

# Financial Planning Guide



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## FOCUS ON INVESTING



## Why keep your investments under one roof?

**T**he sturdiness of a house depends on its foundation, walls, and roof being skillfully assembled. What about your investments? Are they working together to build a strong portfolio?

Here are five reasons why you might want to keep them consolidated within one institution.

### 1. Improved tax-efficiency

With all your investments in one place, it's often easier to spot tax-saving opportunities — for example, placing highly taxed interest-earning investments in your tax-deferred registered accounts.

### 2. Better asset allocation

Determining your asset allocation is a lot simpler when all the information you need is in one place. Also, any overlap or duplication becomes clearer.

### 3. More accurate tracking

It's easier to monitor your progress towards your financial goals — like your retirement or your child's education.

### 4. Potentially lower fees

Consolidating may reduce the number and amount of account administration fees that you pay. You may qualify for reduced fees or higher interest on balances above a certain level.

### 5. Easier withdrawal management

Whether you need regular income from your investments or need to meet a one-time expense, a consolidated investment portfolio will make identifying the most effective options obvious.

With professional advice, you can consolidate your assets to get maximum effectiveness from your portfolio. <sup>n</sup>

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## FINANCIAL PLANNING

### Getting married? Start off right

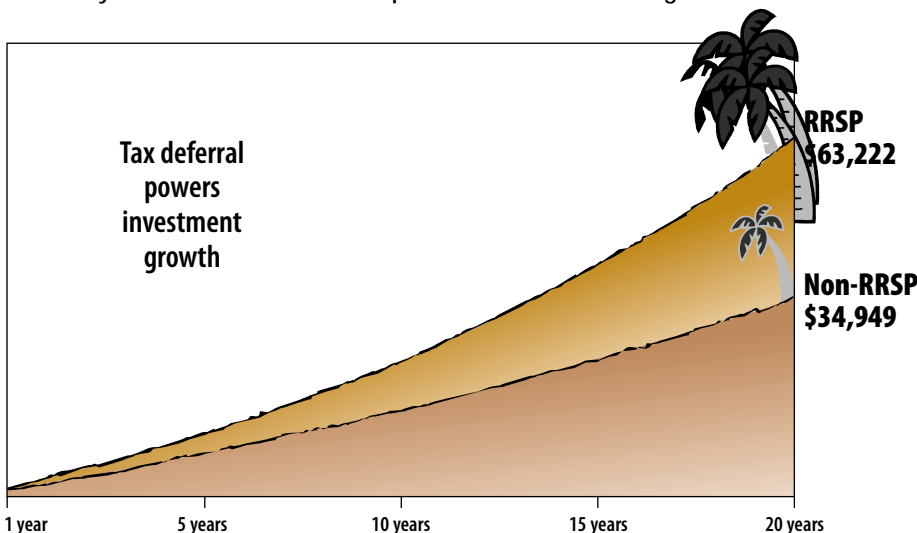
When arranging their nuptials, it's not unusual for happy couples to get so tied up in wedding plans that they forget about financial planning. This can be a serious oversight, with potentially costly implications.

It's always wise to document the wealth of both parties — fully disclosing assets and debts — before entering into the marriage. As well, taking the time now to agree on short-term financial goals and discuss long-term ones can help reduce disagreements later. And coordinating group insurance coverage under plans at work may save money and optimize protection.

Ideally, you and your spouse-to-be should explore your financial life together with a professional.

### Why your RRSP will take you higher

FOR MOST CANADIANS, a Registered Retirement Savings Plan (RRSP) is by far the easiest, most effective way to build wealth. The main reason: The plan earns income on money that would otherwise be siphoned for tax in a non-registered account.



Based on monthly deposits of \$100 earning 6% per year over 20 years and a marginal tax rate of 40%. Assumes RRSP contributions generate a tax refund that's reinvested in the RRSP. For illustrative purposes only. Actual returns may vary.

