Macquarie Private Wealth
A world of opportunities

MACQUARIE

OUR VIEW

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Thank you to all of our clients who have referred their friends, family and associates to us. We are very fortunate to have such wonderful clients and we appreciate your confidence in us.

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DO YOU INVEST WITH EMOTION?

Ongoing market volatility in recent years has made it difficult for some to keep their emotions in check. The predisposition to act emotionally is often triggered when the brain becomes excited or fearful and may lead to poor decision making.

Have your financial decisions been based on your long-term best interests, or have they been influenced by the turbulence within the short-term?

The study of behavioural finance has helped to explain how emotions influence the decision-making process for investors. This contrasts traditional economic and financial theory that assumes that investors always act rationally and that, as a result, markets are efficient. Take, for example, the concept of “recency bias.” Although most investors recognize that markets are cyclical and will experience highs and lows, this bias causes investors to believe that recent patterns or events will continue into the future. “Anchoring” may cause an attachment to a particular investment. As an example, investors may hold on to an asset for longer than is prudent, despite changes in fundamentals, believing that the asset will reach, or return to, a certain price level.

Overconfidence, or the belief that one is above-average, may also influence investment decision making. Why is it that most of us claim that we are above average drivers? Studies have shown that most people consider themselves to be above-average performers. This translates into many aspects of life, including investing. Prominent economist Robert Shiller, who teaches behavioural finance at Yale University, notes that during recent market turbulence, most investors were surprised to have suffered losses although they should not have expected otherwise, especially given that most portfolio management is based on longer-term investment strategies.

Are emotions getting in the way of your decision making? We’re here to help provide an alternative perspective when needed. We can assist you in reviewing your financial goals and remind you of the investment strategies that will guide you to make decisions without letting your emotions take charge.

THINK TWICE

CONSEQUENCES OF EARLY RRSP WITHDRAWALS

Before you look to your retirement savings as a source of cash, it is important to consider the consequences of early Registered Retirement Savings Plan (RRSP) withdrawals.

First, the contribution room represented by the withdrawn amount will be lost forever. Many investors forget the impact of time on the value of an investment. As an example, if you make a withdrawal of $20,000 20 years before retirement, you will forego over $53,000 in retirement savings, assuming a 5 per cent return annually. This is a significant amount that would have been tax-sheltered over time.

Second, the withdrawn amounts are considered income for the year and must be reported for tax purposes. When funds are withdrawn, the financial institution will also withhold tax, depending upon the place of residence and amount withdrawn (note that the tax withheld may not fully account for tax owed on withdrawn amounts each year, so further payments may be required). Residents of Canada are subject to the following withholding rates:

- 10 per cent (21 per cent in Quebec) on amounts up to $5,000;
- 20 per cent (26 per cent in Quebec) on amounts over $5,000 up to and including $15,000; and
- 30 per cent (31 per cent in Quebec) on amounts over $15,000.

There are two ways to avoid these consequences: early withdrawal of RRSP amounts for i) the Home Buyers' Plan (HBP); and/or ii) the Lifelong Learning Plan (LLP). Various conditions must be met in order to participate in either of these programs.

Under the HBP, individuals may borrow up to $25,000 from their RRSP in one lump sum or via a series of withdrawals throughout the year to buy or build a first-time house. The entire amount must be repaid within 15 years, starting in the second year after the withdrawal, generally at a rate of 1/15th per year. If an individual fails to make the minimum annual payment, that amount must be claimed as income on the tax return of that year.

Under the LLP, individuals may borrow up to $20,000 from their RRSP to pay for full-time training or education at a qualifying institution for an individual or an individual's spouse. A maximum of $10,000 may be withdrawn from the RRSP per calendar year and the total amount withdrawn must be repaid over 10 years, generally at a rate of 1/10th per year, with the timing of the repayment period based on the length of enrolment of the student.

