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Wealth Perspectives

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THE REARVIEW MIRROR HAS LIMITED USE

Look Forward, Not Back

Most people, investors or not, tend to base their views on what is most current in their memories. Renowned investor Warren Buffett suggested that it's an "*unshakable habit: looking into the rearview mirror instead of through the windshield*." We all tend to drive by the rearview mirror to some extent.

With recent reports indicating that Canadian GDP growth continues to be lacklustre, contrasting the relatively robust economic expansion in the U.S., optimism regarding our economic path forward remains in short supply.

First — Why the Divergence?

Higher interest rates have affected Canadians more than Americans, primarily due to our higher debt loads and shorter debt renewal periods. The average Canadian mortgage has a 5-year term, compared to the average 30-year term in the U.S. Many Americans secured fixed rates during their lows and have less exposure to rising debt payments. This has helped to support U.S. consumer spending, which comprises 68 percent of U.S. GDP.[1] As long as labour markets remain strong, the long-awaited recession in the U.S. appears unlikely. U.S. government initiatives, including in infrastructure and sustainability, have also supported the economy, creating jobs and spurring billions in private investments.

While Canadian economic output has been sluggish, let's not forget the central banks' objective in raising interest rates was to slow growth to curb inflation. Economic resilience has largely surpassed expectations. Wealth, wages and employment are all higher than before the pandemic.

Consider also that GDP data is backward looking, whereas equity markets look forward. And, there are reasons to look forward with optimism. We're living in a pivotal time due to the availability of big data, high-powered computing and advances in artificial intelligence (AI). Market strategist Ed Yardeni believes we may be at the onset of a "productivity boom" akin to the Roaring 20s. While U.S. equity markets have handsomely rewarded many tech stocks, AI's productivity and growth potential are expected to reach far beyond the tech sector.

There may be impatience with the lagging Canadian stock market — ours is generally at its best when interest rates are low, global manufacturing is robust and there's high demand for resources. Yet, it may be poised to benefit from interest rate stability and declining long-term rates. Corporate earnings may be driven by improved margins through efficiency gains and lower input costs, especially as inflation moderates. The resilience of our largest trading partner is likely to provide near-term momentum. And, the anticipated interest rate cuts are expected to further support equity markets.

Seasoned investors accept that economies and markets will ebb and flow over time; just one reason to support diversification in portfolio management. Periods of retrenchment are natural parts of the business cycle and are sometimes needed for economies to cleanse excesses or spark innovation and growth.

The investing road is a long one; be guided accordingly. The rearview mirror is great for safety and perspective on where we've just been, but don't necessarily let what you see dominate your drive to the future.

1. https://fred.stlouisfed.org/series/DPCERE1Q156NBEA

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To My Clients:

The S&P 500 hit new all-time highs to start the year; yet, uncertainty, doubt and a degree of worry persist. This is what a bull market feels like. If the outlook were rosy, most of the money slated for equities would have already been committed. As the average peak-to-trough decline for the U.S. index during the year is around 14 percent, there will be volatility. In times of volatility, consider the merits of having a solid investment plan — and sticking to it.

As it is tax season, cast a critical eye as you prepare your tax return. Are there opportunities to save tax dollars relating to your investment strategies? A good place to start is tax-advantaged accounts like TFSAs. Surprisingly, many high-net-worth individuals aren't fully taking advantage of the opportunity (page 2). If I can help, please contact the office. Here's to many sunny days ahead this spring.

TAX SEASON IS HERE AGAIN

Are You Doing All You Can to Save Tax?

It is personal income tax season, a time when many of us are focused on keeping as much of our hard-earned dollars as possible. As we deal with receipts and returns, here are a handful of actions to consider:

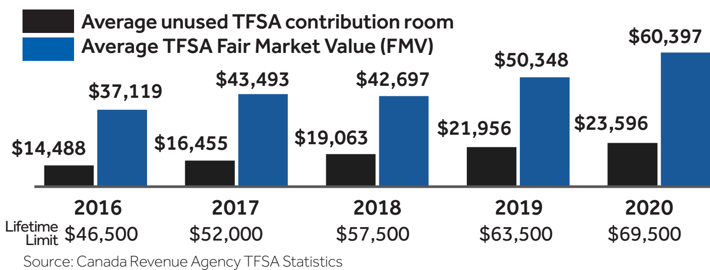
Take Advantage of the Deductions/Credits Available — Tax law changes each year and so can your circumstances. Consider the support of an expert to assist with your tax return to ensure you are taking full advantage of the credits/deductions available. This can also provide continuity in the event something were to happen to you or a spouse. Encourage younger folks to file a tax return if they have generated income, even if it is below the basic personal exemption, so that they can generate Registered Retirement Savings Plan (RRSP) contribution room.

