



# The Personal Financial Advisor

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## LET THE SUMMER(S) CONTINUE

J. Christopher Snyder, CFP, RFP

Sam and Maxine just had a wonderful summer. Now that they had both retired, they were able to spend the whole summer at the family cottage. This cottage had been built by Maxine's parents and was passed to them on the their death.

Sam and Maxine had improved the cottage considerably over the years and it had become a gathering spot and place of much enjoyment for their three children and most recently for their seven grandchildren. The trips on the boat to the store, fishing for sunfish at the end of dock, swimming, the August 1st regattas, the wail of the loon, waterskiing, canoeing, playing with the cousins, the first summer romance, and the many other things that go with a cottage. Like most real estate, it had recently increased in value. While they had many fond memories, they had a gnawing concern of what would happen to the cottage after they became unable to take care of it and were gone. They were currently in very good health and did not see this as an immediate problem. However, being diligent with their financial affairs, they thought they should do something about it now. They called their financial advisor for guidance.

### *Further fact-finding*

After sharing cottage stories, their advisor determined:

- 1) the approximate current value of the property is about \$350,000
- 2) in order to assess the gain for tax purposes, they needed to know the initial value plus costs of the improvements. The value of the property when they had inherited it from Maxine's parents in 1976 was only \$50,000. They had, however, spent approximately \$150,000 on capital improvements over the ensuing years. This increased the adjusted cost base (ACB) to \$200,000. Their advisor also determined that they had owned the property for 6 years prior to 1982. This was important as each spouse at that time could each have a principal residence and the gain to that date would be tax-free. Because of this, the date to be used for valuation purposes was 1982. The property at that time was worth \$75,000. This meant the ACB would be \$75,000 plus \$150,000 of improvements = \$225,000. Thus the capital gain was \$125,000 (\$350,000 - \$225,000). 50% of this would be taxable at their top tax rate, which meant the tax would be approximately \$28,750.

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## WHAT, ME WORRY? I'M PROTECTED!

Ian G. Johnson, CFP, PRP

Do you recall the heady days of the late 80's and early 90's? Remember the collapse of Confederation Life and the default of those minor trust companies who paid those inflated rates of interest. Some of you may think back to the months of waiting for the return of your capital perhaps with a loss of interest.

Well, nowadays interest rates are low and financial institution collapses are rare. Economic times are good in spite of geopolitical unrest. But are your investments completely safe? Are you fully protected in case of financial default?

Most people have their savings invested in four different product areas – deposits, insurance and segregated products, mutual funds and securities. All four have investor protection plans in place, which individually have different terms, limits and restrictions. However, in all cases the protection is automatic and you do not need to apply to obtain the coverage.

It is prudent to understand the major features of these plans. The complete details are available on websites and should be investigated to determine your exposure.

### Canada Deposit Insurance Corporation (C.D.I.C)

The most common and well-known deposit protection plan is the C.D.I.C. This Federal Government program covers all of Canada and protects deposits in banks, trust and loan companies in case of institutional failure.

However, it does not cover credit unions or caisse populaires. They have their own provincially-backed deposit insurance protection plans such as BC Financial Commission of BC (F.I.C.O.M.); Ontario (Deposit Insurance Corporation of Ontario (D.I.C.O.); Quebec (Autorite des Marches Financiers). If you deal with these types of financial institutions, you would need to check their websites or ask questions at the local branch to obtain

all the details. For example, all GIC deposits are covered regardless of their term and in some provinces, the amount of protection is unlimited.

The C.D.I.C. currently has a \$100,000 maximum (up from \$60,000) covering each separate account in the name of an individual, joint owners or monies held in trust. It covers non-registered deposits as well as RRSP's, RRIF's, LIF's, LRIF's and RESP's. It includes savings and chequing accounts, money orders, drafts, certified cheques, term deposits and GICs up to a maximum of 5 years maturity.

The plan has a considerable number of rules, limits and restrictions as well as a complete listing of member institutions. For full details, check their website ([www.cdic.ca](http://www.cdic.ca)).

### Assuris (Life Insurance)

Assuris changed its name from Compcorp in December, 2005. It is a not-for-profit industry funded organization that protects Canadian life insurance investors (policyholders) in the event that their life insurance company becomes insolvent. In such a case, Assuris will minimize the loss of benefits and quickly transfer their policies to a solvent company.

