

Financial Planning Guide



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FOCUS ON INVESTING



Make a date with your spouse — to file your tax returns

Working on your 2004 tax return? If you're part of a couple, make sure that you and your partner take advantage of these tax-saving opportunities.

Bills. If the higher-income spouse pays the household expenses and both partners' tax bills, the lower-income spouse can invest his or her earnings and have the returns taxed at his or her lower rate.

Medical expenses. Combine medical expenses and have the spouse with the lower income claim them. That's because the medical tax credit for 2004 applies only to expenses that exceed \$1,813 or 3% of taxable income, whichever is less. So if your spouse earned \$20,000 in taxable income, there would be a tax credit for all medical expenses in excess of \$600.

Donations. Combine charitable donations to maximize the value of claims over the \$200 threshold, where the higher

tax credit comes into effect. Claiming the credit on the return of the spouse with the higher income may help reduce or eliminate provincial surtax.

Dividends. If your partner doesn't earn much, you may be able to claim a spousal tax credit. Some low-income spouses receive stock dividends, perhaps on inherited shares. If those dividends qualify for the dividend tax credit, you can file an election to include them in your income so they don't reduce the spousal credit.

These tax breaks — routinely used by formally married couples — are also available to common-law and same-sex couples who've been together for at least one year, or who have had a child by birth or adoption.

Professional advice can help you find tax-saving opportunities that apply to your situation. ■

Are you investing for income? Here's how mutual funds can help

When it comes to generating income, mutual funds vary widely — in the type of income they distribute, when they distribute it, and how the income is taxed. If you are seeking income from your mutual fund portfolio, you'll want to take all these factors into account.

Types of income

Here's a look at the different types of mutual fund distributions and their tax implications.

Interest. Interest income is fully taxable at your marginal tax rate, unless you hold the fund units in a registered plan such as a Registered Retirement Savings Plan (RRSP), Registered Retirement Income Fund (RRIF), or Registered Education Savings Plan (RESP).

Any fund that has a cash component in its portfolio is likely to have interest earnings to distribute. Some funds, such as money market funds, mortgage funds, and bond funds, are designed to pay interest monthly or quarterly. Many balanced funds also make quarterly distributions of interest from bonds and cash holdings.

Dividends. Dividends are corporate earnings distributed to shareholders, including mutual funds. Many equity, and virtually all balanced, funds receive dividends on their stocks and make distributions monthly, quarterly, or annually. Dividend funds were designed to generate dividend distributions, but may also hold income trusts that provide other forms of income.

Distributions of dividends from Canadian stocks qualify for the dividend tax credit. Dividends from foreign stocks are fully taxed, unless they're in a registered plan.

Capital gains. Over the course of the year, fund managers may buy and sell stocks and bonds for the fund, generating capital gains or losses. Trading gains that exceed losses and deductible expenses are

MUTUAL FUNDS



distributed to unit holders, usually in December. Outside of registered plans, capital gains are taxed on only half of their value.

Return of capital. In addition to the types of investment income above, which most people are familiar with, some funds pay out return of capital, which is not immediately taxable. Instead, these payments reduce the adjusted cost base of the units. Essentially, the tax is deferred until you dispose of the units, at which time it will increase any capital

gain generated (or decrease a capital loss).

Some companies offer "tax-efficient" funds that focus on providing return of capital. Basically, they return a bit of your money in the expectation that ongoing growth will replace it.

Return of capital payments are also available in some income trusts, when they flow through corporate tax breaks such as depreciation and resource credits. Tax breaks not used for the fund's own tax accounting go to unit holders as return of capital.

Systematic withdrawal plans

Many investors seeking a regular income from a portfolio of mutual funds will set up a systematic withdrawal plan (SWP). A SWP automatically redeems units to create monthly or quarterly income — a set amount or percentage of the fund's value.

Each month or quarter, sufficient fund units will need to be redeemed to provide the desired level of income, along with any dividends, interest, or return of capital distributions generated. The rest of the units will stay invested and can continue to grow. If growth is strong enough, it may even more than offset the withdrawals from the SWP.

