

# Financial Planning Guide



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## Taxes on your mind? Plan now for a better next year

**A**fter your 2005 tax return is completed, review it for tax-saving opportunities for 2006. Following are some key questions to ask.

**Are you due a big refund?** If so, you gave the government an interest-free loan. If the refund was due to recurring deductions, such as Registered Retirement Savings Plan (RRSP) contributions or childcare expenses, you can ask the Canada Revenue Agency (CRA) to let your employer deduct less tax at source. File form T1213, available on the CRA Website ([www.cra.gc.ca](http://www.cra.gc.ca)). Quebec taxpayers should also file Revenu Québec form TP-1016 ([www.revenu.gouv.qc.ca](http://www.revenu.gouv.qc.ca)).

**What's your marginal tax rate?** That's the tax on your final dollar of income. Knowing this helps you determine the tax benefit of certain deductions. For example, a marginal tax rate of 45% means that an extra \$1,000 RRSP contribution will give

you a \$450 tax benefit — as long as you don't exceed your contribution limit.

**Did you have a lot of interest income?** Outside of registered plans, dividends and capital gains face less tax than interest does. If you hold both registered and non-registered accounts, it's important that your overall portfolio be tax-effective.

**Were your healthcare costs too low to qualify for a medical expense tax credit?**

You can claim expenses incurred in any 12-month period that ended during the year. By combining 2005 and 2006 receipts, you may be able to claim the credit on your 2006 return. Consider spending in advance for your family's costly healthcare needs, so that those payments fall within 12 months of your big spending in 2005.

Consult a professional tax advisor for other possibilities to explore and for guidance based on your circumstances. ■

## RETIREMENT PLANNING

### Pensions: Remember the rollover

If you've recently received a lump-sum "retiring allowance" from an employer because you've lost your job, retired, or sold your business, you may be able to contribute some or all of that payment tax-free directly into your Registered Retirement Savings Plan (RRSP). How much qualifies for the rollover will depend on how long you worked for that employer and whether you belonged to a company pension plan. Basically, you can transfer \$2,000 for every year (or part year) of service prior to 1996, plus an additional \$1,500 for each year (or part year) of service prior to 1989 for which you did not belong to the company pension plan. The rollover doesn't apply to years of service in 1996 or later and doesn't affect your usual RRSP limit. ■



## HOME IMPROVEMENT

### Planning to renovate?

Just over 75% of the homeowners polled last year said they were planning some form of home renovation by the end of 2006. If you're among them, you might be wondering how much your improvements are likely to increase the value of your house. To get an idea, check the Home Renovation Survey conducted annually by the Appraisal Institute of Canada ([www.aicanada.ca](http://www.aicanada.ca)). According to the Institute, the best potential payback comes from bathroom renovations, kitchen renovations, and repainting. The Institute's Website also has a free calculator that shows the likely payback for your project. ■



## TAX PLANNING

### Boost your medical expense tax credit

Many employees are not aware that the premiums they pay for group medical and dental insurance count toward the medical expense tax credit. The same goes for premiums that travellers pay for out-of-Canada medical coverage. You should also track the portion of your healthcare spending that your insurance does not cover. Suppose you pay your dentist \$175, but only get \$125 from your group plan. That \$50 difference counts towards the credit. Also, the list of eligible healthcare expenses is much broader than many people think. You'll find a list of qualifying expenses under publication number IT-519R2 on the Canada Revenue Agency's Website: [www.cra.gc.ca](http://www.cra.gc.ca). ■



## FINANCIAL CLASSROOM

*your guide to the basics and how to benefit*

### Dividends

*Corporate dividends are receiving lots of attention from wise investors.*

#### What they are

A dividend is a distribution of a company's profits made to shareholders, usually every three months. Mutual funds that hold dividend-paying shares pass along these distributions to unitholders.

#### How they work

Companies are not required to pay dividends. The company's directors decide whether to distribute earnings to shareholders or reinvest them in the company. Large companies in mature industries are more likely to pay dividends than smaller companies or those in growth industries. Banks and utility companies have almost always paid dividends. Details of a company's dividend record are available from its investor relations department and are often found on the company's Website.

#### Why they matter

For investments held outside of registered accounts, dividends received from Canadian corporations qualify for the dividend tax credit. As a result, dividend income is taxed less heavily than interest income. Dividends are generally considered a sign of a company's strength. Stock market analysts have found that companies with a pattern of rising dividends in recent years have tended to do well going forward. At the time of press, the federal government had proposed reducing the taxation of dividends even further.



## MUTUAL FUNDS

# 5 reasons to invest regularly in mutual funds

**A**ranging for automatic mutual fund purchases is a tried-and-true strategy that can reduce stress, may potentially boost returns, and can even accelerate tax savings when you're purchasing units for a Registered Retirement Savings Plan (RRSP).

The concept is simple: Invest the same amount in a mutual fund every month. If you aren't already investing through a pre-authorized debit (PAD) or pre-authorized contribution (PAC) program, here are five compelling reasons to get started.



### It's easy

You complete a simple form that authorizes the mutual fund company to withdraw a set amount from your bank account monthly and use this money to buy units of one or more funds. Automatic purchase plans run on auto-pilot — out of sight, out of mind. These contributions become routine so that typically, after a few months, investors don't even miss the money.



### It's affordable

For a one-time, lump-sum purchase, mutual fund companies sometimes require a minimum purchase of \$500 or \$1,000. When you sign up for regular purchases, the minimum is usually much lower — possibly as low as \$25 a month for mutual funds held within an RRSP.



