PERSONAL NEWSLETTER FROM THE BOYCHUK KNOBLAUCH FINANCIAL GROUP

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BOYCHUK KNOBLAUCH
FINANCIAL GROUP

SUMMER...A TIME OF FRESH PERSPECTIVES

Our advisory practice is built on the satisfaction of clients like you. We continue to accept new clients and would welcome your introduction to friends, business colleagues, or family who could benefit from our experience and advice.

We would be grateful for any such referrals and will, of course, deal with them in the strictest of confidence, as you would expect. Whether it is a fresh opinion on an existing portfolio or advice relating to a new situation, we are here to help. Please have them contact us, or call our office and we would be happy to follow up with them.

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HAPPY 150TH BIRTHDAY, CANADA

As Canada marks its 150th birthday (along with CIBC!), we should take pride in how far our nation has come. Year after year, Canada consistently places in the top ranks of many global indices: 7th in the Index of Economic Freedom (2017), due to our strong liberties and a free market system that rewards hard work; and 2nd in the Reputation Index (2016), as we are well-regarded by other nations. We are also home to some of the world's happiest people, ranking 6th in the World Economic Forum Happiest Countries Index (2016).[1] When we compare ourselves to our neighbours to the south, we rank higher on virtually every measure, including life expectancy, education and net worth. As a recent article in Maclean's magazine aptly put it, "the American dream has moved to Canada."[2]

Canada's financial systems continue to be viewed favourably. Even during tough economic times, Canada has shown its resilience. During the financial crisis of 2007/08, when various U.S. financial institutions went bankrupt, the balance sheets of the major Canadian banks remained strong. Even as commodity prices have struggled in recent years, our nation has pushed towards economic recovery, with Canada's recent GDP growth figures (Q4 2016) surpassing expectations. Canada continues to be one of the most competitive places in which to do business, having corporate tax rates that are amongst the lowest of the world's advanced economies.

We also have one of the highest life expectancies globally thanks, in part, to a strong healthcare system. We are living longer than any generation prior. In 1900, the average Canadian lived to only 50 years old; today the average Canadian will reach 82. There are 5,800 Canadian centenarians alive today, compared to only 650 just 50 years ago.

BUT STILL ROOM FOR IMPROVEMENT...

This year also marks the 100th birthday of personal income tax (PIT) in Canada. According to the Fraser Institute, when it comes to PIT, we pay more than most nations. Compared to the U.S., 42 of the 50 U.S. states have lower combined federal-state top rates than British Columbia, the province with the lowest combined top marginal tax rate. As nations such as the U.S. continue to take actions to lower PIT rates, Canada's high PIT rates could negatively impact its competitive position.

Canada's debt levels also continue to soar, totalling almost $1.4 trillion. With increasing debt interest payment obligations of around $63 billion/year, we shouldn't lose sight of the consequences of having too much debt, made evident by the European debt crisis.[3]

Despite these and other challenges, our economic progress and quality of life continue to be envied around the world. We have great things to celebrate as Canadians: Happy birthday!

Notes: 1. Index of Economic Freedom, Heritage Foundation, heritage.org; Reputation Index, reputationinstitute.com; Happiest Countries Index, weforum.org; 2. "The American Dream Has Moved to Canada", Macleans.ca, 02/28/17; 3. "How Owe Turns to Woe", National Post, 1/19/17.

YOUR QUESTIONS ANSWERED: THE CAPITAL GAINS TAX

HAVE THERE BEEN CHANGES TO THE CAPITAL GAINS TAX?

No. There was much speculation that Canadians would be seeing an increase in tax on capital gains in this year's federal budget, by way of a rise in the inclusion rate. However, no changes were made, possibly due to continuing Canadian economic uncertainty. The capital gains tax hasn't changed in many years. The inclusion rate has been adjusted over time, but the latest change was made in 2000 when the rate was reduced to 50%. Prior to that time, in the 1990s, it remained at 75%.

WHAT IS THE CAPITAL GAINS TAX ADVANTAGE?

