



The RRSP/RRIF Tax Trap

The Canadian RRSP/RRIF industry manages well over \$400 Billion of Canadians' money. If you include pension assets, the total is well over \$1 Trillion. With such a mammoth amount of money to manage (and of course while earning lucrative investment management fees), the industry does everything it can to perpetuate some of the mythology surrounding the annual RRSP contribution blitz that occurs each January and February. It is also interesting to note the amount of media advertising and articles promoting the so-called benefits of RRSP investing. Have you ever wondered who the number one advertisers and information suppliers of this media onslaught are? If you guessed financial institutions, you'd be correct.

The RRSP has become an acronym that makes financial institutions and governments rich and retired taxpayers poor. The CD Howe Institute has published numerous papers dealing with the adverse effects that RRSP/RRIF income has on seniors. In fact, many studies suggest that if you are approaching retirement and hold less than \$100,000 of RRSP assets it is advisable to liquidate them prior to retirement as you will lose out on valuable government credits and income tested pensions during retirement. All we have to do is look at the income tax act and its assault on the income of retirees with income derived from RRSP/RRIFs.

Some of the regulations affecting not only seniors but all RRSP investors are:

- (a) If you are over 65 and have an income in excess of \$31,000 the government will claw back your age tax credit. You have already lost the Guaranteed Income Supplement and GST rebate.
- (b) If you are over 65 and have an income in excess of \$62,000 the government will begin to claw back your Old Age Security Pension.
- (c) Capital Gains earned on stocks and equity mutual

funds double in taxation upon removal from your RRSP/RRIF.

- (d) Dividends earned from stocks and equity mutual funds do not qualify for the dividend tax credit when held within the RRSP/RRIF.
- (e) The RRSP cannot be used as collateral for a loan or mortgage (i.e. vacation property, investments).
- (f) Capital Losses within the RRSP/RRIF are not tax deductible and are lost forever.
- (g) All fees, costs, interest on money borrowed for an RRSP are non-deductible.
- (h) The four narrow tax brackets mean that if you are over 65 and your income exceeds \$37,000, such as when you roll your RRSP to a RRIF, you will go from a 15.5% federal tax rate to the 22% rate on each incremental dollar with provincial tax on top! As RRIF withdrawals increase with age, the tax rate is likely to increase not decline, as was the original intent of the RRSP income deferral.

Many financial institutions will have you believe that an RRSP contribution will provide you with a reduction in your taxes. The sobering reality of the RRSP contribution is that it is only a deferral of income. Furthermore we do not know if it saves us tax dollars until we withdraw the money. Savings will occur only if the tax rate is lower at the time of withdrawal. Because of the potential pitfalls and loss of control, we really do need to question whether or not an RRSP is the most efficient tool for building wealth.

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UPCOMING EVENTS

We are pleased to announce our next Wealth Strategies Group Seminar to be held on March 26, 2008. Please contact one of our advisors for further details.





Powers of Attorney for the Management of Property

In Ontario, there are two types of powers of attorney. One type of power of attorney is called a Power of Attorney for the Management of Property. The other type of power of attorney is called a Power of Attorney for Personal Care. The former deals with your money and stuff, and the latter deals with your person, e.g. consent to medical treatment. In this article, I will be discussing Powers of Attorney for the Management of Property.

The word "attorney" does not mean a lawyer, it means an agent; an attorney is the substitute decision-maker named to look after the financial affairs of someone else pursuant to a power of attorney. An attorney is not a trustee; but may have trustee-like duties.

More than one attorney can be named in a power of attorney, either to act together ("jointly") or to implement decisions independently of the other ("jointly and severally"). Note that an appointment of two attorneys jointly and severally does not imply a power to delegate all decision-making by one attorney to another. Assuming that both attorneys have agreed to act, both attorneys have fiduciary duties to fulfill and a standard of care with which to comply. To the extent that the attorneys act separately, they must act in concert, in consultation with the other attorney(s), and not at cross-purposes. On the other hand, from the point of view of third parties, a transaction is sufficiently authorized if directed by one of two attorneys who are appointed jointly and severally. Flexible implementation of decision-making is facilitated by a joint and several appointment on the basis that the grantor has determined that a check on the activity of one or the other attorney is not required.

The use of a power of attorney as a tool for substitute decision-making for incapable persons is new to our generation. A "continuing" (or "durable" or "enduring") power of attorney does not automatically terminate on the incapacity of the donor if it expressly provides that it continues to be valid even if the person who makes the power of attorney ceases to be competent. If you become incompetent and do not have a continuing Power of Attorney for Property, then the Public Guardian and Trustee ("PGT") will manage your affairs unless someone applies to replace the PGT as statutory guardian. Alternatively an application may be made to have a guardian of property appointed by the court, but this process may be cumbersome and expensive.

