



Taxes and Your Retirement

*Reducing your income taxes today and
through retirement*

Introduction

- The four D's of tax planning
- Tax effective investing
- Impediments to wealth accumulation & preservation
- Some grave issues
- Fundamentals in planning

The 4 D's of Tax Planning

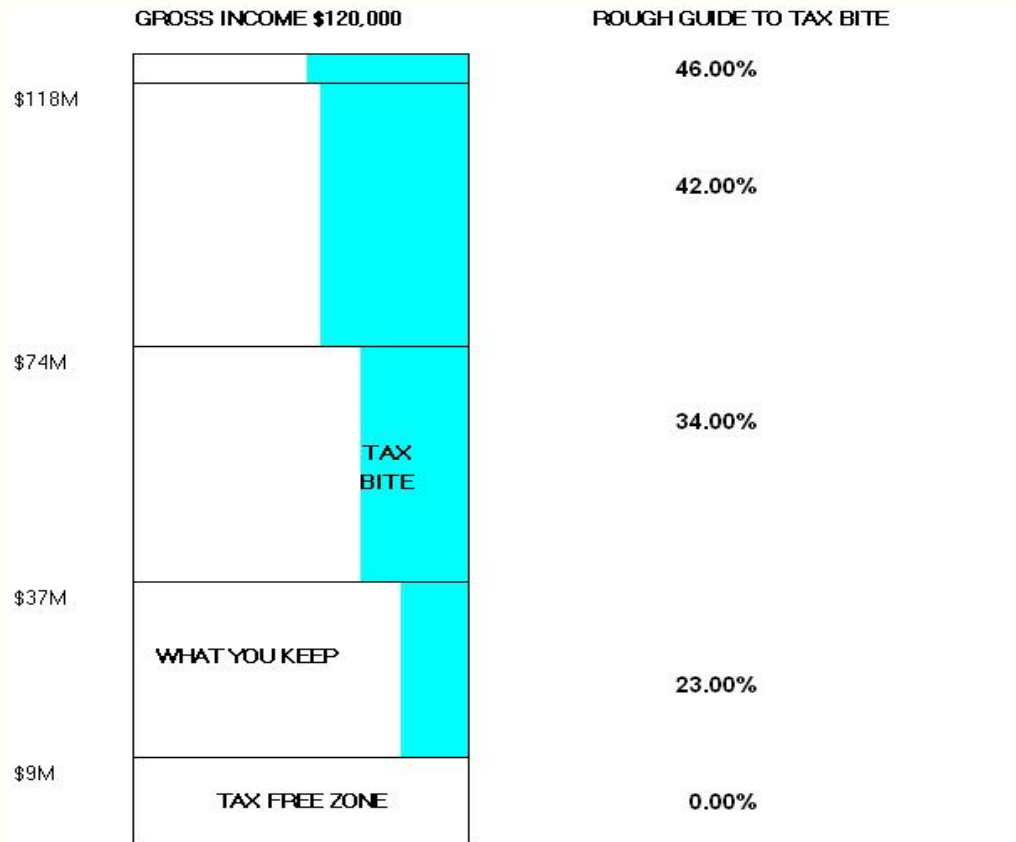
- Deduct
- Divide
- Defer
- Discount

The 1st D

Deduct

1ST D – Deduct

Deduction and the difference between a deduction and a tax credit



Deduct - Defined

- **Deduction** – Removes taxable income from the taxpayer's top income level
- In the previous example: a deduction of \$5,000 would be worth close to \$2,200 in tax savings
- Net "Cost" to taxpayer at this level = \$2,800

Deduct – Reducing taxable income

- Pension Contributions
- RRSP Contributions
- Qualifying Moving Expenses
- Child Care Expenses
- Investment income management fees
- Interest on money borrowed to earn investment income

Deduct – Increasing the tax free amount

- A tax credit increases the tax free amount
- Using the example - \$5,000 of Tax Credits would be worth \$1,150 to taxpayer
- Net “Cost” to taxpayer \$3,850
($\$5,000 - \$1,150$)

Deduct – Examples of Tax Credits

- The Pension Income Tax Credit – Often a missed opportunity !
- Allowable medical expenses
- Child Fitness Credit
- Tuition Fees
- Textbook Tax Credit
- Education Amount
- Student Loan Interest
- Disability tax credit
- Public Transit Passes

