



**Armstrong & Quaille**  
ASSOCIATES INC.

# Financial Planning Guide



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In a flat market environment, it can be a challenge to maintain a long-term focus. But to achieve your objectives, it's essential to remember that over time stocks have proven to produce stronger returns than other asset classes. That outperformance is associated with greater volatility — or more ups and downs.

Right now, we're progressing through one of those down periods. While it's difficult to watch equity investments performing weakly, keep in mind that in the history of the stock market there has never been a dip without a recovery. The best way to weather the storm is to stick to your investment strategy and engage in careful tax planning to minimize the tax toll on your portfolio.

If you have any concerns about the markets or would like to schedule a tax-efficiency check-up, give me a call to set up an appointment.

## FOCUS ON INVESTING



## Are you saving enough for your children's education?

**A**s schools reopen each fall, it's only natural for parents to think about their dreams for their children's higher education. At the same time, reports of rising costs cause many to wonder whether they'll be able to fund those dreams when the time comes.

Tuition fees get the most attention because they soared during the 1990s as government support declined. Fortunately, that trend has now slowed substantially, except for some professional programs.

But tuition is just one expense. What about textbooks, accommodation, transportation, telephone bills, food, and drink? Living costs can add significantly to the overall price.

Location makes a difference as well. Education Web site *Schoolfinder.com* profiled three common lifestyles for liberal arts students living away from home. The total cost of one year's schooling in

Toronto ranged from \$13,049 to \$18,529. The range in Edmonton was \$10,218 to \$15,890. Tuition accounted for only 22% to 38% of that.

How can you find out what it might cost to see your kids through university? The federal government has developed a calculator to help parents project college and university costs even if their kids are now infants. The Student Financial Planner is tied to a database including detailed information on living expenses and fees at schools across Canada. You can find it at [www.canlearn.ca](http://www.canlearn.ca).

Once you know the costs, it's time to start saving. Regular investing, using a Registered Education Savings Plan and government contributions through the Canada Education Savings Grant, can be an effective way to meet your goals. Professional advice can help you find the best strategy for you and your family. ■

## MUTUAL FUNDS



# Selling investments? Watch your foreign content!

If the foreign investments in your Registered Retirement Savings Plan (RRSP) or Registered Retirement Income Fund (RRIF) put you close to the 30% foreign-content limit, be careful about redeeming any mutual funds — even those that count as Canadian content. The redemption might boost or reduce your foreign-content room, or even trigger a penalty for exceeding the limit. Here's why.

The 30% limit is based on the "book value" of the investments in your plan. Book value refers to the original or purchase cost, and may not be the same as the investment's market value (what it's worth today).

For example, suppose you put \$10,000 in your RRSP — \$3,000 in a foreign fund and \$7,000 in a Canadian equity fund. You've maximized your foreign content at 30%.

What happens if the foreign fund increases in value to, say, \$4,000? The answer is: nothing happens. The book value is still \$3,000, or 30%.

Difficulties arise, however, when you buy or sell, because every transaction resets your plan's book value.

Here are some examples that illustrate how transactions can affect your plan's foreign content. In each case, the RRSP's book value is \$100,000.

### Example A

Book value of foreign content: \$30,000.  
Market value: \$40,000.

Action: Sell the foreign content.

Impact: The \$10,000 gain would boost the plan's book value to \$110,000 and the foreign-content limit to \$33,000. That sounds good, but is it? You'll have \$40,000 available, but you'll be able to reinvest just \$33,000 in a new foreign fund. If you reinvested the full \$40,000 in foreign content, you'd be \$7,000 over the limit and face a penalty of 1% per month.

### Example B

Book value of foreign content: \$20,000.  
Market value: \$10,000.

Action: Sell the foreign fund.

Impact: The foreign-content limit would fall. However, the plan's foreign content would still be well below the maximum 30%.

### Example C

Book value of Canadian content: \$70,000.  
Market value: \$75,000.

Action: Sell the Canadian content.

Impact: The \$5,000 gain boosts the book value and increases the foreign-content limit by \$1,500. This signals an opportunity to add to your plan's foreign exposure.