There has been only three insurance company defaults in Canada over the last 100 years. There was 100% recovery for both Confederation Life (1994) and Les Cooperants (1992) and 96% of policyholders in Sovereign Life (1992) had 100% recovery. All life insurance companies in Canada are required to be members of Assuris and a full list of the members is on their website ([www.assuris.ca](http://www.assuris.ca)).

The website offers complete details of the coverage for the insurance products which includes non-registered deposits and segregated funds as well as RSP's, RRIF's, LIF's, LRIF's, annuities and accumulated value benefits. All policies of companies merged or transferred are still covered. Covered benefits include:

Monthly income	\$2,000
Health expenses – ie. critical illness or disability	\$60,000
Death benefit	\$200,000
Cash values in policy	\$60,000
Accumulated value benefits ie. Universal Life	\$100,000

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## WHAT, ME WORRY? I'M PROTECTED!

If a policyholder's benefit exceeds these amounts, Assuris will cover 85%.

### Mutual Fund Dealers Association of Canada (M.F.D.A.)

The M.F.D.A. Investor Protection Corporation will protect your cash, securities, mutual funds and segregated funds and certain other property held in the account of an M.F.D.A. member who becomes bankrupt. In Quebec, similar protection is supplied by the Quebec Securities Commission.

The M.F.D.A. is a national, non-profit, self-regulatory organization (S.R.O.) for the distribution side of the Canadian Mutual Fund industry. Members are mutual fund dealers who are licensed with the various provincial securities commissions and who sponsor the thousands of mutual fund salespersons across Canada. For example, Investment Planning Counsel of Canada (IPC) is an M.F.D.A. member.

Coverage is up to the amount of \$1 million per customer account. Many customers will have two separate accounts – a general account and a separate account which could include retirement plans, RESP's, Trusts, Guardianships, partnerships holding corporations. If you do deal with more than one mutual fund dealer, you gain separate protection.

However, it is important to note, the protection plan does not cover losses caused by market or unit value declines, unsuitable investments or the default of an issuer of a mutual fund.

### Investment Dealers Canadian Investor Protection Plan (C.I.P.F.)

What if your investment dealer becomes bankrupt? In that case, as an eligible customer, you have the Canadian Investor Protection Plan (C.I.P.F.), which, within certain limits, will protect your cash and securities. An eligible customer may be an individual, a trust or Executor, trustee or any other legal representation, a partnership or a corporation.

The dealer must be a qualified member of either the Investment Dealers Association of Canada, the Bourse de Montreal Inc. or the TXS Group of Companies. In recent years, securities regulation and enforcement has become

very stringent and while dealer bankruptcies may occur, they are becoming a less common occurrence.

Losses are covered in cases where a member dealer cannot return cash or securities held in the customer's account. The maximum limit of coverage available is \$1 million per a customer's account. The C.I.P.F. does not cover losses that result from market declines, unsuitable investments or the default of an issuer of securities.

Claims must be made within 180 days of the bankruptcy. The Board of Governors of the C.I.P.F. will determine the value each loss at the date of insolvency and their decision will be final. Cash losses will be reduced by applicable amount of deposit insurance. All the details of the Plan are on the website ([www.cipf.ca](http://www.cipf.ca)).

### Use Caution

In this era of low interest rates, we are all trying to maximize our rates of return. And we want to do it with a minimum of risk.

These protection plans do help to reduce that risk, but they are not the complete or ideal solution. Depending on the circumstances, there could be a considerable delay in the return of your assets and the attached income. And there are limits and restrictions in each plan and these need to be understood before investing.

All the required details are readily available through questions, print material and websites. However, there is no substitute for due diligence either by yourself or in partnership with your trusted advisor.

Some things that appear to be too good to be true are just that. Use these protection plans to your advantage but don't rely on them to bail you out from poor judgement.

## LET THE SUMMER(S) CONTINUE

- 3) Their advisor also determined that other assets had been used to take advantage of the \$100,000 tax-free capital gains that were allowed until 1994.
- 4) All three of the children and grandchildren lived close by and as it turned out, all would have an interest in continuing to use the cottage. Maxine and Sam wanted to keep the cottage in the family.

