Wealth Matters - Winter 2006

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Retire Right

As part of our regular professional development activity, we read hundreds of articles and studies about financial planning and investment management. This fall, we came across two interesting research studies on the attitudes of Canadians with respect to financial planning and retirement lifestyles. The studies were conducted by Innovative Research Group and AXA International. We thought you might be interested in some of the results.

- Innovative Research Group found that 88% of Canadians believe it is important to have a financial plan, but only 38% have a financial plan with clear investment objectives. The rest of the results cited below come from the AXA study.
- Only 20% of working Canadians know how much retirement income they're likely to receive. Even in the age group closest to retirement, only 26% knew what their income would be after they stop working.
- Of working Canadians, 78% said they had started preparing for retirement – the 2nd-highest percentage of any population in the world. The average age they started to prepare was age 30. We believe that the high percentage result is largely due to the popularity of RRSP contributions, but we are concerned that very few of those who have started to prepare still have no clear investment objectives in their financial plan.
- Just under half of working Canadians believe that children should help to financially support their retired parents. However, only 27% of retired Canadians believe their children should help to financially support them.
- 69% of retired Canadians (of all ages) have paid off their principal residence mortgage, and 13% owned a second home. These results highlight a financial planning need. If you have a second home or cottage, you may already be aware that this second property could be subject to substantial income tax on capital gains building up in the property as it grows in value. This tax becomes payable when you sell the property for a profit, or when you die if you haven't sold it yet. Careful planning can reduce or eliminate such taxes.

As a family wealth management firm, our role is to help our clients assess their goals and resources, and define a set of financial strategies to help them achieve their goals while minimizing unnecessary taxes. Regardless of your stage of life, a financial plan can help you set and prioritize your goals, and give you peace of mind in knowing that you are doing everything possible to achieve them in the most efficient manner possible. So if you are among the 88% of Canadians who believe in the importance of a financial plan, we would be glad to show you how we can help.

Improvements to GIC Administration

Over the past year we have worked closely with our Mutual Fund Dealer, Worldsource Financial Management, to develop additional tools and services for GIC investors. Some of these include:

- higher interest rates on RRSP and RRIF investments through self-directed accounts;
- interest payments on cash balances held while consolidating several maturities in self-directed accounts;
- consolidated statements combining GICs and mutual fund holdings on a single statement; and
- the ability to view current statements of all holdings over the internet.

Some of these advantages will automatically become available to you in the new year as we begin using Worldsource's computer systems to administer your GIC holdings instead of the Page Deposit Brokers Corp. system. The format of our maturity notification letter and statement will change beginning in January but there will be no change to your investments. We would be glad to set up self-directed accounts for you, so you can take advantage of some of the benefits unique to these accounts.

The strategies discussed in this newsletter are not for everyone. We would only recommend a particular strategy after fully understanding your unique situation, objectives, and values. We would be glad to offer a complimentary **'Initial Assessment and Evaluation'** meeting, and a written **'My Life – My Wealth'** report of the areas in which we believe we could help you achieve your financial goals. Please call us if you would like to discuss this opportunity.

Income Trusts

Halloween delivered more than tricks and treats for kids. Our federal government took advantage of the Halloween distraction to pull a trick of its own by announcing changes to the taxation of Income Trusts. While the changes caused an immediate drop in the market prices of income trusts, prices stabilized within a few days after the announcement, and the change is not expected to have a major tax impact on most Canadian investors until the new rules take effect in 2011. Despite the price drop in the value of income trusts, year-to-date returns are still attractive, and investors with properly diversified portfolios will not notice much of an impact.

We are surprised at the lack of detailed information about these changes that can be found in public sources, so we have prepared a report about the effects of these changes. Due to the length and technical nature of the report, we have not included it here. Please call us at 905-884-5563 or email us at contact@askpage.com to request a copy.

New Tax Savings for Retirees

The Halloween budget changes will allow taxpayers receiving pension income to 'split' this income with a spouse. The example at right shows how this could save a typical retired couple over $4,000 of income tax each year beginning in 2007.

In this example, Bob is in a higher tax bracket than his wife Judy. In 2007, Bob can deduct up to 50% of eligible pension income, and Judy includes this amount on her tax return, paying a lower rate of tax. Eligible pension income may include income from a life annuity, pension plan, RRSP or RRIF.

This new opportunity to save taxes through income splitting may make it more desirable to accumulate or maintain plans that can create easily-splittable pension income rather than accumulating non-registered investments for the lower income spouse.