With professional assistance, you can set up a portfolio that will give you the income you need, when you need it, without any tax surprises. ■

After tax: What's left of your loonie?

NOT ALL INVESTMENT income is taxed equally. For each dollar earned in interest, capital gains, and dividends, here's what's left after tax. ■



Figures are based on a British Columbia taxpayer, with total taxable income of \$75,000 in 2004 (marginal tax rate, 39.7%). Reflects known rates as of Aug. 20, 2004. For illustration only. Actual tax rates will vary. Source: Ernst & Young 2004 Personal Tax Calculator



TAX PLANNING

Moving? Here's a tip

Few people bother to report the sale of their principal residence, since the profit is tax-free. Technically, though, you're supposed to file Form T2091 with your tax return. The Canada Revenue Agency normally overlooks failures to file, but does have the

ability to deny the exemption. It's best to play it safe. You can download Form T2091 from www.cra-arc.gc.ca/E/pgb/ta/t2091_ind/. ■

INSURANCE

Do you understand your disability coverage?

Do you ever worry about becoming disabled or critically ill? "Yes," said 60% of the respondents in a recent national survey carried out by Ipsos-Reid. But only 46% were confident they were financially prepared for such a situation. About half of those polled said they do have some form of disability insurance, but nearly half of that group indicated they did not understand their coverage. Professional advice will help you understand the coverage you have, determine whether it is sufficient, and obtain additional insurance if necessary. ■



EDUCATION

Why parents, not grandparents, should be the RESP sponsor

Grandparents often ask about sponsoring Registered Education Savings Plans (RESPs) for their grandchildren. That's a wonderful gift — but it's usually better to provide the money and have the child's parents open the plan. If the child does not pursue post-secondary education, each RESP subscriber can transfer up to \$50,000 from the plan to his or her RRSP as a normal contribution. At that time, a grandparent might be past 69, the RRSP maturity age. Also, what would happen if the grandparent died before the RESP was used? That can get complicated if not covered in the grandparent's will. ■

TAX FILING TIPS

Don't forget about transferable credits

Certain tax credits can be transferred to another family member if you don't need them to reduce your tax bill to zero. A student who qualifies for the tuition and education credits, for example, can transfer unused amounts (up to \$5,000) to a supporting spouse, parent, or grandparent. Credits that can be transferred between spouses include the disability credit, the age credit, and the pension income credit. The

person receiving transferred credits must file Schedule 2 with his or her tax return. ■



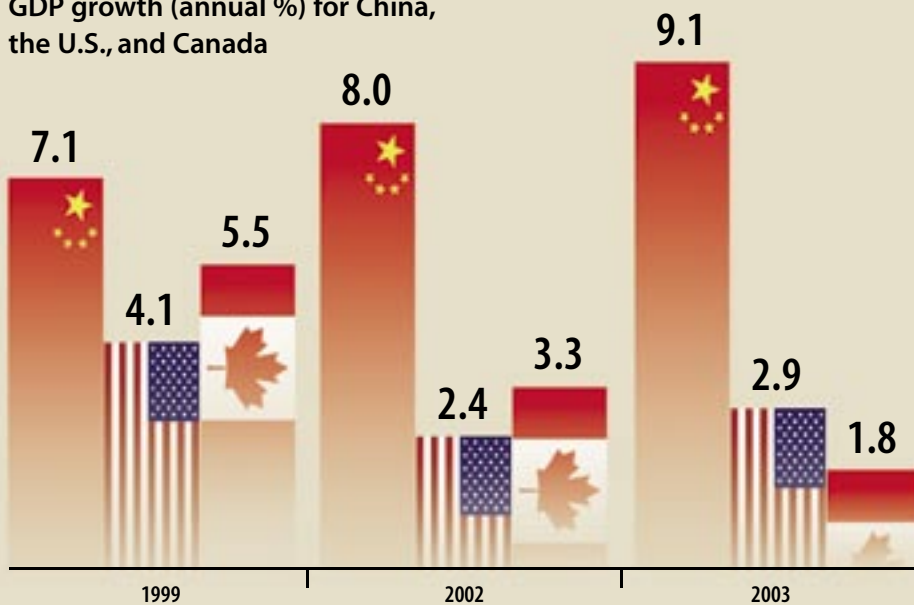
EYEOPENER

graphic evidence of how investing works

China's banner years

CHINA'S INCREDIBLE ECONOMIC growth has caught the attention of investors the world over. As with any emerging market, the potential benefits of investing in China come with significant risk. Professional advice is recommended. ■

