Personal Finance

Seeking the perfect mix

Couple wants tax-saving retirement plan to juggle many sources of income

money makeover By: Joel Schlesinger

Yet, they should consider the following: not all losses are market-based. When it comes to GICs and savings, particularly in a corporate investment account, they are losing money on taxes and inflation. And those losses are essentially guaranteed.

Still, conservative investments have a big role to play in their portfolio -- only in a different account: the RRSP (or a registered retirement income fund -- a RRIF). Here their money can grow slowly and tax-sheltered -- something that can't be accomplished as well inside a corporate account.

There are no concerns about tax-efficiency in an RRSP or RRIF because withdrawals are taxable as normal income.

Consequently, they receive no tangible reward for taking on more market risk.

Vincent and Alexandra's finances

INCOME
Vincent: $38,000 ($3,000 net a month)
Alexandra: $48,000 ($3,500 net a month)

MONTHLY EXPENSES: $6,670

DEBTS: none

ASSETS:
Home: $500,000
Savings: $226,000
Corporate account: $822,000
Alexandra TFSA: $43,000
Vincent TFSA: $43,000
Vincent RRSP: $315,000
Alexandra RRSP: $331,000

NET WORTH: $2.28 million

Given they're seeking a tax-saving strategy, Diamond cannot underscore the importance of developing a plan that uses both accounts in tandem.

"If they employed a more tax-efficient investment structure for the retained earnings, that would certainly open the door to use a combination of RRIF income and income from the corporation," he said.

Essentially, both accounts defer taxation.

The difference is withdrawals on retained earnings can be taxed more favourably in certain circumstances and, unlike RRIFs, there are no minimum withdrawals for income.

This is why Vincent and Alexandra should consider a plan to strategically draw on their registered accounts sooner rather than later to ensure paying as little tax as possible.

This can be accomplished by withdrawing income up to the next highest tax bracket, for example, with the excess above their spending needs funding the TFSAs.

More broadly, the trick to building a tax-efficient retirement income is brewing the ideal mix -- one that withdraws money from the right place at the right time.

A crucial component is always having accessible savings, but only as much as required. Already they have a large pool of liquid assets to serve that need: $226,000 in cash. But they also should have a short- to medium-term pool of capital, which would involve a laddered investment strategy involving bonds or GICs with maturities of one to five years.

The upside of this approach is always having money coming due feeding their immediate income needs, while capital from their longer-term investments -- such as equities -- can be efficiently sold and reinvested in five-year maturity GICs or bonds to replenish the laddered holdings.

But the main take-away is Vincent and Alexandra require a little more balance of risk and return in their portfolio to execute a truly tax-efficient strategy.

That doesn't mean a lot of exposure to markets. If they started by changing half of their assets in the corporation to dividend-paying equities, for example, their overall asset allocation would still reflect a very conservative mix of 75 percent fixed income and 25 per cent equities.

"In fairness, they're in a good situation: even with low rates of return they may be fine given how much capital they have to create the income they want, but they need to take a hard look at their investment strategy," Diamond said.

"The conservative approach may be intended to preserve capital, but it's likely to have the opposite effect."

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