Elder Planning Counselor Designation Program

Desk Reference Module 3 – Financial Issues

Contents at a Glance

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Chapter 1

Social Security & Medicare Programs

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1 - 1 KEY OBJECTIVE OF THIS CHAPTER

Approximately one half of the income of Canadians aged 65 and over comes from Old Age Security and Canada or Quebec Pension plan benefits. A solid understanding of these programs is beneficial to anyone who works closely with elder Canadians.

Maintaining their health is the number one priority for most Canadian elders. As a result, no other group has a greater interest in the sustainability of Canada's publicly funded health care system.

This chapter is designed to provide you with an overview of Canada's retirement income and healthcare systems with attention paid to some of the challenges facing both.

1- 1.1 How Will These Objectives Be Achieved?

We will take an in depth look at such programs as Old Age Security, the Guaranteed Income Supplement, the Spousal and Survivor Allowance and the Canada Pension Plan. We will examine the application process, the benefits available, how benefits are calculated, income splitting opportunities, and claw back provisions and taxation. We will also allude to the challenges currently facing Canada's social safety net and at some of the changes these challenges may necessitate.

We will also look at the history of publicly funded Medicare in Canada as well as the principal participants and their responsibilities. We will also look at the problems currently surfacing in the system and at some of the suggestions put forward to deal with them.

1 - 2 INTRODUCTION

In terms of both elder health and wealth, the news is generally quite positive. Most elders in this country live in their own homes and lead active and independent lives. A substantial majority report that their health is good, very good, or even excellent. Most engage in regular physical activity, travel extensively and continue to make an important contribution to society.

Through an outstanding level of volunteerism, elders give many hours of their time to various community initiatives.

And many Canadian elders play an important role in the lives of our young people, sharing in the raising of their grandchildren and easing the burden of working families.

In recognition of their contributions and in order to ensure that Canadian elders continue to be a social asset, our governments have put in place a variety of programs for their benefit.

Our health care system, for example, provides free hospital and physician services. Support is also available to many elder specific initiatives - things like retirement and nursing homes and adult day care centres.

A variety of government sponsored income replacement programs are also available. Some are broadly available to any elder who has lived in Canada for a specified period (e.g., Old Age Security). Others require that the elder has worked in Canada and paid premiums (e.g., Canada Pension Plan). And still others are designed specifically for low-income elders (e.g., the Guaranteed Income Supplement, the Spousal and Survivor Allowance).

Canadians, age 65 and older, represent about 17.5% of the country's population, but they consume almost 50% of all publicly funded health care. Financial pressures on the health care system will worsen dramatically as the number of elder Canadians explodes over the course of the next 25 years.

In 1972, the year that all ten provinces implemented universal hospital and medical insurance programs, Canadian health care costs consumed just 7.4% of Gross Domestic Product. By 2016 this figure had increased - by almost 50% - to10.6% of Gross Domestic Product (or over 210 billion dollars). Clearly, an ever-increasing percentage of Canada's wealth is being - and continues to be - dedicated to public health care costs.

Health care costs have been growing faster than our economy - and over the past 20 years they have been outpacing both inflation and population growth.

Growth in health care costs in the United States has been substantially more troubling (rising from 7.6% of Gross Domestic Product in 1971, to over 17.2% in 2016).

While Canadians have managed to contain spiralling health care costs better than their neighbours to the south, this management has not come without a cost.

In addition to providing you with an overview of some of the major government sponsored income replacement programs currently available in Canada, this chapter will look at how long waiting lists, the slow adoption of new technologies, and rationed care are the unpleasant underbelly of the Canadian health care system.

1 - 3 OLD AGE SECURITY

Old Age Security (OAS) is one of the cornerstones of Canada's retirement income system. Benefits include the basic Old Age Security pension, the Guaranteed Income Supplement and the Spousal and Survivor Allowance. After briefly describing the program's history and overall features, each of these specific benefits will be covered in turn.

1- 3.1 Legislative History

Canada's first public pension plan had been introduced in 1927 with the passing of the *Old Age Pensions Act*. That legislation established a means-tested pension for men and women 70 years of age and over who had little or no income. Benefit costs were shared equally between the provinces and the federal government until 1931, when Ottawa's portion was increased to 75 per cent. This increase was the result of an election campaign promise made by Prime Minister Bennett.

The provinces joined the program gradually. British Columbia led the way in 1927. The other three western provinces joined by the end of the decade, as did Ontario. The Atlantic Provinces were relative latecomers, partly because of internal political factors and partly out of concerns over the cost. These provinces were not well off financially, and they had larger than average numbers of seniors amongst their populations.

Prince Edward Island began participating in the Old Age Pensions program in 1933, Nova Scotia in 1934, and New Brunswick in 1936. Nova Scotia was helped in meeting its pension payments by the revenues from government-owned liquor outlets opened after the ending of Prohibition in the province.

Quebec entered the program shortly after New Brunswick in 1936. By this time enduring traditional attitudes to poor relief that saw responsibility resting with municipalities and charities, not with the state, had been overcome by political figures and labour groups in the province.

Over time, amendments to the *Old Age Pensions Act* relaxed some of the eligibility criteria and opened the program to greater inclusiveness. In 1937, benefits for blind people over the age of 40 were provided, and in 1947 the British citizenship and five year provincial residence requirements were removed, while the age of qualification for blind pensioners was reduced to 21. Incidentally, 1947 was also the year that Canadian citizenship first became possible, by virtue of the new *Canadian Citizenship Act*. It is interesting to note the implications that this had for women. The Old Age Pension legislation had made a point of allowing widows who had been British subjects before marriage to a non-British subject to continue to qualify for a pension under the program like other British subjects. This had to be clarified since, before the 1947 citizenship legislation, a married woman was usually seen to share the nationality of her husband. Now she was able to hold citizenship in her own right.

While the most recent Old Age Pensions scheme was an improvement on earlier relief practices, official efforts to minimize public costs and enforce family responsibility for the care of seniors made it increasingly unpopular. The means test, for example, was justified by the fact that the provinces formally obliged adult children to support their aged parents if they were able to do so.

Applicants had to prove that their children could not support them in order to be considered for a pension. Officials even encouraged some elderly parents to sue their children for maintenance so that the state could be relieved of responsibility or, at the very least, benefits could be reduced.

Equally distasteful was the provision in the Old Age Pension program that enabled the government to recover the total amount of benefits paid out through claims against the estates of deceased recipients. By the end of the 1940s, the Old Age Pension system was in disrepute. There was popular demand for reform that would do away with the degrading means test and lower the qualifying age to help workers who found themselves out of the workplace before reaching the age of 70.

By 1951, maximum Old Age Pension payments were $40 per month and 308,825 people were participating in the program. The latter figure amounted to about 47 per cent of Canadians 70 years of age or over. In comparison, almost 5 million people in Canada received the maximum Old Age Security pension in 2013. According to Statistics Canada's data this represents over 90 per cent of the population aged 65 and over, with most non-recipients being newcomers to Canada who had not met the minimum residence requirements.

In 1951, the *Old Age Pensions Act* of 1927 was replaced by the *Old Age Security Act* and the *Old Age Assistance Act*. The new programs generated by this legislation went into effect on January 1, 1952 under the administration of the federal Department of National Health and Welfare.

The *Old Age Security Act* introduced a universal, flat-rate pension for people 70 and over, with 20 years residence in Canada immediately prior to the approval of an application as enough qualification. People who had been absent in that time could still receive payments if they had been a resident prior to the 20 years for twice the length of time away, provided the last year had been spent in Canada.

Benefits would be $40 per month as they had been since 1949 under the *Old Age Pensions Act*, an amount that would be equivalent to roughly $300 in 2013. The program would be managed by the federal government alone. Old Age Security pensions would be financed through a small (two per cent) increase in personal income and corporate taxes and the earmarking of a portion (again, two per cent) of manufacturers' sales taxes for this purpose. Application forms for the new pensions could be picked up at the post office and once enrolled in the program, everyone received the full amount. Pensioners who went to live abroad forfeited their benefits, but an absence of six months or less entitled them to receive payment for three of those months upon their return.

The number of Canadians receiving old age pensions more than doubled with the introduction of the new program, and this time status North American Indians were included. Blind people, formerly receiving benefits under the *Old Age Pensions Act*, were provided with their own program under the *Blind Persons Act* passed in 1951. By March 1952, Old Age Security was being paid to over 643,000 people. Over the next full fiscal year, that figure would rise steadily, and expenditures would reach $323 million, or about seven per cent of the total federal budget. In comparison, combined Old Age Security and Canada/Quebec Pension Plan payments totaled approximately $95 billion in 2018 and represented close to 40 per cent of federal spending in Canada.

To complement the new Old Age Security program, the *Old Age Assistance Act* established a cost-shared, income-tested allowance for people between the ages of 65 and 69. The provinces would administer the Old Age Assistance program and the federal government would reimburse them for 50 per cent of their benefit costs through grants-in-aid from the Consolidated Revenue Fund, made up of general revenues. When recipients reached 70, they would transfer to the Old Age Security pension.

Eligibility was confined to people between 65 and 69 whose income fell below a certain threshold. Maximum benefits were set at $40 per month, but as outside income approached the threshold, the $40 figure would be reduced. Residency rules were the same as for Old Age Security, except that it was not necessary to have lived in the country for the year immediately prior to the start of payments. Old Age Assistance would not be paid for absences from Canada.

There was no citizenship requirement, and Aboriginal peoples were eligible for this program as well, but exclusions included people who were in receipt of war veterans or blind person's allowances. Significantly, the federal government no longer insisted that provinces make recovery attempts against pensioners' estates. A little over a year after Old Age Assistance went into effect on March 31, 1953, approximately 20 per cent of the population between the ages of 65 and 69 were receiving these benefits.

Since its' introduction in 1952, Old Age Security has undergone a variety of changes - some of the most important of which are described below:

- The drop in age of eligibility from 70 to 65 (1965)
- The establishment of the Guaranteed Income Supplement (1967)
- The introduction of full annual cost-of-living indexing (1972)
- Quarterly indexing (1973)
- The establishment of the Spousal Allowance (1975)
- Payment of partial pensions based on years of residence in Canada (1977)
- The inclusion of Old Age Security in international social security agreements (ongoing)
- The extension of the Spousal Allowance to all low-income widows and widowers aged 60 to 64 (1985)
- Maximum of one year of retroactive benefits (1995)
- The ability to request that their benefits be cancelled (1995)
- The extension of benefits and obligations to same-sex common-law partners (2000)
- The 2012 budget proposed changes to the OAS that will gradually increase the age at which Canadians are eligible to collect OAS from 65 to 67. The change was reversed by the new Liberal government in 2015.
- The ability to delay receiving OAS (and in the process increase the benefit received) came into effect in 2013.

1- 3.2 Funding

Old Age Security is funded through general tax revenues and provides a basic minimum income for Canadian elders.

It is a **pay-as-you-go** program, which is to say that the benefits paid to current retirees are funded by the contributions made by current taxpayers.

The OAS program is the most widely accessible source of income for older Canadians, providing approximately 6.5 million Canadians age 65 and older with roughly 52 billion dollars in benefits annually.

Old Age Security payments are currently the largest expenditure of the federal government.

It addition to the basic pension provided, Old Age Security provides additional benefits to eligible low-income pensioners and their spouses, or common-law partners, in the form of the Guaranteed Income Supplement (GIS) and the Spousal and Survivor Allowance.

1- 3.3 Administration

The Income Security Programs Branch of Human Resources Development Canada (HRDC) administers the Old Age Security program through regional offices located in each province and territory.

The International Operations Division in Ottawa, as its name suggests, is responsible for benefits stemming from Canada's International Social Security Agreements.

1- 3.4 Maximum Pension and Quarterly Indexing

All benefits payable under the Old Age Security Act are "indexed." They are adjusted in January, April, July, and October - if there are increases in the cost of living as measured by the Consumer Price Index.

The maximum monthly Old Age Security payment (at age 65), as of the fourth quarter of 2020, was $614.14 per month. Given current trends with respect to changes in the Consumer Price Index it is safe to say that the maximum monthly Old Age Security benefit should increase by roughly 2% annually in 2021 and 2022.

Since qualifying for the maximum Old Age Security benefit is as simple as meeting the residency requirements it should come as no surprise that the vast majority of elder Canadians receive a benefit that is at or close to the maximum. The average monthly benefit received in in 2018, for example, was $570 - or approximately 95% of the maximum monthly benefit available at that time.

1- 3.5 Application

Old Age Security benefits are not automatically processed and distributed to elder Canadians. They must be applied for. Application for the basic benefit and the Guaranteed Income Supplement should be made six months prior to turning age 65. The Spousal and Survivor Allowance is available as early as age 60 and it should be applied for as soon as the beneficiary qualifies.

While there are some provisions for retroactive payments, the rules and the time frames tend to be quite restrictive. Old Age Security, the Guaranteed Income Supplement and the Allowance are normally only available retroactively for up to one year.

While it may be possible to argue for retroactive benefits beyond 12 months at a Review Tribunal - the process is lengthy, onerous and satisfaction is far from guaranteed.

The best approach is to be proactive - elders should be encouraged to apply for benefits as soon as they are available.

In 2004, for example, an estimated 50,000 elders, who were eligible for Old Age Security, had not yet applied for benefits. In the process they sustained a total annual income loss of approximately $250,000,000.00.

1- 3.6 Qualification

To qualify for the full Old Age Security pension, an individual must have lived in Canada for at least 40 years since attaining the age of 18.

A person who does not qualify for a full pension may, however, apply for a partial pension if he or she has lived in Canada for a minimum of 10 years after age 18. For each year of residence, a credit of 1/40th of the full pension is earned. Once a partial pension has been approved, it may not be increased as a result of added years of residence in Canada.

A special exception applies to residents of Canada who were born prior to July 2, 1952. So long as they lived in Canada on or prior to July 1, 1977 (or possessed a valid immigration visa on that date) they can qualify under the old rule. In order to receive the full Old Age Security pension only ten years of residency - immediately prior to their application for the pension - is required. Even in situations where they fail this ten-year residency test, a full pension is still possible - each year they are short can be offset with a minimum of three years of prior residency.

Special rules also apply to Canadians who have lived abroad in one or more of the countries with which Canada has a reciprocal social security agreement. Periods of residency in these countries can be used to satisfy Canadian residency requirements. Canada has agreements of this nature in place with 50 countries.

Table 1 – 1 Canada's International Social Security Agreements

Country	Catalogue #		Country	Catalogue #
Antigua and Barbuda	ANT1-03-05E		Korea	KOR1-08-03E
Australia	AUS1-03-05E		Latvia	LATV-11-06E
Austria	AUT1-03-05E		Lithuania	LITH-11-06E
Barbados	BAR1-03-05E		Luxembourg	LUX1-08-03E
Belgium	BEL1-03-05E		Malta	MAL1-08-03E
Chile	CHI1-03-05E		Mexico	MEX1-08-03E
Croatia	CRO1-03-05E		Morocco	MOR1-08-03E
Cyprus	CYP1-03-05E		Netherlands	NET-08-03E
Czech Republic	CZE1-03-05E		New Zealand	ZEA1-08-03E
Denmark	DEN-03-05E		Norway	NOR1-08-03E
Dominica	DOM1-03-05E		Philippines	PHI-08-03E
Estonia	ESTO-11-06E		Portugal	POR-08-03E
Finland	FIN-03-05E		St. Kitts and Nevis	STK1-08-03E
France	FRA-08-03E		Saint Lucia	STL1-08-03E
Germany	GER1-03-05E		Saint Vincent and the Grenadines	STV1-08-03E
Greece	GRC1-03-05E		Slovakia	SLOVAK1-08-03E
Grenada	GRE1-08-03E		Slovenia	SLO1-08-03E
Hungary	HUN-03-05E		Spain	SPA1-08-03E
Iceland	ICE1-09-01E		Sweden	SWE1-08-03E
Ireland	IRE1-03-05E		Switzerland	SWI1-08-03E
Israel			Trinidad and Tobago	TRI1-08-03E
Italy	ITAL1-03-05E		Turkey	TUR1-03-05E
Jamaica	JAM1-03-05E		United Kingdom	
Japan	JAPAN1-02-06E		United States	USA-08-03E
Jersey and Guernsey	JER1-03-05E		Uruguay	URG-08-03E

For more information please refer to the above listed catalogue numbers on Social Development Canada's web site - http://www.sdc.gc.ca.

