

# OUR VIEW

Volume 1, Edition 1



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## RESETTING OUR GOALS

The second decade of the new century is now well underway. The acute pain of the Great Recession has eased, with the economy displaying positive signs of a strengthening recovery. Yet challenges remain, recently evidenced by worries over European debt levels, weakening commodities demand from China and general unease over global political tensions and the fragile environment of the Gulf of Mexico. Markets have gyrated in response to these events, while other economic indicators point to brighter days ahead.

For most of us, the past two or three years have been unforgettable, to say the least. Global challenges continue. Governments across the world have incurred unprecedented deficits in an effort to support their citizens.

Closer to home, several familiar corporations have ceased to exist while others now operate under the strict guidelines of the courts as they attempt to avoid bankruptcy. Unemployment also continues to be an issue. However, not all sectors have been adversely affected, with residential real estate having weathered the storm in many urban centres.

This is an excellent time to review your investment plan and reset your goals if required. Has anything changed in your personal situation since we last conducted such a review? Marriage or divorce, births or deaths, and aging family members can affect our perspectives and our objectives, both in the short and long term. Has your risk profile changed? Should your investments be altered to reflect changes in your risk tolerance or capacity?

It may be helpful to remember that investing is a long-term process that will, undoubtedly, consist of ups and downs. Volatility should remind us that growth does not always occur at a steady rate and that goals are not always achieved without enduring some hardship along the way.

Individual investors may have experienced mixed results in the recent past. However, with investing, the keys to success include a commitment to a longer holding period and an emphasis on quality, value and diversification. If your personal investment plan continues to reflect your needs, stick to it and let time in the markets help you to achieve your goals.

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# HARMONIZED SALES TAX ARRIVES

## Ontario and British Columbia get ready to implement a harmonized sales tax

For residents of Ontario and British Columbia (BC), July 1, 2010 marks not only Canada Day but also the implementation date for the harmonized sales tax (HST).

### What is Harmonized Sales Tax?

The Ontario and BC governments have chosen to integrate their respective provincial retail sales taxes (PST) with the federal goods and services tax (GST) to form the HST, effective July 1, 2010. The HST will apply at a rate of 13 per cent in Ontario (i.e., 8 per cent provincial and 5 per cent federal) and 12 per cent in BC (i.e., 7 per cent provincial and 5 per cent federal).

These provinces will now join New Brunswick, Newfoundland and Labrador, and Nova Scotia, which all moved to a harmonized sales tax system in 1997, and are the only provinces that have implemented the HST.

### Provincial sales tax and harmonized sales tax rates across Canada as of July 1, 2010

| Province         | PST/HST              | Province              | PST/HST               |
|------------------|----------------------|-----------------------|-----------------------|
| British Columbia | 12% HST <sup>1</sup> | Quebec                | 7.5% PST <sup>3</sup> |
| Alberta          | no PST               | Newfoundland/Labrador | 13% HST               |
| Saskatchewan     | 5% PST               | Nova Scotia           | 13% HST               |
| Manitoba         | 7% PST               | New Brunswick         | 13% HST               |
| Ontario          | 13% HST <sup>2</sup> | Prince Edward Island  | 10% PST               |

<sup>1</sup> 7% PST to be harmonized with the GST to create HST of 12%, as of July 1, 2010.

<sup>2</sup> 8% PST to be harmonized with the GST to create HST of 12%, as of July 1, 2010.

<sup>3</sup> Proposed increase to 8.5% QST on January 1, 2011.

### When does HST apply?

For a majority of items, the taxable status of goods and services under the HST will not change. The provinces have made various products and services exempt from the provincial portion of the HST, including books, children's clothing, car seats/booster seats, diapers, and feminine hygiene products. However, only BC has exempted gasoline, ethanol and diesel fuels for motor vehicles and boats from the provincial portion of the HST. Meanwhile, only Ontario has exempted meals under \$4 and print newspapers.

There will be a significant increase in taxes with respect to certain goods and services for which PST does not currently apply. These items include electricity, Internet access fees, personal services (i.e., haircuts and styling), professional services (legal services, accounting services, and real estate fees and commissions), mutual fund management expense ratios (MERs), and, in Ontario, gasoline. For more information, consult the provincial government website related to the province of enquiry:

**Ontario:** <http://www.rev.gov.on.ca>

**BC:** <http://www.gov.bc.ca/fin/>

## TURNING THE TABLES

# TAKE ADVANTAGE OF LOW INTEREST RATES

A quick glance at your bank statements over the past year may have caused you to adopt a "glass is half empty" view of current interest rates. However, these low rates have created two potential opportunities that may change your opinion.

