



Wealth
Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

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Tax and wealth planning considerations when paying investment management fees

In wealth planning, small decisions, such as deciding the account from which to pay your investment management fees can make a large impact and play a key role in building wealth over time. This article reviews the tax deductibility of investment management fees as well as other wealth planning factors to consider when deciding how to pay your investment management fees.

Registered investment accounts

Deductibility of investment management fees

For income tax purposes, the annual administration and investment management fees that relate to registered accounts, such as, registered retirement savings plans (RRSPs), registered retirement income funds (RRIFs), tax-free savings accounts (TFSA), registered educational savings plans (RESPs), registered disability savings plans (RDSPs), tax-free first home savings accounts (FHSA) and locked-in plans, are not deductible. This is the case even if you paid the fees from your non-registered account.

Options for paying fees for your registered accounts

Notwithstanding the deductibility of the fees, if you have registered and non-registered accounts at the same financial institution, you may have the option to pay the administration and investment management fees on your registered account either by using the funds in that registered account or by using the funds in your non-registered account.

Paying fees from your registered account

If you pay your registered account fees with funds from your registered account, this will simply reduce the amount available for future



withdrawal. The payment of the fees will not be considered a contribution or a withdrawal.

You cannot use the funds in one of your registered accounts to pay for fees incurred by another registered account, even if you are the annuitant of both accounts. For example, if you are the annuitant of several RRSP accounts, you cannot combine the fees for all of the RRSP accounts and have one RRSP account pay the combined fee. If you do, the excess amount paid, over and above the fees that apply to that particular RRSP, may be taxable to you.

Paying fees from your non-registered account

If you pay your registered account fees with funds from your non-registered account, you can avoid reducing the amount in your registered account and continue to enjoy the tax-deferred or tax-free growth on your investments, depending on the nature of the account. The payment will not be considered a contribution to your registered account and will not reduce your contribution room, where applicable. For example, if the fee relates to an RRSP, you will not be able to deduct the fee as an RRSP contribution.

If you intend to pay the fees with funds from your non-registered account, and the funds are fully invested, you may need to liquidate some investments to raise cash to pay for the fees. In this case, you will need to consider the liquidity of your investments and the convenience of liquidating them to pay the fees. Also, if you have to sell investments in your non-registered account, you may realize a capital gain or loss that you will need to report for tax purposes. Lastly, if you sell certain investments in a managed account with automatic rebalancing, consider that paying the fees from that account may trigger a rebalancing, perhaps sooner than you intended.

Other considerations when paying fees for your registered accounts

There are other factors that you may want to consider in deciding from which account to pay your registered fees. These may include your time-horizon or how long you will be invested in the registered plan. For example, it may be more beneficial for you to pay the fees from your non-registered account if you have a longer time until retirement. This allows more time for your investments to grow on a tax-deferred or tax-free basis, which will potentially increase the value of your wealth and retirement savings.

The rate of return you expect to receive on your investments can also influence your decision on from where to pay your fees. In general, the higher your rate of return, the more you will benefit from leaving your funds invested in a tax-deferred or tax-free account.

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Lastly, although it's generally more tax-efficient to pay your TFSA investment management fees from your non-registered account to preserve the amount of income you can earn tax-free, when it comes to your RRSP or RRIF fees, you may want to consider the type of income your investments generate. For example, if you're only earning tax-preferred income (such as capital gains or eligible dividends) in both your registered and non-registered portfolio, then it may make sense to pay the investment management fees from inside your RRSP or RRIF. This would leave more money in your non-registered account to earn tax-preferred income, which is generally a more tax-efficient strategy.

Non-registered investment accounts

Deductibility of investment management fees

Unlike fees that relate to registered accounts, if you incur management fees for investments in a non-registered account, the fees may be tax deductible if they relate to investment counsel advice on buying or selling a specific security that you hold directly. Securities include stocks, bonds, mutual funds and exchange-traded funds (ETFs). You may also deduct the fees you pay for the administration or the management of the securities held in your non-registered account. For example, fees you paid for the custody of securities, the maintenance of accounting records, and the collection and remittance of income would normally qualify as deductible expenses. Fees you paid for other types of advice such as general financial counselling or planning are generally not deductible.

The fees need be paid by you to a person whose principal business is advising others whether to buy or sell securities or whose principal business includes the administration or management of securities. The amount of fees you pay must also be reasonable, considering the amount of time the person providing the advice or service spent on the work and the type of work they did.