1- 3.7 Payments outside Canada

Once a full or partial Old Age Security pension has been approved, it may be paid indefinitely outside Canada - so long as the pensioner had lived in Canada for at least 20 years after reaching the age of 18. Otherwise, payment will be made only in the month of a pensioner's departure from Canada and for six additional months thereafter.

The benefit may be reinstated if the pensioner returns to live in Canada and continues to meet all conditions of eligibility.

The Guaranteed Income Supplement and the Spousal and Survivor Allowance may only be paid outside Canada for six months following the month of departure, regardless of the length of time the recipient had lived in Canada.

1- 3.8 Old Age Security Claw back

High-income elders must repay some or all the Old Age Security benefits they receive. In 2020, this "claw back" began at a net income of $79,054.

Any income above this threshold was subject to a 15% claw back.

An elder with $85,000 of 2020 net income would, for example, have been forced to repay 15% of the difference between $85,000 and 79,054 (or a total of $891.90).

Step one - $85,000 - $79,054 = $5,946

Step two – $5,946 x 0.15 = $891.90

In 2020, individuals with a net income of $128,137 or more had all their Old Age Security benefits clawed back.

If a high-income elder must repay some Old Age Security benefit in a given year - in the following year, an appropriate amount will be automatically deducted from his or her monthly OAS pension payments. This saves the elder the trouble of paying back a large lump sum at tax time.

There is widespread confusion in Canada between the claw backs on Old Age Security and the means tested Guaranteed Income Supplement and Allowance payments. The latter is quite punitive - the former extremely generous.

It is possible for an elder couple with a joint net income of almost $160,000 to experience no claw back of OAS benefits. Recipients of the Child Tax Benefit and Supplement, for example, do not fare nearly so well – in 2019/2020 claw backs began as soon as net family income exceeded $31,120.

Anomalies of this nature combined with the financial pressures that an aging population will exert on government social programs are likely to result in significant changes in the near future.

1 - 4 GUARANTEED INCOME SUPPLEMENT

In addition to the Old Age Security pension, a Guaranteed Income Supplement (GIS) is available to low income elders. An elder must already be receiving an OAS pension in order to qualify for the supplement. The amount of this supplement is dependent on the amount of OAS benefit already being received and the income level of both the recipient and his or her spouse.

Guaranteed Income Supplement payments are combined with OAS pension benefits and both are paid monthly.

Recipients must re-apply annually for the Guaranteed Income Supplement benefit by filing an income statement or by completing an income tax return (by April 30).

The amount of monthly payments received each year may increase or decrease according to reported changes in a recipient's yearly net income.

Unlike the basic Old Age Security pension, the Guaranteed Income Supplement is not subject to income tax. As well - as noted above - the Guaranteed Income Supplement is not payable outside Canada beyond a period of six months, regardless of how long the person has lived in Canada.

Currently approximately 165,000 Canadians have no other income other than Old Age Security and Guaranteed Income Supplement.

1 - 4.1 Amount of Benefits

The amount of the Guaranteed Income Supplement to which a person is entitled depends on his or her income, marital status, and his or her spouse's OAS pension eligibility.

There are two basic rates of payment for the Guaranteed Income Supplement:

1. The first applies to single pensioners—including widowed, divorced or separated persons—and to married pensioners whose spouses or common-law partners do not receive either the basic Old Age Security pension or the Allowance.
2. The second applies to legally married couples and couples living in common-law relationships, where both spouses are receiving benefits (either an OAS pension or a spousal allowance).

The following table illustrates the maximum Guaranteed Income Supplement and the maximum combined Old Age Security and Guaranteed Income Supplement.

Table 1 – 2 Maximums Available - Fourth Quarter 2020

	Maximum Monthly GIS	Maximum Monthly Combined OAS and GIS
Single pensioner	$916.38	$1,530.52
Married to non-pensioner (someone who does not receive OAS or the Spousal Allowance)	$916.38	$1,530.52
Married to OAS pensioner or Spousal Allowance recipient	$551.63	$1,165.77

Note that the monthly maximum Guaranteed Income Supplement is lower for individuals who have partners who are also receiving benefits ($551.63 versus $916.38).

It is also important to note that the maximum amount of GIS available can be higher than what is indicated in the above chart.

If an individual receives less than the maximum OAS benefit, the Guaranteed Income Supplement may be increased in order to ensure that his or her income reaches the combined (OAS and GIS) maximums ($1,530.52 for single recipients and $1,165.77 for dual recipients). Service Canada should be contacted in situations of this nature in order to determine eligibility for this "top up" benefit.

1 - 4.2 Reductions in Guaranteed Income Supplement

The maximum Guaranteed Income Supplement amounts illustrated above are only available to elders with very little or no other sources of income. Benefits are reduced quite aggressively as the other income of the recipient increases. Other income is defined the same way it is for federal income tax purposes, with one notable exception: Old Age Security, Guaranteed Income Supplement and the Spousal and Survivor Allowance benefits are not included in the calculation of income. All other income (Canada Pension Plan benefits, private pension income, employment income, Employment Insurance benefits, Workers Compensation, alimony, interest, dividends, capital gains, etc.) is included. In the case of married or common-law partners, the combined income of both is taken into account.

Generally, income earned in the previous calendar year is used to calculate the amount of benefits paid in a payment year, which is from July of one year to June of the next year. However, if a pensioner or a spouse has retired or has a loss of pension income, an income estimate for the current calendar year may be substituted for the income of the preceding calendar year.

For a single, widowed, divorced or separated pensioner, the maximum monthly supplement is reduced by $1 for each $2 of other monthly income. If, for example, a single pensioner was receiving a monthly maximum GIS of $891.18 and he subsequently started earning $200 a month in additional other income, his monthly GIS payout would be reduced by $100 to $791.18. In the case of couples (spouses or common-law partners), if both are receiving an Old Age Security pension, the maximum monthly supplement of each pensioner is reduced by $1 for every $4 of their other combined monthly income. If both were receiving a monthly GIS payout of $495.89 and they started to earn a combined total of $400 in additional monthly income, then both parties would have their $495.89 payouts reduced by $100 to $395.89.

For a couple in which only one spouse or common-law partner is a pensioner and the other is not in receipt of either the basic Old Age Security pension or the Allowance, the program is somewhat different. The maximum monthly supplement is reduced by only $1 for every $4 of combined monthly income, even though they qualify for the higher "single" monthly payout. In addition, the first reduction of $1 is made only when the yearly combined "other" income of the couple reaches a threshold of more than $4,096 (2020).

The following table supplies some additional examples:

Table 1 – 3 Monthly GIS (after reductions for "other" income)

Annual "Other" Income	Single Pensioner	A pensioner who is married to a non-pensioner (not receiving OAS or Spousal Allowance)	A pensioner who is married to an OAS pensioner
Nil	$916.38	$916.38	$551.63
$24.00	$915.38	$916.38	$551.63
$48.00	$914.38	$916.38	$550.63
$4,096.00	$703.38	$915.38	$465.63
$18,600.00	Nil	$541.44	$124.21
23,904.00	Nil	$405.15	13.41
$44,592.00	Nil	Nil	Nil

1 - 5 SPOUSAL AND SURVIVOR ALLOWANCE

The Spousal and Survivor Allowance is designed to recognise the difficult circumstances faced by many surviving spouses and by couples living on the pension of only one spouse or common-law partner. Recipients of the Allowance must re-apply annually. The benefits received are not considered as income for income tax purposes and the Allowance is not payable outside Canada beyond a period of six months, regardless of how long the person lived in Canada.

1- 5.1 Eligibility Conditions

The Allowance may be paid to the spouse or common-law partner of an Old Age Security pensioner, or to a survivor. To qualify:

- ❖ An applicant must be between the ages of 60 and 64 and must have lived in Canada for at least 10 years after turning 18. An applicant must also have been a Canadian citizen or a legal resident of Canada on the day preceding the application's approval.
- ❖ The combined yearly income of a couple, or the annual income of a survivor, cannot exceed certain limits that are established quarterly. Old Age Security and Guaranteed Income Supplement benefits are not included in determining yearly income.

The Allowance stops when the recipient becomes eligible for an Old Age Security pension at age 65, or if he or she leaves Canada for more than six months or dies.

For a couple, the Allowance stops if the recipient's spouse or common-law partner ceases to be eligible for Guaranteed Income Supplement or if the spouses or common-law partners separate or divorce. In addition, the Survivors Allowance stops if a survivor remarries or lives in a common-law partnership for more than 12 months.

1- 5.2 Amount of Benefits

The Allowance is an income-tested benefit. The maximum amount payable to the spouse or common-law partner of a pensioner is equal to the combined full Old Age Security pension and the maximum Guaranteed Income Supplement at the married rate. The maximum amount for a person whose spouse or common-law partner has died is somewhat higher.

Table 1 – 4 Maximum Spousal and Survivor Allowance (Fourth Quarter 2020)

Spousal Allowance	$1,165.16
Survivor Allowance	$1,388.92

1- 5.3 Reductions in Allowance

In the case of a surviving spouse, the maximum monthly Survivor Allowance is reduced by $3 for every $4 of other monthly income—until an amount equal to the Old Age Security portion of the Allowance is reduced to zero. The balance (or the GIS portion of the Allowance) is then reduced by $1 for every $2 of additional monthly income.

For couples, the maximum monthly Spousal Allowance is also reduced by $3 for every $4 of other monthly income—until an amount equal to the Old Age Security portion of the Allowance is reduced to zero. Then both the Guaranteed Income Supplement-equivalent portion of the Allowance and the pensioner's Guaranteed Income Supplement are reduced by $1 for every $4 of the couple's combined additional monthly income.

Table 1 – 5 Monthly Allowance (after reductions for "other" income)

Annual "Other" Income	Spousal Allowance	Survivor Allowance
Nil	$1,165.16	$1,388.92
$48.00	$1,162.16	$1,385.92
$4,096.00	$909.16	$1,090.92
$20,000.00	$300.41	$210.45
$25,056.00	$194.41	Nil
$34,416.00	Nil	Nil

1- 5.4 OAS Summary

The following table provides a snapshot of the three components of Canada's Old Age Security program.

Table 1 – 6 Old Age Security Program Provisions

	Basic Old Age Security	Guaranteed Income Supplement	Spousal and Survivor Allowance
Age of Eligibility	65 and over	65 and over	60-64
Application Process	It is not paid automatically - it must be applied for	It is not paid automatically - it must be applied for	It is not paid automatically - it must be applied for
Residence Requirements	At a minimum 10 years (since reaching age 18) - 40 years to qualify for the maximum benefit	10 years - since reaching age 18	10 years - since reaching age 18
Other Requirements	None	Must be receiving an OAS pension to qualify for the GIS	The spouse must either be deceased or receiving both OAS and GIS
Means Tested	No - pension is available to anyone who meets residency requirements	Yes - benefit is only available to low income elders	Yes - benefit is only available to low income elders
Taxable Benefit	Yes	No	No
Funding	"Pay as you go" program	"Pay as you go" program	"Pay as you go" program

Indexed	Yes - quarterly based on changes in the CPI	Yes - quarterly based on changes in the CPI	Yes - quarterly based on changes in the CPI
Reductions	High Income elders have benefits clawed back	Benefits are reduced as "other income" increases	Benefits are reduced as "other income" increases
Retroactive Benefits	Yes - for a maximum of one year	Yes - for a maximum of one year	Yes - for a maximum of one year
Payable Outside Canada	Yes - so long as the elder has 20 years of residency since age 18	Yes - but for a max of 6 months	Yes - but for a max of 6 months

1 – 5.5 Changes to Old Age Security

The Government of Canada, in the 2012 Budget, announced three changes to Old Age Security:

1. The age of eligibility for Old Age Security (OAS) pension and the Guaranteed Income Supplement (GIS) will gradually increase from 65 to 67 over six years, starting in April 2023. The ages of eligibility for the Allowance and the Allowance for the Survivor will also gradually increase from 60 to 62. These changes were cancelled in 2015.
2. As of July 2013, a voluntary deferral of the OAS pension allows you to delay receipt of your OAS pension by up to 60 months after the first date of eligibility in exchange for a higher monthly amount.
3. An automatic enrollment process will eliminate the need for many seniors to apply for the OAS pension. This change is being phased in gradually starting in April 2013.

1 – 5.6 OAS Pension Deferral

As of July 2013, it became possible to defer receiving Old Age Security (OAS) pension for up to 60 months (5 years) after the regular date of eligibility (age 65). In exchange for this deferral, a higher monthly amount will be paid. If elder delays receiving an OAS pension, his monthly pension payment will be increased by 0.6% for every month payments are delayed, up to a maximum of 36% at age 70.

A person who chooses to defer receipt of an OAS pension, will not be eligible for the Guaranteed Income Supplement, and their spouse or common-law partner will not be eligible for the Allowance benefit for the period during the delay in OAS pension.

In deciding when to start receiving an OAS pension, an elder should consider his personal situation, taking into account such things as:

- current and future sources of income
- employment status now and in the future
- health, status
- plans for retirement

There is no financial advantage in deferring an OAS pension after age 70. In fact, a person risks losing benefits. Anyone over the age of 70 should apply immediately.

Who will benefit from deferring their Old Age Security pension?

People who can continue working and those who can afford to wait to receive an Old Age Security (OAS) pension.

People who earn more than the maximum annual income allowed for a given year will have to repay part or their entire OAS pension. If they can delay receiving it until they have a lower income, they will be able to keep more of the OAS pension, and their OAS pension amount will be higher because of the increases for every month they delayed receiving it.

1 - 6 CANADA PENSION PLAN

Unlike Old Age Security, The Canada Pension Plan (CPP) is a contributory, earnings based social program. It is designed to protect the contributor and his or her family against the loss of income associated with death, disability and retirement.

A parallel plan, that mirrors the CPP very closely, is available in Quebec. It is called the Quebec Pension Plan (QPP). The Canada Pension Plan is funded on a "steady-state" basis, which is a hybrid between a "fully funded" approach and the "pay-as-you-go" approach used with Old Age Security.

Assets in the plan, combined with current premiums, are designed to fund future benefits for approximately 75 years.

The current CPP program is, in other words, not sufficiently funded to cover all future benefits.

1- 6.1 Legislative History

The Canada Pension Plan was introduced on January 1, 1966. Several key amendments have been made in subsequent years - among them:

- Annual cost-of-living indexing of benefits
- The exclusion of low earnings years (while caring for a child under age 7) in pension calculations
- Flexible Retirement benefits - payable as early as age 60 (1987)
- Continuation of Survivor benefits upon remarriage (1987)
- Pension Sharing (1987)
- Premiums increased, investment policy revised, and pay-as-you-go funding replaced with fuller funding in order to build a reserve (1998)
- Same sex benefits introduced (2000)
- New formulas for pensions taken prior to age 65 and after age 65 (2012)

1- 6.2 Contributors

With few exceptions, every person in Canada (outside of Quebec) between the ages of 18 and 70 - who earns an income - must contribute to the Canada Pension Plan. Employees cover half of the required premium and employers pay the balance. Self-employed individuals pay both portions.

People under age 18, age 70 and over, and pensioners (i.e., anyone who is collecting benefits) are not required to make premium payments.

1- 6.3 Premiums

Premiums are based on an employee's salary - or on net business income (after expenses) in the case of self-employed individuals.

Premiums are only required on income that falls between a set minimum (i.e., $3,500) and specified maximum (that is adjusted each January, based on changes in the average wage). Income that falls within this range is called "pensionable" earnings.

