

# Financial Planning Guide



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## How well are you following your retirement plan?

**A**ccording to a recent survey of Canadians, almost 60% of employees age 40 or older said that they have a retirement savings plan. And more than half of retirees polled said that they have a strategy for managing their savings. That's the good news. Unfortunately, only half the respondents in either category said they're actually following their plans!

Obviously, even the best financial plan doesn't do much good if you don't follow it. Here are four tips to help you keep on top of your retirement plan.

### 1. Keep RRSP contributions in line with your earnings

Do you invest through automatic payroll or bank account deductions? Don't just run on autopilot. Increase your savings as your salary goes up or when you pay off significant debts.

### 2. Review your progress annually

If you're consistently ahead of your savings schedule, you may be able to expand your retirement lifestyle expectations or consider early retirement. If you're a little behind, taking action now can get you back on track as soon as possible.

### 3. Revisit asset allocation as needed

It's essential to review your mix of cash, fixed income, and equity holdings annually and whenever you experience a major life change — marriage, divorce, a new job — or when the markets have substantially altered your portfolio's make up. These developments can have an impact on your retirement plan.

### 4. Get regular professional advice

You're far less likely to put your plan away and forget about it if you've set up regular follow-up sessions. ■

## RETIREMENT PLANNING

### Benefit from the increased pension tax credit

This year's federal budget doubled to \$2,000 the amount of pension income eligible for a tax credit. This break isn't just for pension plan members. It also applies to interest from guaranteed deposits issued by life insurance companies and withdrawals from a Registered Retirement Income Fund (RRIF) provided the planholder is over 65.

If you haven't yet taken out at least \$2,000 from your RRIF, doing so by December 31 will enable you to take full advantage of the new, higher credit. Those under 65 can claim the credit for Registered Retirement Savings Plan (RRSP), RRIF, and annuity income (but not lump-sum payouts) received as a consequence of their spouse's death. ■



## TAX PLANNING

### Payback for professionals

Many professionals continue to carry liability insurance after they retire or cease practicing. The Canada Revenue Agency (CRA) now says that those premiums are tax-deductible even if there's no related income. That's a big departure from the general rule that grants deductions only for business expenses incurred to generate income. If you missed out on this deduction in prior years, you may be able to claim it retroactively by asking the CRA to reopen your tax returns going back as far as 10 years. ■



## FINANCIAL CLASSROOM

*your guide to the basics and how to benefit*

### Income trust conversion

*Over the past few years, many Canadian corporations have restructured as income trusts. Why?*

#### What it is

For tax purposes, a corporation is treated as a separate individual. The corporation must report and pay tax on earnings yearly. As a trust, any earnings can be flowed through to unitholders and taxed in their hands, usually at a much lower rate than the company would pay.

Conversion enables corporations to reduce taxes at the corporate level. The underlying business operates much as before — though the need to make cash distributions to the trust means management might have less capital to reinvest in the business.

#### How it works

An income trust owns the right to all or substantially all of the earnings from an active business. This money is distributed on a regular basis to investors who own the trust's units. Any tax breaks associated with the money earned by the company are also passed through to the unitholders, so some or all of the distributions may be tax-deferred.

A real estate investment trust, for example, can pass through tax-deductible depreciation on its properties. A trust holding resource companies may be able to pass along special tax incentives associated with oil and gas exploration.

#### Why it matters

If you are currently holding shares in a corporation that is restructuring as a trust, the share price will probably rise upon the corporation's conversion. For the corporation, shifting tax from the corporate level means that it may pay less tax over time, possibly leaving more income to distribute to investors.

Though the trust may make steady monthly or quarterly distributions, it's not a fixed-income investment. Despite the change in corporate structure, it's still an equity investment, and distributions will depend on the success of the underlying business.

## FINANCIAL PLANNING

### Plan now to split income

January is the best time to split income by lending your spouse money to invest in his or her name. That's because tax rules require that interest on such loans be paid by January 30 of the following year. By making the loan in January, your spouse will have use of the money for a full year without having to pay any interest. For a loan made in June, for example, the interest would have to be paid after only six months. ■



# Widen your world with global mutual funds

**T**he Canadian stock market has been among the world's top performers for more than five years. At the same time, the soaring loonie has substantially reduced returns from foreign investments when converted to our currency. As a result, the Canadian equity portion of your portfolio may have grown substantially while your international equity mutual funds may have grown less or even declined.

While some exposure to Canadian equities is certainly desirable, there are several compelling reasons to invest globally as well. In fact, given the strength of the Canadian dollar, now may be an especially good time to increase international holdings. If the Canadian dollar weakens, mutual funds denominated in foreign currencies will become more expensive.

Here is a brief review of some of the benefits of diversifying globally through mutual funds.

## Diversification reduces risk

Perhaps the most important reason to hold international as well as Canadian mutual funds is for the diversification they provide. A portfolio concentrated in any one area is vulnerable to a correction in that area.



**MUTUAL FUNDS**

By diversifying into other markets, especially those that tend not to move at the same time or in the same direction as Canadian markets, you reduce the risk level of your portfolio overall.

## More options

Even as a leader in performance, the Canadian stock market is very small by international standards. In fact, about 96% of the world's capitalization is found outside of Canada.

More significantly, our market is heavily concentrated in just three sectors: financials, energy, and materials. A portfolio that is heavily weighted in Canadian equity funds may be missing out on the potential

growth in other important sectors, such as telecommunications and healthcare.

