Assante® WEALTH MANAGEMENT

WELL-ADVISED

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John Alexander, BA., CFP
Senior Financial Planner
jalexander@assante.com

Cathy O'Neill
Administrative Assistant
coneill@assante.com

Sara Moynan
Administrative Assistant
smoynan@assante.com

Assante Capital Management Ltd.
101 McIntyre St. West
North Bay, ON P1B 2Y5
Tel: 705-476-5422
Toll Free: 1-800-461-9519
Fax: 705-476-7842
www.johnalexander.ca

THE SMART WAY TO VIEW AN EXPECTED INHERITANCE

It's tempting to count on an expected inheritance as money in the bank – but it doesn't always work out so perfectly. Anyone's parent or parents could encounter situations or challenges that jeopardize the legacy they wish to leave to their children.

Understand the risks

An inheritance could be less than anticipated simply because life expectancy is increasing. Funding the cost of living until age 90 could erode savings that would otherwise have been given to children. Or, funds designated for heirs could end up paying for long-term care, which could potentially cost hundreds of thousands of dollars for an extended stay in a long-term care residence. Perhaps heirs receive less than expected because the parents leave large sums to other beneficiaries, such as charities, grandchildren or new family members from a blended family. Then there's the unexpected – like a single parent remarrying, travelling the world and leaving the majority of estate assets to the surviving spouse.

A gift, not a guarantee

You just never know if it'll be your parents who are unable to leave the inheritance they wished to leave. What happens if you plan on an inheritance but the amount you receive is much lower than expected? Before retirement, you might not have saved enough. Or you might retire earlier than you should have. During retirement, you might overspend your savings. That's the trouble with counting on an inheritance – you can fall short of meeting your financial objectives.

A better way to view your expected inheritance is as a welcome gift. You'll avoid unpleasant surprises if you designate the funds to enhance – not support – your retirement lifestyle.

Whenever you're planning your financial future, you can always reach out to us. We'll help you meet your life goals with a financial plan based on factors you can control. ■

FACTOR THE NEW LONGEVITY INTO YOUR FINANCIAL PLANS

In 2001, there were 3,795 Canadians aged 100 or over. In 2016, the number more than doubled to 8,230 centenarians.[1] According to Statistics Canada, a Canadian male aged 65 is expected to live to 84 and a female to age 87. These are average life expectancies, so it's probably wise to count on a longer life when making financial plans. Imagine, you might enjoy a retirement of 30 years, even longer. Here are some of the financial planning areas affected by the new longevity.

Setting a retirement date

The issue of when you can retire usually revolves around your savings – whether you have enough to fund the retirement lifestyle you desire. That becomes more involved now that you're looking at a period of perhaps three decades. The good news is that you're not alone in setting the date. You can picture the lifestyle you imagine, and we can help you with the financial side. We'll estimate the size of your nest egg at a particular retirement date and project your estimated retirement income based on an investment and income program that suits your situation.

Planning an inheritance

When it comes to the timing of giving an inheritance, living to older ages can cause a dilemma. You want to ensure you don't outlive your savings, so it's beneficial to leave an inheritance the traditional way, through your will. But if you live to an older age, your children may already be established, even retired. They may have appreciated the funds decades earlier when they purchased a home and started a family.

What do you do? Give while living or give through your will? One idea is to use your will but give to grandchildren. Another is to help children when they need it most, but compromise, such as gifting part, not all, of a down payment. You can ask for our assistance in assessing whether a specific gift amount will affect your retirement plans.

Covering health care expenses

If you're fortunate, you'll remain healthy enough during retirement that health care expenses won't be a factor. But living a longer life also opens the possibility of developing a chronic medical illness or cognitive impairment, requiring expensive long-term care. In Ontario, for example, the cost for a private room in a government-supported long-term care facility is $2,641 per month, not far off the average of all provinces.[2] The cost can be twice that rate for a private nursing residence. So it's prudent to either purchase long-term care insurance or set aside funds as a precaution.

