Higher Taxes Ahead? Good News: Only 10% of Canadians Max Out Their TFSAs and RRSPs

Description

With the Liberal government taking 159 seats in last week's election (158, after Kevin Voung's departure), and the NDP sealing 25, many investors are worried about one thing: a potential hike in the capital gains tax.

As you may recall, the NDP rallied around a pledge to increase investment gains from 50% to 75%. Given that Liberals are also looking for ways to boost the government's revenues as well as a general discontent around wealthy people getting wealthier off interest, higher capital gains taxes may be in Canada's future.

For worried Canadians, there is one source of hope (or two). You can bypass the capital gains tax by taking full advantage of your TFSA and RRSP.

TFSAs and RRSPs: A missed opportunity?

At this point, you may feel the need to say, "Invest in an RRSP and TFSA? Well, *duh.*" But here's the thing: despite the obvious tax advantages of these accounts, most Canadians *aren't* taking advantage of them.

According to the CRA itself, only a small percentage of Canadians (1.5 million) who have a TFSA (around 14 million) are maxing out their contribution room. That's just a sliver more than 10% of TFSA holders. And with over 50% of Canadians indicating no plan to contribute to their RRSP this year, it doesn't seem like *that* retirement account is much better.

Recall that capital gains realized in both RRSPs and TFSAs are *not* taxable. That means you could invest in a **Shopify**-like stock that balloons in a short period of time, and so long as your shares are under the tax shelter of a registered retirement account, you won't have to worry about paying capital gains taxes.

For Canadians who are worried about an increase to the capital gains tax — and who aren't taking full advantage of TFSAs and RRSPs — that means one thing: move your investments into a tax-sheltered account as soon as possible.

Pay taxes now and save later

If you hold investments in a non-registered retirement account, an increase in the capital gains tax could have a drastic effect on you. Though you only incur the tax when you "realize" gains, that is, when you sell your investments for a profit, the moment you do sell, you'll have to pay taxes on a portion of your earnings (50% for now, possibly 75% later).

Most savvy investors will wait to sell their stocks until retirement, when their marginal tax rate is lower and they'll pay less on capital gains. But if we're talking about a 25% increase in the capital gains tax, I'd say, sell now while you have the chance. Pay the 50% on your gains, then reinvest your money in the same securities under the tax shelter of a TFSA or RRSP. You could also do the same for investments you've lost money on, as your capital losses could balance out your capital gains, resulting in a lower tax bill.

Many of the best online brokerages will let you open TFSAs and RRSPs within their platforms. You can find most of the same securities you'd find in a non-registered retirement account, and you can move your money fairly quickly from your chequing or savings account.

Should you wait?

For the record, nothing has happened yet. The capital gains tax is still at 50%, and the government hasn't released news on an upcoming increase. If you'd rather wait until the government announces its plans, you can certainly do so, though I'd have a strategy in place just in case it does.

Finally, it's important to note this isn't the first time a government has increased the capital gains tax. In fact, if you look at the last 30 or so years, you'll see the capital gains tax has gone up and down with different governments. In 1990, for instance, the Conservative government raised the capital gains tax to 75%, with the Liberal government returning it to 50% in the years after. While history doesn't always repeat itself, it's possible that the capital gains — if it's raised to 75% — will return to a 50% rate later.

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