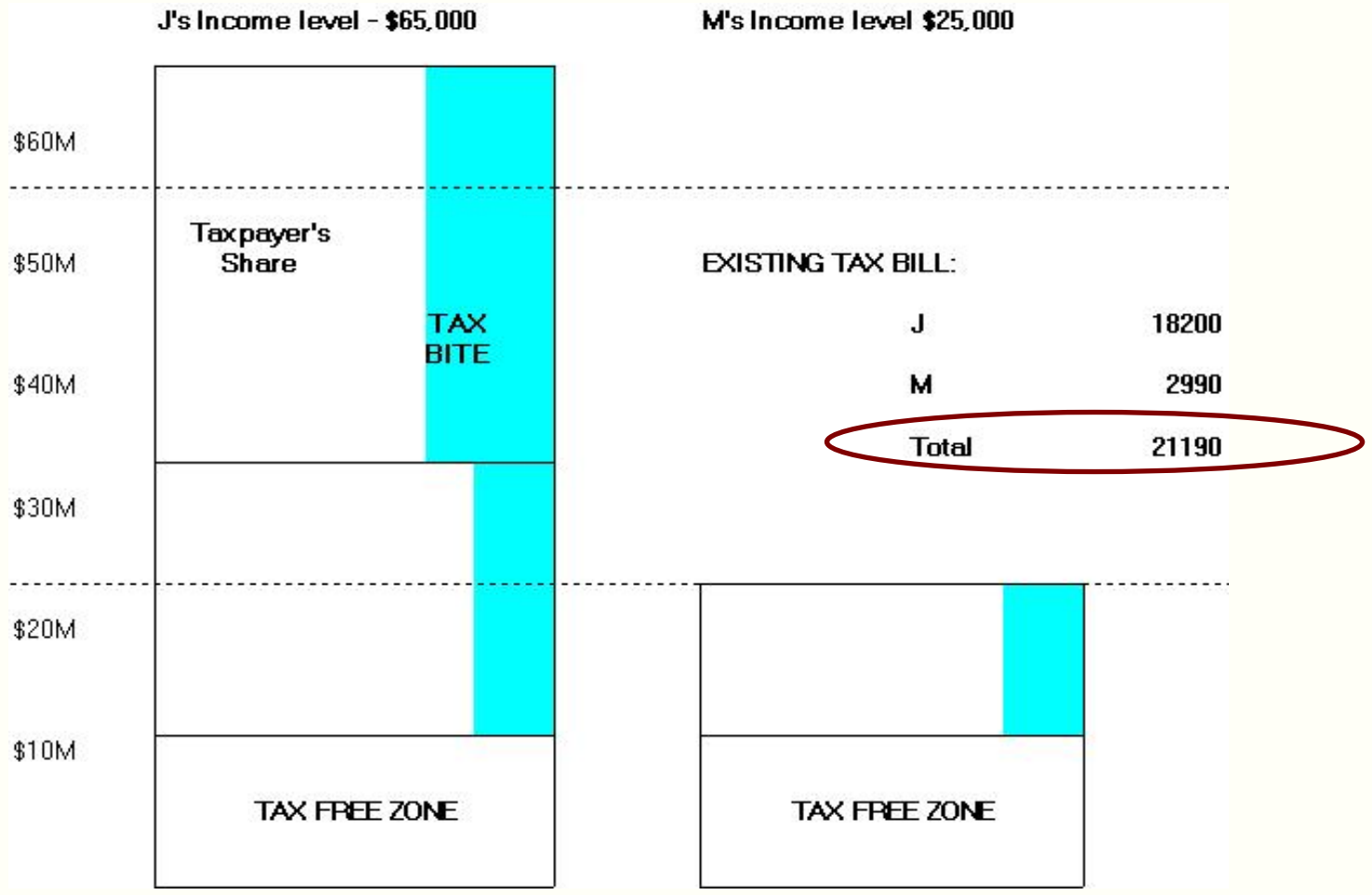
The 2nd D

Divide

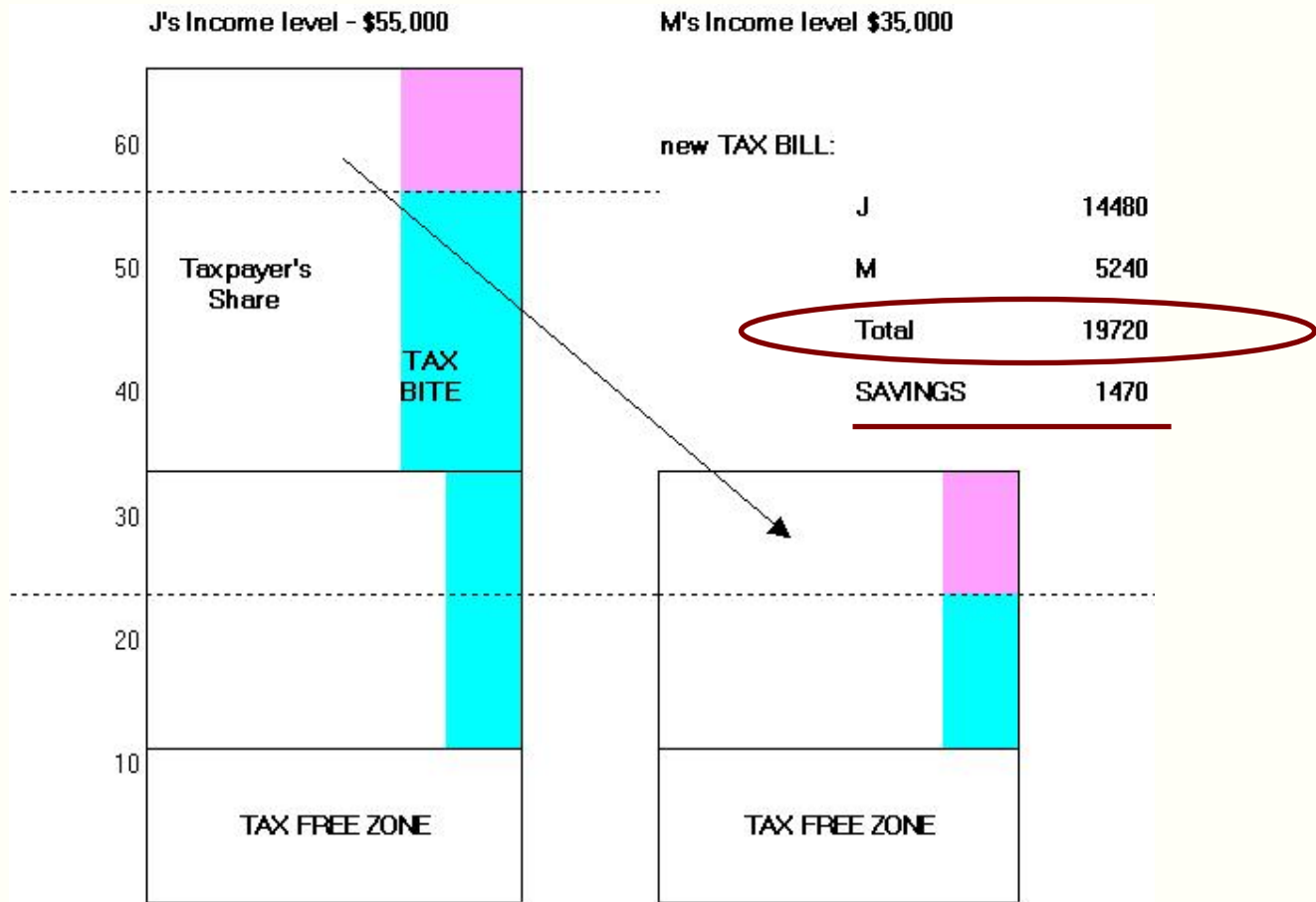
Divide - Defined

- Division of Income between spouses
 - Also known as income splitting
- A very important tax reduction strategy for many taxpayers

2nd D - Divide



2nd D - Divide



Divide - Division Techniques

1. Spousal RRSP – Put money away in name of the anticipated lower taxpayer during withdrawal years [Retirement]
2. Investment in Lower Taxpayer's name during accumulation period – simply by using lower income spouse's earnings for non-registered savings [Document carefully]
3. Lending the lower income spouse money for investments [BUT Carefully Document]
4. Income Splitting CPP retirement income payments – another frequently missed tax reduction technique

2nd D – Divide

What's new for 2008

Retired spouses may now split up to half of the pension income they receive [Not CPP or OAS]

Spouses aged 65 plus may now split up to half of RRIF or RRSP annuity income received

Additional potential benefit – Doubling up of Pension Income Amount [Tax Credit]

THIS ELECTION OCCURS ANNUALLY AT TIME OF FILING

Will this make spousal RRSP contributions redundant?

