Future Financial News

Certified Financial Planners, Chartered Financial Consultants, Chartered Life Underwriters

SUMMER 2010 NEWSLETTER **Carl Eppstadt, CLU, CHFC, CFP, CHFS**

Carl's Comments

TFSA – Still Confused?

You are not alone! According to a Mackenzie survey, only 43% knew that TFSA contributions are not tax-deductible and 22% knew you could have more than one.

So, let's try to make this nice and simple. First of all, I'm quite upset that the government brought out this program. To me it's going to be a real pain. The government brings out programs without consulting the people that are in the trenches. Years ago we used to get $1000 in interest income tax-free. It was taken away from us and replaced with a program that virtually does the same thing only with much more administration. The administration in the future will be a nightmare.

I just feel they could have accomplished the same result another way. My other question is, why would the government bring out this program anyway? I imagine the big reason is because there is a mass discrepancy between MPs pensions and a CEO's pension or RRSP program. After an MP has been in office for 8 years, have a look at what they receive in terms of benefits. The maximum contributions allowed for a CEO in an RRSP or pension is nowhere near what the government officials are putting into their programs to get out what they do. Maximum RRSP contributions are <u>not</u> limited to 18% of an executive compensation but rather to a cap of $22,000 for 2010. For someone making $220,000 that's only 10% and for someone making $440,000 it's only 5%. The 18% figure that we are allowed to contribute to RRSPs from our net income is an actuarial calculation and if you consistently contribute that amount, you should be generating 70% of your pre-retirement income. Again, what about the person that is capped at 5% or 10% of their salary, they are at a huge disadvantage.

In an effort to calm down executives and understanding that there is a disparity, the government brought out the TFSA. Yahoo! At the same time they spent taxpayer's money promoting this as the best thing since sliced bread. What I find more interesting is they did not promote the tax-deductible RRSP that nearly 20 million Canadians didn't contribute to last year.

Having said all that, we have to use the tools that are given to us and the TFSA can be effective tool overtime. Two spouses saving $10,000 per year accumulating interest over a 10 year period will add up to a sizable amount. The eventual withdrawals from the TFSA for lump sum expenses would be tax-free and have no impact on your OAS or claw-back.

Who should buy a TFSA? My feeling is someone who has maximized their unused RRSP room and who has no non-deductible debt. What should you buy in your TFSA? I think you need to be reasonably aggressive. Earning 1% tax free is not very exciting, but earning 10%, **now that is something to talk about!**

What's a T-Series Fund and is it for Me?

Are you interested in tax-efficient investments and possibly giving back down the road to charity? T-Series or T-Class funds might be a great addition to your portfolio.

Through monthly distributions, T-Series funds provide either a 6% (Series T6) or 8% (Series T8) regular stream of tax-efficient income. All or a significant portion of the distribution is return of capital (ROC) which, in a non-registered account is taxable only when the funds are sold or once the adjusted cost base (ACB) reaches zero.

Once the ACB reaches zero, additional ROC distributions are taxable as capital gains - this is where T-Series can be used in conjunction with charitable donations. Donations of publically traded securities are not subject to tax on capital gains. Consider donating securities instead of cash – the tax savings can be significant!

T-Series funds are offered through a number of mutual fund companies. If you would like to know more, please contact us.

Maximizing your Estate

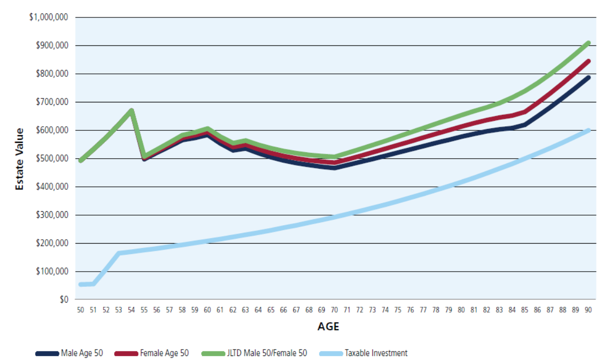
Through a product called UltraVision, Manulife has come up with an interesting option for insurable, weathly individuals under 65 who:

- Have maxed out their RRSPs and TFSAs
- Have a high marginal tax rate
- Own significant taxable investments
- Wish to ensure any legacies do not cause tax burdens
- Want to offset tax liabiliites

The product is a simple universal life policy, with an investment focus. There are no monthly premiums to pay and the policy can never lapse. You choose the type of investment product that meets your objectives and risk tolerance. The cost of insurance (a spread rate percentage) is deducted from the posted interest rate of each policy's investment. The guaranteed spread rate is based on a number of factors including age, gender and health.

Consider the following scenarios that assume a $50,000 deposit is made each year for 3 years, a 5% rate of return and a 45% marginal tax rate.

Estate Value Comparison – Balanced Portfolio



**Assumes taxable investment income is 30 per cent interest, 20 per cent dividends, 20 per cent deferred capital gains and 30 per cent realized capital gains.*

The additional tax free death benefit is represented by the spread between the taxable investment (lightest line) and the UltraVision insurance option. In the early years, the death benefit spread is substantial and still continues to be very attractive even at age 90. In addition, the assets are creditor proof, and with a named beneficiary can avoid probate and can be tax free.

As an incentive to making additional deposits, there is a spread-rate discount which can significantly reduce the insurance costs as well as a bonus payment after the fifth year's deposit. As with any investment, timing, size of deposits and investment selection will affect performance.

B eneficiary Mishaps

Designating a beneficiary is a small, yet very important and often overlooked piece of the estate planning puzzle. With the quick stroke of a pen this final step in the life insurance contact is completed, sometimes never to be thought about again.

In most provinces a Will can be used to make or change a beneficiary on life insurance policies. The relevant insurance policy must be clearly identified in the Will and have been in force prior to the execution of the Will. Although this seems simple enough, there are grey areas to watch out for as our intentions may be 'clear as mud' to others when it matters the most.

There was a case this year where the husband's will adequately identified a number of life insurance policies totaling $1.75M and named his wife as the beneficiary. The provision in the Will stated "proceeds of life insurance policies already naming her beneficiary and any additional insurance monies necessary to provide her with a total of $450,000."

The issue that was identified was whether the phrasing in the Will revoked earlier designations and capped the wife's entitlement to $450,000 or if she was entitled to this dollar amount in addition to the direct designation proceeds. The trial judge found in favour of the wife however on appeal, the decision was reversed and her entitlement was capped at $450,000.

I nterest Rate Concerns

Improved economic conditions, a large amount of government debt and concerns of rising inflation are some factors that cause interest rates to increase.

To a large extent, the recent move upwards is a result of positive economic data. The historically low level of interest rates we have seen over the past year and a half are less necessary, meaning that rates may move back up to more normalized levels.

As the economic recovery strengthens, concerns over higher inflation arise which, puts pressure on the Bank of Canada to keep inflation within its 1-3% target. The primary tool for the Bank to keep inflation in check is by raising interest rates.

The exact timing of when interest rates will rise is unknown. What we do know is that it is dependent on how rapidly our economy grows, which is an effective proxy for demand and supply pressure of goods and services and the resulting inflation. Economic growth picked up in Q4 2009 to 5% annualized. Although expectations for the first half of 2010 are slightly less, in June we saw one interest rate increase of one quarter of a percent and one could still conclude that another this year should not be unexpected.