Capital gains are created when investments are sold for more than their cost. In a taxable account, the current inclusion rate of 50% means that only 50% of total capital gains is taxed as regular income. As such, capital gains are taxed at one of the most preferential rates in Canada. Interest income is taxed at ordinary rates and dividend income is eligible for a dividend tax credit, but the resulting tax rate ends up being higher in all provinces/territories (see chart).

WILL THERE BE FUTURE CHANGES TO THE TAX?

Finance Minister Bill Morneau has said that future changes to the tax on capital gains have not been ruled out, but it will be interesting to see if Canada will make changes given that the U.S. has recently proposed a tax plan to significantly lower personal income taxes.

While potential changes to the capital gains tax are out of our control, there are ways to reduce how much tax we pay. First, capital gains generated inside a Tax-Free Savings Account are generally not subject to tax. For securities held in non-registered accounts, net capital losses can offset capital gains in the current year or prior three years, or be carried forward indefinitely.

COMBINED TOP MARGINAL TAX RATES: INDIVIDUALS 2017

Province	Capital Gains	Interest/Regular Income	Eligible Dividends
BC	23.85%	47.70%	31.30%
AB*	24.00%	48.00%	31.71%
SK	23.88%	47.75%	30.33%
MB	25.20%	50.40%	37.78%
ON*	26.76%	53.53%	39.34%
QC	26.65%	53.31%	39.83%
NB***	26.65%	53.30%	33.51%
NS	27.00%	54.00%	41.58%
PEI	25.69%	51.37%	34.22%
NL	25.65%	51.30%	42.61%

As at April 30, 2017. Source: Ernst & Young LLP.

Individuals can also choose to use the Principal Residence Exemption (PRE) on the sale of a home. The gain will not be taxable if the property has been a person's principal residence throughout the time it has been owned. If you own multiple properties, get professional advice to optimize the use of the PRE.

For donations of publicly-traded securities to a registered charity, capital gains on the securities are tax exempt. Finally, if you own a farming/fishing property or shares of a Canadian-Controlled Private Corporation that has increased in value, you may be entitled to the lifetime capital gains exemption ($835,716 or $1,000,000 for farming/fishing properties in 2017) if certain conditions are met.

UNDERSTANDING OLD AGE SECURITY

As you approach retirement, consider giving thought to how the Old Age Security (OAS) program will play a role. This federal retirement assistance program provides monthly payments to Canadian citizens or legal residents that can begin at age 65, or be deferred to age 70 to increase the benefit amount. The amount of the OAS benefit depends on certain factors, including how long you've lived in Canada after the age of 18 and your net income in retirement. Payments are indexed to inflation and adjusted on a quarterly basis. The current maximum benefit at age 65 (for April to June 2017) is $578.53 per month.

INCOME-TESTED BENEFITS: THE "CLAWBACK"

If net income is above $74,788 (for 2017), the OAS will be clawed back (reduced) at a rate of 15%. For example, if net income is $84,788, the clawback will be equal to 15% of the $10,000 that exceeds the income threshold, or $1,500, reducing monthly payments by $125 to $453.53 (assuming a $578.53 benefit without the clawback). The OAS is fully eliminated when net income reaches $121,071. If OAS is deferred to age 70, the maximum benefit rises to $786.80 per month (an increase of 0.6% for every month of deferral).

Here are some things to remember:

The withholding is determined by using net income from your previous year's tax return. If your net income will be substantially lower than in the previous year, request a reduction in the withholding by filing Canada Revenue Agency form T1213(OAS) - Request to Reduce OAS Recovery Tax at Source.

Be aware of the impact on net income if offsetting capital gains with capital losses. Prior years' capital losses carried forward to offset capital gains will not reduce net income for OAS clawback purposes. This is because the clawback is based on net income before adjustments (i.e., capital loss carryforwards) on a tax return. But, capital losses in the current year will impact net income used to calculate the clawback.

Consider how different sources of retirement income can be prioritized to help maximize OAS benefits. For example, TFSA withdrawals aren't considered taxable income so they may help to preserve income-tested benefits like OAS.