BACK TO SCHOOL

THE HIGH COST OF POST-SECONDARY EDUCATION

With children now back to school, parents may be breathing a sigh of relief. But, how prepared are you when it comes to post-secondary education costs?

Are you prepared?

Around this time of year, we often stress the importance of education savings as part of a broader financial plan. Post-secondary education costs continue to rise, with Statistics Canada reporting a 12 per cent increase in average tuition costs across Canada over the past three years. Including tuition, a year in residence may cost a student up to $15,000 or more.

Without proper planning, a student may be left with a large student debt upon graduation. A variety of options exist within the education savings realm.

Government programs

The Registered Education Savings Plan (RESP) offers parents and grandparents the opportunity to contribute up to $50,000 per beneficiary, on a tax-deferred basis, for up to 31 years for post-secondary education. Under the Canada Education Savings Grant, the government may also add up to $7,200 in grant dollars to the student's RESP for beneficiaries up to the age of 17. Other provincial programs, such as those in Alberta and Quebec, may also offer education savings opportunities.

Other opportunities

An in-trust account, or informal trust, may complement an RESP. This non-registered investment account may be set up for a beneficiary and offer tax advantages if structured correctly.

We would be happy to discuss these or other opportunities in greater detail. If you haven't started an education savings plan, or would like to explore options to supplement your current plan, please contact us.

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.

YEAR-END APPROACHING

EFFECTIVE YEAR-END TAX PLANNING

With the end of the calendar year quickly approaching, now is the ideal time to properly plan to minimize current and future income tax liabilities.

Reducing income

In general, taxable income may be reduced by deferring income or by splitting income with family members. For instance, income could be potentially deferred by choosing to receive a bonus payment after the end of the calendar year.

If you are in a high tax bracket, significant tax savings may be realized if a portion of your income is transferred to your spouse and/or children in a lower tax bracket. In general, this may be achieved by paying a reasonable salary to your spouse and/or children for services provided to your self-employed business or private company and/or by electing to split eligible pension income with your spouse on your tax return.

Another potential opportunity to split income with your spouse is by way of an investment loan. The loan must bear interest at a rate greater than, or equal to, the prescribed rate determined by the Canada Revenue Agency at the time the debt was incurred. Interest on the loan must be paid within 30 days of the end of each calendar year, otherwise any income (including capital gains) earned on the proceeds of the loan will be attributed to the high tax bracket spouse and included in their income for tax purposes.

Before implementing any income splitting strategy, consider the potential impact on payroll related taxes and how an increase in the income of an individual in a lower tax-bracket will affect any tax credits, benefits, or federal/provincial programs that are calculated based on their income.

A Tax-Free Savings Account (TFSA) may also reduce taxable income. Up to $5,000 may be contributed annually and any unused contribution room will be carried forward indefinitely. Although TFSA contributions are not tax-deductible, income earned in a TFSA is tax exempt. Withdrawals are tax-free and may increase contribution room in future years.

Tax Deductions and Tax Credits

While there are many tax deductions available, the following are some commonly overlooked deductions. As previously noted, interest paid on loans used to earn investment income is generally deductible for tax purposes. Thus, effectively structuring your debt obligations may provide tax relief. Consider an individual who has a non-registered investment portfolio as well as non-deductible debt. Assume that the investment portfolio could be liquidated at a nominal tax cost and the proceeds from the liquidation used to pay down any non-deductible debt. If the individual could then borrow an equivalent amount to invest in a new qualified investment portfolio, the previously non-deductible interest would be exchanged for deductible interest.

The recent performance of the stock markets may have created loss positions in many investment portfolios.

However, unrealized losses may provide tax relief in the current taxation year and possibly provide for a recovery of taxes previously paid if the securities in a loss position are sold prior to the end of the calendar year.