### It allows you to benefit from market volatility

When you invest the same amount

every month, you automatically buy more units when prices are down and fewer when they are up. This strategy, known as dollar-cost averaging, can lower your average cost per unit over time.



### It curbs the desire to try to "time the market"

Most investors are naturally inclined to pour money into hot markets,

the very time when astute investors are pulling back. When the market "corrects," there's a tendency to ride to the bottom and then bail out, the very time when astute investors are starting to buy. There is also the risk of "investing paralysis" for those who keep waiting for the right time to commit money, earning little or no return in the meantime.

When you invest automatically, you're far less likely to experience either irrational exuberance or irrational despair as market values fluctuate.



### It helps you to reach your maximum RRSP contribution

Most Canadians feel it's wise to meet their maximum RRSP contribution every year, but relatively few actually do. Most often, they lack cash when the deadline rolls around — the very time when they face bills from the holiday season or a mid-winter getaway. It's much easier to make 12 smaller monthly contributions than one big one. You might even be able to enjoy the benefit of your contribution throughout the year, instead of having to wait until you file your return, by requesting that the Canada Revenue Agency reduce tax deductions at source.

With professional advice you can set up an automatic purchase plan that fits your budget and complements your financial goals. ■

## Life changes... your financial plan should too

**CREATING A FINANCIAL plan is not a one-time event. Here are some examples of the types of changes you might face, and how these could affect your financial plan.**

### Your cash flow

Whether it's an increase or decrease, a change in cash flow affects a number of elements in your financial plan. Getting a raise, for example, will increase your RRSP contribution limit for the following year.

### Your family

Marriage, the birth of a child, the death of a family member — events like these are likely to require adjustments in your insurance coverage, will, and RRSP beneficiary designation.

### Your asset allocation

The mix of growth, fixed-income, and cash assets in your portfolio can change over time, as each asset class performs differently. To get back to your target allocation, you might need to rebalance.

### Your time horizon

As time passes, goals that were once long-term become short-term, and may require a different strategy.

### The investment environment

The financial industry is constantly evolving, and your financial plan needs to stay in step with it.

In a changing world and throughout your life, the guidance of a professional advisor is invaluable in helping you keep your plan on track. ■

# Is a low down payment a good idea?

**A** conventional home mortgage requires a 25% down payment. For a home selling for \$250,000, that amounts to \$62,500 — which can be a lot of money, especially for those just starting out.

But lenders also offer “high-ratio” mortgages, which may require as little as 5% down on an owner-occupied home. At 5%, the down payment on that same home is a more manageable \$12,500.

Before you sign on for a high-ratio mortgage, however, make sure you review the following points.

## Affordability

Many homebuyers don't want to wait to accumulate a 25% down payment, particularly as prices rise. Whether you're trading up, buying a recreational property, or purchasing your first home, ask yourself this question: Can you truly afford a home of this value at this point in your life? A mortgage is just one of many costs that come with owning a residence. There are also taxes, insurance, maintenance, and utilities — any or all of which might rise over time.

And then there are the unexpected costs. What if the furnace breaks down and you have to buy a new one? Or what if the roof needs fixing? Unanticipated home repairs can easily run into thousands of dollars.

## Added cost

If you take out a high-ratio loan, you'll also be required to purchase default insurance. This protects the lender in case you

aren't able to keep up with payments.

The less you put down, the higher the premium. With a 10% down payment, the premium is 2% of the full loan amount; if you put down 5%, the premium is 2.75%. What does that mean in dollars and cents? It means that, on a \$250,000 home with 5% down, the insurance adds \$6,531 to the cost of the home.

In addition, the premium has to be paid upfront. Usually, the lender pays the fee and adds it to the mortgage — at the same rate, and amortized over the same period. At 6% amortized over 25 years, this would almost double the cost of the insurance.

## The bottom line

A high-ratio mortgage makes it much easier to own the home you want, but at a significant cost. This might be a minor consideration for those expecting strong income growth in the coming years. The danger, of course, is that you could wind up buying a home that costs more than you can really afford — especially if you currently have other sizeable financial commitments.

The federal housing agency, Canada Mortgage and Housing Corporation (CMHC), offers several affordability calculators in its *Home Buying Step by Step* guide. It's available on CMHC's Website — [www.cmhc-schl.gc.ca](http://www.cmhc-schl.gc.ca) — or you can order the guide by phone at 1-800-668-2642.

Professional advice can help you decide on the mortgage that works best within your overall financial plan. ■

# Surround yourself with home-buying help

IF YOU'RE SHOPPING for a home, or about to start, arrange for a first-rate home-buying team:

**Financial advisor.** You will want professional input to help you determine how much you can afford to spend, based on your overall financial plan. This advice is especially important if you plan to dip into your retirement funds by taking advantage of the RRSP Home Buyers' Plan.

**Real estate agent.** Most homes are sold through realtors, who collect commissions that are normally paid by the seller. Realtors vary widely in terms of service. Find one who understands what you want, will indicate whether your wish list is reasonable, and is committed to helping you find what you're looking for.

**Lawyer.** You will need a lawyer, preferably one who specializes in real estate. Don't wait to find one; deals can be completed very quickly in high-demand areas. Find out if your lawyer would like to review your purchase offer before it's presented. His or her wording might be more precise than the clauses found in most standard documents.

**Home inspector.** Offers on resale homes are normally made conditional on passing an inspection. The inspector will check all major structural and mechanical systems. If you're buying a brand-new home, you may want to consider hiring your own inspector to check the builder's work. ■

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