Investing during retirement

To fund a retirement of 25 years, 30 years or longer, an investment portfolio typically includes a substantial equity component. Beyond that, however, there is no single investment formula that works for all retirees.

Some retirees might have an asset allocation similar to their holdings just before retirement, when their portfolio became conservative. Others could have a retirement program quite different from the investments of wealth accumulation years, including annuities and other guaranteed products to provide lifelong income.

Withdrawal methods can also differ greatly. One approach is the systematic withdrawal method, where a specific amount or percentage is regularly withdrawn from the overall portfolio. The equity component may be gradually reduced and fixed income increased to minimize risk as the retiree ages.

Another example is the bucket approach, involving separate investment pools. Retirement income is withdrawn from the first bucket, which holds government benefits and secure investments like money market funds. The second bucket, which typically holds fixed-income investments, replenishes the first bucket. The third bucket holds growth-oriented equities and replenishes the second bucket. This approach gives equities a chance to recover after a downturn, before they become income.

Investing for a long retirement calls for a customized solution, which you arrive at with your advisor. We'll take into consideration your net worth, marital status, retirement lifestyle, inheritance and charitable giving plans, savings for possible long-term care, and risk tolerance. ■

Sources:

1. Statistics Canada, Censuses of Population, 2001 and 2016
2. The Care Guide, Source for Seniors, 2018

MINIMIZING TAXATION OF ESTATE ASSETS

Of the G7 nations, Canada is the only one without an estate tax. But the federal government still has its ways of collecting tax when someone passes. Remaining assets in a Registered Retirement Savings Plan (RRSP) or Registered Retirement Income Fund (RRIF) are taxed as income on the final tax return, which means about half of the balance could go to tax. And 50% of realized capital gains are also taxable on the final return – that could amount to tens of thousands of dollars in the case of vacation property, for example.

There are ways, however, to minimize the amount of tax payable by an estate. Here are some of the more common strategies.

Transfer assets to your spouse

Transferring assets through your will to your spouse can defer taxes. This means no tax is payable on income or capital gains involving these assets on your final return. Tax will be payable when your spouse sells the assets or passes away. This strategy includes RRSP or RRIF assets, which can also go to your spouse on a tax-deferred basis.

Give while living

In some cases it makes financial sense to gift assets during your lifetime that would trigger tax on capital gains if left through your will. Stocks in a non-registered account, for example, or a more significant asset, like vacation property. If you were to gift the cottage, cabin or chalet to your children now, it could result in a tax bill that is manageable, compared with a burdensome tax liability for your estate after many more years of capital appreciation.

Use the donation tax credit

An advantage of donating to a charity through your will is that the claim for a charitable donation can be up to 100% of net income, instead of the usual 75% limit. Also, you can be certain you're donating funds not needed during your lifetime. The person filing your tax returns has the flexibility to report the donation in your estate, your final taxation year or the previous year.

Name vacation property as principal residence

In some cases, the value of vacation property can appreciate more than the family home. You may be able to apply the principal residence exemption (PRE) to the vacation property instead of the home, reducing the tax on capital gains.

Plan for the capital gains exemption

If you're a business owner counting on the lifetime capital gains exemption (LCGE), it's critical to remain eligible for the tax break. Say that a business owner passes away prematurely and triggers capital gains tax on business shares. In 2018, with a capital gains exemption limit of $848,252, the LCGE would save over $210,000 in tax (at a 50% marginal tax rate). But the estate could only apply these savings if the owner met all qualifying criteria for the exemption. It's important to work with your tax advisor to remain eligible, in case purification, crystallization or another technique is required.

Please contact us or your tax advisor about these strategies and other ways to pay less tax on estate assets and leave more funds for your heirs. ■

THE ESTATE FREEZE

The key reason to use an estate freeze is to minimize the capital gains tax liability on assets left to children. It's typically used when transferring a family business to the next generation. Capital gains on an owner's interest in the company become taxable in the year of the owner's passing. A significant tax bill could be a hard hit to the estate and heirs. Or, if the owner intends to cover the tax owing, an excessive sum can be a challenge to offset.