Spousal RRSP still has uses

- Older spouse still working past age 71
- Young couple want to save for home – one with high income, other at home, studying or in a pension plan
- Other splitting options available may just not sufficiently split income to maximize tax reduction

The 3rd D

Defer

3rd D - Defer

- Deferring Tax payable is a major contributor to wealth building
- In essence it can be as or more powerful than an interest free loan
- To gain a quick understanding of this power it might be helpful to understand the rule of 72

Rule of 72 – Quick mental arithmetic

- Take the number 72 and divide by a yield or interest rate
- The result is how many years it takes to double an investment
- Alternatively put, if an asset has doubled in value in a given period of time, divide the time elapsed into 72 to get an approximation of compound rate of return

Rule of 72 – (Actual)

Interest rate	Iterations (Years)	Compounded value of \$1,000
2%	36	\$2,040
4%	18	2,026
5%	14.4	2,021
6%	12	2,012
8%	9	1,999
10%	7.2	1,988
12%	6	1,974
18%	4	1,938
24%	3	1,906

3rd D – Deferral in Action

- Sal puts \$10,000 into an RRSP at 6%. She simultaneously puts \$6,000 into a non-registered investment at 6%
- We assume she is earning \$80,000 and is in an approximate 40% tax bracket
- This means that her out of pocket cost is the same for each investment

Putting Rule of 72 to Use

- She keeps the investments for 24 years
- Using the rule of 72 her RRSP doubles twice
- \$10,000 becomes \$40,000
- Her tax rate reduces her effective yield on her non-registered investment from 6% to 3.6% (2.4% in effect goes to income taxes)
- The iteration rate of $3.6 = 20$, so her \$6,000 doubles once in that time
- \$6,000 becomes \$12,000
- By year 24 this will grow to \$14,000

The RRSP-Non Registered Investment Comparison Continued

- The difference is substantial at \$26,000
- The amount of gain directly attributable to the deduction is \$16,600 at this marginal tax rate, time elapsed & investment rate assumed
- The amount attributable in this case to deferral is \$9,400 at the same tax rate

The RRSP-Non Registered Investment Comparison Continued

The benefit doesn't end there

- If Sal takes her income from each at that time, the RRSP will produce \$200 taxable income per month at 6% continuing investment rate, **AND** ...her tax rate may be lower at that time
- The **Non-registered investment** will **also** give her **TAXABLE** income per month of \$70

The 4TH D

Discount

4th D - Discount

- An important and often overlooked financial planning tactic
- The potentially largest opportunity in discounting is discounting tax payable by making a non-deductible loan into a tax deductible cost
- Another discounting opportunity – This one provided by the government – the RESP

4th D – Discount in Action

- This in effect is to be used with only Non-Registered Investments
- The Investment made with the funds must be able to realistically generate returns greater than cost of borrowing [CRA rule]
- Jerry has non-registered investments of \$100,000 and an outstanding mortgage of a similar amount
- Jerry pays the mortgage off by cashing in the investments. [This might create a tax position]
- Jerry then arranges a new mortgage and the funds from this flow to the investment. HE MUST LEAVE A PAPER TRAIL
- He may now write off the interest on Line 221 of his tax return under carrying charges

Tax Effective Investing

- Here we examine the relative tax impact of:
 - Regular Interest and Net Rental Income
 - Capital Gains
 - Eligible Dividends
 - Non-Eligible dividends

Investing, Inflation & Taxes

Investing can be like driving your car on a highway and then coming to stop signs and traffic jams which slow you down from time to time. Occasionally you may be forced to take detours (Negative markets) which cause you to be further from your destination for a while.

Taxes – Still driving your car, but now with one foot on the brake, worse still, the faster you drive, the harder your foot presses down.

Inflation – Like driving your car with a parachute trailing behind – But when you are stuck in the traffic jam or are in a detour– the wind even pulls you back further. It can also cause you to run out of gas !

Simplified Comparative Tax Chart

Assumes \$5,000 of investment income [Seniors]

Threshold	Interest & Rental	Capital Gains	Eligible Dividends	Non-eligible Dividends
Low Tax Rate To \$37,000	\$1,252	\$626	(\$30)	\$420
Mid Income Rate To \$74,000	\$1,716	\$858	\$548	\$991
Mid High Income Rate To 118,000	\$2,494	\$1,297	\$1,163	\$1,669
Top Rate Unlimited	\$2,320	\$1,160	\$1,062	\$1,567

Simplified Comparative Chart

What the senior gets to keep (Of the \$5,000)