Maximize Tax-Advantaged Accounts — Have you fully contributed to your RRSP and Tax-Free Savings Account (TFSA)? Latest statistics suggest we may not be doing the best job (TFSA chart below). If you need support, consider setting up a monthly contribution plan.

The TFSA: An Overlooked Opportunity?

The opportunity to invest and grow funds on a tax-free basis over a lifetime should not be overlooked. Yet, the latest statistics suggest that many high-net-worth individuals may not be taking full advantage:

TFSA Unused Contribution Room & FMV, $250,000+ Income



Source: Canada Revenue Agency TFSA Statistics

Optimize Asset Location — Different types of income (interest, dividends, capital gains) may be taxed differently depending on the type of account from which income is generated. For example, if you hold foreign investments that pay dividends in a non-registered account, you may receive a foreign tax credit for the amount of foreign taxes withheld. If the same asset is held in a TFSA, no foreign tax credit is available. A comprehensive view of your assets may identify opportunities to optimize asset location across accounts.

Plan with Your Spouse — If you are part of a spousal/common-law partner unit with a higher-income and lower-income earner, there may be income-splitting opportunities. For instance, if you expect your spouse to have significantly less income than you in retirement, contributing to a spousal RRSP for the low-income spouse may be beneficial. Or, retirees may be able to split eligible pension income on their tax returns or elect to split Canada Pension Plan benefits.

Interest on Overdue Taxes

For Q2 2024, the interest charge on unpaid balances is 10 percent, the highest rate in 20 years. Be sure to file taxes on time and pay any amounts due to avoid significant charges.

How Long Do I Keep Records?

Remember: You are required to keep tax records for six years from the end of the last tax year to which they relate.* The CRA may request these records for audit purposes.

*Or the filing date, if filed late.

"Reduce" Your Refund — If you receive a tax refund from the Canada Revenue Agency (CRA) on a regular basis, it shouldn't be a cause for celebration. You're effectively providing an interest-free loan to the government. Consider completing a new TD1 form with your employer, which is used to calculate how much tax to deduct from your pay. You may also file CRA form T1213 if you know you'll have significant deductions in a given year. This will reduce the tax taken from your pay.

If Over 64, Consider Opening a Small RRIF — The pension income tax credit kicks in at age 65, allowing for a tax credit on up to $2,000 of eligible pension income. If you don't have eligible income, consider setting up a small Registered Retirement Income Fund (RRIF) for the year you turn 65 (or sooner if you're widowed) to create pension income. You don't have to convert your RRSP to the RRIF until the year you turn 71, but this way you can still claim the pension tax credit.

Please seek the advice of a tax expert relating to your personal situation.

You Asked: What Is a Bare Trust?

With new reporting rules in place for "bare trusts," some clients have asked about this arrangement. Generally, if you hold assets in an arrangement with a separate legal and beneficial owner, where the beneficial owner oversees the assets, it may be considered to be a bare trust. According to the CRA, a bare trust "exists where a person, the trustee, is merely vested with the legal title to property and has no other duty to perform or responsibilities to carry out as trustee, in relation to the property vested in the trust."[1] Here are two examples where a bare trust may exist:

- You have been added to the property title of an elderly parent for estate planning, but the parent retains beneficial ownership/control.
- As a parent, you have added your name to the title of an adult child's home to help the child qualify for financing.

Bare trusts are subject to the new trust reporting rules for tax years ending after December 30, 2023. Accordingly, a *T3 Trust Income Tax and Information Return* must be filed within 90 days of the trust's tax year end (unless specific conditions are met).

The good news is that since reporting rules were expanded to include bare trusts, the CRA will provide penalty relief if a return hasn't been filed by the deadline for bare trusts for the 2023 tax year only.

Since the intent of the arrangement when it was first set up can impact whether it is considered a bare trust, it's best to consult tax and legal advisors to understand if you have reporting obligations. For more information: https://www.canada.ca/en/revenue-agency/services/tax/trust-administrators/t3-return/new-trust-reporting-requirements-t3-filed-tax-years-ending-december-2023.html

1. https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/p-015/treatment-bare-trusts-under-excise-tax-act.html.