Sometimes powers of attorney for property are worded in such a way that they cannot be used unless the grantor is incompetent. Incompetency is often not a black and white issue: There can be clear-cut cases, for example, if the grantor is in a coma, but competency may deteriorate slowly and it is often difficult to determine when someone is incompetent. He or she may be lucid one day but less so the next. Powers of attorney for property may be used without a finding by a court as to a person's mental capacity when the grantor may be in a "grey" zone and therefore without affecting the grantor's legal rights to act on their own behalf. Therefore, many lawyers recommend that a power of attorney for property is effective when signed. This means that the attorneys can use the power of attorney right away and without the necessity of proving to a bank teller that the grantor is incompetent. This also means that the power

of attorney for property may be used if the grantor is travelling or otherwise indisposed and needs to have something done with respect to his or her property right away.

If you believe that the substitute decision-maker you have chosen should not make decisions unless you are mentally incapable of making them yourself, then maybe you should reconsider the person you have chosen. If you do not trust someone to act in your best interests or according to your wishes when you are capable then there is no reason to trust that person when you are incapable! Because continuing powers of attorney for the management of property usually grant broad powers to the attorneys, it is very important that the attorneys you choose are people you trust and people you believe would be prudent in the management of your money and other property.

In the event that you have in mind appointing someone who is trustworthy and has common sense, but does not have investment experience, it is a good idea to ensure that the power of attorney expressly authorizes the attorney to delegate decision-making with respect to investments. Although it is often said that an attorney can do anything that the grantor can do except make a Will, an attorney cannot delegate decision-making that is considered to be "non-administrative". An express power in the power of attorney will clearly allow the attorney to choose a professional to make investment decisions on his or her behalf, or maintain a relationship with an investment professional that the grantor has established prior to becoming incompetent.

It is also important to note that U.S. securities law applies to U.S. residents wherever they deal with investments and even if the investments are owned by a Canadian resident and situated in Canada. The U.S. Securities Exchange Act of 1934 generally makes it unlawful for any broker or dealer to buy or sell securities unless that broker or dealer is registered with the U.S. Securities Commission. Individual states have applicable securities regulations as well. Therefore if the proposed attorney is resident in the United States, a power to delegate investment authority may be necessary in case the Canadian dealer that the attorney would like to retain is not registered with the U.S. Securities Exchange Commission and cannot take instructions from the U.S. attorney.

Powers of attorney should be reviewed when planning and organizing your financial affairs to ensure that substitute decision-making can be accomplished economically and effectively by the person you choose and in whom you have confidence when you are unable to make decisions yourself.

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Planning for Disabled Individuals

Over the past few years, the federal government has provided increasing support to disabled persons, their families and caregivers. In 2002 and 2003, for example, the income-tested Child Disability Benefit was introduced and the list of eligible medical expenses expanded. Amendments to the Income Tax Act proposed in December 2002, together with the Federal Budget announcements of February 2003, would make it easier, and more tax-efficient for parents (and grandparents) to leave their RRSPs and RRIFs to disabled children.

These amendments have been tinkered with over the years such that it should now be possible to roll an RRSP or RRIF to a trust for a dependant, disabled child or grandchild on the death of the parent or grandparent. Tax is thereby deferred until payments are made to the disabled person, not at the death of the parent or grandparent. Depending on the terms of the trust, it should also be possible to protect the provincial benefits that a disabled person in Ontario may receive (under the Ontario Disability Support Plan). Where the trust is a "Henson" Trust – i.e., one that provides the Trustees the complete discretion to make payments to the disabled beneficiary – the Canada Revenue Agency has indicated that if the trust is structured properly, it should qualify as a trust for purposes of the RRSP/RRIF rollover.

Families with disabled children will often establish what has become known as a "Henson," or discretionary trust, either on an inter vivos or testamentary basis, for such children. The courts have confirmed that the value of a properly-established Henson trust will not be included in the calculation of the ODSP recipient's assets for purposes of the ODSP asset test. However, it must be borne in mind that the ODSP policies and regulations restrict the amounts that may be paid out to or for the benefit of the disabled beneficiary.

The March 19, 2007, Federal Budget, included a new and significant addition to the support provided to disabled persons. The proposed "Registered Disability Savings Plan" (RDSP) will allow disabled individuals, their parents or other "legal representatives" to accumulate savings on a tax-deferred basis for the disabled individual. Draft legislation was released in October of 2007 and tabled, with minor adjustments, in a Notice of Ways and Means motion released on November 13, 2007. The RDSP was introduced in accordance with recommendations of the Report of the Minister of Finance's Expert Panel on Financial Security for Children with Severe Disabilities, which was delivered in December of 2006. If passed as currently drafted, the relevant legislation will generally apply to the 2008 and subsequent taxation years.