Threshold	Interest & Rental	Capital Gains	Eligible Dividends	Non-eligible Dividends
Low Tax Rate To \$37,000	\$3,748	\$4,374	\$5,030	\$4,580
Mid Income Rate To \$74,000	\$3,284	\$4,142	\$4,452	\$4,009
Mid High Income Rate To 118,000	\$2,506	\$3,703	\$3,837	\$3,331
Top Rate Unlimited	\$2,680	\$3,840	\$3,938	\$3,433

The Seniors' Claw backs

- Age Exemption: A tax credit is given to seniors but only really benefits modest income seniors. Income over \$31,000 and under \$65,500 have this tax credit clawed back at the rate of 15%.
- OAS Claw back. This affects seniors with incomes in excess of \$63,500 and claws back at 15% until completely erasing any benefit for pensioners with taxable income in excess of \$103,000

All 2007 tax figures

90 years of Canadian inflation

Depression Era

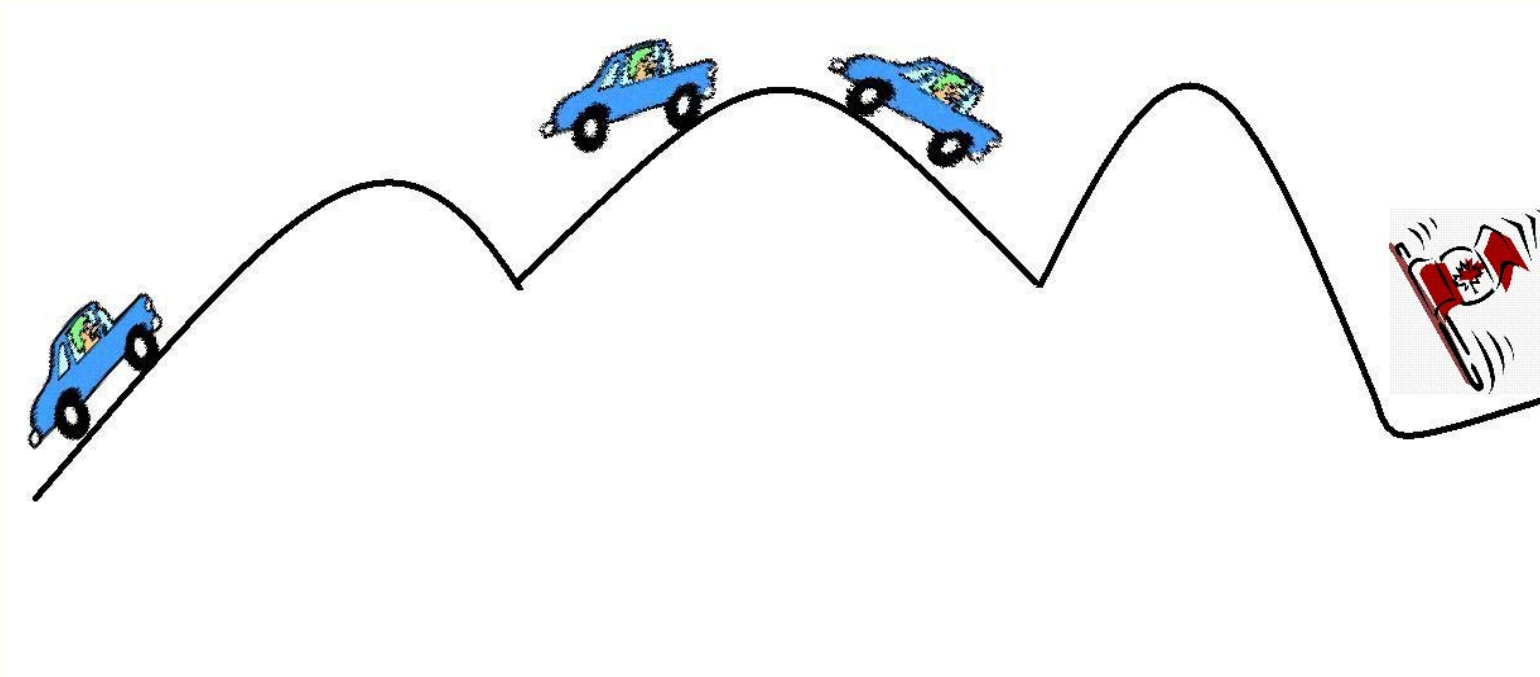
**Baby Boom
Borrowing Era**

1917-1927	.92%
1927-1937**	-1.53%
1937-1947	3.59%
1947-1957	2.99%
1957-1967	2.13%
1967-1977**	6.61%
1977-1987**	7.15%
1987-1997	2.65%
1997-2007	2.17%
Average except **	2.25%