### Look before you leap

These examples demonstrate the importance of reviewing all the implications for your long-term plan if you're thinking of redeeming funds in your RRSP.

If you want to avoid triggering changes to your plan's book value whenever you switch funds, you may wish to consider investing in corporate class mutual funds. Their unique structure allows you to switch among funds within a certain class without actually redeeming the units.

Professional advice can help ensure you make the most of your foreign-content room, without exceeding the prescribed limits. ■



## EYEOPENER

graphic evidence of how investing works

# Second-guess that emotion

By mapping emotions to stages of the market cycle, this chart shows how emotions can lead to investing mistakes — namely, buying high out of sheer euphoria, and failing to buy low when moods are grim but opportunities abound.



# Don't let taxes eat away at your non-registered portfolio

**A**lmost everyone complains about income tax. Yet 52% of the Canadians polled in a national survey this year said they had not talked to a financial professional about reducing the bite on investments they held outside of tax-sheltered Registered Retirement Savings Plans (RRSPs), Registered Retirement Income Funds (RRIFs), and Registered Education Savings Plans (RESPs).

The same poll found that 46% of those with at least \$10,000 in unsheltered investments underestimated the impact of tax on their portfolios by focusing only on pre-tax returns.

The lesson? Canadians need to become more tax-smart when it comes to investing. And the first step to doing so is to understand the three basic categories of investment taxation and how they can affect returns.

## Interest income takes a big hit

Tax rates vary among income levels and provinces, but the bottom line is that interest income is most heavily taxed, receiving the same treatment as employment income.

In 2002, for example, a top-bracket British Columbia taxpayer pays tax at a rate of 43.7%. In other words, tax claims 43.7¢ of each dollar of interest, leaving 56.3¢ to spend or reinvest.

You might even have to pay tax before you receive the interest. Multi-year deposits such as compounding GICs, Canada or provincial savings bonds, or strip bonds are taxed annually on the accrued interest, even though it isn't actually paid until maturity.

## Dividends get a break

Dividends from Canadian corporations are taxed at a lower rate, thanks to the dividend tax credit. In B.C., the rate for a top-bracket taxpayer is 31.6%.

From a \$1 dividend payment, 31.6¢ goes to the government and 68.4¢ to the investor. That's about one-fifth more than the after-tax net on interest.

Unfortunately, the credit applies only to Canadian dividends. Dividends from foreign corporations are fully taxed, like interest.

## INVESTING



### Capital treatment

Capital gains face the lightest bite. Only half of the gain is taxed.

In B.C., the rate in the top tax bracket is 21.8%. Accordingly, a \$1 capital gain produces 21.8¢ in tax and leaves the investor with 78.2¢.

In addition to the lower rate, tax on capital gains applies only when an investment is sold (or otherwise disposed of) at a profit — not as the value accrues. So

your stock or mutual fund could compound for years without facing tax.

Remember, however, that your decision to hold or sell an investment should not be determined primarily by tax considerations. Make sure you're keeping the investment because it's helping you reach your long-term goals.

### Consider risk first

Notice the inverse relationship between an investment's risk and its tax treatment. Interest income is the most reliable, and also the most heavily taxed. Capital gains, the most uncertain, are the least heavily taxed.

The key is to manage your tax exposure in the context of your overall financial plan. Go for the right level of tax, not necessarily the lowest.

For example, money for a home or some other big-ticket purchase should be kept safe from market loss even if tax consumes almost half the interest earned. Conversely, money that won't be needed for years is ideal for capital gains investing. With professional advice, you can weigh market risk and taxation to determine the best investments for you. ■

## RETIREMENT PLANNING

### Split your pension to reduce taxes



**THERE IS AN** easy way for retiree couples to pay less tax if one spouse earned considerably more than the other during their working lives. The Canada Pension Plan (CPP) and Quebec Pension Plan (QPP) allow couples to pool the credits accumulated while together and split their total benefit.

For example, suppose that Gene always earned enough to make maximum contributions. When he retires, he's due a full C/QPP pension, about \$9,600 a year.