In general, capital losses can only be used to offset capital gains. To the extent that capital losses exceed capital gains in the current year, the resulting net capital loss may be carried back to any of the three preceding taxation years to recover taxes paid on the taxable capital gains realized in those years, or carried forward indefinitely to reduce capital gains realized in future years. The optimal amount of capital losses to be carried back to prior years should take into consideration the preservation of any non-refundable tax credits claimed in the preceding taxation years and a comparison of the effective tax rates at which the capital losses would be applied in the preceding tax years versus carrying the capital losses forward to future tax years.

In addition, tax planning opportunities may exist permitting the transfer of capital losses between spouses, in the event that one spouse has unrealized capital losses while the other spouse has capital gains in the current year or any of the preceding three tax years.

You should also perform a careful review of your investment portfolio at the end of the year to determine if your portfolio has shares in companies that are bankrupt or insolvent, as it may be possible to file an election in your tax return to claim a capital loss on those shares in the current taxation year, provided certain conditions are met.

Prior to implementing any tax planning involving capital losses, recognize that rules in the Income Tax Act may deny a capital loss in certain circumstances, most notably in transactions involving an “affiliated person” (which includes a spouse or controlled corporation) and when identical securities are acquired or disposed of within a certain time frame. We recommend that you seek the advice of a tax professional prior to implementing any strategy to ensure it applies to your particular situation.

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.

INNOVATIVE WAYS TO GIVE

Charitable donations can also benefit you by reducing your tax liabilities.

As the holiday giving season approaches, here are some innovative donation strategies that may help to reduce your tax liabilities and enhance your capacity to give. We recommend seeking advice from a tax professional prior to implementing any strategy.

Gifts of securities

If you have marketable securities with accrued gains in your portfolio, you may consider donating the securities to a charity, especially if you had intended on selling these securities on the open market in order to fund your donation.

Ordinarily, when you sell marketable securities that have appreciated in value you are subject to tax on one-half of the capital gain realized. However, if these securities are disposed by way of a donation to a public charity or a private foundation, you will generally not be subject to income tax on the resulting capital gains. In addition to avoiding any capital gains tax, you will also receive a donation receipt from the charity for the fair market value of the marketable securities.

Gifts of employee stock options

When exercising an employee stock option in a publicly-traded company, you are deemed to have received a taxable benefit in employment income in an amount equal to the difference between the fair market value of the shares on the date of exercise and the option's exercise price. If these options were out-of-the money at the time of grant (i.e., the exercise price was greater than, or equal to, the fair market value of the shares at the time of grant), you should receive a deduction equal to 50 per cent of the resulting employment income. If you decide to donate all, or a portion, of these share options to a charity in the year they are acquired and within 30 days of acquisition, provided certain conditions are met, you could receive an additional deduction equal to 50 per cent of the resulting employment income. As a result, you may not be subject to tax on the stock option benefit and you would also receive a donation receipt from the charity for the fair market value of the share options.

These tax benefits may also apply when you exercise your options and direct your broker to immediately sell the shares and donate all, or a portion, of the proceeds to a charity.

Corporate gifts of securities

Generally, Canadian corporations that gift appreciated marketable securities will also avoid capital gains tax and obtain a donation receipt equal to the fair market value of the securities donated. For private corporations in Canada, a corporate donation of marketable securities can also provide a significant benefit by way of the capital dividend account. This notional account tracks surpluses accumulated by a private company which can be distributed as tax-free capital dividends to the company's Canadian shareholders.

One source of the surpluses tracked is the untaxed portion of the company's capital gains, which is generally one half of the gain realized. When a corporation makes a donation of marketable securities to a charity, no portion of the capital gain is subject to tax. As a result, the company's capital dividend account is increased by the full amount of the gain realized, which significantly increases funds available to be distributed tax free to shareholders.

Things to remember

You do not have to claim donations made this year on your 2010 tax return. Any donations not claimed in the current year may be carried forward for use over the next five taxation years.

Also, by administrative concession, the Canada Revenue Agency generally allows individuals to claim on their tax returns charitable donations made by their spouses. This provides tax relief where spouses are in significantly different tax brackets such that the charitable donation credit can be maximized within the family unit.

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