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## TAX PLANNING

### New definition of disability could reduce taxes

The 2005 federal budget contained several provisions aimed at making it easier to qualify for the disability tax deduction. For example, eligibility is now based on the total effect of all conditions. The Canada Revenue Agency has implemented those changes and published a new plain-language guide (RC4064) that tax advisors call a "must read" for those with a disability or those who care for someone with a disability.

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## TAX DEDUCTIONS

### Moving? Claim these tax deductions

You can claim tax deductions for a wide range of expenses if you move at least 40 kilometres closer to your place of work. (Home-based self-employed people get the same break if they move at least 40 km.) For example, you may be able to deduct up to \$5,000 of the cost of maintaining a vacant home while trying to sell it. Other eligible expenses include the cost of replacing a driver's license and other legal documents, as well as utility connection and disconnection fees. For complete details, read Form T1-M on the Canada Revenue Agency Website at [www.cra-arc.gc.ca](http://www.cra-arc.gc.ca).

# Your mutual fund profits will be taxed — here's how

**M**utual funds offer investors access to a widely diversified professionally managed portfolio in a single investment. But because they hold a wide range of assets, mutual funds generate different types of distributions that are not taxed uniformly. For unitholders, this can be confusing. Here's what you need to know.

## What and when

With the exception of money market funds, which are designed specifically to generate interest income, most mutual funds will earn a mixture of interest, dividends, and capital gains. Funds that hold investment trusts may also generate return-of-capital distributions.

Distributions are passed through from companies to unitholders and taxed in their hands. Distributions may be monthly (for money market funds), or they may be quarterly or semi-annually (for bond funds, dividend funds, and balanced funds). Capital gains are usually distributed annually, at the end of the year.

## Tax treatment

Investment income earned by the fund retains its character when distributed to unitholders. In other words, outside of registered plans, distributions of interest are fully taxable at the unitholder's marginal rate, while capital gains, Canadian-source dividends, and return of capital are taxed less heavily.

Note that distributions are taxable even if you receive them in the form of additional fund units rather than as cash. Inside registered plans, of course, distributions have no immediate tax implications.

## Switching without tax

A capital gain (or loss) may also occur when you sell or transfer fund units for more (or less) than you paid. There is an exception, however, with corporate-class funds. These funds typically include a number of different offerings under a single corporate issuer. Switching from one

to another doesn't trigger a capital gain or loss if you stay within the corporation.

## Name or misnomer?

Remember, a fund's name may not always provide a clear indication of the types of income it distributes. Some dividend funds, for example, hold a large proportion of common shares and may generate significant capital gains. And increasingly, "income" funds are relying on income trusts that generate return of capital.

The best way to understand the distribution profile of your funds, and those you may be considering, is to seek professional guidance.



# RRSPs and other investments work better together

**B**oth registered and non-registered investments have a role to play in helping you meet your goals. Saving for retirement may be your most important goal, but it's probably not the only reason you're investing. Some of your goals are likely to be shorter-term, such as buying a car or taking a family vacation.

When your registered and non-registered investments work together effectively, your whole portfolio becomes stronger — helping you to realize your goals. Here's how.

## Tax treatment

Inside a registered plan, investment earnings accumulate tax-free. Upon withdrawal, they are fully taxable at your marginal rate, just like employment income.

Outside of registered plans, the tax treatment depends upon the type of investment income that is generated:

- **Interest.** This type of income is fully taxed every year.
- **Dividends.** Those from Canadian corporations (but not foreign companies) qualify for a tax credit that substantially reduces the tax due.
- **Capital gains.** These are realized, or become due, when you sell or transfer an investment for more than you paid for it. Only 50% of the increase in value of the investment is taxable. In addition, capital losses can be used to offset taxable capital gains.
- **Return of capital.** These distributions, which essentially give back a portion of your initial investment, are not taxable. They are subtracted from the asset's adjusted cost base, resulting in a higher capital gain (or a lower capital loss) when the asset is eventually sold or transferred.

## Portfolio strategies

Here are some strategies that could help make your registered and non-registered assets work together effectively.