Enter the estate freeze. Simply put, this strategy locks in, or freezes, the business's current fair market value for tax purposes. The business owner is responsible for paying tax on capital gains assessed at the time of the freeze, but it's only due once the owner's final tax return is filed. Future growth of assets from the time of the freeze becomes taxable to the children. An estate freeze can be established in which the parent still controls the business after the freeze.

An estate freeze can also be used for personal estate planning with such appreciating assets as vacation property or non-registered investments. ■

INVEST WISELY AND SLEEP WELL AT NIGHT

If you want to sleep well even when markets are volatile, you must invest according to your own risk tolerance. It's one of the most important factors in investing. Also important, however, is that risk tolerance isn't something you set and forget. It can change over time because of personal experiences or evolving life situations.

Market cycle reaction

At first, you guess how you'll react to a bear market. Years later, you've lived through one or multiple market cycles. As investment experience grows, risk tolerance can change in either direction. One person can realize that market drops are too much to cope with and decide to reduce holdings in higher-risk equities. Another person may feel reassured that declines are followed by recoveries and move some fixed-income investments to equities.

Shortening time horizon

Say that a 45-year-old parent has education savings heavily invested in equities for a child five years away from attending university. And a 55-year old investor is also heavily invested in equities, hoping to retire well before 65. For many years these portfolios suited each individual's risk tolerance. But today, how well do they sleep knowing one major market downturn could jeopardize their plans? Tolerance to risk can change as time horizon shortens, usually signalling a shift toward more conservative investments.

Changes in financial status

If someone's financial picture improves or suffers, tolerance to risk may be affected. Say that a recently divorced individual pays spousal and child support. With reduced nest egg contributions, this person may be less able to withstand portfolio losses. Lower-risk investments may be needed.

Or take someone who receives a significant windfall – an inheritance or property sale. In such a situation, investor personality determines any change in investments. One investor may allocate funds to more aggressive investments, knowing there's a large base for long-term support. Another could make their portfolio more conservative, changing the focus to wealth preservation.

Respect your comfort zone

Whenever there's a change in risk tolerance, it must be warranted. Imagine a couple approaching retirement who sacrificed large sums to help out family members. They're thinking about investing in higher-risk equities beyond their risk tolerance to boost retirement savings. But that means going from comfort zone to danger zone – they could end up in worse shape. The couple is better off saving more, postponing retirement, earning income during retirement, or modifying their retirement lifestyle.

When to talk to us

It's important to talk to us whenever your risk tolerance changes so we can adjust your investments. If you become more tolerant of risk, you'll have new investment opportunities. If you become less tolerant of risk, we'll ensure that you meet your investment goals while enjoying peace of mind. ■

PLAN NOW TO MINIMIZE OAS CLAWBACK LATER

Ever wonder if you'll be affected by Old Age Security (OAS) clawback? To give you an idea, OAS benefits are reduced for the July 2018 to June 2019 period when net income for 2017 exceeds $74,788.

To minimize OAS clawback, you need to reduce net income. During retirement, an effective strategy is splitting pension income. But several strategies, including the following, can be initiated before retirement arrives.

Use a spousal RRSP. With pension income splitting, you can split up to 50% of eligible pension income. But with a spousal Registered Retirement Savings Plan (RRSP), you can place a greater amount of retirement income in your spouse's hands and reduce your own income.

Invest in corporate class funds. Corporate class funds have lower taxable distributions than traditional mutual funds. You pay less tax on non-registered investments in income-earning years and reduce taxable income during retirement.

Maximize TFSA savings. Tax-Free Savings Account (TFSA) withdrawals are not taxable income and cannot reduce OAS benefits.

Make early RRSP withdrawals. If you retire early, you could withdraw RRSP funds while in a lower tax bracket. This strategy will reduce your minimum Registered Retirement Income Fund (RRIF) withdrawal, reducing net income.

Realize capital gains. If you plan on selling vacation property, rental property or other significant assets in the near future, you may want to sell before OAS pension begins. Triggering large capital gains while receiving OAS benefits could result in clawback. ■

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