Table 1 – 7 CPP Premiums and Premium Calculations for 2020

Year's Maximum Pensionable Earnings (YMPE)	$58,700.00
Year's Basic Exemption (YBE)	$3,500.00
Maximum Contributory Earnings (YMPE - YBE)	$55,200.00
Maximum Employee Premium (5.25% of Contributory Earnings)	$2,898.00
Maximum Employer Premium (5.25% of Contributory Earnings)	$2,898.00
Maximum Self-employed Premium (10.5% of Contributory Earnings)	$5,796.00

1- 6.4 Retirement Benefits

A Canada Pension plan retirement pension is a monthly benefit that is paid to people who have paid premiums into the plan. The pension is designed to replace roughly 25% of the earnings on which a person's contributions were based.

An elder is eligible for a Canada Pension Plan retirement pension if he or she has made at least one valid contribution (payment) to the Plan and: ***Is age 60 or older***

Starting in 2012, if a CPP recipient is under age 65, he and his employer must continue to make CPP premium payments.

As with Old Age Security, an elder must apply for CPP retirement benefits. If, however, the elder is already receiving a Canada Pension Plan disability pension, it will automatically convert to a retirement benefit at age 65.

Application for a CPP retirement pension should be made at least six months in advance of the date the elder wants the pension to begin. As with Old Age Security, there are legislative restrictions on retroactive payments - a delay in application could therefore result in a loss of benefits.

1- 6.5 Benefit Calculations

An elder's retirement pension is based on three things: how much they contributed, how long they contributed, and the age at which they chose to retire.

Calculating a retirement benefit based on these various factors is a necessarily complicated exercise. And to further complicate matters certain adjustments - designed to ensure that a person receives as high a pension as possible - are also thrown into the mix. Among them:

- ❖ Low income periods - when a contributor is raising children under the age of seven - are thrown out of the retirement pension benefit calculation
- ❖ Any month in which a contributor was eligible for CPP disability benefits is thrown out of the retirement pension benefit calculation
- ❖ The 15% of a person's contributory period, in which his or her earnings were the lowest, are thrown out of the retirement pension benefit calculation
- ❖ Monthly earnings after age 65 automatically replace lower earning months prior to age 65

An elder's CPP retirement pension is normally payable the month after his or her 65th birthday. For 2020 the maximum monthly CPP retirement benefit at age 65 is $1,175.83. However an elder can elect to take a retirement pension as early as age 60 or as late as age 70. In these situations, the benefits payable will be adjusted accordingly.

Under the pre-2012 rules, if an elder elected to take his or her pension early, the payout was reduced by 0.5% per month. This was a permanent adjustment - if the elder elected to take a pension early, the amount payable did not increase as they age.

If, on the other hand, the elder elected to take a pension well after reaching age 65, the pension payable increased by 0.5% for every month beyond age 65.

Several new CPP rules have recently come into effect.

Starting in 2012, Ottawa started to phase in a bigger reduction for people who elect to take a CPP retirement benefit prior to age 65.

The early-bird reduction rose to 0.6 per cent per month in 2016, or a maximum 36 percent reduction for those who start receiving CPP payments at age 60 rather than waiting until they reach 65.

Similarly, those who wait until after the age of 65 to start collecting CPP will get a bigger increase in their retirement benefit.

Before 2011, the rules stated that the CPP retirement benefit was boosted by 0.5 per cent for each month after age 65 that an individual put off receiving it. So someone who waited until age 70 would enjoy a 30 percent boost in their payments.

But starting in 2011, the government began to phase in a gradual increase to that delay bonus.

In 2012, the increase for each month after 65 that a person delays applying for CPP went to 0.64 per cent – or a maximum increase of 38.4 per cent for those who start receiving a pension at age 70. In 2013, the maximum bonus moved to 42 per cent.

These changes will not affect people who are already receiving CPP benefits. They are being made, according to Service Canada, to restore these adjustments to "actuarially fair levels," so there are "no unfair advantages or disadvantages to early or late take-up of CPP retirement benefits."

Changes to the CPP “drop out year” provisions are also being made. Canadians currently do not need to contribute to the CPP every year from age 18 to age 65 to get a full CPP retirement pension. When someone's average earnings over their contributory period are calculated, 15 percent of their lowest earning years are automatically ignored when the calculation is made. For someone who takes their CPP retirement pension at age 65, means seven years of low or zero earnings are dropped from the equation.

But starting in 2012, that "general drop-out provision," as it is called, went up to 16 per cent.

For someone eligible for CPP benefits in 2012, this allowed up to 7.5 years of the lowest earnings to be excluded from the calculations, boosting the retirement benefit paid.

In 2014, the percentage rose to 17 per cent, which will allow up to eight years of low earnings to be dropped.

These changes can really benefit people who entered the workforce late, who were unemployed for a long time, or took time off to go back to school.

One point to note is that there are separate drop-out provisions specifically for time spent out of the workforce because of disability or to have children.

Another change applies to the old work cessation rules. CPP rules used to require that someone stop or drastically reduce the amount they earned during the two consecutive months before they began to receive a CPP retirement pension.

This was, for many Canadians, an annoying and costly requirement — especially since so many people now ease into retirement instead of stopping work completely.

Now, that rule is history. Beginning in 2012, the "work cessation test" was eliminated.

There is another rule change that is important for semi-retirees to be aware of. Before 2012, if someone started receiving a CPP retirement pension early — say, at age 62 — they did not have to make any CPP contributions if they decided to collect payments but also keep working after age 62.

Now if you are under age 65 and continue to work while also drawing a retirement pension, you and your employer must make CPP contributions.

The good news for employees is that these extra contributions will be credited to what is called a Post-Retirement Benefit (PRB), which will result in a higher CPP retirement pension in the year after you make contributions to your PRB. This measure is a nod to the reality that many "retired" Canadians are still working.

Canadians who continue working after age 65 and are receiving a retirement benefit will have the choice of whether they want to make CPP contributions. If they choose to make them, their employer must kick in their share too. Those additional contributions will go toward higher benefits beginning the year after the PRB contributions.

1- 6.6 Pension Options

When an elder decides to take a CPP retirement pension is entirely dependent on individual circumstances. The factors that may come into play in making this decision include:

- Their health
- Their retirement plans
- Whether or not they are still earning income and contributing to CPP
- Tax planning considerations
- Their spouses circumstances
- The other sources of income available to them

After electing to take a CPP retirement pension, an elder can change his or her mind. In order to cancel the pension, the elder must make a written request within six months of the date the pension started. All benefits received must be repaid and CPP premiums must be paid on any employment earnings during the period.

1 - 6.7 Pension Sharing

Assignment, or "pension sharing," is available to spouses or common-law partners who are together (i.e., not separated or divorces) who are receiving CPP retirement benefits. With pension sharing, each spouse, or common-law partner, receives a portion of the other's pension. While this does not in any way affect the total pension amount received, it may present certain tax advantages.

In situations where there is a wide disparity between the marginal tax brackets of the spouses, pension sharing can help to reduce the couple's income tax burden. Even if only one spouse or common-law partner has contributed to the CPP, pension sharing can still be employed.

The contributions of the sole contributor - that were made during the period of co-habitation - can be divided into two equal payments. The amount of pension that can be shared is dependent on how long a couple lived together during their respective contributory periods. If they lived together for 20% of both their contributory periods, they would each keep 80% of their pension; and the remaining 20% would be divided equally between them. The following example will help to illustrate:

Table 1 - 8 Pension Sharing

	CPP Pension	**% of Pension Earned During Cohabitation**	**Pension Available to Share**	**New CPP "Shared" Pension Amount**
Spouse A	$800	75%	$600	$200 (Pension Amount not shared) $300 (1/2 of Spouse A's "sharable" pension) $100 (1/2 of Spouse B's "sharable" pension) = $600 (New Pension Amount)
Spouse B	$200	100%	$200	$0 (Pension Amount not shared) $300 (1/2 of Spouse A's "sharable" pension) $100 (1/2 of Spouse B's "sharable" pension) = $400 (New Pension Amount)

Pension sharing stops under any of the following circumstances:

- If either party asks to end the assignment
- In the 12th month after the couple separates
- In the month, the couple divorces
- If a partner who has never paid into the Canada Pension Plan begins contributing
- The month one of them dies

When a pension sharing arrangement ends, each party reverts to their original pension entitlement.

1 - 7 CPP SURVIVOR BENEFITS

If a contributor dies, his or her spouse (or common-law partner) may be eligible for Canada Pension Plan survivor benefits. These benefits are also available to a "separated" spouse, so long as he or she does not have a cohabiting common-law partner.

Even same-sex, common-law partners can qualify - so long as the contributing partner died on or after January 1, 1998.

Elders are often able to collect two separate CPP pensions at the same time: their own CPP pension and a survivor benefit. The combined benefit is lumped into a single monthly payment.

Survivor benefits are also available to dependent children. The Canada Pension Plan children's benefit is paid to the natural or adopted children of the deceased contributor or to children in the care and control of the deceased contributor at the time of his or her death. Qualifying children must either be under age 18 or between the ages of 18 and 25 or be attending school full time. In 2020 the maximum monthly CPP survivor child benefit was $255.03 (per child).

The amount a surviving spouse or common-law partner will receive depends on:

- ❖ How much, and for how long, the deceased paid into the Plan
- ❖ The spouse or common-law partner's age when the contributor died
- ❖ Whether the spouse or common-law partner has dependent children
- ❖ Whether the spouse or common-law partner is also receiving a Canada Pension Plan disability or retirement pension.

1- 7.1 CPP Death Benefit

The Canada Pension Plan death benefit is a one-time, lump-sum payment made to the deceased contributor's estate. If there is no estate, the person responsible for the funeral expenses, the surviving spouse or common-law partner or the next of kin may be eligible, in that order. As with most Canada Pension Plan benefits, the amount of the death benefit depends on how much and for how long, payments were made into the Canada Pension Plan.

Canada Pension Plan first calculates the amount that your Canada Pension Plan retirement pension is or would have been if you had been age 65 when death occurred. The death benefit is equal to six months' worth of this ‘calculated’ retirement pension, up to a maximum of $2,500.

Most CPP beneficiaries receive a death benefit pay out at or close to the maximum. In 2018, the average CPP death benefit paid was $2,310.22.

The survivor benefit available is based on how much the deceased's Canada Pension Plan retirement pension is or would have been if they had been age 65 at the time of their death. The following table provides a benefit synopsis.

Table 1 – 9 Canada Pension Plan Survivor Benefits (2020)

If the survivor is:	Then the benefit is:	Maximum Survivor Pension Amount
Age 65 or over	60% of the deceased's retirement pension (subject to adjustment based on other CPP benefits received*)	$705.50
Under Age 65	A flat amount, Plus 37.5% of the deceased's retirement pension (subject to adjustment based on other CPP benefits received*)	$638.28

1 - 8 CPP DISABILITY BENEFITS

Working elders between the ages of 55 and 65 are three times more likely to be disabled than workers 54 years of age and under. Canada Pension Plan disability benefits are therefore of interest to this group.

The Canada Pension Plan pays a monthly benefit to people who have contributed to the Plan and who are disabled according to Canada Pension Plan definitions.

A monthly benefit is also available to the dependent children of disabled pensioners.

In order to qualify, an individual must:

- Have contributed to the Canada Pension Plan for a minimum number of years
- Be considered disabled according to Canada Pension Plan definitions
- Be under the age of 65, and
- Apply in writing

A disabling condition can be either physical or mental. According to Canada Pension Plan definitions, the disability must be "severe and prolonged." "Severe" means that the condition prevents the individual from working regularly at any job, and "prolonged" means the condition is either long term or that it may result in their death.

1- 8.1 Minimum Contributions

To qualify for a disability, pension a CPP contributor must have paid premiums into the plan in three out of the last six years and have earned at least 10% of each Year's Maximum Pensionable Earnings (e.g., $5,870 in 2020).

Exceptions to the previous rule are made under the following circumstances:

- When failure to meet the requirements is due to a delay in application (i.e., the contributor would have qualified if he or she had applied earlier)
- If the contributor was raising the children, who were under seven years of age, during the past six years
- If the contributor worked (and contributed) in another country, with which Canada has a reciprocal social security agreement
- If the individual contributed in each year following a previous claim for CPP Disability Benefits

1- 8.2 Benefit Amount

The disability benefit is made up of two parts: the first is a flat, fixed amount and the second is based on how much, and for how long, the individual paid into the Canada Pension Plan.

The maximum monthly disability benefit available, in 2020, was $1,387.66. The dependent children of disabled contributors also qualify for benefits ($255.03 each, per month, in 2020).

As with Canada Pension Plan retirement benefits, disability benefits are adjusted annually to reflect changes in the Consumer Price Index.

Disabled contributors may earn some income without impacting their disability benefits. Disabled contributors may also do volunteer work, return to school, or participate in a retraining program without impacting their benefits.

1- 8.3 Cessation of Benefits

Disability payments cease:

- When a contributor is no longer disabled
- At age 65 when the Canada Pension Plan retirement pension begins (or between ages 60-65 if an early retirement pension is elected)
- At the contributor’s death

1 - 9 QUÉBEC PENSION PLAN

The Québec Pension Plan is, overall, very similar in kind to the Canada Pension Plan. Among the similarities:

- Contribution provisions are identical (i.e., everyone between the ages of 18 and 70 - not already collecting a CPP/QPP pension - who has income in excess of $3,500 must contribute)
- Contribution rates are similar (i.e., both employees and employers contribute 5.40% of earnings between $3,500 and the YMPE - self-employed individuals pay 10.80%)
- Retirement pension provisions are similar [e.g., normal retirement is age 65; pension can be taken as early as 60 and as late as age 70]
- Retirement pension benefit amounts are similar
- Disability benefit provisions and benefit amounts are very similar

The Quebec Pension Plan does, however, differ from the Canada Pension Plan in some notable areas - including:

- Assets are managed separately by the "Caisse de dépôt et placement du Québec"
- Basic Survivor benefit amounts are substantially higher (e.g., survivors between age 45 and 64 - and survivors under age 45 who are disabled or who have dependent children can receive in excess of $700 monthly if they qualify for maximum benefits)
- The benefits for surviving children are substantially lower
- A flat QPP Death benefit of $2,500 is paid in all cases (regardless of contribution duration and amounts)
- All QPP pension contributions, made during the period of cohabitation, are divided equally between the two spouses upon separation or divorce
- Some definitions and provisions differ from those of the Canada Pension Plan

1 - 10 FUTURE CHALLENGES

Canada's social security programs are among the best - and most generous - available in the world. Unfortunately, the rapid aging of our population is going to place enormous pressure on our social safety net.

Annual Old Age Security payments currently total in excess of 52 billion dollars.

Between now and 2036, the number of Canadians 65 years of age and older is going to grow by close to 50% (based on Statistics Canada's Medium Growth - population projection - Scenario). Tens of billions of dollars annually will be required just to cover the additional cost of Old Age Security. Since Old Age Security is funded entirely by current tax revenue, this additional burden will fall largely on the shoulders of working age Canadians. This segment of the population is going to shrink between now and 2036. They are going to need very broad shoulders!

Canadians 65 years of age and older are also responsible for an inordinately large share (approximately 45%) of publicly funded Medicare costs. The 70+ billion dollars we currently spend, annually, on elder medical care will balloon to over 100 billion dollars during the next two decades. We will need an additional 30 billion dollars just to maintain the existing system. Where will the money come from?

In order to cover the costs of Old Age Security and elder Medicare we will need to find 10s of billions of dollars annually by 2036.

And the challenges do not stop here. Canada Pension Plan, even with the changes initiated in the late 90s, still has significant unfunded liabilities. Who is going to cover them?

In the coming years there will not be any easy solutions. Tough decisions are going to be required.