### Prescribed rate loans

The first opportunity involves making a documented "prescribed rate" loan, with principal due on demand, to your spouse and/or minor children for investment purposes. As long as your spouse and/or minor children pay the interest on the loan by January 30 following the end of every year the loan is outstanding, the tax attribution rules will not apply (i.e., the investment income they earn on the loan proceeds will not be considered yours for tax purposes).

The prescribed rate is determined every quarter and is based on the rates for certain Government of Canada Treasury Bills. The rate in effect for the second quarter of 2010 is one per cent — the lowest the rate has been in over 25 years.

Further, the prescribed rate prevailing at the time the loan is made to your spouse and/or minor children is the rate of interest that remains in effect for the duration of the loan.

This strategy is particularly attractive in situations where you may be in the top tax bracket but your spouse and/or minor children are in a substantially lower tax bracket. Instead of investing funds personally and paying tax on the income at the highest tax rate, you can lend these funds to your spouse and/or minor children at the prescribed rate.

You will report the interest income received from the loan on your tax return. However, assuming your spouse and/or minor children can achieve a return on their investments of greater than one per cent, you will have effectively split your income and reduced your family's overall tax burden. While the difference between the rate of return achieved by your spouse and/or minor children on the invested funds and the prescribed rate payable on the loan may not be significant now, this spread may increase as the economic climate improves.

### Home purchase loans

The second opportunity also takes advantage of historically low prescribed rates and involves an employee drawing on or replacing an employee home purchase loan from their employer. If you, as an employee, obtain a home purchase loan from your employer to acquire, repay or replace a loan used to buy your home (or the home of a related person), you will be assessed a taxable benefit equal to the amount by which the prescribed rate exceeds the amount of interest that you paid on the home purchase loan. Thus, if you can obtain an interest-free home purchase loan from your employer, the assessed benefit will only be one per cent of the value of the loan.

Since the prescribed rate used to calculate the taxable benefit is the prescribed rate in effect at the time the home purchase loan is made, reset on every fifth anniversary of the loan, you will be ensured a one per cent benefit for the next five years.

## DIFFERING PERSPECTIVES

# PERSPECTIVES ON INVESTMENT STRATEGIES

### **Volatility in the markets has sparked renewed interest in market timing strategies.**

During periods of uncertainty, it is human nature to begin questioning our ways. As a result of the market turbulence beginning in 2008, and the more recent volatility at the start of 2009, there has been much discussion regarding equity investment strategies, and more specifically market timing strategies. Market timing, as an equity investment strategy, is generally considered a shorter-term, "active" strategy that is intended to capture short-term changes by optimizing returns through buying and selling shares. Typically, technical, fundamental or quantitative analysis is used as a measure to judge the state of the market and determine when share prices are low, indicating opportunities to buy, or when share prices are high, indicating opportunities to sell.

Higher risk is associated with this approach given the potential for mistiming transactions related to changes in the market. Also, the approach may result in higher costs due to the prospect of a greater number of transactions and tax events over time.

Market timing strategies have been the subject of much controversy, challenged by those who believe that it is impossible to time the markets consistently and correctly, as so many factors impact changes in the markets. Many influential individuals successful with market timing have only correctly predicted a few of these events historically. Finding investors who consistently (and correctly) predict turns in the markets is difficult. Remember — only the minority can outperform the majority.

In order to be successful as the minority, significant positions that go against the majority are required which often involve increased risks. A contrasting approach to the market timing strategy is the buy and-hold strategy, considered a longer-term, "passive" approach that is intended to capture the earnings potential and appreciation of shares over time.

This strategy focuses on investing in shares of a company with long-term prospects for sustained earnings and continued growth, even though there may be price swings throughout the holding period. Shares are sold when the underlying fundamentals no longer support the stock or the holding no longer fits the investor's investment goals.

The buy-and-hold strategy is considered to be less risky as market timing errors are minimized.

Investment recommendations for all clients will ultimately be based on each individual's investment plan. Within this broad guideline, defined objectives and measurable goals will help maintain perspective despite market volatility. Asset allocation, risk tolerance, and investment timeline, to name a few important factors, must all be considered. As financial markets constantly change, the plan will need to adapt accordingly. Prospects of specific companies, industries, or even whole classes of securities may be attractive today but not as attractive tomorrow.

As an investor, your needs will also change over time depending upon your investment timeline and financial goals. Your holdings should be adjusted periodically to provide for changing circumstances.

Don't hesitate to contact us to discuss any aspect of the investment process to meet your personal investment objectives.

