

# How Investments Are Taxed in Non-Registered Accounts



Investing can help build long-term wealth, but to maximize the benefit you should aim to minimize the tax you pay on your investments. For many people, a good first step is to invest in registered accounts like a Registered Retirement Savings Plan (RRSP) and a Tax-Free Savings Account (TFSA).

Both account types provide tax breaks. When you contribute to an RRSP, you get an immediate tax deduction to lower your income tax, plus any income and growth in your plan will be tax deferred until you withdraw money (typically in retirement, when your tax bracket is usually lower). With a TFSA, contributions are made using after-tax dollars, so they won't earn a tax deduction but any growth in your account will never be taxed.

## When to use a non-registered account

RRSPs and TFSAs have specific contribution limits, so if you've contributed the annual maximum and still have money available for investing, consider a non-registered account. Similar to registered accounts, it is possible to invest in a wide range of securities, such as stocks, bonds, mutual funds, exchange-traded funds and more. However, your contributions are not eligible for a tax deduction, while earned income is taxable.

Unlike registered accounts, a non-registered account has no contribution limits or stipulations regarding withdrawals. This greater flexibility means you can invest as much in a non-registered account as you choose, draw income when desired and stay invested in the account for as long as you want.

## How income is taxed

For tax purposes, not all income earned in non-registered accounts is the same. Be mindful of how each income type is taxed, since it may impact investment decisions as you try to reduce your tax obligations.

Three common types of income are interest, dividends and capital gains.

**Interest:** Whether it comes from bonds, fixed income funds, savings accounts, GICs or other sources, interest income is fully taxed at your marginal tax rate, which means it's the least tax-efficient source of income. Many people put interest-earning products in their RRSPs or TFSAs to take advantage of favourable tax circumstances. This doesn't mean you should avoid investing in interest-generating products in a non-registered account, but be aware of the income tax you must pay.

**Dividends:** Some stocks and funds distribute income in the form of dividends. These payments can be a regular source of tax-efficient cash flow. Eligible dividends come from Canadian public companies or from funds holding shares of such companies. Their tax rate takes into account a gross-up on the value received, as well as a dividend tax credit on the grossed-up amount. The same principle applies to non-eligible dividends from private companies, except that the value of the gross-up and the tax credit differ. Non-eligible dividends, i.e. those received from foreign companies, do not qualify for the dividend tax credit. At the final tax level, eligible dividends are taxed at the most attractive rate, followed by non-eligible dividends, then interest (which is taxed at the same rate as salary). When a financial institution issues annual tax slips, the dividend calculation is often done for you.

**Capital gains:** If you sell an investment for a higher price than you paid, or if a fund you hold distributes a capital gain to its investors, that realized gain is taxable. Only half of your capital gain is subject to income tax, making this a tax-efficient form of income. However, as of June 25, 2024, the inclusion rate is 66.7% for the portion of earnings exceeding \$250,000 annually. This means that earnings up to this threshold will still be taxed at 50%. Also, if you have capital losses (i.e., you sold securities at a loss) during the tax year or from previous years, these losses can reduce the tax you pay on capital gains. To help offset past gains, you can apply these losses to gains on your tax returns up to three years back and indefinitely into the future.

An advisor or tax specialist can help you understand how different income types affect your tax obligations, and how reducing income tax may help you build wealth more effectively over time.

**To learn more about how we can create a suitable investment strategy based on your specific needs, contact us today.**

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