1 – 11 MEDICARE PROGRAMS FOR CANADIAN ELDERS

1 - 11.1 The Current Debate

In Canada, Medicare is based on the view that health care is a basic human need and should not be denied to anyone. In survey after survey, Canadians stress their support for a publicly funded, accessible health care system.

It is becoming clear, though, that as health care needs evolve and cost pressures mount, difficult decisions will have to be made about priorities and levels of funding.

Already, there are many services that Canadians must pay for themselves—out of their own pocket, or through private health insurance. And Canadian private health expenditures - which include drugs, dental care, and alternative medicines - are growing three times faster than public expenditures.

Currently, private clinics are not allowed to charge any additional fees to cover what is deemed to be medically necessary services. And this has created a lot of debate.

Some Canadians feel strongly that there should be a private alternative to the public funded system - and creating one would solve many of the problems associated with the current system. Others, meanwhile, argue that a parallel private system would pose a real threat to publicly funded Medicare, and that we would find ourselves on a slippery slope toward "American style" health care.

1 - 12 THE HISTORY OF MEDICARE IN CANADA

Understanding the history of Canada's health care system, cannot help but be of assistance in understanding the current system and its' challenges.

If we were to travel back in time, we would discover that publicly funded health insurance has comparatively shallow roots in Canada. There was effectively no recognisable form of health insurance in the 19th century.

The provision of health care was not a priority of the Fathers of Confederation - unlike education, health care was not discussed at all. The British North America Act, still the governing document of Canada's constitution, does not even contain the word *health*.

Before the 1920s, the predominant sense was that a young, hardworking, prosperous North American country was relatively insulated from the worst of Old World problems and did not need Old World policies. The national symbol of Canada at the beginning of the 20th century was tough, sleeves-rolled-up, Johnny Canuck, who was busy logging, and making railways, and clearing land, and playing hockey, and getting ready by 1914 to volunteer to fight the Huns in France.

The idea of somebody providing unemployment insurance, pensions, and health insurance for Johnny, or for his good-looking and wholesome little sister Janey, seemed preposterous. Judging by its real roots, health insurance had something to do with European countries' "identity."

Nonetheless, Canadians' desire for access to health care did increased steadily - during the early 20th century - as medical diagnosis and treatment became more effective and costlier. Canadians wanted to be able to visit doctors and wanted access to the modern hospital. In what has been called "the health century", health care was becoming substantially more important in everyday life.

Doctors, who had traditionally been expected to provide free health care services to those in need, were among the leaders in discussing a public health care system.

As an Ontario family doctor said in 1944, "Every day I see patients who are getting inadequate medical service, both diagnostic and curative, because they are unable to pay for it, or if they do pay, they are left with insufficient money to provide a decent standard of living. Every such case is a demand, even though usually unexpressed, for some form of health insurance."

The Pearson government in the 1960s, an era of unparalleled Canadian confidence, created what was proudly called "socialised medicine." Although extremely popular with ordinary citizens, who suddenly had no more worries about medical and hospital bills, Canadian Medicare soon began disintegrating under cost pressures and competition from the private sector. The Trudeau government responded, introducing the Canada Health Act in December 1983. It was passed unanimously by Parliament in 1984. The public health insurance system, covering core medical and hospital care, was now guaranteed to survive, not on its merits, but through the mechanism of a legislated monopoly.

If the state health care monopoly had worked, and if governments had been able to deliver on the 1964 promise of universal access to health care "without hindrance of any kind," the rest of the world might have followed suit.

The trouble was, as most students of monopolistic behaviour know, command economies do not tend to work well over the long run. By the late 1980s the whole of the Western world had come to appreciate the flaws of socialist economic management.

Remove an industry from market conditions, replace price signalling with administrative fiat, outlaw competition, and you create the classic conditions for inefficiency, declining productivity, and gradually increasing consumer dissatisfaction. Not a single country anywhere copied the flawed Canadian "model."

Canadians themselves began to wonder how their system could be sustained as the population aged, its health care expectations continued to increase, lineups and blockages and shortages increased, and providers became increasingly disgruntled.

The idea that one approach to health care was integral to Canadian identity began to seem increasingly anachronistic. In fact, Medicare was a healthy centrepiece of Canadian policy for only a few years and Canada, Canadian health care needs have almost always been in flux. The very notion of monopolistic state run health care began to seem narrow, stultifying and offensive, as Canadian society became more diverse and pluralistic. The country had changed. Health care had changed. Canadians had changed. The world had changed. The system created by the Canada Health Act, once seen as part of the solution, had become part of the problem - an obstacle citizens faced in trying to access for themselves and their children, the best possible health care.

And yet, despite the problems, many Canadians - particularly Canadian elders - remain heavily invested in the current system. Elders remember what it was like before Medicare, when Canadians put off seeing the doctor if possible because their families could not afford to pay. Many of us bear scars from those days when we did not get appropriate and timely care.

Families often experienced heavy debt from the costs of hospitalisation for serious illnesses or accidents. In many cases, they were forced to sell their homes. Young people put off their extended education (sometimes indefinitely) to go to work to pay off family debts for health care.

Table 1 - 10   Brief History of Medicare in Canada

1867	The Constitution Act of 1867 (formerly known as the British North America Act) defines health care as a family or local concern and makes the provinces and territories responsible for its maintenance. Quarantine, marine hospitals, natives, and immigrants are the only aspects of health care handled by the federal government.
1938	The Rowell-Sirois Commission identified health care as an important and expensive issue. Subsequent court cases and interpretations have established the paramount authority of the provinces when it comes to health care delivery and of the federal government's right to set national standards.
1948	The federal government implements the Health Grants Program, which opens the way to a national health insurance plan. This program offers a 50–50 cost-shared plan to all provinces for health care assessment, professional training and hospital construction. In the same year, Saskatchewan Premier Tommy Douglas introduces universal hospital insurance in the province.

1957	The Hospital Insurance and Diagnostic Services Act provide conditional grants to the provinces from the federal government. Both governments share in the cost of establishing a national hospital insurance plan.
1964	Appointed by Prime Minister John Diefenbaker, former Saskatchewan chief justice Emmett Hall heads the Royal Commission on Health Services from 1961 to 1964. Hall affirms the criteria of the national health plan (universality, portability, and public administration). He adds to its mandate that health care must be accessible and comprehensive by extending the health plan to health care beyond the hospitals.
1966	The federal government passes the Medical Care Act. It extends health care coverage to include doctors' services outside hospitals.
1972	All provinces universally participate in what we now call Canadian Medicare.
1974	The Minister of National Health and Welfare, Marc Lalonde, releases A New Perspective on the Health of Canadians: A Working Document. It outlines health care strategies for a universal medical system.
1977	The Federal-Provincial Fiscal Arrangements and Established Programs Financing Act changed the cost-sharing model of financial support for health care. The federal government offers block funding, which consists of tax transfers and cash payments to the provinces based on the gross domestic product (GDP). These payments are conditional on the provinces' ability to meet certain criteria as outlined by the federal government.
1980	Former chief justice Emmett Hall releases a report called Canada's National-Provincial Health Program for the 1980s. The report suggests that extra billing by doctors and user fees by hospitals will endanger the principle of universality by denying reasonable access to health care for all Canadians.
1981	The House of Commons Task Force on Federal-Provincial Fiscal Arrangements agree with Hall's 1980 report, but also concludes that federal funding for health care is inadequate.
1984	The Canada Health Act consolidates previous federal legislation regarding health care. It also reaffirms the criteria for the provinces to receive federal funding for insured and extended health care services. The five criteria are as follows: public administration, comprehensiveness, universality, portability, and accessibility.
1986	The Minister of National Health and Welfare, Jake Epp, releases Achieving Health for All: A framework for Health Promotion. It emphasizes that income security; employment, education, housing, and agriculture all have an impact on health care policy.
1990	The Senate Standing Committee on Health and Welfare, Social Affairs, Science and Technology produces a report called Accessibility to Hospital Services—Is There a Crisis? It looks at inefficiencies in acute-care hospitals and concludes that these issues have been resolved through innovative problem solving by hospital administrators.

1991	The House of Commons Standing Committee on Health and Welfare, Social Affairs, Elders and Status of Women tables its report, The Health care System in Canada and Its Funding: No Easy Solutions. The report concludes that problems in the existing health care system cannot be resolved through increased spending. Therefore, more cost-effective solutions need to be implemented at the community and local levels.
1994	The Minister of Health, Diane Marleau, sets up the National Forum on Health. With a four-year mandate and a budget of $12 million, its 22 members will hold discussion groups and town hall meetings across Canada to determine a new vision health care system.
1995	Finance Minister Paul Martin announces a new federal formula for funding the provinces called the Canada Health and Social Transfer (CHST). Though not official until April 1997, this block fund is worth $27 billion and covers all annual support for health, education, and social services to the provinces. This legislation had the effect of reducing the amount of money being transferred specially for health care. All provinces had to agree to a new unilateral funding distribution, or the government will impose new arrangements on them.
1999	The Liberal government of Jean Chrétien announced an $11.5-billion investment in health over five years.
2002	Don Mazankowski's report on public health care (sponsored by the Alberta government) is released.
2002	Roy Romanow's report on public health care (sponsored by the Canadian government) released.
2004	Canada's health bill has been outpacing economic growth. The Government report reveals Canada's total public health tab grew from $69.8 billion in 1992 to $74.7 billion in 1996. But in 1997 spending began to soar—jumping from $78.5 billion that year to $83.6 billion in 1998, $89.7 billion in 1999, $97.4 billion in 2000, $105.6 billion in 2001, and $112.2 billion in 2004. John Horne, a health economist in Winnipeg, said he is not convinced spending is out of control and people should remember that the recent infusion of cash was necessary to fill gaps left by years of cuts.
2005	A new report on provincial and territorial government health spending by the Canadian Institute for Health Information (CIHI) shows continued growth in health care spending by provincial and territorial governments. The report reveals that provincial and territorial governments are expected to spend $91.4 billion in 2005–2006, an increase of 7.5% over the previous year. Provincial and territorial government health spending is estimated to have reached $79.9 billion in 2003–2004 and $85.0 billion in 2004–2005, reflecting annual growth rates of 7.7% and 6.4%, respectively. After removing the effects of inflation, health care expenditures in constant 1997 dollars are projected to reach $75.7 billion in 2005–2006, reflecting a real growth rate of 4.7%

2005	In June 2005, the Supreme Court of Canada ruled that Quebec's prohibition against private health insurance for medically necessary services violated the Charter of Rights and Freedoms. This decision has opened the door to significantly more private sector participation in health care.
2007	In April 2007, Stephan Harper announced that all ten provinces and three territories had agreed to establish "wait time guarantees" - a measure designed to address one of the most pressing problems in the health care system. Each jurisdiction will implement guarantees - in at least one priority area - by 2010.
2012	The Canada Health Transfer to the provinces has grown steadily from $20.3 billion in 2005 to 36 billion in 2016-17 — an annual growth rate of over five percent. Under the federal government's new unilateral funding formula this growth stopped in 2017-18 and then proceeded in line with nominal GDP growth with a growth floor of at least 3 percent a year.

1 - 13 THE CANADIAN HEALTH CARE SYSTEM

The Canadian health care system is a publicly financed and privately delivered system. Three main groups constitute the health care system: the federal government, provincial governments, and private physicians.

1 - 13.1 Federal Government

While health care is not under its constitutional jurisdiction, the federal government is responsible for the following:

- Setting and enforcing national health care standards through legislation such as the Canada Health Act (CHA)
- Assisting in health system financing through the transfer of tax revenue from the federal government to the provinces
- Providing direct health services to specific groups (i.e., native Canadians and veterans)
- Fulfilling other health-related functions such as disease prevention and health promotion

1 - 13.2 Provincial Governments

Under the Canadian constitution, health care is the jurisdiction of the provincial and territorial governments. These governments are responsible for the following:

- Managing and delivering health services
- Planning, financing, and evaluating hospital care and other health care services
- Managing some aspects of prescription care

1 - 13.3 Private Physicians

Private physicians deliver publicly funded health services. Most physicians in Canada are not government employees but self-employed practitioners who work in private practices. Most are paid on a fee-for-service basis and submit their claims directly to the provincial health insurance plan for payment.

Physicians negotiate price with the provincial governments regarding the various services they provide.

1 - 14 THE CANADA HEALTH ACT (CHA)

In the early 1980s, many provinces placed limits on the fees doctors could collect for their services—essentially capping their incomes. These caps, however, were seldom effective. Many doctors simply imposed additional fees on patients for services—a practice called "extra billing."

This controversial practice led to the passage of the Canada Health Act in 1984, which established penalties for provinces that permitted extra billing and combined the hospital and medical insurance bills into one comprehensive piece of legislation. Within two years, all the provinces had passed legislation banning extra billing, despite vehement physician opposition, including a strike by Ontario doctors. Doctors were forced to work within the confines of the publicly funded system or to accept only those patients who could afford to pay out-of-pocket.

The Canada Health Act (CHA) sets the Canadian health care national standards. The CHA ensures that all Canadian residents have access to necessary health services, regardless of their ability to pay. Provincial insurance plans must meet CHA standards in order to qualify for full federal health contributions. The CHA stipulates that provincial health care programs must meet the following five criteria:

1 - 14.1 Criteria One - Public Administration

The provincial or territorial administration of the health care insurance plan must be carried out on a non-profit basis by a public authority. For example, the Alberta Minister of Health administers and operates the Alberta Care Insurance Plan on a non-profit basis for the benefit of the province's residents.

1 - 14.2 Criteria Two - Comprehensiveness

All medically necessary services provided by hospitals and doctors must be insured. The patient, the physician, and the provincial or community standards of practice determine what services are "medically necessary."

1 - 14.3 Criteria Three - Universality

All insured persons in the province or territory must be entitled to public health insurance coverage on uniform terms and conditions.

1 - 14.4 Criteria Four - Portability

Coverage for insured services must be maintained when an insured person moves or travels within Canada or travels outside the country.

If an insured person needs Specialty care that is unavailable in Canada, they may apply to the province to have the treatment fully covered.

1 - 14.5 Criteria Five - Accessibility

Reasonable access to medically necessary hospital and physician services by insured persons must be unimpeded by financial or other barriers. Health services may not be withheld based on income, age, health status, or gender.

1 - 14.6 Services Covered

There are two groups of services covered by the Canada Health Act: Insured Health care Services and Extended Health care Services.

1 - 14.7 Insured Health Care Services

Insured health care services are medically necessary hospital services, physician services and surgical-dental services provided to insured persons.

Insured hospital services are defined under the Canada Health Act and include medically necessary in-patient and out-patient services such as standard or public ward accommodation; nursing services; diagnostic procedures such as blood tests and X-rays; drugs administered in hospital; and the use of operating rooms, case rooms and anaesthetic facilities. Insured physician services are defined under the Act as "medically required services rendered by medical practitioners." Insured surgical-dental services are services provided by a dentist in a hospital, where a hospital setting is required to properly perform the procedure.

Physicians in conjunction with their provincial and territorial health insurance plans generally determine medically required physician services. Insured persons are eligible residents of a province, but do not include those who may be covered by other federal or provincial legislation. Persons not covered by the Canada Health Act include serving members of the Canadian Forces or Royal Canadian Mounted Police, inmates of federal penitentiaries, and persons covered by provincial workers' compensation.

1 - 14.8 Extended Health Care Services

Extended health care services covered by the Canada Health Act address certain aspects of long-term residential care (nursing home, intermediate care and adult residential care services), as well as the health aspects of home care and ambulatory care services.

1 – 14.9 Multiple Healthcare Systems

Canada's universal medical care system was designed from the bottom up: by the provinces, for the provinces. There is no single "Canadian" health care system.

Instead, what we have are ten distinct provincial systems that are tailored to the specific needs of their citizens and to their unique political philosophies.

