholder does not deal at arm’s length
- An interest in, or right to acquire any of the above (stock options)

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Prohibited Investment (cont'd)

- Significant interest
  - 10% of any class of shares (10% of FMV of partnership or trust)
  - Includes all shares held by those at non-arm's length
  - Point in time test
- Non-arm's length
  - Related persons by blood
  - Fact specific

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Example

- Bob and Bill are founders of XYZ Explorations Inc., a company listed on the TSX, and each own 6% of its only class of outstanding shares
- Bob and Bill are not directors of the company
- Bill wants to contribute his shares into his TFSA

Example (cont'd)

1. If Bob and Bill are at arm's length?
2. If Bob and Bill are brothers?
3. What if Bill is a director?
4. What if XYZ Explorations gets delisted?

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Private company shares

- Non-arm’s length (<10%, or fact test)
  - If reducing share ownership, consider sale price or side agreements as non-arm’s length by fact
- Specified small business corporation
  - 90% of assets in active business carried on primarily in Canada
  - Canadian corporation
  - Not controlled by non-resident persons

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Non-qualified investment tax

- 50% of the value of the investment (RC339)
- Refundable if:
  - Security disposed of by the end of the year in which the tax arose, AND
  - If it is unreasonable to conclude that the planholder should have known better,
- Income thereafter subject to income tax
- Must write in for refund (no form)

Advantage tax

- 100% of:
  - The FMV of the benefit, if any
  - The amount of the debt
  - The amount of the registered plan strip
- May be waived at the discretion of the Minister

Swap transactions

- Substituting an investment (or cash) in a non-registered account with an investment (or cash) in a Reg Acc with no change in contribution room
- Advantage tax applies on <u>all</u> swap transactions
- Can still be used to remove prohibited investments from Reg Acc for cash

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Overcontribution tax

- 1% per month tax on the excess contribution amount
- Payable 90 days after the end of the calendar year in which there was an overcontribution
- $2,000 overcontribution threshold for RRSPs; $nil on other Reg Acc
- T1OVP form required

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Other Cautions

- Cannot borrow money from within a Reg Acc
- Cannot carry on a business within a Reg Acc
  - Day trading—except within RRSP and RRIF, as long as it relates to qualified investments
- Contributions of shares in-kind
  - Recognizes capital gains
  - <u>Denies </u>capital losses

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CRA Audits

- Strong focus on TFSA audits
- Targets:
  - High contribution room individuals
  - Private company / unlisted shares
  - Non-arm's length relationships