In general, investment management fees are deductible against any type of income on your personal income tax return. However, if you are a tax resident of Quebec, the amount of investment management fees deductible is

limited to the amount of investment income you earn on your Quebec tax return. If you don't have enough investment income to fully use the deduction, you can carry back the unused portion for three years and/or carry it forward indefinitely.

Commissions

Commissions are not considered a payment for investment counsel advice and are generally not tax deductible. Fees relating to commissions when you purchase an investment can be added to the adjusted cost base (ACB) of your investment or deducted from the proceeds of disposition when you dispose your investment. This will typically reduce your capital gain or increase your capital loss for your investment.

All-inclusive fees

In some cases, the account fee you pay on your investment account may be an all-inclusive fee. The all-inclusive fee can cover a number of different services including, but not limited to, investment advice, securities brokerage and execution services and account management and administration services.

Usually, an all-inclusive fee includes compensation for purchase and sale transactions based on the value of the assets in the account as well as remuneration to the advisor. In addition to the all-inclusive fee, a transaction-based fee may be charged if the number of transactions allotted to the account is exceeded within the calendar year.

Generally, the portion of the all-inclusive fee that is associated with investment counsel advice and administration and management services is deductible. Since the all-inclusive fee relates to a number of different services, it's important to consult with your own professional tax advisor who can look at your specific situation in determining the portion of the fees that may be tax deductible.

Sales taxes

You may also pay sales taxes, such as the Goods and Services Taxes (GST), the Harmonized Sales Tax (HST) and the Quebec Sales Tax (QST) in addition to the investment management fees. Where it's determined that the management fee you paid is deductible for tax purposes, you can deduct the GST/HST/QST related to this fee.

Non-deductible fees or portion of fees

If a particular fee or a portion of the account fee related to your non-registered account is determined to be non-deductible for tax purposes, it may still be possible to obtain some tax benefit from the fee. Usually, any expenses incurred to acquire a security,

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such as commissions, transaction fees, and legal fees can be added to the ACB of the security. This adjustment serves to reduce your future capital gain or increase your future capital loss. As such, this tax benefit is deferred until the security is disposed of (or deemed to be disposed of).

Outlays and expenses incurred to sell a security can also be deducted from your proceeds of disposition when calculating your capital gain or loss when you sell your security. Similarly, this adjustment serves to reduce your capital gain or increase your capital loss.

Options for paying fees for your non-registered accounts

For your accounts

There are various methods of paying the investment management fees related to your non-registered accounts. For example, one method is to have the account fee directly debited from your non-registered account. Another method is to pay an invoice from another one of your non-registered accounts. Both methods should allow you to deduct the investment management fees as you are paying the fees directly.

For your family's accounts

There are also different ways you can help pay for your family's account fees. For administrative ease, sometimes one combined fee is issued for all of the accounts of one family. Certain account programs can accommodate this request. However, before making this request you should be aware that this option can affect your family's ability to deduct all the fees you paid.

Assume that your family of four each has their own non-registered investment account. For simplicity, assume that each account has an annual account fee of \$5,000 for a total family account fee of \$20,000. If the \$20,000 account fee is paid fully by you or directly from your own account, then you will only be able to claim \$5,000 (not \$20,000) as a tax deduction since that was the fee you paid, relating to your own account. The remaining \$15,000 account fee cannot be claimed by your other three family members since they did not pay this fee. In order for the full \$20,000 account fee to be deductible by your family, the \$5,000 account fee should be paid by each family member for their own account.

For joint accounts

In situations where your non-registered account is held jointly, the deduction of management fees may be more complicated. You will need to ensure you pay your portion of the fee relating to the joint account in order for the fee to be deductible.

For example, say you owned a joint non-registered account with your brother. You have a 40% interest in the account and your brother has the remaining 60%. As such, you report 40% of the investment income and your brother reports 60% of the investment income for tax purposes. If the deductible investment management fees of say, \$10,000 are directly paid from the joint account, then \$4,000 would be deductible on your personal tax return while \$6,000 would be deductible on your brother's tax return. Alternatively, if you each individually pay the fee with funds outside of the joint account, then you would need to pay \$4,000 and your brother would need to pay \$6,000 to ensure that you both can claim the maximum deduction for this management fee.

Conclusion

As the tax issues relating to deducting investment management fees can be quite complex, you should speak with a qualified tax advisor about your personal situation. A qualified tax advisor can help you determine whether the investment management fees are tax deductible as well as the most appropriate way to pay the investment management fees for you and your family.

This article may contain several strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal and/or insurance advisor before acting on any of the information in this article.



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