This is not intended to be a comprehensive or legal discussion on bare trusts.

ESTATE PLANNING CONSIDERATIONS

Be Aware: Survivor Benefits May Be Lacklustre

In estate planning, a common goal is to ensure the financial security of our loved ones. This may involve preparing for potential income loss to support a surviving spouse after one partner's death. However, a significant challenge often stems from widespread misconceptions about survivor benefits.

Although pensions from the deceased's workplace may continue, survivor pension benefits are frequently provided at a reduced rate. Many don't realize that government benefits may also be lacklustre, thereby leaving a shortfall in income or cash flow for the survivor. This may pose challenges because essential expenditures like property taxes and other bills often persist at their usual levels.

Consider the situation in which both spouses collect maximum CPP and OAS benefits — this could potentially provide over $49,000 in annual retirement income for a couple, based on a monthly CPP of $1,364.60 (2024) and OAS of $713.34 (Q1 2024) for a retiree at age 65. If one spouse were to pass away, consider that the deceased spouse's annual benefits, or over $24,500, would be entirely lost.

This is because you cannot receive a survivor's pension while also receiving a full retirement pension: The most that can be paid to a survivor who is eligible for CPP benefits and the CPP survivor's pension is the maximum retirement CPP benefit. With OAS benefits, there is no survivor benefit. The CPP provides a "death benefit," limited to $2,500 (one-time payment), available if the deceased has been a qualifying CPP contributor.

For survivors not receiving maximum CPP benefits, perhaps due to time out of the workforce, lower CPP contributions or other reasons, they may be entitled to a survivor's benefit. Survivors are eligible for 60 percent of the deceased spouse's CPP pension (if over age 65; under this age, survivor benefits are 37.5 percent of the deceased's pension, plus a flat rate, if that spouse is not receiving other CPP benefits). When combining multiple benefits, the total amount of combined CPP benefits paid is adjusted based on the survivor's age and other benefits received. You will need to apply for survivor benefits, keeping in mind that back payments will be made for up to 12 months, so delaying may result in lost benefits.

Since CPP and OAS can make up a substantial portion of a couple's retirement income or cash flow when both are living, thinking ahead about the potential loss of these benefits — or any income stream — is an important consideration. When reviewing wealth plans, having an income buffer in the event of the loss of one spouse or planning to pivot and use other sources for retirement income may be considerations. For information on CPP survivor benefits, see: www.canada.ca/en/services/benefits/publicpensions/cpp/cpp-survivor-pension.html

Estate Planning for Spouses: Tools to Consider

Addressing income loss is just one consideration when estate planning to protect a spouse. Others may include asset protection, planning for the tax efficiency of assets, minimizing probate or other estate tax, control over asset distribution and others. In brief, here are some tools that may provide support:

Trusts — May help to protect and manage assets for the benefit of spouses who need support, or other heirs.

Joint Ownership — May help to bypass probate (where applicable), provide tax efficiency and simplify the transfer of assets.

Spousal Rollover — Can allow for the tax-deferred transfer of assets between spouses upon the death of one spouse, preserving more of the estate's value for the surviving spouse.

Insurance — May provide support for long-term care, financial security, estate preservation, estate equalization or liquidity to cover immediate expenses or other estate expenses, such as taxes. Insurance can also provide creditor protection or help to facilitate the transfer of a business.

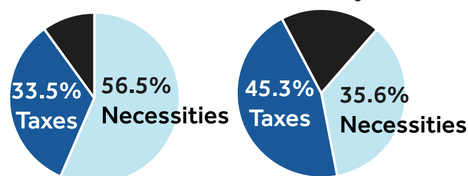
PERSPECTIVES ON THE COST OF ESSENTIAL EXPENDITURES

The Rising Cost of Living: A Taxing Time

While the increasing cost of living remains a prominent concern for many Canadians, a different perspective has emerged on our growing expenses. Despite the challenges posed by inflation, a recent report suggests that the burden of escalating expenses now weighs more heavily on taxes than on essential needs.[1]