Other impediments to wealth maintenance

- Running out of Gas
- Taking [Retirement] Income too soon
- Bad Timing
- Issues with RRIF & LIF income

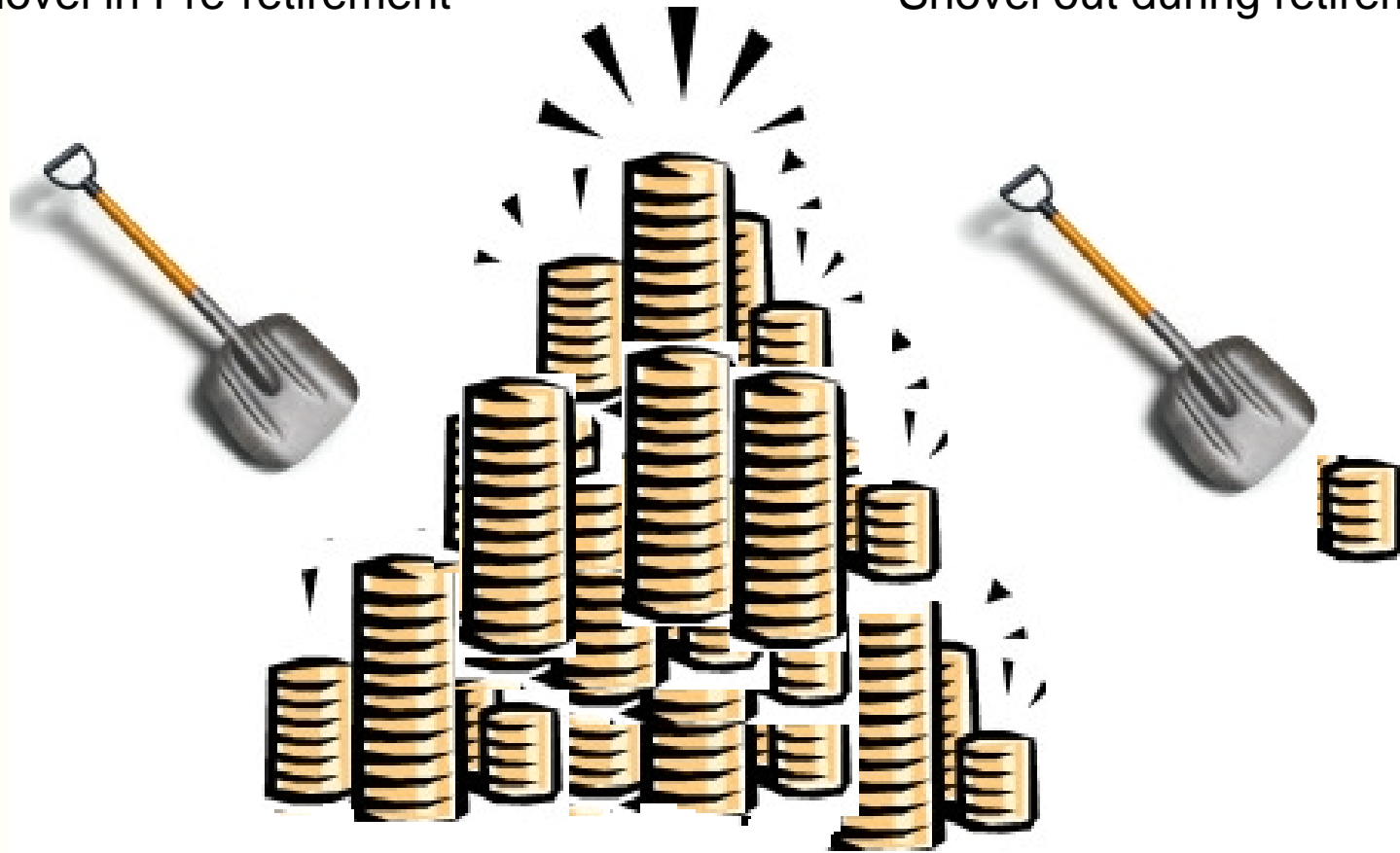
Running Out of Gas



The “Constant Gardener” – Shovel in motion – Was your crop ready?