## PLANNING INHERITANCES

# GIFTING ASSETS TO CHILDREN

Most readers are aware that certain taxes will come into play upon their death and wonder if giving their money to their kids while alive is not a viable option.

Canada has no estate or gift taxes, per se, unlike the rules in the United States. A U.S. individual can give no more than \$12,000 per year to any other person free of tax. Estates are subject to confusing (and evolving) rules on exemptions and tax rates. In Canada, there is no limit as to how much can be given to anyone. Moreover, Canadian gifts will be free of tax to the recipient, whether made before death or by way of a bequest after death.

However, the donor will be liable for capital gains taxes on any property transferred as of the date of the transfer. This will include gains on any securities, but also on a cottage or other vacation property. The same rules apply on death when the securities will have been deemed sold just prior to the demise, although special rules apply for spouses and dependent children.

There is no simple solution to avoid these taxes. For distribution through a will, various arrangements involving life insurance<sup>†</sup> are a possibility, with the intent of having the insurance benefit cover the taxes owing.

However, the practical effect may be to merely prepay the tax liability through ongoing insurance premiums. Still, they may be useful in certain individual situations.

Giving cash while still alive can bring its own rewards. The recipient may really appreciate it, and the donor will have the pleasure of seeing their assets put to good use while alive.

Of course, it all depends on whether the donor is comfortable parting with the money, whether recipients are capable of handling such a bequest, and whether other possible beneficiaries will be adversely impacted, particularly emotionally.

<sup>†</sup>Insurance products and services are offered by life insurance licensed Advisors through Macquarie Insurance Services Ltd., a wholly owned subsidiary of Macquarie Private Wealth Inc.

The comments contained herein are general in nature and are not intended to be, nor should be construed to be, legal or tax advice to any particular individual. Accordingly, individuals should consult their own tax advisors for advice with respect to the tax consequences to them, having regard to their own particular circumstances.

# SUCCESSION PLANNING: CONSIDER AN ESTATE FREEZE

## **The economic downturn may provide financial planning opportunities for business owners.**

As a business owner developing your succession plan, you must consider your personal goals, the objectives of the business and the role that future generations of your family will play in the business. A potential strategy may be to implement an estate freeze.

## **What is an estate freeze?**

An estate freeze "freezes" your interest in the business at a particular time by exchanging your shares on a tax-free basis for fixed value "freeze shares."

The business then issues new "growth shares" to your children or other heirs so they can participate in the future increase in value of your business. Your heirs may acquire growth shares directly and/or indirectly (i.e., by way of a discretionary trust).

When implementing a freeze, many owners maintain control of their businesses by ensuring that the freeze shares received have all, or a majority of, the voting rights of the company.

## **Benefits of an estate freeze**

Since the value of the shares that you own is fixed, you will have limited your tax liability on death and deferred the tax on any future growth until such time as your heirs pass away or sell their growth shares.

Also, the locked-in value of the freeze shares should allow you to estimate the amount of taxes owed upon death so that appropriate planning measures can be made to fund that liability. Furthermore, since the value of frozen assets owned at death will be lower than the value of assets without a freeze, the amount of probate fees or estate administration taxes, if applicable, may be minimized.

In certain situations, you may be able to use your lifetime capital gains exemption limit to shelter up to \$750,000 of capital gains when freezing your shares. Additionally, an estate freeze may allow you to multiply the use of the capital gains exemption limit as your heirs may be able to use their exemption limits when they, or the discretionary trust, dispose of the growth shares in the future.

An estate freeze may also provide an effective means of splitting income with your heirs.

## **Is an estate freeze right for me?**

A variety of factors should be considered when deciding if an estate freeze is right for you:

- **Current value of your business** — As an estate freeze locks the current value of the business into freeze shares, it is generally preferable to freeze when the value of the business is low, which may be the case in the current economic environment.
- **Forecasted growth** — One of the benefits of the estate freeze is tax deferral resulting from transferring the future growth of the business to your heirs. If future growth prospects are not substantial, other potential strategies may be more appropriate.
- **Your age and financial position** — Before proceeding with a freeze, you must be satisfied that the fixed value of the freeze shares, along with any other assets that you own, will be sufficient to provide financial security for the remainder of your lifetime. If you are not comfortable transferring all of the future growth of the business to your heirs, you may consider a partial freeze of the business (i.e., you acquire a portion of the new growth shares) or implement a flexible freeze (i.e., you become a beneficiary of the discretionary trust).
- **Age and interest of your heirs** — You should ensure your heirs are ready and willing to participate in the equity of the business. If your heirs are minors, a discretionary trust may be a viable alternative. If you are considering an estate freeze, consult a professional to determine the most appropriate path considering your circumstances.

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