The provincial plans that have evolved in Canada are like one another, but not identical. All the provincial plans cover medically necessary services that are provided by licensed practitioners in hospitals, clinics, and doctors' offices. This is required by the Canada Health Act. But keep in mind that it is within the purview of each jurisdiction to determine what "is" "medically necessary." The services of psychiatrists and psychiatric hospitals are also fully covered in all the provinces. But this is a result of provincial choice - not federal requirements.

Provinces tend to be distinguished mostly by how far they have decided to extend coverage beyond physician services and general hospital costs. Four provinces offer nominally universal Pharmacare plans.

Some provinces provided some limited routine dentistry and optical care (e.g., inpatient dental surgery, refractions, and corrective lenses) and three provinces—Alberta, Manitoba and Saskatchewan—provide partial coverage for chiropractic care.

Long-term care and home care coverage also not covered under Medicare, differ only slightly among provinces. For nursing home care, accommodation and overhead costs are usually charged back to the patient, whereas all health service and drug costs are insured. Public coverage for home health care is growing, and most of the provinces already provide at least partial funding for both transient post-acute home care and chronic home support services. However, the design and scope of home care services vary widely across the provinces.

1 - 15 SHARED RESPONSIBILITY

The Government of Canada provides financial support to provincial and territorial governments on an ongoing basis to assist them in the provision of programs and services.

Transfers help ensure that all Canadians receive reasonably comparable levels of public services, wherever they live. They support important provincial programs: health care, post-secondary education, social assistance and social services, as well as early childhood development and early learning and child care.

As part of the 2003 Health Accord, First Ministers agreed to restructure the Canada Health and Social Transfer (CHST) and create separate transfers for health (Canada Health Transfer) and for other social programs (Canada Social Transfer), thereby enhancing the transparency and accountability of federal support for health while continuing to provide provinces and territories with the flexibility to allocate funds among social programs according to their respective priorities.

In 2011-12, Ottawa transferred about $58 billion in cash to the provincial and territorial governments. The three main provincial cash transfer programs are the Canada Health Transfer at $27 billion, the Canada Social Transfer (for child, post-secondary education and social programs) at about $12 billion and Equalization (funds for those provinces with a weaker fiscal capacity) at almost $15 billion.

1- 15.1 Canada Health Transfer (CHT)

Provides provinces and territories support for health care. The CHT was put in place in 2004-05, when the Canada Health and Social Transfer (CHST) was restructured to enhance the transparency and accountability of federal support for health.

A new formula for the CHT was introduced in 2012. Under it, the current annual CHT growth rate of 6 per cent will be replaced in 2017-2018 with a new funding formula pegged to a "three-year moving average of nominal Gross Domestic Product (GDP)" growth. What this means is that the annual growth of the CHT transfers will be determined by the speed at which Canada's GDP grows. Under this new funding formula, CHT funding would be prohibited from growing at a rate of less than 3 per cent annually — an important safety feature, given the slow-paced global economic recovery that has been ongoing since the 2008 financial crisis and the possible fiscal meltdowns in Europe and the United States which have the potential to substantially damage Canada's GDP growth.

The new CHT formula puts significant pressure on all provinces to ensure they are being cost-effective and properly managing their health dollars. Gone are the days when provinces could squander billions on ineffective programs like Ontario's eHealth electronic medical records and Orange air ambulance scandals that cost Ontario taxpayers over $1.3 billion in misspent health funds. The new CHT makes it clear that Ottawa is not going to pay for egregious mistakes made by provincial governments who mismanage their health care budgets.

1- 15.2 Canada Social Transfer (CST)

Provides provinces and territories support for post-secondary education, social assistance and social services, including early childhood development and early learning and child care. The CST is made up of both a cash transfer and tax transfer component.

1- 15.3 Equalization

Ensures that less prosperous provinces have enough revenue to provide reasonably comparable levels of public services at reasonably comparable levels of taxation. Equalization payments are unconditional; the provinces can spend them according to their respective priorities.

In 2017–18, six provinces received payments under this program, totaling $19 billion.

1- 15.4 Territorial Formula Financing (TFF)

Ensures that territorial governments can provide services to their residents, considering the higher costs in the North. In 2017-18, the three territories received payments totalling more than $3 billion.

1 – 16 MAJOR ISSUES

Surveys have repeatedly shown that Canadians are highly satisfied with the care they receive once it is delivered. However, the general view among most Canadians is that their health care system is not as well managed as it must be.

They are increasingly concerned about the lack of timely access to see their family physician, the long wait times for diagnostic testing, a widespread lack of access to specialists and specialized treatment, and the compromised quality of care in overburdened emergency rooms, or the unavailability of nearby ER facilities altogether. With our aging population, end of life issues are becoming increasingly important, yet many do not have access to expert palliative care.

The founding principles of Medicare are not being met today either in letter or in spirit. Canadians are not receiving the value they deserve from the health care system. Issues such as quality of care, accountability and sustainability are now recognized as key aspects of a high-performing health system. "Health" by today's standards is not just the assessment and treatment of illness, but also the prevention of illness, and the creation and support of social factors that contribute to health. Also missing from our current system, but vitally important to proper care, is health information technology (HIT). In this area, Canada is woefully lacking in both resources and coordinated efforts toward a plan of HIT implementation.

Before addressing the missing elements in Canada's health care system, a proper diagnosis of the current system requires a closer look at how the health care system fails to deliver on all five founding principles of Medicare.

1. Universality

Studies have consistently shown that poorer, marginalized populations do not access necessary care. Wealthier populations use health care services more frequently than lower-income populations despite higher illness rates in low-income populations. Poorer communities have fewer services to support good health.

The most vulnerable populations are least able to access and navigate the health care system. At the same time, these are the people most likely to need health care because the essential determinants of health – housing, education and food security – are often not available to them.

Canada's system of universality resonates strongly with Canadians. However, while there is universal first-dollar coverage for insured hospital and medical services, there is uneven coverage of other services also essential to health and quality of life (e.g., prescription drugs and home care).

2. Accessibility

The principle of accessibility in the *Canada Health Act* does not define "timely access" to necessary care. For many patients, the months of waiting for necessary treatment amount to a complete lack of "accessibility."

While wait times have been reduced for a limited number of surgical procedures, many Canadians are still waiting far too long to receive necessary medical care for a wide variety of conditions. For many types of treatments, Canadians wait longer than citizens in most other industrialized countries that have similar universal health systems.

Clearly wait times are one of the most serious concerns with Canadian medical care. Not only are Canadians are often forced to wait not only for non-emergency surgeries but also for simpler services such as seeing a specialist, radiation treatment, hospital beds and diagnostic tests.

A series of recent surveys have revealed that:

- 57% of Canadians wait 4 weeks or more to see a specialist
- The average wait time, from referral by a general practitioner, to consult with a specialist, to treatment is 17.7 weeks
- 12% of Canadians wait for 4 months or more for non-emergency surgery (compared to just 1% of Americans)
- 24% of Canadians wait for 4 hours or more in emergency rooms

Approximately five million Canadians do not have a family doctor, severely restricting access to adequate primary medical care

3. Comprehensiveness

Provincial/territorial health insurance plans must insure all "medically necessary" hospital and physician services. Canadians are entitled to all medically necessary (evidence-informed) services to the greatest extent possible. However, since Medicare was established in the 1960s, care patterns have shifted dramatically – away from being primarily acute care in nature, to broader health needs including prevention, treatment and long-term management of chronic illnesses. In addition, new technologies, treatments and medications that were not foreseen by the original planners of Medicare have been developed to diagnose and treat illnesses.

At the time the *Canada Health Act* was passed, physician and hospital services represented 57% of total health spending; this has declined to 41%. Notwithstanding these changes, there is significant public spending beyond services covered by the *Act* (in excess of 25% of total spending) for programs such as seniors' drug coverage and home care; however, these programs are not subject to the *Act*'s program criteria and are often subject to arbitrary cutbacks. While most of the working-age population and their families are covered by private health insurance, those with lower incomes are less likely to enjoy such benefits. Furthermore, the proportion of Canadians working in non-standard employment conditions (e.g., part-time, temporary or contract work) is increasing and these workers are less likely to have supplementary benefits. In addition, while most jurisdictions provide some form of seniors' drug coverage, access to other supplementary benefits post-retirement is most likely highly variable.

Some of the more severe gaps in coverage include:

- ❖ The lack of access to prescription medications for those without private health insurance or who are ineligible for government drug benefit programs; this problem is particularly significant for many residents in Atlantic Canada
- ❖ Tack of continuing care, including both support for people to stay in their home (home care) or appropriate residential care (e.g., facility-based long-term care)
- ❖ A lack of adequate mental health services. Mental illness is one of the leading burdens of illness in Canada. Access to mental health services for both children and adults is poor. Psychiatric hospitals are not covered under the *Canada Health Act*. Many essential services, such as psychological services or out-of-hospital drug therapies, are not covered under provincial/territorial health insurance plans.

4. Portability

Canadians should receive coverage while travelling outside of their home province or territory. Portability under the *Canada Health Act* does not cover citizens who seek non-urgent and nonemergency care outside their home province or territory. Canadians who obtain such care in another province or territory are not covered by their health insurance program unless they receive prior approval (usually for services not available in their home province or territory). This principle is honoured by some jurisdictions but has never been fully implemented in Québec.

Québec did not sign bilateral reciprocal billing agreements with the other provinces and territories stipulating that providers would be reimbursed at host-province rates.

Consequently, Québec patients who receive medical care outside of their province must often pay cash for medical services received and then apply to recoup a portion of their costs from the Québec health insurance program.

5. Public Administration

Health care insurance plans must be administered and operated on a non-profit basis. The principle of public administration is often misinterpreted to mean public financing of publicly delivered services. In fact, while Medicare services (medically necessary hospital and physician services) are overwhelmingly publicly financed, most services are privately delivered. Most physicians are independent contractors while most hospitals are private organizations governed by community boards. This misconception of what constitutes public administration has inhibited the development of innovative models for publicly funded, privately delivered services. While Canada's system of Medicare is administered publicly, a case can certainly be made that Canada's health care system is not delivering value for the money spent: Canada is one of the highest spenders of health care when compared to other industrialized countries that offer universal care – Canada is the fifth-highest spender per capita on health care and sixth-highest in terms of spending on health as a percentage of GDP. Canadians spent an estimated $264 billion on health care in 2019, or over $7,000 per person. Of this amount, $185 billion, or 70%, is spent through the publicly funded system.

Health care spending in Canada has increased by between 6 and 8% annually over the past decade and has been increasing faster than the growth in the economy and more importantly faster than revenues at the federal and provincial/territorial levels. Canada's health care system is under-performing on several key measures, such as timely access, despite the large amounts we spend on health care. Experts agree that Canada's current health care system is not delivering the level of care that other industrialized countries now enjoy.

The Conference Board of Canada, the World Health Organization, the Commonwealth Fund and the Frontier Centre for Public Policy have all rated Canada's health care system poorly in terms of "value for money" and efficiency. New governance models should be considered to improve both system effectiveness and accountability.

1 – 16.1 Fiscal Sustainability

In addition to the need for improving the performance of our health system is the issue of fiscal sustainability. In 1998, the Auditor General of Canada, Denis Desautels, was among the first to sound an alarm about sustainability with a report on the implications of the aging population. His report projected that government spending on health as a share of GDP; if increases continued apace at an annual rate of 2% of real growth; could as much as double from its 1996 level of 6.4% to 12.5% by 2031. According to the most recent estimates from the Canadian Institute for Health Information (CIHI), government health spending as a percentage of GDP reached 11.6% in 2019.

In February 2010, Parliamentary Budget Officer Kevin Page again sounded the alarm in his Fiscal Sustainability report. He projected that total provincial-territorial government health expenditure could rise to over 14% of GDP by 2040-41. This report presents estimates of the fiscal gap (which is defined as the increase in taxes and/or reduction in spending, measured relative to GDP) that is required to achieve sustainability over the long term. Under their baseline scenario, the government would need to increase revenue and/or reduce spending by $15.5 billion annually. Given that most commentators expect the demand for health care services to increase, reduced spending seems unlikely; hence the need to increase revenue is the most likely option. If there is no political appetite or public support for increasing public revenues for health based on universality and risk pooling then we will be faced with choosing among options for raising funds from private sources.

1 - 17 INCONVENIENT TRUTHS

As noted above, Canada's prized Medicare system is facing serious challenges on two key fronts: in meeting the legitimate health care needs of Canadians and in being affordable for the public purse. The founding principles of Medicare are not being met today either in letter or in spirit. Canadians are not receiving the value they deserve from their health care expenditures.

In 2009 the “Euro-Canada Health Consumer Index” ranked Canada 30th of 30 countries (the U.S. was not included in the sample) in terms of value for money spent on health care. Canadians deserve better.

Canada cannot continue this path. The system needs to be massively transformed, a task that demands political courage and leadership, flexibility from health care professionals and far-sightedness on the part of the public.

The evidence is strongly mounting that many Canadians are incorrect in believing that we have “the best health care system in the world.” For years, The Conference Board of Canada has given a “B” to Canada’s health care system, ranking it 10 out of 17 countries. Several issues, fuelled by an aging population and internal cost pressures, make it clear that we must face some “inconvenient truths” when it comes to health care.

1 – 17.1 The Canadian Health Care System’s Goal is Not Well Articulated

There is little agreement among Canadians on the desired health care goal. Some see it in terms of acute care hospital outcomes; others in how many people are serviced, or how much procedure waiting times are reduced. We need a clear and agreed-upon articulation of the goals.

The real goal should be to promote the health and happiness of individuals in our society. This is not necessarily achieved by focusing as strongly as we do on acute care and patient processing.

1 – 17.2 The Debate about Health Care is a Debate about Trade-offs

Rising health care costs and public funding for the existing system are limiting public investments in other areas that could make us a more effective, equitable, and successful society—particularly among and between generations. Health care costs are rising toward 50 per cent of provincial budgets and are crowding out spending on other priorities.

Interestingly, on the margin, health care services are not a major determinant of the health of a population—social and economic factors and resulting individual behaviours are the primary drivers. As such, an argument can be made that a dollar invested in improving the economic and social factors affecting population health has more impact than an additional dollar invested in our health care system—particularly when the system remains focused on the acute care aspect of health care.

1 – 17.3 Sustainable Care and Vested Interests

As with any enterprise, some individuals and groups are fully vested in maintaining the status quo—the existing system. They wish the system to be “durable”—to continue what it is doing, but with more resources. Others understand that putting more resources into the "system” to maintain what exists will not lead to its true sustainability. They wish for the sustainability of “health and health care”; not for the existing “health care system” to be sustainable.

1 – 17.4 Ideology is Preventing Real Transformation

We have tied our identity as Canadians to our health care system. We need to decouple our identity and values from the dialogue around health care services if we are to realize real change. A healthy society and health care access for all are values we can share. The notion that the system is largely funded through public resources is a choice we have decided to make. Public resources can, however, be channeled through public or private delivery mechanisms (for profit and not-for-profit) to achieve societal health care goals.

The European experience demonstrates that private delivery of health care service within publicly financed health care systems can be beneficial. In the end, transforming the delivery of health care services and creating greater innovation and flexibility in our health care system should not be viewed as an assault on our values.

1 – 17.5 Our Health Care System is “Balkanized”

If we had a pan-Canadian health care system, we would be taking full advantage of the benefits that can be captured when we share knowledge development, best practices, and purchasing power for key inputs across and within jurisdictions. Simply stated, we do not share enough in any of these areas. In addition, not enough knowledge is being stored or shared in the system to leverage efforts and treatments. While everyone agrees health care should be patient-centered, we have been talking about this for decades, but never achieve it as we pass patients through loosely connected health care “workstations.”

1 – 17.6 The Health Care "System" is Stuck in 1960s

This does not mean that clinical procedures have not changed. Rather, it means that the functioning of the health care system is not configured or operated in a way that helps it achieve maximum effectiveness or efficiency. We are fighting to deliver modern health care within the constraints of multiple outdated systems: physical infrastructure, service delivery models, provider incentives, labour contracts, and the flow of information, to name but a few. The "system," as developed in earlier days, was designed to protect citizens financially should they be hit by catastrophic health events where most of the treatment cost occurs due to acute medical interventions that takes place in hospital. The health care system, as it was designed then, did well in delivering desired results for the first few decades. Much of the available care that once took place only in hospitals can now be delivered in the community and even in the home. However, the current system that was built in the 60s is ill-equipped to efficiently support this new delivery of health care.