The RDSP is intended to be designed like the Registered Education Savings Plan that parents and others are entitled to establish to save for a child's post-secondary education. "Canada Disability Savings Grants" will be available whereby the government will match RDSP contributions. The

matching rate will depend on net family income and the amount contributed, and may be as high as 300% of the RDSP contribution. Further, the Budget proposes to assist lower income families with disabled children by paying "Canada Disability Savings Bonds" to RDSPs even where the family has not made a contribution. CDSBs of \$1000 a year will be paid to families with income not exceeding \$20,833 (indexed in subsequent years); the value of the CDSB will be reduced gradually as the family net income increases (to a maximum of \$37,178). A lifetime limit of \$20,000 may be paid in respect of an RDSP beneficiary.

As with an RESP, contributions to an RDSP will not be deductible, however the income that accrues on contributions will not be taxable while held in the RDSP. When funds are paid out of the RDSP to the disabled beneficiary, the investment income, the CDSG and CDSB will be taxable to the beneficiary (presumably at a relatively low tax rate).

RDSP payments must commence by the end of the year in which the disabled person turns 60 and will be limited to a maximum amount based on the value of the assets in the plan and the individual's life expectancy. Unlike with an RESP, contributors to an RDSP for a disabled beneficiary will not be entitled to a refund of contributions. Rather, on the death of the beneficiary or cessation of his or her disability, the funds (net of re-payment of the CDSG and CDSB) will be paid to the beneficiary or his or her estate.

The Budget documents indicated that the federal government will work with the provinces to ensure that RDSPs are "an effective savings vehicle to improve the financial security and well-being of children with severe disabilities." To this end, it is hoped that value of the RDSP does not disqualify a disabled beneficiary from receiving provincial disability benefits (like the ODSP in Ontario) when examining the disabled person's assets. The federal government has indicated that the income from RDSPs will not be taken into account when determining eligibility for income-tested federal benefits, including Old Age Security and Employment Insurance; hopefully the provinces will ensure that payments from RDSPs will supplement provincial benefits rather than allow the provinces to reduce the already-low level of benefits provided to disabled persons. We are awaiting confirmation from Ontario and the other provinces that this will be the case.

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Personal Financial Planning for Small Business Owners: More vital than you may think

Many Canadians are aware that small businesses are a major force in today's economy. With the establishment of cost-effective technologies such as the Internet and the personal computer breaking down the high cost barriers of entry, many entrepreneurs are testing the waters of self-employment like never before. According to one estimate by CIBC senior economist Benjamin Tal, by the end of the decade, one-in-five Canadians will be self-employed.

Along with greater independence and the increased earnings potential that self-employment can provide comes a list of potential financial risks. Unlike the majority of Canadians who contribute to and benefit from the Canada Pension Plan, Employment Insurance and company sponsored benefit programs, if their enterprise either fails or they succumb to a disability, small business owners are on their own. This hard fact makes personal financial planning an essential strategy for the owner of a small business to succeed.

The challenges that many small business owners face are often industry-specific and diverse. However, on a more personal level, the financial planning challenges that individuals face often share common ground. For example, during the early stages of a small business start-up when personal income and business income are often one and the same, cash flow management can be an issue. In addition, finding ways to minimize tax is an important step in maximizing personal income.

Just starting

Once a business is up and running, small business owners face additional challenges that are unique. For example, once a business owner becomes profitable, they need to carefully consider what to do with their money. The natural tendency

is to reinvest all of their profits back into their business. But there are a number of personal risks associated with this strategy. A better alternative may be to invest a portion of the proceeds into market-based investments such as segregated funds, which have the unique feature of providing potential protection from creditors. That way, if the business fails, the owner would have diversified their personal assets and assets and may have something to show for their efforts.

Up and running

For mature businesses, owners are advised to continue the financial planning process to protect their personal interests. Two issues that need to be addressed at this stage are safeguarding their business in case of sudden disability and succession planning. In terms of protecting the business, strategies such as purchasing "key person" insurance and business loan protection are worthy considerations since it can protect the owner from the unexpected. Life insurance can also fund capital gains tax on a business at death, offer split dollar arrangements and buy-sell funding.

For owners looking to pass on their business, succession planning is vital if the owner wants to plan for the significant capital gains charges generated by the sale of, or the transfer to either family members or partners with a stake in the business.

Business owners must understand the importance of beginning the planning process early. Once a business is in trouble, it is almost impossible to establish a plan that protects their interests effectively. Perhaps the most important factor in creating a successful personal financial plan for business owners centres on the issue of timing. Contact your financial advisor today.

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