His wife, Joan, however, earned significantly less during her working years. She qualifies for C/QPP payments of about \$4,000 a year.

By pooling their entitlement, and then dividing it equally, they would get \$6,800 each (that is, \$9,600, plus \$4,000, divided by 2 equals \$6,800).

If Joan is in a lower tax bracket than Gene, the annual tax savings can be significant. Pension splitting like this is particularly useful if one spouse has few or no C/QPP credits.

Pension sharing is available only when both partners are at least 60 years old and no longer making C/QPP contributions. The amount that can be split is prorated according to the amount of time the couple lived together while making contributions.

Either spouse can cancel the division. It also ends with marital breakdown or death. The division is not retroactive.

Professional advice can help you determine whether splitting C/QPP payments is an appropriate strategy for you and your spouse. ■

## Give wisely to worthy causes while reaping tax benefits

**T**he closing months of each year produce a surge in charitable giving as people take stock of what they can afford to donate and the tax they'll save in return. Here's a summary of the rules, as well as some strategies for using them wisely.

### The tax credit

The charitable donation tax credit has two parts. The first \$200 in contributions generally saves about 25¢ per dollar donated in federal and provincial tax.

Contributions above \$200 generate credits based on the top tax rates, saving approximately 50¢ in tax for each dollar donated. Generally, claimable donations can be as high as 75% of your net income. The maximum contribution is higher — 100% of net income — for the year of death and the preceding year.

One way to maximize donations over \$200 is for spouses to combine receipts. Another is to combine contributions from several years. You have up to five years to report a donation.

Donations to U.S. charities can be claimed against income from U.S. sources.

### Giving ways

A straightforward cash gift isn't the only way to support your favourite charity. Here are some popular alternatives:

- **Donate publicly listed securities.**

There is a special tax break if you donate stocks or mutual funds with accrued gains. You face half the normal capital gains tax, but get a credit for the donation's full value.

- **Make a bequest.** Many people choose to name charities as beneficiaries in their wills. Your estate can claim a credit for donations up to 100% of your final year's net income. Any excess can be applied to the prior year's income, again to a maximum of 100%.

### Planned giving strategies

The following approaches are probably less familiar than those discussed above. If you think any might be appropriate, seek professional advice on the best way to proceed.

- **Life insurance.** Gifting an existing policy or taking out insurance and naming a charity as the owner can be a very cost-effective way to make a large donation for a small outlay of cash.

- **Charitable remainder trust.** Here, you irrevocably donate property (such as a cottage or business), but retain the right to its use or income during your lifetime. The tax receipt equals the property's value discounted by your life expectancy.

### Check out the charity

Before pursuing any charitable donation strategy, make sure you're dealing with a legitimate charitable organization. Every registered charity must file information return T-3010 with the Canada Customs and Revenue Agency (CCRA). The CCRA can tell you what the charity has raised from various sources, what services it provides, and its expenses.

Some of these strategies can be complex. Professional tax advice is essential. ■

## A timely tip when buying short-term investments

**ARE YOU PLANNING** to park money in Treasury bills or short-term deposits outside a tax-sheltered plan? Maybe you're saving for a major purchase. Or you might be skittish about this year's stock markets.

Here's a tip if you have new cash to stash or a T-bill or deposit facing renewal. Pick a maturity date after December 31. That way, you won't have to pay tax on the interest until 2004, when you file your 2003 return. Money that would otherwise go to Ottawa can be kept working for 12 more months.

T-bills and short-term deposits normally carry terms of 30, 60, or 90 days. But you can set your own. You could, for example, book a 63-day deposit on October 31 that would mature on January 2.

Note that there's a difference between the taxation of holdings that mature in less than a year and longer ones such as compounding Guaranteed Investment Certificates (GICs). Interest on short-term deposits is taxed in the year it's received. Similar treatment applies to T-bills, which are sold at a discount and mature at their face value. The difference between your cost and the final proceeds is taxed as interest earned in the year of maturity.

Compounding GICs, however, are taxed on an "accrual" basis. Each year, you pay tax on the interest earned in that year, even though the interest is locked in until the GIC matures. ■