1 – 17.7 Patients should be Empowered and Trusted to Lead

Health care is a service industry that exists to meet the needs of patients. However, the system is still stuck in a model from the past, in which providers made the rules and controlled all decisions. As societies evolve, citizens increasingly demand transparency and participation in decision-making. They also expect the system to respect their values and preferences and to facilitate access to health care services.

Patients do not care about silos within the system; they want to have access to seamless services that meet their physical and emotional needs. To achieve this, we need to halt the paternalistic approach that assumes the system knows what patients need and shift to involving them as active participants in the redesign process.

1 - 17.8 Creating the Right Incentives and Holding People Accountable

Health care should put less emphasis on counting transactions and interventions and more on knowing whether these interventions make a difference in patients' lives. Improving the quality of health care services and increasing value for money requires a fundamental transformation in the culture, incentives, and working practices of health care providers and administrators. This shift in culture and practice should be supported by measuring outcomes and establishing accountability frameworks tying these outcomes to performance targets. The expenditure of many additional billions of dollars following the 2002 publication of the Romanow Report did less to improve health care outcomes than it did to boost professional salaries. As reported by the OECD, we rank 7th in the cost of our system in terms of total health spending per capita—significantly above the OECD average. But Canada is well below average in terms of available per capita resources such as physicians, hospital beds, CT scanners, and MRI units. And Canada's ranking in health outcomes ranges anywhere from 5th to 25th for key indicators. For example, Canada ranks 13th in life expectancy and 18th in mortality due to neoplasms (which include cancer and benign tumors).

1 – 17.9 The System Does Not Effectively Utilize Innovation

This is especially true of information and communication tools to improve performance and outcomes. Canada is a slow adopter of innovative technologies that could enhance the quality of health care services and improve the health and quality of life of Canadians. In addition, there is widespread agreement that the health care sector is one of the last outposts of slips of paper and fax machines. Progress on applying information technology more widely within the health care system has been stifled by suboptimal strategies to engage health providers in the uptake of these technologies. Progress has also been restrained by endless debate focusing solely on privacy needs that could be accommodated through appropriate security. These obstacles are blocking the adoption of even rudimentary tools that would improve outcomes, speed process, ease work burdens, and improve the sharing of useful information and protocols.

The failure of the system to embrace new technologies has been widely documented. According to a study by economists at Baruch College in New York, in 2006, there was one MRI machine in the U.S. for every 37,000 Americans and one Tomography Scanner for every 31,000 Americans. The comparable figures in Canada were, one in 182,000, and one in 87,000.

1 – 17.10 The Health Care System is Misaligned with the Needs of Elders

Many patients in today's hospitals, particularly in the medical units, are elderly. They are in the hospital because they are losing overall functionality due to a complex set of conditions, often related to age. Many of these patients end up in hospitals because they have limited or no access to appropriate geriatric, psychological, and physical care.

Nor do they have the behavioural, social, and healthy living support required to maintain seniors' independence and safe living at home. Hospitals are risky places, particularly for seniors who are more vulnerable to infections and who do not cope well with limited mobility and disruptions in their routines. The frail elderly often do not do well when they are eventually discharged from the system, having been bed-bound and out of their routine for a week or even several weeks. Again, the current system has not adjusted to the very real differences in our population and its needs as they have changed from the 1960s through to the 21st century.

1 – 17.11 Society Must Cast a Broad Net in Improving Health

We need to include social housing, mental and addiction health services, and childhood nutrition and development in our calculations about the "system," rather than myopically focusing mostly on acute care activities. Acute care is where societies' failures end up.

1 – 17.12 Individuals Need to Accept Responsibility

A patient who arrives in an acute care setting with medical problems induced from a lifetime of unhealthy choices is not something the system can, or should be fully expected to, address on its own. Hospitals are not like auto repair shops staffed by mechanics: spare parts are not always available or possible to obtain, and the problems caused by complex and interrelated diseases cannot always be repaired. In addition, individuals and their families must recognize the sole common reality of life: we all die. Deciding how far to go to avoid the inevitable is something individuals should have an explicit dialogue about with their loved ones and their medical providers.

As psychologists note, the first step toward a cure is understanding that you have a problem. We need to start with a broad understanding that real change is needed in our approach to better health and the care of our health.

1 - 17.13 Issues with Primary Care

Over the past number of years, primary care has clearly changed, but the tools to manage this change are not in place. Health care providers, especially physicians, rarely make house calls, and their offices are not open 24 hours a day, 7 days a week. Unfortunately, illness does not wait for office hours! This has put enormous pressure on Emergency Departments in Hospitals even though they were neither designed for nor intended to deliver primary care.

People must resort to Emergency Departments simply because little else is available for a large portion of the day.

1 - 17.14 Doctor Shortages

While the ban on extra billing has not left physicians impoverished, it has clearly compromised their earning potential. In 2018, Canadian doctors averaged about $281,000 in gross annual income (before expenses and taxes) - which was less than the average net income of U.S. physicians which was $299,000 (or 397,000 in Canadian dollars).

And as high as their earnings may seem to the average Canadian, remember that they must complete years of post-secondary education and many run their own offices and put in excessive hours by virtually any measure (often as high as 70 or 80 hours per week).

It should come as no surprise that many established doctors have decided to move south, while newer physicians are opting for staff positions rather than private practice.

The net result of this chronic under funding has been a significant shortage of doctors - particularly primary care general practitioners.

According to the Organisation for Economic Co-operation and Development (OECD), Canada has just 2.2 doctors per thousand of the population - which compares to the OECD average of 3.0 doctors per thousand.

1 – 17.15 Cost Cutting

Funding for Canada's health care system has changed significantly over the past 30 years. In the late 1970s, worried about its open-ended agreement to pay half of each province's medical bills, the federal government began to transfer a lump sum per capita payment to each province, based on past practices.

While there were some administrative advantages in taking this approach (since the federal government was no longer paying half the tab, it is no longer required the provinces to mail in their bills), it also opened the door to a dramatic reduction in funding.

As federal contributions to health care declined, the provinces found themselves trapped, "between the public's unlimited expectations of a free system—expectations that are fuelled by politicians—and a federal government intent on reducing the debt."

The above changes resulted in a dramatic reduction in the federal government's contribution to public health care.

Currently federal transfers account, on average, accounts for only slightly more than 20% of provincial medical care costs. In some provinces, this figure is even lower. British Columbia, for example, pays for 88% of its' health care costs.

Many Canadians worry that a continued reduction in payments will reduce the incentive for the provinces to continue to enforce the five basic health care principles that most of the country holds sacrosanct.

1 - 18 FIXING THE PROBLEM

In the end, the health care system needs to be transformed. This transformation will require several things:

- Society, in the form of patients and citizens, need to be involved in this dialogue. Given that patients and citizens are both the users and the payers of the publicly funded health care system, their input is essential if we are to set the right goals for the system. In addition, public input is required on the necessary trade-offs. Some of the areas that need to be addressed (e.g., housing, the workplace, and even urban design) are not within the purview of existing health care professionals and experts.
- A true interprofessional dialogue is required. There are strongly articulated positions and implicit beliefs among members of the various health care professions, including physicians, nurses, pharmacists, and others. Everyone needs to engage in an open-minded dialogue and come to the discussion table—not to defend their own interests, but to advance the interests of patients and their families.
- Governments will have to coordinate the dialogue: it involves many moving parts, often simultaneously.
- System redesign will involve reconfiguring key elements across many jurisdictions—from access to the system to coordination of services and to patient navigation.

- ❖ Implementing the transformation will have to move us from "endless experimentation" to real planning and implementation.

1 – 18.1 Five Key Priorities for Reform

1. Fix the gateway to the health care system as we begin to reimagine how we deal with all aspects of health care delivery. Primary care, not the emergency room, should be the first contact point within the health care system and the key access point for other health-related services. There was a strong consensus that interdisciplinary family care teams should be the standard model for primary care, and that these teams should be expanded and strengthened in all provinces and territories. These teams need to be armed with the knowledge and tools needed to care for seniors and other vulnerable populations.
2. Invest in and use technology in the health care system, particularly information and communication technology. More intensive and standardized use of information technology will allow patient information to be collected and shared seamlessly, making treatment more effective (better outcomes and fewer errors) as well as efficient—thereby boosting the productivity of the system overall.
3. Change the compensation system and related labour contracts for health care professionals. Compensation models need be linked more to patient and community health care outcomes and less to activities such as treatment and consultation. This is necessary to create the right incentives structures and improve the alignment with accountability.
4. Focus on the state of the health and wellness of Canadians overall. A healthy population should be our goal. A healthy population will demand fewer acute care services caused by preventable chronic diseases. We need a system focused on "wellness" as well as "health care." Employers, community organizations, and families have important roles to play in supporting individual wellness.
5. Build a more transparent and accountable health care system with respect to goals, management, and performance. Creating greater transparency and accountability in a properly configured system will go a long way in mobilizing support for changes among all stakeholders—patients, taxpayers, and care providers. The health care system also needs the energy and commitment of more individuals like Helene Campbell and Dr. Chris O'Connor, who have been empowered by data and are using social media to raise awareness and mobilize action.

Pouring more resources into a system that is not configured to achieve the outcomes society wishes and does not necessarily focus on the drivers of health and wellness. It is like "pouring water into sand." We need to identify practical solutions among the many experiments and pilots that have been undertaken across the country over the past decade. There is a deficit in how we manage the system: the deficit can be addressed by reconfiguring the system and by selecting and implementing the best processes. These new solutions, backed by transparency and accountability, will deliver effective and fair health and economic outcomes. If fully implemented, the fundamental reforms we can put forward should allow Canadians to truly say we have "the best health care system in the world" and make Canada more competitive internationally.

A variety of different approaches have been employed to address the many problems that have surfaced in Canada's publicly funded health care system.

British Columbia, for example, has established a reference-based pricing scheme to help control costs, through which it generally pays for only the lowest-cost drug. (Denmark, New Zealand and Australia have similar plans.) The policy obligates family doctors to prescribe the lowest-cost, or "reference" version of a drug.

The logic behind reference-based pricing is that in some drug classes, an older, cheaper drug works just as well as a newer "copycat" drug. If a doctor believes the reference drug is not suitable for a patient, he or she must get permission to prescribe another by faxing a special authority request to British Columbia's Pharmacare.

Some provinces have also tried to cut costs and improve delivery by decentralizing control over health care to the district, or local board level. Ironically, others have taken the opposite approach!

Many provincial districts have "centralised" services to cut costs (layoffs and reductions in hospital beds are usually part of the program). These new centralised operations sit strategically between the expectations of the provincial government, the interests of health care providers, and the wants and needs of citizens. The idea is that a healthy tension between these three actors will result in an efficient and successful system.

Many Canadians would argue that the only long-term solution to Canada's health care concerns is increased federal funding.

Nine out of ten Canadians, according to government polls, favour spending any federal budget surplus on medical care.

Popular opinion holds that the provinces should not have to, (and in most cases cannot afford to) shoulder many health care costs. Unfortunately throwing money at the current system has not tended to pay dividends in the past.

Worse, in the coming decades it will become difficult to maintain the current system - even with a substantial influx of new money. Canada's system is trying to cope with the same problems the U.S. has—an aging population and increased cost of drugs and technologies.

1 – 18.2 Examples of Pay-For-Performance Programs

Many provinces have already had success with pay for performance programs. Some of these success stories are outlined below.

- Nova Scotia Family Physician Chronic Disease Management Incentive Program
- Ontario Cumulative Preventive Care Bonuses for achieving specified thresholds of preventive care for their patients in five areas: influenza vaccine, pap smear, mammography, childhood immunizations and colorectal cancer screening
- Manitoba Physician Integrated Network has a Quality Based Incentive component

- Alberta Performance and Diligence Indicator (PDI) Fund for Family Physicians: The PDI Fund provides payments to family physicians who meet specific indicators in the care of their patients. The PDI program "will provide payments to individual family physicians, in and out of primary care networks, who meet specific performance and/or diligence indicators that deliver substantive clinical value.
- British Columbia Full Service Family Practice Incentive Program: this includes an obstetrical care bonus payment and an expansion of the Full Service Family Practice Condition Payments that were introduced in 2003. The condition-based bonus payments are related to the monitoring patients' course of care according to BC Clinical Guidelines for diabetes, congestive heart failure and hypertension.

1 – 18.3 Three Visions for the Future

Despite all the reasonable suggestions identified in the sections above, there is absolutely no consensus among Canadians when it comes to the best way to maintain and improve our health care system. Three dramatically different visions have all garnered a following:

- To make the present system work better
- Introduce a two-tier medical system
- Push the envelope of the Canada Health Act

1- 18.4 Vision One - Make the Present System Work Better

The "make it work better" vision is espoused by the federal government as well as many of the provinces—particularly Saskatchewan.

This vision is based upon a commitment to the current health care system's philosophy and supports reforms that improve the system while staying true to its underlying philosophy. The underlying philosophy is that health care is a Canadians' right and that health care should be distributed according to need not ability to pay. Proponents believe that the best means of accomplishing this is through a dominant public health care system. This philosophy is entrenched in the Canada Health Act, which requires all "medically necessary" services to be insured and the administration of health care insurance to be carried out by a public authority on a non-profit basis.

It also entitles all insured persons to equitable insurance coverage (coverage on uniform terms and conditions) and reasonable access to medically necessary hospital and physician services, unimpeded by financial or other barriers. Therefore, the "make it work better" vision strongly supports the Canada Health Act and the strict enforcement of its five criteria.

Reform strategies generally include making the health system more cost effective through technology and organizational changes.

The vision tends to be critical of any reforms that threaten the right to universal and equitable health care or the dominance of the public health care system. This vision does not support a parallel private system, user fees, or major reductions in the services covered by public insurance plans.

A prime example of the "make it work better" approach was the Romanow Report which was made public in November 2002. The Prime Minister appointed Roy Romanow to head a Commission focused on the Future of Health care in Canada. His mandate was to recommend changes to ensure the long-term sustainability of Canada's health care system.

This report would highlight countless interviews with thousands of Canadians—health experts and ordinary citizens, Health Ministers and Premiers, researchers and health care workers.

Romanow's report, in short, recommended expanding the mandate of Canada's public health care system - and pumping large sums of cash into it. It was a popular - if not entirely realistic - solution to a serious and growing problem.

1- 18.5 Vision Two - Introduce a Two-tier Medical System

Many physicians advocate the introduction of a two-tier medical system. In recent years, the Alberta government has also shown interest in moving towards a limited two-tier medical system. Under such a system, two levels of care are available for patients. One level would be funded entirely out of tax dollars and would work in the same way our public health system operates now.

The other level would be funded directly by consumers and would operate as a private health system. Presently, the Canadian health system has both a private and public component. The public system covers all 'medically necessary' services. The private system, which accounts for approximately 30% of all health spending, covers everything else.

A two-tier medical system differs from this present situation in that the private and public systems would no longer be mutually exclusive, with the private sector participating only in non-necessary services. Instead, the same services would be offered in both systems and the consumer could choose between the systems.

As controversial as this sounds, there is already strong evidence that, for all intents and purposes, a system of this nature already exists in parts of Quebec.

There are three basic rationales for a two-tier health care system. First, many argue that a single public health system is financially unsustainable.

Second, a parallel private system would reduce the fiscal pressure on the health system and the public purse. Third, a two-tiered system would provide Canadians with choice and competition in their health care services. This would give the public sector far more incentive to be cost effective and would give Canadians greater control over their health care.