**Allocate wisely.** When you have both registered and non-registered assets, it may be more efficient to hold high-taxed investments that generate interest income inside your RRSP, where they can be fully sheltered. Investments that generate tax-preferred dividends, capital gains, and return of capital may be better suited to your non-registered account. Inside an RRSP, the tax benefits don't apply.

**Buy and hold.** Capital gains are taxable only when realized. By adopting a buy-and-hold approach with your non-registered equities, you can defer taxation for years and even time the sale so that it falls in a year when you have little other income. Of course, buy-and-sell decisions should never be based solely on the tax implications.

Professional advice can help you build a portfolio that maximizes the benefits of both registered and non-registered investments.

# Take care when sharing recreational property

**B**ooming interest in recreational properties has priced many getaways beyond the reach of many Canadians. Joining with others to buy a place can make the unaffordable affordable, but this requires a lot of planning. Make sure all participants are aware of their responsibilities, and put everything in writing.

Here are some points to consider:

**What are you buying?** Exactly what do you own — physical property or right of use? Many people are interested in time-share developments. They like the convenience of having a management company take care of cleaning and maintenance so that they can focus on leisure. They also treasure the ability to swap time at their place for time at another. All they own, though, is the right to use that space for a set period each year. A new variation called “fractional ownership” works much like a time-share but you do own an interest in the property itself.

**Rules of use.** If you own property with others — maybe a lakefront cottage or a ski chalet — it’s vital to agree on written rules for the property’s use. How often does each owner get to use it, and when? What’s the maximum number of guests allowed? Can a co-owner rent or lend it to others?

**Who’s responsible?** Obviously, one partner must be responsible for paying property tax, insurance premiums, and other routine expenses. Your agreement should obligate all co-owners to pay their share in full on time and should spell out the consequences if there’s a breach.

Consider the case of a ski chalet with electric baseboard heating. One couple might consume hundreds of dollars in hydro during a week’s stay when temperatures are subarctic, while another didn’t use the place at all that month. Determine in advance how bills will be split.

**Maintenance.** Repairs and upgrades are also a potential minefield. You will need tie-breaker rules for times when partners can’t agree on the scope and cost of the work to be done, or whether it’s needed.

**Liability.** What happens if damage is discovered and nobody claims responsibility? Appreciate, too, that when you own physical property outright with others, you become vulnerable to claims on that asset by their creditors. (Holding the place through a trust is one way to address this.)

**The exit clause.** It’s critical to have clear rules on what happens when one partner wants out. How will that share be valued? If that’s not established up-front, the other owners might take advantage of the departing partner or that partner’s estate. If the other partners can’t or won’t buy the interest, how much say do they get in approving an outside buyer? In the case of death, make sure the surviving partners can bill the deceased’s estate for maintenance costs until ownership is settled.

These are just a few of the issues that you and your co-owners could face. As you can see, sharing property is complex. But an up-front investment in careful planning and professional advice can lay the foundation for a long-running arrangement that everyone enjoys. <sup>n</sup>

# It’s all in the details... make them clear

SOMETIMES, A SEEMINGLY simple wish can become extremely complicated. Consider the case in which a man nearing death left objects of sentimental value to his wife on condition that the children from his former marriage inherit them when she died.

But when his wife passed away, it was discovered that one object was missing and another was broken. The result was a messy fight between his heirs and hers.

The best way to prevent such family arguments is to be as precise as possible in your estate plan. Here are some tips.

**Consider a trust.** Sometimes the property is valuable enough to merit a formal trust that provides for a “life interest.” This grants the heir use of the property for life but not ownership.

**Write it down.** If the property has more emotional than financial value, it might be better dealt with through a simple written agreement.

**List expectations.** Whether using a trust or a simple agreement, it’s important to clearly spell out the obligations of the recipient in safeguarding the property and the consequences of damaging or disposing of it. Unless otherwise specified, a bequest becomes the property of the recipient to do with as he or she pleases.

**Seek advice.** If you wish to attach conditions to your bequests, get professional advice. An experienced estate planner can cite what-if scenarios and offer ways to address them. <sup>n</sup>

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