2006 Taxes

	Bob	**Judy**	**Total**
Pension Income	50,000	0	50,000
Other Income	10,000	10,000	20,000
Total Income	60,000	10,000	70,000
Tax Payable	13,302	177	13,479
Age Credit		-177	-177
Pension Deduction	-375	0	-375
Total Tax	12,927	0	12,927
NET INCOME	**47,073**	**10,000**	**57,073**

2007 Taxes (using 2006 rates)

	Bob	**Judy**	**Total**
Pension Income	25,000	25,000	50,000
Other Income	10,000	10,000	20,000
Total Income	35,000	35,000	70,000
Tax Payable	5,608	5,608	11,216
Age Credit	-867	-867	-1,734
Pension Deduction	-375	-375	-750
Total Tax	4,366	4,366	8,732
NET INCOME	**30,134**	**30,134**	**61,268**

Charitable Donations

Last year's Budget provided a new opportunity to obtain even higher tax savings from charitable donations. By making a donation of publicly-traded securities, investors can avoid the tax on selling the shares, while still getting the full tax credit for the value donated. The example below assumes you bought $5,000 of shares that are now worth $10,000, so there would be tax to pay when you sell them. You could sell your shares and net $8,850 after tax. If you then donate the proceeds, you get a donation credit, but give up the $8,850, for a net cost of $4,779 for the donation. The best strategy is to give the shares directly to charity, you are also out-of-pocket the $8,850, but you get a donation credit based on the larger pre-tax value of the shares, so your net cost drops to $4,250. But wait, there's more! In this case the charity got not $8,850 but $10,000 since it can sell the shares and pay no tax. Finally, donating the shares directly can avoid a large capital gain which could raise your income to the point where you start to lose some of your Old Age Security benefits.

	Sell Shares	**Sell Shares and Donate**	**Donate the actual Shares**
Value of Shares	$10,000	$10,000	$10,000
Cost Basis	$ 5,000	$ 5,000	$ 5,000
Capital Gain	$ 5,000	$ 5,000	$ 5,000
Tax Payable on Sale	$ 1,150	$ 1,150	$ 0
Net Proceeds of Sale	**$ 8,850**	$ 8,850	$10,000
Amount Donated	$ 0	$ 8,850	$10,000
Donation Credit	$ 0	$ 4,071	$ 4,600
Net Cost of Donation	**N/A**	**$ 4,779**	**$ 4,250**

More for the Charity.

Less out of your pocket.

Testamentary Trusts

In our last newsletter we told you that many of our clients hold GICs and investment accounts in joint names with their spouse or children to avoid probate fees and reduce estate settlement costs and taxes. We also mentioned that this approach may avoid probate fees of up to 1.5% of the assets, but suffers from a number of drawbacks related to who will own them, who pays the tax, exposure to the child's creditors, and loss of control of the assets. One of the alternate strategies that can avoid such problems is the Testamentary Trust.

Essentially, a testamentary trust is a separate taxpayer created through the testament (the last Will). This trust can receive some or all of the assets of the estate after payment of probate fees, and all debts of the estate. Since the trust is a separate taxpayer from both the deceased and the estate beneficiaries, the trust's income is taxed starting at the lowest rates instead of the beneficiary receiving investment income and having to add this to his or her existing income from employment, pensions, or investments. This can save the beneficiary thousands of dollars of taxes each year.

Here is an example: Mom and Dad own $500,000 of investments held jointly with Son, plus $500,000 owned individually but intended for Daughter's testamentary trust through the Will. Son and Daughter each earn $75,000 per year from employment and investments. Let's see the results after Mom and Dad's estate is settled:

Son:	Daughter:
Changes ownership of the joint investments to his own name after Mom and Dad's death	Becomes beneficiary of a testamentary trust after Mom and Dad's death, with the trust owning the assets.
No probate fees	Probate fees up to 1.5% on the estate assets or $7,500 on this $500,000, plus Will redrafting fee of $1,000
$500,000 invested, earning 5% = $25,000 investment income	$491,500 invested, earning 5% = $24,575 investment income, less $500 for annual trust tax return filing = $24,075 net income
Son's income increases from $75,000 to $100,000 per year, placing the extra income in a 43% tax bracket	The trust pays tax on this $24,075 net income at the lowest tax rate of 21.3%
Income tax on the extra $25,000 income = $10,750	The trust pays tax of $5,128
Net annual benefit $25,000 less $10,750 tax = $14,250	The trust's value increased $24,075 less $5,128 = $18,947 after tax, which can be paid out to Daughter tax-free
Son has an extra $14,250 to spend each year.	Daughter has an extra $18,947 to spend each year. This is almost $4,700 more per year than her brother.

Within two years, Daughter has saved more tax than the total cost of probate and the redrafting of the Will! And she continues to benefit year after year, with about one-third more investment income than she would have had by being the joint owner on her parents' investments.

Aside from the pure tax advantage, there are several important financial planning advantages to this strategy:

- one trust can have multiple beneficiaries, and it can be set up to pay income to the child during his or her lifetime, and then continue to pay income or capital to the grandchildren;
- the trust is not exposed to the claims of the beneficiary's creditors;
- the trust assets are not part of the beneficiary's marital assets, therefore the assets are not divided with the beneficiary's spouse in case of a marriage breakdown.

Other estate planning strategies include the use of lifetime trusts, and the use of holding companies. The choice of strategy will depend on the particular situation and objectives of each family. If you would like to discuss your situation with us in confidence, please call us to arrange an Initial Assessment and Evaluation.

Feedback

We hope you've enjoyed this newsletter. Your comments are important, and they are very valuable to us. Please let us know any ideas you may have for improving the newsletter, or topics you'd like to see in future issues!

Did you know? – you can receive this newsletter by email? We'd gladly give our environment a break by sending you the next newsletter electronically. Please email contact@askpage.com with your full name, and we'll switch you to the email version next time. *Thanks!*