1- 18.6 Vision Three - Push the Envelope of the Canada Health Act

The "push the envelope" vision is supported by several provinces, particularly Ontario, and strikes a middle ground between the "make it work better" and two-tier approaches to reform.

While not going as far as advocating a full two-tier health system, this vision does push the envelope of the Canada Health Act by advocating greater private sector participation.

Reforms under the "pushing the envelope" vision often include:

- User fees or private participation
- Higher health care premiums
- A reduction in the services covered by public insurance plans.

The rationale for this vision is twofold. First, many argue that simply making the present system better through increased efficiency will not sustain the health care system.

Reforms that are more drastic are needed to reduce costs and create alternative sources of revenue. Second, like those who advocate a two-tier system, 'pushing the envelope' supporters argue that increased private sector participation will give consumers greater choice in their health care and will reduce costs through competition.

1 - 19 MEDICARE CONCLUSIONS

The Canadian health care system is at a crossroads. Like all health care systems in the world, it must undergo radical change if it is to get out of the current crisis.

While the need for reform is widely recognized, the form it will take remains an open question. For years now, the health care system has been in the print and broadcast news almost daily.

Horror stories (e.g., overcrowded emergency rooms, poor quality of care, inequitable access to resources, financial scandals, medical errors, etc.) have been reported alongside news on the wonders of modern medicine and technology (e.g., new medications, potential breakthroughs in treatments for major diseases, genetic miracles, the possibilities offered by alternative medicine, grafts, remote diagnosis and treatment by means of telemedicine, universal access to quality medical information on the Internet, and so on).

This flood of contradictory information contributes to creating a strong feeling of concern. The question being raised more and more is whether we will be able to count on a quality health care system, with universal access, in the future.

To answer this question, we must first try to understand why the Canadian healthcare system, like that of all developed nations, is experiencing serious difficulties, and why its transformation is unavoidable.

In the late 1950s, Canadians thought that, considering the spectacular successes of modern medicine, they could improve public health and eliminate disparities among social groups by making all medically required health services available to all citizens, under a government health insurance system. To achieve this goal, the federal government passed legislation on two occasions—in 1956 for hospital services, and in 1968 for medical services—to encourage the provinces to set up universal hospital insurance and health insurance plans by funding half the cost of the programs. The specific form health insurance took in Canada was influenced by the division of power between the federal and provincial governments.

The criteria defining what was covered by health insurance had to be as simple as possible so that the federal government could ensure its financial contribution to health insurance was not diverted by the provinces, which have full jurisdiction over health services.

It was decided that all hospital and medically required services dispensed by physicians would be covered, provided the provinces complied with five basic principles (i.e. Public management, full coverage, universality, accessibility—additional charges for insured services were not permitted—and transferability).

The commitment of the provinces was embodied in laws prohibiting private insurance from covering services insured under public health insurance.

Today, over 50 years later, the Canadian health insurance plan is still based on these principles. In addition, despite its undeniable success, it has become increasingly clear that its transformation is inescapable.

Observers are now saying that despite considerable health care spending, disparities in health are as great as when health insurance was first introduced, and that the increase in life expectancy is not reducing health problems but, on the contrary, fueling their growth and evolution. Although health insurance has not helped reduce health problems, it has had three important repercussions. First, it has significantly increased the public security about health.

Second, it has constituted, through government funding, an incredible system of redistribution of wealth among professional categories and between the sick and the healthy. In this way, it has contributed to making society more equitable and thus more amenable to the improvement of public health. It has also become an essential sector of economic activity: in Canada today, one worker in ten works directly in health care.

A poll conducted early this century by Price Waterhouse Cooper indicated that 60% of Canadians supported the idea of expanding private health services to solve the health crunch, and nearly half backed user fees.

Yet, the same poll found that 75% of Canadians were willing to make 'compromises,' such as paying higher taxes to ensure that all Canadians have equal access to health care.

More important, 99% of Canadians fully supported the Canada Health Act's five governing principles. Overall, 90% of the public rate the current system as good to excellent.

And yet, as much as we may like the current system, in the end, the aging of our population will, of necessity, drive a whole variety of changes to it.

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Chapter 2

Retirement Planning and Investing

2 – 1 KEY OBJECTIVE OF THIS CHAPTER

A long and fruitful retirement is not just the product of good health - careful financial planning is also necessary. Making the right investments; managing debt; making the income tax system work in your favour; and ensuring that appropriate insurance coverage is in place are all a part of the mix.

Inevitable cut backs in government programs combined with increasing longevity make financial planning - at a personal level - increasingly important. Unfortunately, many elders and pre-elders have very limited understanding of the most basic of financial planning principles - and even more have simply failed to plan.

For anyone interested in elder issues, this represents a wonderful opportunity to provide assistance and add value.

2 - 1.1 How Will This Objective Be Achieved?

We will provide a broad overview of financial planning and investment basics. Along the way we will also take a closer look at such topics as:

- The steps involved in developing a financial plan
- Elder financial challenges
- Issues to consider prior to retirement
- Effective tax planning
- Investment strategies
- Investment vehicles

In the course of the above discussion it is important to remember just how important financial planning is to elders of all ages. Often younger elders (i.e., those between the ages of 55 and 64) are playing catch up - quickly trying to set aside and invest assets for their retirement years. A sound plan is of the essence.

As for older elders age 65 and older, the same holds true. Most can expect to live - on average - another 20 to 25 years. Making their assets last that long - or longer - is not something that should be left to chance.

And, as for the oldest elders, a tax-efficient legacy plan needs to be put in place.

We often think that financial planning is the domain of the pre-55 set, but nothing, in fact, could be further from the truth.

2 – 2 INTRODUCTION

Becoming financially secure is a realistic and obtainable goal, once an investor, young or old, understands the necessary strategies and techniques for reaching his or her objectives. Fortunately, gaining the knowledge for success is neither complicated nor mysterious.

The approach for accumulation of wealth during the working years and maintaining assets during retirement is straightforward. Most successful professional advisors and informed investors use the same method - they utilize conservative and proven investment strategies and combine them with common sense.

However, before implementing any investment strategy, one should understand both the specific investment requirements and the psychological make-up of the stereotypical investor. Most investors are savers. Investors willingly assume risk while savers seek guarantees. Most savers, particularly elders, have an emotional need for guaranteed interest rates and guaranteed return-of-principal.

While satisfying an emotional need, eliminating risk places a disproportionate importance on the preservation of capital. Few savers understand that the loss of purchasing power (inflation), not market risk, should be their major long-term concern. Hence, the first objective of a financial professional or investor should be to understand the importance of persistence, planning, and professional guidance. Within that framework, one must also accept the concept that risk assumption, within acceptable constraints, is necessary to obtain a competitive long-term total return.

Communicating investment basics to investors is essential. Financial professionals must have a working knowledge of investing principles. Presenting them to clients in a concise and understandable manner is another matter.

An advisor must incorporate and explain certain investment basics in order to meet suitability requirements, address the client's risk tolerance, and give the client a comfort level, enough to implement an investment strategy. An appropriate strategy will depend on the individual client, the product or service presented, and the advisor's investment philosophy.

2 - 2.1 Financial Planning Basics

Retirement involves new circumstances: reduced income, activated retirement funds and new insurance requirements. Elders and their families often have many questions. Will mom be able to afford a nursing home? Does a new retired couple have enough retirement money to keep pace with the cost of living? To answer these questions, it can be helpful to develop a financial plan.

A financial plan is about planning your financial future in order to achieve your goals. It is not about being rich beyond your wildest dreams. It is certainly not about "buying and holding" or "timing the market." It is about what planning the elder has already undertaken; it is about understanding what the elder wants, what it will take to get there, and how to do it in the most efficient way possible.

The difference between what an elder wants and what they currently have is "the gap" that needs to be addressed in the financial planning process. A financial plan designed for an elder will focus on such matters as:

- Developing a retirement budget
- Consolidating income
- Resolving how to pay for care, including comparing the options for financing long term care costs
- Making investment planning decisions
- Making estate planning decisions
- Addressing tax issues

The good news for elders is that it is never too late to address these issues. It does however require some work, including:

- Compiling a financial inventory (i.e., making a record of all income, assets, expenses, and liabilities).
- Discussing preferences. Is the elder thinking of retiring in another country or province? Will the elder be selling his or her home? What life goals does the elder plan to pursue … and what might they cost?
- Gathering information ahead of time - including an understanding of post retirement changes to an elder's health insurance coverage (health care costs can increase with age and insurance plans typically do not cover all the costs - so remember to factor increased health care costs into a retirement budget)

Two other factors that need to be kept in mind include:

- Since the average life expectancy is increasing, older adults need to plan for a longer retirement. Elder need to save, invest, and budget accordingly
- Laws regarding insurance, taxes, and retirement benefits are constantly changing. Keeping abreast of new information is vital

2 - 2.2 Dealing with Misconceptions

When it comes to developing an appropriate financial plan, several broadly held financial misconceptions tend to muddy the waters. Among them, the assumption that:

- Expenses will drop at retirement
- Retirement will only last for 10 -15 years
- Government and company pension plans will cover basic living expenses
- Pension payments will keep pace with inflation

- ❖ An employer's health insurance plan will cover medical expenses
- ❖ There is plenty of time to start saving for retirement.
- ❖ Saving just a little bit will not help

2 - 2.3 Keeping the End in Mind

The ultimate objective for all investors is to gain financial independence as quickly and efficiently as possible. The elder community is no different.

Which raises an interesting question: since everyone understands the importance of accumulating wealth, why do so few succeed?

They fail for two reasons:

- ❖ Gaining financial independence requires sacrifice, planning, and commitment
- ❖ Few investors have the knowledge or understanding to manage their assets effectively

2 – 3 THE FINANCIAL PLANNING PROCESS

Basic financial planning involves eight simple steps or stages.

2 - 3.1 Step One - Goal Setting

Knowing what it is that you are trying to accomplish makes planning and decision making easier. It is extremely helpful if elder couples: have identified their later life goals; determined which goals are most important; and come to a consensus. Without a clear understanding of goals - of the destination - it is impossible to develop an appropriate plan. Too often families operate on "automatic pilot" without any clear sense of what their goals are.

Most people - in the later stages of life - have four principal financial goals. They are:

1. <u>Self Sufficiency</u>

Most people do not want to outlive their income and assets. Being able to pay their own way and stretch their finances until their death can be an important way to create a sense of independence and self-sufficiency.

2. <u>Spousal Financial Security</u>

Many families have a goal of protecting the financial security of the healthier spouse. This means providing enough money to pay for a place to live, daily living expenses, and any long-term care required when only one spouse remains alive.

3. **<u>Control</u>**

Many people want to maintain their independence and ability to make decisions regarding their financial resources until they die. Some parents choose not to transfer assets to adult children since they feel that doing so would involve a loss of control. Even after assets have been transferred, family members often have unwritten agreements and assumptions regarding who really controls them.

4. **<u>Leaving an Inheritance</u>**

Leaving an inheritance is a goal for many elders. However, many people are not willing to meet this goal if they must give up privacy, control, or self-sufficiency.

Often people choose to leave a legacy - but only if their health co-operates and makes it possible.

Adult children often express varying expectations regarding an inheritance. Knowing the realities of their parents' financial situation often leads them to not expect any type of inheritance or to accept gifts only reluctantly. This is especially true when the children perceive their parents are living on very little money. At times, adult children accept gifts with informally agreed upon "conditions." Often adult children will set aside any money received to be used - if necessary - for a parent's care in the future.

Other children, however, may feel they are being cheated out of an inheritance when all their parents' financial assets are consumed by care and the cost of care facilities.

Gifting, at the expense of financial security for the older generation, can be a source of disagreement, not only among parents and adult children, but also between spouses.

Keep in mind that different perceptions of goals are normal and to be expected among family members and across the generations. It is important for each family member to identify his or her own financial goals and then determine where these goals align with the goals of others involved in making financial decisions.

Whatever goals are agreed to - they must be realistic and specific. Effective strategies must do three things:

1. They must move the elder toward the goal and provide motivation
2. They must define the goal as well as establish a period to reach it
3. They must be rooted in the elder's current financial position. If an elder feels that the goal relates to their situation, they will act on it

2 - 3.2 Step Two - The Net worth Statement

This step requires some basic research into the elder's financial past and present status.

The object is to determine the elder's current status and then compare it to their future goals.

Among the information that needs to be covered:

Liquid Assets

- Cash, Chequing Account, Guaranteed Income Certificates
- Common Stocks , Corporate & Government Bonds
- Mutual Funds and other assets

Retirement Plan Assets

- Pension Plans, RRSPs
- TFSAs
- Other

Fixed Assets

- Primary Residence, Other Real estate
- Business Ownership
- Other

Liabilities

- Bank Loans
- Credit Cards and Credit Lines
- Auto Loans
- Mortgages
- Business debt * Other

The result of the above exercise will be the production of a net worth statement. Remember: Total Assets – Total Liabilities = Net Worth.

Table 2 - 1 Net Worth Statement - Assets and Liabilities

Liquid and Income Producing Assets	The Elder	The Elder's Spouse
Cash, bank accounts, term deposits, TFSAs		
Guaranteed investment certificates		
Quebec Stock Savings Plan		
Stocks, Bonds, and Mutual Funds		
Life Insurance (Cash Value)		
RRSP		
Pension Benefit		
Other Assets		
Sub Total		

Non-Income Producing Assets		
Principal Residence		
Secondary Residence		
Personal effects (car, furniture, boat jewellery, etc.)		
Other Personal Assets		
TOTAL ASSETS		
Liabilities		
Mortgage (Residence)		
Mortgage (Other)		
Other Debts		
TOTAL LIABILITIES		
Total Assets		
Minus Liabilities		
NET WORTH		

2 - 3.3 Step Three - Debt Management

At this point it is necessary to discuss such difficult matters as:

- Reducing mortgage debt (frighteningly an increasing number of elders are entering their retirement years with mortgage debt)
- The proper use of credit cards and bank loans
- Eliminating non-deductible debt
- The goal should be to eliminate all non-deductible debt prior to considering any tax advantaged investment opportunities.

2 - 3.4 Step Four - Leveraging the Income Tax Act

The income tax act offers various opportunities for tax deferral. Sheltering money from tax helps to enhance growth. Among the vehicles available:

- Registered Retirement Savings Plans (RRSP)
- Spousal Registered Retirement Savings Plans
- Registered Education Savings Plans for children and grandchildren (RESP)
- Tax Free Savings Accounts (TFSA)
- Other "income splitting" strategies can also be employed - among them loans to adult children, salary to spouse or children

2 - 3.5 Step Five - Retirement Planning

This step focuses on the importance saving for the "after work" years.

This is where the use of Registered Retirement Savings Plans (RRSP), Registered Pension Plans (RPPs), and Tax Free Savings Accounts (TFSA) are taken into consideration.

2 - 3.6 Step Six - Document the Plan

To provide the elder with timely advice and protect the planner from future litigation, documentation should include the following:

- Planning Procedure
- Planning Assumption
- Caveats and limitations of advice and recommendations
- Recommendations and strategies of how to achieve them
- Client's decisions
- Commitment to future planning
- Input provided by outside professionals

2 - 3.7 Step Seven - Implement the Plan

The plan is an exercise in futility if it is not carried out. It is the planner's job to motivate the elder to put the plan into action.

2 - 3.8 Step Eight - Monitor the Plan for Reassessment

The plan needs monitoring, so timely adjustments can be made to keep the plan on track. This is the reason why the plan should be reviewed on a regular basis.

2 – 4 RETIREMENT CRISIS

A silver tsunami is about to wash ashore, and governments and corporations have been the first to take cover. CPP and OAS have both been revamped to reduce entitlements and costs. Funding for healthcare and long term care is being slashed. Pricey defined benefit pension plans are giving way to less costly defined contribution plans.

Taking care of an aging population is expensive ... and it appears that no one wants to get "Stuck with the bill."

Unfortunately against this troubling backdrop the average Canadian is saving less money, not more!