## Emerging opportunities abound

One of the attractions of investing in Canadian equities is that Canada has a mature economy. That means that our markets, for the most part, provide relatively steady overall growth.

Emerging markets, on the other hand, tend to be more volatile. On the downside, this means potential market declines can be sudden and severe. But on the positive side, it's not unusual for countries such as China, India, Korea, Brazil, and Mexico to post double-digit economic-growth figures, and for investors to benefit when that happens. So adding international mutual funds — in keeping with your optimal asset allocation and risk tolerance level — offers the potential to increase returns from your portfolio.

## Mutual funds make it easy

Mutual funds are an ideal choice for investors who want to gain exposure to the global market. A wide range of international and global funds are available to choose from. Some are broadly diversified, holding different kinds of assets from a number of countries or regions, while others are highly focused. And because mutual funds are professionally managed, you don't need to worry about researching or tracking individual foreign investments.

With professional advice, you can find the funds that best complement your Canadian-content mutual funds. ■

## Take note of target-date funds

**T**arget-date funds are a fairly new offering to Canadian investors. For those who have a specific goal and end date when they will need access to the money they have invested, target-date funds offer the ultimate in simplicity.

Following is a brief summary of some things to consider when investing in target-date funds.

### Convenient and easy

Target-date funds are typically "funds of funds": They are made up of individual equity, fixed-income, and money market funds. In the early years of your invest-

ment in the fund, asset allocation is skewed toward equity funds, in order to maximize the long-term growth potential of these investments.

Over time, the holdings gradually shift toward a more conservative mix. By the time the target date arrives, the fund will consist primarily of money market funds, in order to provide the liquidity needed to fund your goal.

The gradual shifting of asset allocation is done automatically by the fund managers, as is periodic rebalancing. All you have to do is pick the end date that coincides with your needs.

### Right for you?

Target-date funds can be a useful solution if you have a defined amount and end date in mind. They are a popular choice, for example, for Registered Education Savings Plans.

Keep in mind, however, that they are a one-size-fits-all solution. As a result, they may not provide the flexibility and customization available in a more traditional mutual fund portfolio. In addition, their "set and forget" approach assumes that your goals and investment constraints won't change. This may, or may not, be the case in your specific situation.

Professional advice can help you decide if a target-date fund is a good choice for you. ■

# Get the gift of less tax through charitable donations

**Charitable donations must be made by December 31 to generate a tax credit for your 2006 return. And this year there's a generous new wrinkle.**

The 2006 federal budget waived the capital gains tax due if you donate publicly traded securities, including mutual fund units, which have accrued gains. You still get a tax credit slip for the full value, but there's no tax due on the disposition.

## Give strategically

Here are four ways to capitalize on the new tax treatment.

**1. Donate and buy back.** Suppose you'd like to give \$1,500 to your favourite charity. You have the cash, but you also have \$1,500 of mutual fund units available, for which you paid \$1,000. Instead of donating the \$1,500 in cash, you could donate the fund units. Under the new tax rules, your \$500 capital gain is tax-free and you get a donation receipt for \$1,500.

Then, take your \$1,500 and use it to buy the same mutual fund units. Not only do you have your investment back, but your cost of buying is now \$1,500. If you sell or transfer the units in the future, this higher adjusted cost base will result in a lower taxable capital gain.

**2. Donate part of an investment.** Suppose that you have a holding that is worth more now than when you bought it and that you no longer want to own. You could donate just enough of the investment to create a tax credit large enough to offset the capital gains tax

due on the disposition of the remaining shares or units.

**3. Donate flow-through shares.** These shares are from limited partnerships that own natural resource projects. They offer tax deductions for a few years and then are converted to mutual fund units.

Unfortunately, tax rules set the adjusted cost base for those fund units at zero, so the full proceeds from their sale are taxable as a capital gain. Donating the fund units to charity enables you to dispose of them without having to pay any tax.

**4. Donate employee stock options.** This type of donation is for those with "cashless" stock options. They're allowed to buy stock from the company and immediately sell it without putting up any cash. (The company sells the shares to a brokerage, which then sells them on the open market and gives the employee a cheque for the difference.)

The employee would normally pay capital gains tax on any gain, but by donating the stock options and letting the charity exercise them, the employee can avoid paying the applicable capital gains tax.

## Investment considerations

However you choose to make a charitable donation, remember that you are divesting yourself of assets. And any decision to sell investments should never be made solely on the basis of tax considerations. These decisions should be made within the context of your overall financial plan and with qualified professional tax advice. ■

## Be sure to add up all your assets

THE BEST LAID financial plan takes all of your assets into account. Major assets, such as your Registered Retirement Savings Plans, may automatically come to mind. But some less obvious holdings can have just as much impact on your portfolio's optimal asset allocation.

**Common items overlooked.** People often forget to consider their Canada Savings Bonds, Guaranteed Investment Certificates, and Registered Education Savings Plans. Locked-in retirement accounts from former employer pension plans or discount brokerage trading accounts should also be factored into your financial plan. Also, don't underestimate the influence that company stock plans, share options, shares in private companies, and life insurance policies might have on your asset allocation.

**Each component has an effect.** Taking into account all of these items ensures that your investments work together, without duplication or conflict. For example, career public employees with secure, high-quality defined benefit pension plans may be able to assume more equity risk in their own portfolios than those with weak pension plans.

**Other considerations.** Also factor in your current and anticipated debt load. Your debt-service requirements affect how much investment risk you can wisely take on. The same goes for your job security, health, and family obligations.

To maximize the benefit of professional advice, it's important to provide a complete picture of your financial holdings. ■

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