GDP growth (annual %) for China, the U.S., and Canada



Source: The World Bank Group, World Development Indicators database, August 2004

Split income to reduce your family's total tax bill

Many families can significantly reduce their total tax bill by shifting income to members who are taxed at a lower rate. But this requires planning. Consider these well-used income-splitting strategies:

Spousal strategies

- Spousal Registered Retirement Savings Plans (RRSPs) are a way to reduce future tax by enabling the two partners to balance their retirement incomes.

- The Canada and Quebec Pension Plans allow couples to evenly split the retirement benefits earned during their time together. This is called "assignment," and requires a specific request.

- The higher-income spouse can lend the other spouse money for investment. Interest must be charged, but can be fixed at the Canada Revenue Agency's low "prescribed rate."

- Say the lower-income spouse inherits a valuable asset, such as artwork or a cottage. The higher-income spouse can buy it, so the other gets investable cash without losing use of the property.

- You can sell your spouse securities, such as mutual funds and stocks, at fair market value. Any further growth is taxable for the spouse. Or, sell your spouse an option to buy that holding at today's price on or before a future date.

Splitting income with your kids

- Registered Education Savings Plans are long-term income-splitting vehicles because the students will face tax when earnings are withdrawn, not the parents

or others who provided the money.

- Give your minor children money for investment. You'll face tax on dividends and interest generated by the original gift, but not on income from reinvested earnings. A child with no other income can generate more than \$16,000 (in 2004) in capital gains before having to pay tax. The investments should be held in a separate "in-trust" account, or in a formal trust if the amount is substantial.

For business owners

- Pay family members reasonable wages for bona fide services. When selling the business, structure the deal so that family members on the payroll get retiring allowances for pre-1996 service. These can be rolled into their RRSPs.

- If the business is incorporated, your spouse can be a director and collect fees. You can also transfer partial ownership to a spousal trust (but not to a trust for minor children) that receives dividends with little or no tax. You will want professional tax advice to make sure the trust is properly established.

- If your spouse or child is starting an unincorporated business, it may make sense for you to be the initial owner. That way, you can deduct any start-up losses from your income from all sources.

- Pay your spouse a fee if he or she guarantees a business loan, perhaps by pledging personal assets.

Professional advice can help you evaluate whether your family might benefit from any of these tax-saving strategies. ■

How your money is protected

MOST PEOPLE ARE familiar with the Canada Deposit Insurance Corporation (CDIC), which insures deposits at major financial institutions, for up to \$60,000, principal and interest.

In fact, Canadian investors are well protected by a number of programs covering money held in a wide variety of financial institutions:

Credit unions and caisses populaires. Various provincial plans provide coverage of \$60,000 or more on deposits and GICs.

Life insurance companies. The Canadian Life and Health Insurance Compensation Corporation (CompCorp) provides coverage on insurance policies, deposits, and segregated funds. The amount of coverage varies by product.

Brokerage firms. The Canadian Investor Protection Fund covers clients of firms in the Investment Dealers Association. The program regulates how dealers conduct their business and protects investors, up to \$1 million per account, in the event of default by a dealer. Note that the fund does not protect against market losses.

Mutual fund companies. Mutual funds are not insured, but investors are safeguarded because each fund's assets are owned by the unit holders and held in a trust, separate from the mutual fund company itself. Again, investors are not protected from market volatility.

For more information on these programs, go to www.financeprotection.ca. If you have any questions about your portfolio, we're here to help. ■

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