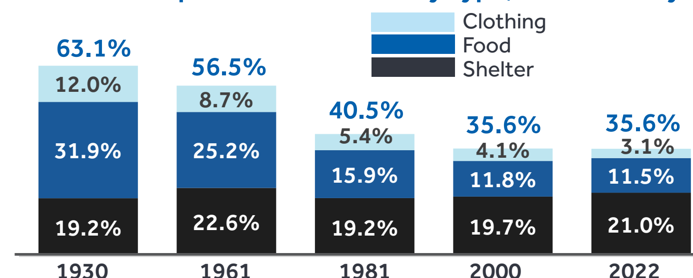
The Canadian Consumer Tax Index tracks Canadian family expenditures on necessities such as food, shelter and clothing, along with the taxes we pay. Today, the average Canadian family spends 45.3 percent of its income on total taxes, compared to 35.6 percent on essentials. Since 1961, there has been a 2,778 percent increase in the taxes we pay, far outpacing the increase in the Consumer Price Index (CPI), which measures changes in consumer prices. Over the same period, the CPI has risen by 863 percent.[1]

Average Canadian Family's Tax Burden vs. Necessities, 1961 and 2022



As we confront a higher cost of living, it's equally notable how the proportion of income spent on food and clothing has declined over time. While we may not feel it, this decline has been substantial. In 1961, Canadians allocated one-third of their income to these necessities. Today, these expenses make up less than 15 percent of household income, on average.

% of Income Spent on Necessities by Type, 1930 to Today



1. https://www.fraserinstitute.org/studies/taxes-versus-necessities-of-life-canadian-consumer-tax-index-2023-edition

Tax Season Reminders: Be Aware of Reporting Changes

During personal income tax season, we should be reminded that tax laws can change from year to year. As such, here are two reporting changes for the 2023 tax year to be aware of:

1. Working from home? The CRA is no longer offering the temporary "flat-rate" method that was available during the pandemic to claim employment expenses for employees who worked from home. Employees are now required to use the detailed method for the 2023 tax year to claim home office expenses by completing an updated CRA Form T2200. This form must be completed by the employer in order for their employees to deduct employment expenses from their income.

2. New trust reporting requirements. There are new trust reporting rules for taxation years ending after December 30, 2023. All trusts, unless certain conditions are met, will be required to file an annual T3 Return with the CRA. Trusts that are required to file a T3 Return generally need to complete Schedule 15 in their annual T3 return to report beneficial ownership information. Bare trusts are now subject to these reporting rules. Please see page 2 for more details on bare trusts.

Keep in mind that changes to your own circumstances may also expose you to new reporting obligations. As a reminder, if you owned specified foreign property with a total cost of C$100,000 or more at any time during 2023, you are required to complete CRA Form T1135. If you sold your principal residence in 2023, don't forget to report this on your tax return.

The deadline to file your 2023 personal income tax return is April 30, 2024. For self-employed individuals and spouses, the deadline is June 17, 2024. However, any taxes due must be paid by April 30, 2024. As you complete your returns, consider seeking the advice of a tax advisor to ensure you complete all of the required reporting obligations and to claim all of the credits and deductions to which you're entitled.

Don't Overlook the TFSA 'Danger Zone'

Have you contributed to your TFSA to start 2024? If you've based this TFSA contribution on CRA "*My Account*" information, be aware that it may not be accurate. According to the CRA, any contributions made or withdrawn in the prior year may not be reflected in current year contribution room until "after the end of February," since issuers have until the last day of February to submit TFSA transactions to the CRA. Yet, the lag in updating this data may extend to March or even late April.

The consequence, of course, is the one percent per month penalty on excess TFSA contributions, which can add up to be substantial. And, it appears that a growing number of TFSA holders are being assessed penalties. Recent reports indicate the total amount of overcontribution penalties paid in 2022 was $132.6 million, more than triple the $41.7 million paid in 2019 and 38 percent higher than the $96.2 million paid in 2021.[1]

Why is this the case? CRA reporting lag times often create confusion. Some may hold multiple TFSA accounts, which can lead to recordkeeping errors — the latest statistics suggest that 245,000 TFSA holders hold between five and nine TFSA accounts![1] For others, there may simply be a misunderstanding of the rules. One example: If you withdraw funds from the TFSA, remember that this amount only becomes available to contribute at the start of the following calendar year.

At the end of the day, it is the taxpayer's responsibility to keep good records. If you do rely on CRA information, a general rule of thumb is to wait until late April when all records should be updated.

1. https://www.theglobeandmail.com/investing/personal-finance/article-people-keep-making-this-costly-tfsa-mistake-and-paying-penalties/

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