### Options

ECC advised that they had several choices:

1. They could do nothing and dispose of the cottage in their Will. If so, they could leave it directly to either one or more or all of the children. There would be capital gains tax on the second death ie. after both Sam and Maxine had passed on. Since half of the gain would be taxed at the marginal rate and if property increased in value say to \$500,000, the tax would be about \$63,000. Money for this tax could come from the other assets in the estate or they could buy some life insurance to pay the tax bill. If they left the property to all three children, the three children would need to have a working arrangement as to who used it when and who would pay the bills. All would have an equal say. Furthermore, it raised the question of what would happen to the child's share if one of the children died ie. would it go to the remaining 2 children or to the children of the deceased.
2. Another option would be to leave it on death to one of the children as their share of the Estate. The other children in turn could receive other assets of a similar value. This would be simple but since they all wanted the cottage, there could be a problem. There would still be a capital gain tax to pay.
3. Another option would be to leave the cottage in their Will to the children in a trust. This would mean the children would have an equal interest and have trustees to look after it, presumably one or more of the children. Tax, however, would have to be paid on the capital gain every 21 years. There would still be the

issue of who uses the cottage and when but this could be worked out. Furthermore, the annual upkeep would have to be shared.

4. Another option would be to transfer it to a Trust or directly to the children today. This would trigger a capital gain on transfer. Tax would have to be paid on half of the gain. This would have the advantage of having it done today and the capital gain locked in. If, however, it was set up in a Trust, there would still be a deemed disposition every 21 years. This would mean they would have to come up with the tax every 21 years.

Furthermore, if they transferred it to a Trust now, the property would be owned by the Trust, Sam and Maxine would lose control of the property as it would be up to the trustees to make the decisions. There is no reason, however, for the trustees not to allow Sam and Maxine to enjoy the use of the property.

### Solution

Sam and Maxine decided to review this with their children. They finally decided that they would deal with it in their Will by leaving the cottage to a Trust with two of their children acting as Trustees but all children being beneficiaries. Taxes on the gain would be paid at that time. Just to make sure they had enough money to pay the tax bill, they decided to take out a second to die life insurance policy. This meant that the death benefit was paid on the second death ie. after both Sam and Maxine had died. Since both Sam and Maxine were in good health and were non-smokers, the premium for \$200,000 based on their ages, (Sam 69 and Maxine 68), would be about \$3,500/year. This decision would mean Sam and Maxine would retain control of the property. This also allowed Sam and Maxine to keep their options open should the children move or lose interest. They also decided that because of the growing family, they should have a cost-sharing and utilization agreement with the children.

# INCOME-SPLITTING OPPORTUNITIES

Fabio N. Ventolini, CFP, CDEA

Splitting incomes between family members can have major advantages. In general, one spouse cannot transfer money to the other spouse or simply name the person as an owner and have that person invest it and the person receiving the money, take the income and pay tax on it.

In such a situation, the income and tax will be attributed (attribution rules) back to the person who gave the money. If, however, money is given to a child 18 or more, gains will not be attributed back to the person who transferred the money. Here are a few income-splitting ideas:

## *Capital Gains*

Attribution does not apply to capital gains earned on disposition of property by a child under age 18 or spouse. So it could be advantageous to loan or transfer funds to a child or spouse to invest in assets that tend to generate capital gains or business income.

The capital gains earned are taxed in the child's hands, however, income is attributed back to the transferor.

## *Canada Pension Plan benefits*

Spouses who are each receiving their CPP benefits can get a portion of each other's pension, if they choose. Both, however, must be 60 or more and if both receive the CPP and wish to split it, each must split in favour of the other. This can be an effective income-splitting technique since each spouse pays income tax only on the amount he or she actually receives.

## *Loans for value/transfers for fair market value*

If an individual makes a loan to a spouse or child, which the spouse or child uses to invest, and interest is charged on the loan at a rate at least equal to Revenue Canada's prescribed interest rate at that time, the attribution rules will not apply. The interest, however, must be paid each year or within 30 days after the end of the year for the attribution rules not to apply. The person making the loan must pay tax on the interest received and the recipient of the loan will pay tax on the income from the investments but deduct the interest costs.

## *Salary to spouse or children*

Where a person carries on a business, either personally or through a corporation, some income splitting can be achieved by paying a salary to a spouse and/or children. You must ensure, however, that services are genuinely being provided and that the amounts paid in salary are reasonable in relation to these services.

## *Spousal Registered Retirement Savings Plans (Spousal RRSPs)*

Contributions made to a spousal RRSP are deductible by the contributing spouse within the applicable contribution limits.

When the plan is converted to an annuity or RRIF on retirement, the money will be taxed in the hands of the beneficiary spouse with no attribution of income back to the contributing spouse.