Income splitting may reduce the clawback. Income-splitting may help a higher-income spouse/partner reduce the OAS clawback, which may be achieved through pension income splitting, or, for retirees with no eligible pension income, Registered Retirement Income Fund or annuity income splitting after the age of 65.

As you give thought to your sources of retirement income and how OAS may play a role, we can provide our perspectives.

PLANNING AHEAD: WHAT'S YOUR RRSP WITHDRAWAL STRATEGY?

Registered Retirement Savings Plans (RRSPs) have been an invaluable tool in building retirement success. But while many of us do a good job of maximizing our contributions year after year, we often forget to plan our future exit strategy for these funds.

While postponing withdrawals until retirement makes sense in most cases, as many individuals have a lower marginal tax rate in retirement, waiting too long can have its own issues. The RRSP will need to be converted by the end of the year in which the plan holder reaches age 71, and if converted to a Registered Retirement Income Fund (RRIF), minimum withdrawals will then be required on an annual basis. Upon death, any amounts remaining in an RRSP/RRIF will be reported as income on the deceased's final tax return and potentially taxed at the highest marginal rate. Although the spousal rollover provision may allow assets to be transferred tax-free to a surviving spouse/common-law partner (CLP), taxes will ultimately be due when the amounts are withdrawn from a surviving spouse's/CLP's RRSP/RRIF account.

Remember that every dollar withdrawn from the RRSP will incur tax at regular income rates. This can create a rather major tax liability. Without an exit strategy, the potential taxes may create problems in retirement. As such, thinking ahead about an RRSP withdrawal strategy may have benefits:

Withdraw Funds in Low Income Years — If your income will be lower in certain years relative to what you anticipate in the future, either before or during retirement, you may consider taking withdrawals so that income will be taxed at lower marginal rates. Although the withdrawal will be subject to withholding taxes, remember that these taxes may be refunded after filing a tax return. If you don't need the funds and wish to continue to maximize the potential for investments to grow, consider contributing withdrawn RRSP assets to a Tax-Free Savings Account (TFSA). Although you may pay tax on the income when RRSP assets are withdrawn, funds can grow tax free in your TFSA afterwards.

Time Withdrawals with Other Income Sources — Consider the impact that RRSP/RRIF income may have on income-tested benefits such as Old Age Security (OAS). In order to maximize these benefits, you may wish to start RRSP withdrawals before the years in which the benefits begin. You may also consider using other forms of income to keep you in a lower tax bracket as you withdraw RRSP/RRIF income over time. As an example, withdrawing TFSA funds may be beneficial, as TFSA income is not considered to be taxable.

Plan to Split Pension Income with a Spouse/CLP — After age 65, you can split up to 50% of eligible pension income that includes RRIF income with a spouse/CLP. If you have a spouse/CLP in a lower income tax bracket, you can convert a portion of your RRSP to an RRIF to take advantage of pension income-splitting with a spouse/CLP, which may allow your partner to claim the pension income tax credit.

Plan Ahead: Spousal RRSP — If one spouse/CLP is expected to have a high level of income in retirement while the other will have little retirement income, setting up a spousal RRSP in your working years may provide future income-splitting opportunities. In retirement, income may be withdrawn by the lower-income spouse/CLP at lower tax rates. Certain rules need to be followed, so advanced planning is necessary.

Other options may be available and planning will vary based on individual situations, so get in touch if you would like to discuss potential RRSP withdrawal strategies.

Note that the comments included in this publication are not intended to be a definitive analysis of tax law. The comments contained herein are general in nature and professional advice regarding an individual's particular tax position should be obtained in respect of any person's specific circumstances.

GOODBYE TO THE CANADA SAVINGS BOND AND OTHER ICONS

In March, the federal budget announced that future sales of the Canada Savings Bond have been discontinued and the program will be phased out. Once a staple in many investors' portfolios, these savings vehicles have seen a decline in their popularity based on historically low interest rates.