Shovel in Pre-retirement

Shovel out during retirement



The power of the “IN” shovel

- Why one extra shovelful in..... can indirectly equal the effect of three (or more) extra shovelfuls out
- Assumptions: Wait one year
- RRSP savings at beginning of year of \$200,000
- Normal rate of deposit \$10,000
- Amount of anticipated annualized withdrawal \$16,000 [8%]
- Since no withdrawal (\$16,000) is made and an extra deposit is available, rule of 72 says that in 12 years there will be \$52,000 extra available and in 24 years there would be \$104,000 extra
- In this example the person who started early would take his/her last withdrawal in year 24, while the deferring retiree would not take their last payment until year 31

Sequence of Return

- During the accumulation phase – hardly an issue. [Other than Psychological]
- During the withdrawal phase – can be a major problem

Sequence of returns during the Accumulation Phase

Age	Return A	Balance	Return B	Balance
55		\$100,000		\$100,000
56	-25%	75,000	25%	125,000
57	-7.5%	69,355	15%	143,750
58	0%	69,375	20%	172,500
59	25%	86,719	-25%	129,375
60	15%	99,727	5%	135,844
61	20%	119,672	-7.5%	125,655
62	15%	137,623	15%	144,504
63	5%	144,504	0%	144,504
64	-7.5%	133,666	-7.5%	133,666
65	20%	160,399	12.5%	150,374
66	12.5%	180,449	11%	166,915
67	11%	200,299	20%	200,299

Sequence of returns during the Withdrawal Phase

Age	Return A	Indexed Withdrawal	Balance A		Return B	Indexed Withdrawal	Balance B
70			\$400,597				\$400,597
71	-25%	\$29,564	\$278,275		25%	\$29,564	\$463,791
72	-7.5%	\$30,229	\$229,442		15%	\$34,692	\$493,464
73	0%	\$30,909	\$198,533		20%	\$37,454	\$547,212
74	25%	\$31,605	\$208,660		-25%	\$31,605	\$386,705
75	15%	\$32,316	\$202,795		5%	\$32,316	\$372,109
76	20%	\$33,043	\$203,703		-7.5%	\$33,043	\$313,636
77	15%	\$33,787	\$195,404		15%	\$33,787	\$321,827
78	-7.5%	\$34,547	\$148,792		0%	\$34,547	\$287,280

Issues with RRIFs

- The RRIF is organized to reduce the investment principle gradually annually
- When re-constructed in 1993– the powers that be formulated the internal rate of return of 6% as a basis for calculating the minimum withdrawal amount
- What this means is that IF AN INVESTMENT YIELDED EXACTLY 6%, the minimum withdrawal would equal the level withdrawal – at least until age 94
- IF YIELDS ARE GREATER THAN 6%, the minimum withdrawal would be an escalating withdrawal
- Conversely IF YIELDS WOULD BE LOWER THAN 6%, the minimum withdrawal would reduce annually
- What many advisors/RRIF holders do is suggest/elect a level income withdrawal
- This will automatically initiate a form of deferred bankruptcy proceedings against this RRIF account
- This generally makes fixed income RRIFs an unfortunately bad choice at this time

