

Unintended Consequences of Public Policy

Comments from EdgePoint Wealth Management

The recent Ontario budget contains a massive tax grab that our Investment Partners should be aware of. The McGuinty government is proposing the harmonization of Ontario's provincial sales tax with the federal GST. The decision to jam an additional 8% tax on the management expense ratios (MER) of your investment products is shockingly unwise and dangerous.

The vast majority of Canadian families appreciate the importance of saving for their retirement. In the face of this, the Ontario government has decided to levy an incremental tax on people who decide to invest a portion of their hard-earned savings to secure a better future for themselves and their families. To be clear, this tax will impact everything from your RESP's to your RSP's and RRIF's.

Is this logical? Is this responsible? Won't this add a disincentive for people to save at a time when fiscal prudence is of paramount importance? Hasn't the government been trying to promote savings?

Most of us have seen ill-advised public policy implemented during our lifetimes. Often, we just shake our heads and drive on. However, before you do so, let's look at how it will affect you.

Let's assume you are 45 years old, you invest \$20,000 in a mutual fund inside your RSP, and this investment grows at 10% per annum (before this recent tax grab). Unfortunately, fees in Canada are among the highest in the world but we'll be generous and assume you only pay a 2.75% MER (before the GST of course) on your mutual fund investment. The harmonized sales tax (HST) would add approximately 22 basis points (0.22%) to the MER.

By the end of year one, your \$20,000 would have been worth \$22,000 before the tax grab. But, with the tax, you have only \$21,956. A seemingly tiny **\$44 difference**, thus increasing the likelihood the government slides in this tax without much of a fuss.

Interestingly, **by the end of year two**, you now only have \$24,103 versus \$24,200 (without the tax grab). **That's a bigger difference of \$97**. Why isn't the difference $\$44 + \$44 = \$88$? Because your investments are growing and the government is taking the same 8% from your expanding pie.

By year 10, you are 55 years old. Luckily, the \$20,000 you put in that mutual fund 10 years ago has grown to \$50,847. You're content, but unaware that without the tax, you would have had \$51,875.....\$1,028 more! The magic of compounding interest is starting to take hold. **The \$1,028 is now 5.1% of your initial \$20,000 investment.**

By year 20, you are 65 years old. Your initial investment has grown to a value of \$129,269. Without the tax harmonization, you would have had \$134,550.....**\$5,281 more or 26.4% of your initial \$20,000 investment!**

Einstein once wrote that the 8th wonder of the world is compound interest. We have trouble debating him on that issue, especially if we consider the next 20 years.

You are now 75 years old. That \$20,000 contribution to your RSP is now worth \$328,645. Little did you know that it could have been \$348,988 without the 2009 tax harmonization.....**a difference of \$20,343 or 102% of your initial investment!** The government has taken over 100% of your initial investment away from you.

By year 40, you are 85 years old. Your \$20,000 has grown to \$835,524. Without the new tax, you would have had \$905,185..... **a difference of \$69,661 or 3.5 times your initial investment!** The government has collected \$69,661 from your initial \$20,000 investment for a 350% tax rate. What could you have done with that extra \$69,661? Could that have made a difference in your life?

Sometimes public policy has unintended consequences. We are not sure whether the current administration understands the materiality of this decision and how it could negatively impact the average person's retirement savings. The important question is, "Can we stop this?"

We are worried that the various interests of industry participants will detract from the real issue at hand. Rather, arguments may be focused on potential financial job losses in Ontario due to the tax, or the inequality of the harmonization of the tax on mutual funds, or the timing of the tax given the weak markets rather than the ultimate cost of the tax to investors over the long run.

The reality is that this tax affects you much more than it affects mutual fund executives or mutual fund company shareholders. Politicians would gladly tax additional financial services and investment products to make this tax more equitable. They would be more than happy to stage this tax in. None of this helps you. We would hope the government would not want to take 350% of your initial investment if they truly understood the consequence of this tax. We're not sure that they do.

A simple message needs to be delivered to the government, and we plan on delivering it. Quite simply, they must be made aware that this tax is bad for you, the investor. As such, we have requested a meeting with Premier McGuinty to share our thoughts.

Because this affects you, our investment partners, take the time to help the government understand the consequences of this unintended tax grab by writing or calling your Member of the Legislative Assembly (MLA) today. We have provided the contact information for the Premier and Minister of Finance below.

We'd also like to hear what you think. Please send us an e-mail at info@edgepointwealth.com and give us your feedback.

Sincerely,

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