As we say goodbye to the Canada Savings Bond, here is a list of other relatively obsolete things that Canadians have bid farewell to over the past 10 years:

- The penny
- Compact discs/DVDs
- Pay phones
- Film developing
- Movie rentals
- Fax machines
- VCR machines
- Paper maps
- The Classifieds section
- Phone books

PURCHASING A HOUSE AS AN INVESTMENT?

As housing prices continue to soar in certain Canadian cities, it may be difficult not to question the potential to build wealth through purchasing residential real estate. However, putting a significant amount of capital into buying a home and assuming that it will yield future significant returns has risks. Here are some perspectives.

Although in recent memory housing prices have been increasing steadily, over the longer term the housing market has seen prices fluctuate. A boom in Toronto's housing market in the late 1980s was followed by a decline in prices that lasted for almost the entire period between 1990 and 1997 and the average sale price fell by 28%.[1]

Certain factors have helped to drive the recent rise in housing prices including supply constraints in major metropolitan areas. Interest rates are at historical lows. A rise in interest rates would impact the ability of mortgage affordability. Regulations can also change. The foreign buyers' tax recently put in place in Vancouver appears to have temporarily cooled the market; it is yet to be seen how newly announced measures will affect Toronto's booming market.

Unlike publicly-traded shares, a house is generally not considered a liquid asset. If you own a rental property, rental income is taxable and capital gains taxes will generally be due on the appreciation of a property that is not a principal residence. Investments like dividend-paying stocks and fixed-income instruments can provide income streams (and can also be held in tax-sheltered accounts), whereas home ownership incurs many costs.

These costs should not be underestimated, as illustrated in the chart below. Between 2012 and 2017, the return on a $400,000 home is shown in three Canadian cities. Although the costs will vary, conservative estimates have been used. Over the same period, the S&P/TSX Composite Total Return Index (with reinvested dividends) returned an average of 7.6% per annum.[2]

While the purchase of a home can have its benefits (e.g., acting as a forced savings plan), there are risks to think about for investors considering it as an opportunity to build wealth.

Notes: 1. Toronto Real Estate Board. Avg. sale price 1989: $273,698; 1996: $198,150; 2. S&P/TSX Composite Total Return Index 01/31/12 to 02/28/17.

ILLUSTRATIVE: COSTS OF HOME OWNERSHIP & IMPACT ON RETURN

	National	Toronto	Vancouver	Calgary
Value at Feb. 2012	$400,000	$400,000	$400,000	$400,000
Value at Feb. 2017	$567,840	$653,840	$594,720	$461,640
% Change	42.0%	63.5%	48.7%	15.4%
Avg. Annual Return	7.3%	10.3%	8.3%	2.9%
Real Estate/Closing Costs[1]	$30,000	$30,000	$30,000	$30,000
Routine Maintenance[2]	$60,000	$60,000	$60,000	$60,000
Property Tax[3]	$12,098	$18,125	$7,872	$13,299
Home Insurance[4]	$4,200	$4,500	$4,920	$4,740
Mortgage Interest[5]	$13,455	$13,455	$13,455	$13,455
Total Costs	$119,753	$126,080	$116,247	$121,494
After-Cost Value	$448,087	$527,760	$478,473	$340,146
% Change	12.0%	31.9%	19.6%	-15.0%
Avg. Annual Return	2.3%	5.7%	3.6%	-3.2%

Notes: 1. 5% real estate agent cost; 2.5% closing costs. 2. Annual upkeep of HVAC, electrical, plumbing, landscape, etc., est. between 3% and 5% per annum. 3. Based on 2016 tax rates on avg. home price for five years. 4. Based on 2012 estimates, Insureye. 5. Interest cost for 5 years, for 20-year, $200,000 fixed-rate mortgage at 2.49%. Sources: 1. Canada Mortgage & Housing Corp. (closing costs est. between 1.5% and 4%). 2. "Ultimate Home Maintenance Guide", Moneysense, Oct. 2011. 3. Municipal government websites.

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