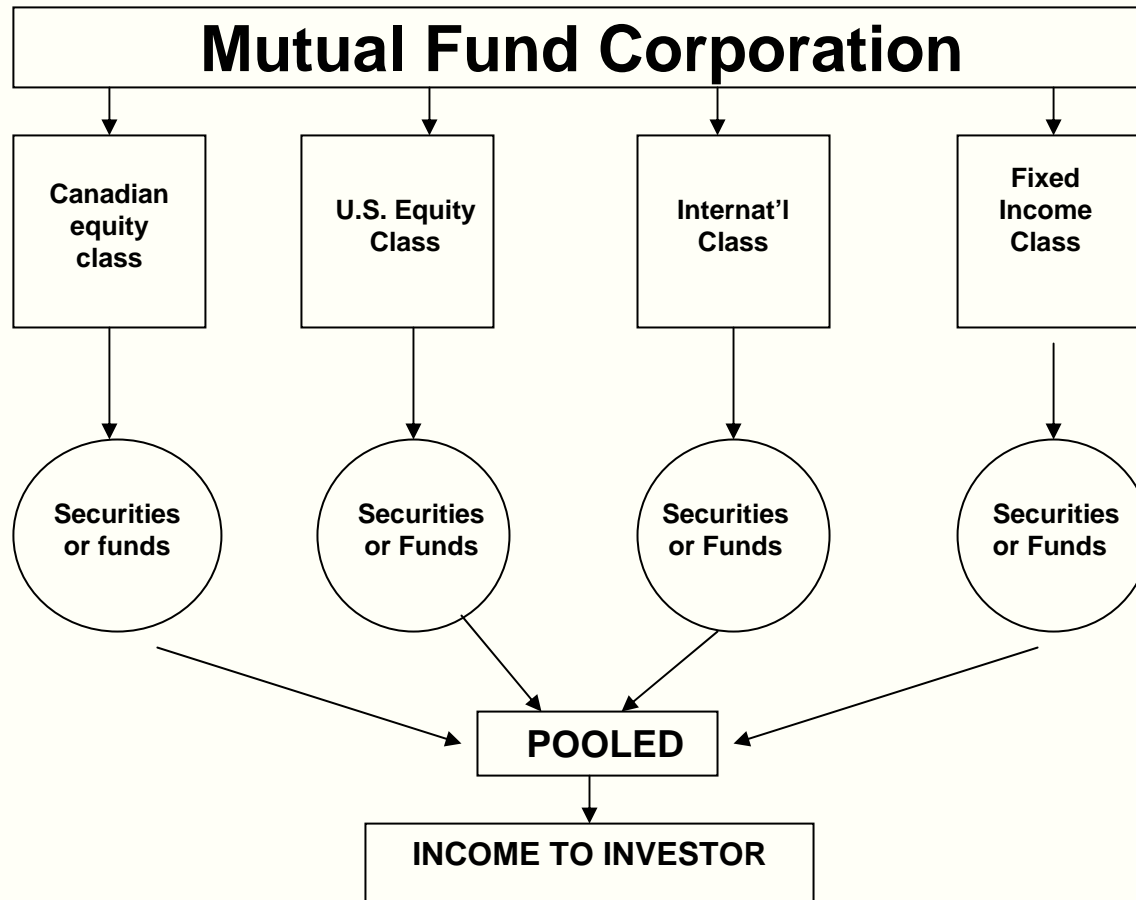
Why bother with a non-registered portfolio ?

- Major purchases such as automobiles, the long awaited world cruise, the big house renovation etc.
- Helping the children/grandchildren financially
- Maneuvering room
- Any sinking fund
- Low[er] taxable impact on death

Tax Efficient Solutions

- PENSIONS [Registered]
- RRSPs [Registered]
- RRIFs [Registered]
- Mutual Fund Corporations [Non registered]
- Tax efficient systematic withdrawal plans or T-SWP [Non registered]
- Prescribed Annuities [Non registered]
- Life Insurance [Non Registered]

Mutual Fund Corporation



Systematic Withdrawal Plans

- T-SWP - Defers much of the taxable income until the later years of the programmed withdrawal and converts some interest income to capital gains
- Prescribed annuity divides systematic withdrawal return of capital into equal installments thereby reducing taxable interest income in the early years of the programmed withdrawal. (Both Life & Fixed Terms available.)

Life Insurance

- Can be structured as a deferred savings plan
- Can be structured to accumulate significant cash with NO tax during the accumulation years
- Can be used as a deferred systematic withdrawal plan using Prescribed Annuity principle
- ALL TAXES WAIVED ON DEATH
- Probate free with named beneficiary

Grave Issues

Taxes at death

- Get your financial house in order
- Tidy up before you close the door and leave
- Say goodbye to the high-cost help before you die
- Show some contempt for the tax men
- Deal with the Family Cottage
- Discuss your situation with your heirs

Planning – the ultimate weapon

- Wills – The issue of probate
- Powers of Attorney
- Benefits of using Insurance Company products – Life Insurance, Annuities, Segregated Funds
- Pre-Paid Funeral Expense
- Joint Accounts
- Trust Agreements
- Gifting

The Principle of Diversifying & Rebalancing

Divide your fortune into four equal parts: stocks, real estate, bonds and gold coins. Be prepared to lose on one of them most of the time.

During inflation, you will lose on bonds and win on gold and real estate: during deflation, you will lose on real estate and win on bonds, while your stocks will see you through both periods though in a mixed fashion. Whenever performance differences cause a major imbalance, rebalance your fortunes back to the four equal parts.

Ian C Gillespie CFP CLU ChFC

Gillespie Adams & Associates

This statement on sound investment management also embodies risk management principles.

Written some 500 years ago – these tenets of financial planning haven't changed one bit.

The author - Jacob Fugger the Rich, Augsburg
1459-1525