Note: Attribution will apply to the contributing spouse if the beneficiary spouse withdraws more than the minimum amount from any spousal RRIF within three years of any contribution being made by any spousal RRSP.

# CHARITABLE GIVING OF SECURITIES NOW AND UPON DEATH

J. Christopher Snyder, CFP, RFP

We have had a number of enquiries about our article in the last issue of The Personal Financial Advisor about charitable giving trusts.

To refresh your memory, if you make an irrevocable contribution of money to a charitable giving trust, you receive an immediate tax receipt for the full amount transferred. This money is invested and the income of between 3% and 5% is transferred annually to the charity of your choice. After 10 years, the capital can be paid out to the charity or the trust continued, if desired. All income earned would be non-taxable to you.

Furthermore, if you have a security on which there is a capital gain, you can donate this to the trust and avoid tax on the gain (this is a new rule) while receiving a charitable receipt for the amount you have donated. These trusts have been organized by some of the financial institutions, including the TD Bank and MacKenzie Financial, who would administer and manage the money.

This new rule relieving tax on capital gains in securities donated to a charity can also have major implications for your estate planning. If securities are left to someone other than one's spouse and there is a gain, there will be

tax to pay. To avoid this, you can leave the security to the charity or charitable trust of your choice. Tax on the gain would be avoided and your final return will receive a charitable receipt, which will reduce your income tax. If this is of interest, you should review the terms of your will.

While none of us has the wealth of Bill Gates or Warren Buffet, many of us have assets, which could be given to provide opportunities to people who do not have the means to provide even some of the basics of life for themselves.

# INCOME TAX - INSTALMENTS

Robert DeMelo, CFP

We receive many calls about tax instalments. The requirements are confusing. Furthermore, it is expensive if you do not pay and you owe but if you overpay, you receive no interest on the overpayment. Hence to submit the right amount is important. The following summary we hope will help.

Those taxpayers that earn income without having tax withheld (for instance, pension, investment, self-employment, rental income, etc.) will have recently (late August) received a notice from CRA (Canadian Revenue Agency) to pay quarterly instalments to cover tax they would otherwise they would have to pay on April 30, 2007. You can also see your instalment reminders online at [www.cra.gc.ca/myaccount](http://www.cra.gc.ca/myaccount).

You will be required to pay your income tax by instalments for 2006 if your net tax owing is more than \$2,000:

- in 2006; and
- in **either 2005 or 2004**.

## You have three options:

### 1) Pay what is on your instalment notices (no calculation option):

This option is best for you if your income, deductions, and credits stay **about the same from year to year**. CRA calculates the instalments owing based on net tax owing from previous years (2004/2005). If you make the payments shown on the reminder by their 2006 due dates, no interest or penalties will be charged, even if the total of the payments is less than the total amount of tax you owe for 2006.

### 2) Pay based on last year's income (prior-year option):

This option is best for you if your 2006 total instalment amount due will be similar to your 2005 amount but the taxes you will owe for 2006 are **much more or much less** than it was in **2004**. The amount to pay though is based on the tax you owed in 2005. Keep in mind, if your instalment payments are too low instalment interest or penalties may be incurred.

### 3) Pay based on this year's income(current-year option):

This option is best for you if you expect your total instalment amount due for 2006 to be more or less than it

was for 2004 and 2005. If you choose this option, you have to calculate your instalment payments based on your estimated current-year (2006) net tax owing plus any CPP contributions outstanding.

Note: the instalment amounts you pay should appear on line 476 of your tax return when you complete your 2006 return.

To minimize instalment payments, we suggest you alter the tax withheld from other sources. This includes:

- OAS/PPP - send a completed Form ISP3520, *Request for Income Tax Deductions*, to the Income Security Programs office of Social Development Canada (SDC). You can get the form on the SDC Web site at [www.sdc.gc.ca](http://www.sdc.gc.ca)
- Pension or employment income - a complete Form **TD1**, *2006 Personal Tax Credits Return*, with your employer or pension plan administrator.

Instalment interest will be applied if you choose not to make instalment payments, or you make payments that are late or less than the required amount. Instalment interest is compounded daily at the prescribed interest rate, currently 8%. As well as interest penalties, there are also instalment penalties to avoid.

Hence, it is important to come as close as you can to submitting the correct amount during the year to CRA.

## The Personal Financial **Advisor**

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