Only 26 per cent of Canadians think they are saving enough to meet their future retirement needs according to a new survey from Angus Reid. Despite widespread knowledge about the need to save early and often for retirement, Canadians are not taking the necessary action to secure their future.

Specifically, those surveyed with a household income of less than $50,000 save on average 7 per cent of their income towards retirement, while household incomes of $50,000-$99,000 save 9 per cent. Of greatest concern, this survey indicated that 15 per cent of Canadians are not making any retirement savings.

2 – 4.1 Retirement Savings

Canadians have left more than $600 billion in unused RRSP contribution room on the table and the average Canadian's RRSP totals just $60,000 at retirement – only enough to provide income for a few years.

Considering these factors, the move away from defined benefit pension plans in the workplace over the past few years is a troubling trend. And while there are many proponents of defined contribution plans in Canada today, that shift is not about cost savings. Rather it is about the transfer of investment risk onto individuals who might not be able to adequately bear that risk.

Having enough money for retirement is one of the primary financial concerns for most working Canadians. Those between the ages of 45 and 65 are in a very high state of anxiety about adequate retirement income.

Three quarters of middle-income Canadians will not save the 15% benchmark percentage of income one must save in order to replace 50% of their income. In fact, half of middle-income Canadians will save less than 5%.

This is a trend that is not correcting but accelerating. Most people surveyed in 2013, said they would be cutting back on their savings because of their strained household budgets. In the same survey of Canadians, half of people aged 55 to 64 indicated that they had have more debt than they do savings, not including their mortgage and this debt is being driven by the need to meet monthly expenses. These individuals are on the verge of retirement age and they have more debt than they do savings! It looks as if the scourge of elder poverty is on the verge of a comeback in Canada.

Only a third of current Canadian workers expect to retire by the age of 65 and not by choice. The problem is they just can see how they will be able to afford to retire. Retirement itself will be different as well. Most people believe they will likely have to work for pay in some measure while retired, in order to make ends meet. The idea of retirement as we have known it is disappearing.

Just as Canadians deal with record levels of debt and dwindling access to secure workplace pension plans, many are unable to put away extra money for retirement once their basic living expenses are paid for.

Not surprisingly, almost two-thirds of Canadians are worried they will not have enough money at retirement, and many have concerns that the type of pension plan they do have will not be enough to cover their basic living costs.

2 – 4.2 Retirement Income – A Major Concern

Having enough money at retirement is one of the top three concerns facing Canadians (after the state of the healthcare system and the environment). A clear majority (64%) are worried they will not have enough money at retirement. Retirement adequacy also trumps personal debt levels when it comes to things keeping Canadians up at night, a surprising trend given Canadians at the end of 2017 faced a record debt-to-income ratio of 169.7% according to Statistics Canada, with the average consumer debt load sitting at a whopping $22,837 at the end of 2017 according to Equifax Canada.

The number of people who say they are very worried about where the money will come from to support them when they retire is on the rise, up to 39% in 2012 from 31% in 2008. Worries about retirement security cut across all ages and income levels, with 70% of those earning between $75,000 and $99,000 anxious about their retirement savings. Retirement income concerns also affect 60% of those earning more than $100,000 a year and 58% of those earning $50,000 to $74,000 a year.

Concern over having adequate retirement income is associated with the type of workplace pension program a person has. Those without any workplace pension and those with a defined contribution (DC) plan are equally likely to be worried: two-thirds of Canadians (69%) without a pension plan and 68% of those with a DC plan say they are personally concerned about not having enough money for retirement. By contrast, only 53% of those with a defined benefit (DB) plan say they are worried.

The difference in levels of concern stems from differences between DB and DC plans: while DB plans provide a predetermined and guaranteed income in retirement, DC plan assets do not provide any guarantee and are tied closely to market volatility which has dogged investors in the wake of the 2008 financial crisis. Without a guaranteed benefit at retirement, Canadians are rightly worried that their pension savings will not be enough.

2 – 4.3 More Canadians are relying on Real Estate

As concerns mount over retirement income adequacy, more Canadians are relying on real estate rather than pension plans. Far more (65%) express confidence their home or property will provide them with adequate retirement income (versus a pension).

2 – 4.4 A Crisis of Confidence

Most Canadians surveyed are not confident they can save what they need to for retirement and their concerns are clearly well founded. Forty per cent expect to receive less in retirement than they anticipate needing. And a further 46% expect to receive less than half of their working income in retirement, a major shortfall given that the clear majority (81%) anticipate needing at least half of their pre-retirement income in retirement.

So how much do people think they need? More than half of Canadians say they will need between 51% and 75% of their working salary as retirement income. Another 20% believe they will need at least 75% of their working income. Only one quarter say they will need 50% or less of their working income in retirement.

2 – 4.5 CPP and OAS

Sustainability of the government's public pension system is another of the top concerns expressed by surveyed Canadians: 68% say they are concerned that federal and provincial retirement benefits will not provide a financial cushion in retirement. Despite this fact, however, most are still relying on government benefits to support them in retirement. When asked what sources of retirement income they have, the majority (78%) said the Canada Pension Plan. This was followed closely by RRSPs (74%) and other savings (45%). Only 39% say they have a DB pension plan and far fewer say they have a DC plan (17%). Inheritance (18%) and a reverse mortgage on a home (3%) are two other sources cited by respondents. Finally, 6% of Canadians do not know what they will have as a source of income in retirement!

Clearly, Canadians are still relying on a government pension, despite fears that benefits like CPP and OAS might not be there for them when they retire. 20% of Canadians surveyed are relying on the pillar of government pensions to ensure adequate income at retirement.

While it is clear not all Canadians are relying on CPP and OAS as their sole source of income at retirement, most (63%) are looking to government benefits to supplement their income to some extent, either moderately or slightly.

As Canadians express their worries over retirement income security, they are also facing monumental challenges on the home front, with high debt levels and a reduced capacity for saving. Against a backdrop of economic instability here in Canada and around the world and as Canada's population ages, these concerns are not likely to go away any time soon.

2 – 4.6 Higher Income Earners are in the Worst Shape

According to a study by McKinsey & Company, 41% of older high-income Canadians are not on track to maintain their standard of living in retirement. These folks make up the highest proportion of "non-readiness" of all Canadian age and income groups. Making matters worse is McKinsey's conservative definition of an adequate retirement income; they define it as being able to maintain 65% of pre-retirement consumption, a standard which many families will find to be an unwelcome squeeze on their lifestyle.

Although McKinsey identified "inadequate savings" as the principal reason for retirement funding shortfalls, there are a variety of underlying causes. Marital break-downs, business reversals, corporate downsizing, health issues and poor investment decisions, as well as profligate or just plain undisciplined spending, can all play a role. For some unlucky souls, it is a series of such set-backs that crush their retirement dreams.

Unlike younger Canadians who can forestall a retirement gap by increasing savings and compounding investment growth over decades, older Canadians need to take immediate and often dramatic action to deal with an impending retirement deficiency. For people in this latter group, the following is a difficult, but recommended action plan.

Get a grip

Developing a current household balance sheet and income statement as well as projected budget is job No. 1. You cannot solve a retirement shortfall until you quantify its scope and lay out a plan to bridge the gap.

Go cold turkey

Many people are reluctant to cut back even when it is clear as day that an intolerable pace of wealth depletion is occurring or just around the corner. There are endless rationales – "Let's just wait until the kids are out of university." "We just want one more summer at the cottage and then we'll sell it." "Let's just hold on until the economy picks up." Meanwhile, with every passing minute, the retirement hole gets dug deeper and deeper.

Focus on the large, low-hanging fruit

Pinching pennies will not balance the books – it is the big ticket items that matter. Selling a vacation property will reduce costs and can increase income-producing assets or eliminate costly debt. Ditto for downsizing a principal residence. Say goodbye to luxury car leases, multiple holiday trips annually and expensive club memberships.

<u>Dump high risk investments</u>

Several years ago, a couple consulted our McKinsey & Company regarding their retirement concerns. They were reluctant to part with a large holding with a fund manager who had been wildly successful but whom we knew had a high risk strategy. With some cajoling, they we convinced that they should redeem their holdings. Since then, this manager's fund has tumbled over 40%. You should not swing for the fences when you cannot afford to miss a pitch, so stick with a well-diversified and balanced portfolio.

<u>Take a rain cheque on retirement</u>

Every year that a person continues working and postpones retirement, two things happen. First, the shortened retirement time horizon reduces the funding requirement. Second, one's investment portfolio grows without the burden of withdrawals.

This dual effect means that even a few years of deferment can make a meaningful difference. One of the greatest worries retirees share is running out of money.

By taking positive steps to right-size spending, restructure assets and realign your portfolio, you can replace retirement anxiety with peace of mind.

2 – 5 A DEARTH OF PLANNING

With many storm clouds on the retirement horizon, you would think that Canadians would start making more effort to plan effectively for retirement. Earlier we saw just how simple and straightforward an effective retirement plan can be. But few Canadians have developed any sort of formal financial plan.

There are thousands of financial professionals of various stripes — financial planners, advisors, brokers and insurance agents — educating, marketing and offering retirement advice to millions of Canadians.

So why is it that despite this substantial focus on retirement products and services, the industry's efforts have fallen short? Why are there so many who do not have a formal plan for retirement, and do not work with professionals to help them prepare such a plan? And why is there such a fundamental disconnect between the financial services industry and the pre-retirees who so acutely need such advice and solutions?

Analysis of this problem has revealed five main barriers inhibiting many Canadians from taking a more disciplined approach to setting retirement goals and putting in place the required mechanisms to achieve a secure future.

These interconnected barriers are:

1. Conflicting priorities

While retirement is a leading concern for most Canadians, many cited difficulty balancing such long-term needs with other, often more immediate financial priorities.

2. A failure to communicate

Financial institutions often do not effectively reach those who may need retirement planning advice and solutions, particularly via the workplace. And even when they do, they do not necessarily integrate consumers' retirement needs as part of a broader financial plan taking into account other priorities.

3. A lack of product awareness

Many consumers are simply not familiar with several retirement product options at their disposal.

4. Mistrust of financial institutions and intermediaries

A significant number of individuals do not have a high degree of trust in financial services providers and their intermediaries to offer objective advice and deliver on what they promise to serve individuals' retirement needs.

5. The "do-it-myself" mentality

Many consumers either do not want or feel they do not need professional advice in retirement planning. For many, this might be a short-sighted decision, given the complexity of retirement finances and the potential value an advisor could offer.

The following material will provide insights into each of the above barriers and suggest how they might be overcome.

Potentially, many of these barriers can be overcome by adopting a more holistic approach, in which retirement needs are addressed early in a customer's lifecycle, but in conjunction with other financial priorities. Changing the mindset of both consumers and retirement services providers and encouraging a more integrated discipline to retirement planning is probably a very important step that can be taken to resolve the retirement dilemma.

2 – 5.1 Planning Makes a Big Difference

Less than 1/5 aging Canadians have a retirement income plan. Let us look at Ontarians for example. Investor Office's 2017 Investing as we Age report found that only 14% of Ontarians age 45+ had a formal, written retirement plan; over half had no plan at all. Most leave it too long and devote comparatively little time to the process.

This is particularly alarming given the fact that an alarming number of Canadians believe that OAS and CPP will not meet their retirement needs. And many Canadians will not have a defined benefit pension plan to fall back on. Yet far too few are taking steps to put into place supplementary or alternative sources of retirement income to secure their financial future.

Moreover, while those with higher incomes are generally more likely to have a plan to finance retirement, greater affluence alone provides no such guarantee. Even among households with incomes over $100,000, many have no formal retirement plan.

2 – 5.2 Why Does Planning Matter for Retirement Security?

Academic research on the topic of planning and goal attainment demonstrates that those who establish plans are more likely to engage in behaviours that help them achieve their goals. That behaviour and the plans themselves are generally developed with a financial advisor.

A Fidelity Survey (published 2011) found that investors with written plans seemed happiest with their advisers. 63% of pre-retirees and 69% of retirees with detailed retirement income plans said they were “very satisfied” with their advisers.

This is supported by a later LIMRA study on beneficiary opinions about the value of the advice and service they had been receiving from their primary advisor. In studying Wealth accumulation and factors accounting for success, the Journal of Econometrics found a high positive correlation between having a plan and building wealth

Accordingly, planning for retirement can have a significant impact on savings and wealth accumulation behaviours.

Planning also helps individuals feel more secure about their retirement. Research has demonstrated that people with a formal plan to generate retirement savings and income are four times more likely to feel very secure about their retirement compared to those without a formal plan. Of course, having a plan does not mean people are saving enough for retirement, but it is a start.

There is also a relationship between the use of professional advisors and retirement security. People with an advisor are more than twice as likely to have a formal retirement income plan than those without an advisor.

Among the other factors fueling retirement insecurity, the two main ones are the failure to save enough for retirement needs, followed closely by a perceived lack of disposable income to save toward retirement.

There is cynicism to overcome here as well, with many Canadians convinced that no matter how much they save, the return on those investments will not be enough to generate enough retirement income.

As well many Canadians do not understand what they need to do to prepare for retirement, do not know enough about retirement products/solutions, and do not trust financial intermediaries to provide objective advice.

Because those with a formal retirement plan feel more secure about their financial future than do those without one, it is reasonable to hypothesize that if more individuals put together such plans, retirement savings, and consequently retirement security, may in turn rise.

The challenge, then, is how to overcome the barriers that are preventing many Canadians from seriously addressing their retirement needs as part of a formal planning process.

2 – 5.3 The Conflicting Priority Barrier

While there are multiple concerns requiring consumers' attention, most Canadians consider retirement one of their most pressing priorities.

In fact, for most retirement savings is a top priority, dwarfing other considerations such as paying off a mortgage or closing out other debts. Not surprisingly, retirement savings becomes more important as people get closer to their anticipated retirement.

Yet the most common reason for not being able to save for retirement is that other financial priorities get in the way.

According to a 2020 report, the biggest barrier to putting aside money is cost of living and monthly expenses, including rent, mortgages and car loans. The major factor preventing Canadians from saving is that they are using disposable income to pay down debt. Many Canadians are finding themselves caught between the struggle to save money and repay their debts, says a survey from TD Bank. The 2020 report found that 38% of Canadians surveyed said they had no savings at all. Over half of the survey respondents said it was very hard or even impossible to save, lack of knowledge or discipline. And do not underestimate the power of social media and changing expectations of what daily life is supposed to look like and cost.

Some Canadians are also worried that healthcare and/or long-term care expenses could overwhelm their retirement savings and income goals.

As a result of multiple, often conflicting financial concerns, many Canadians deal with their financial priorities in a disjointed fashion. A 2017 CIBC poll found that nearly 2/3 of Canadians simply are not making savings a priority.

This myopic focus on the most immediate financial priorities prevents many from seeing the bigger picture and discourages them from considering and accounting for longer-term needs such as retirement.

In addition, many Canadians are pessimistic about their ability to address long-term retirement needs even if they tried. Many do not expect to earn enough of a return on their investments to provide enough retirement income.

This lack of confidence in their ability to make a difference with retirement planning could be one prime reason why so many people do not bother trying to put together a retirement plan in the first place, and therefore see no reason to seek out professional help to do so. After all, in the view of such individuals, what would be the point?

To begin to overcome the 'conflicting priority' barrier, financial services providers should consider offering holistic approaches and solutions. It likely does little good to pitch retirement products alone to someone who is more concerned for the moment with mortgage or other debt issues.

Conflicting priorities could be addressed as part of a comprehensive financial plan that at least gets an individual started on retirement preparation, even if the initial efforts are relatively modest.

By addressing the bigger picture and taking other priorities into account, consumers will likely gain more confidence that they can in fact start accounting for retirement needs at the same time, making adjustments as they advance in the life cycle.

For example, concerns about financing healthcare and long-term care costs could be addressed in conjunction with retirement savings and income planning. Indeed, they are likely to be key components in any comprehensive plan to adequately prepare for retirement.

Part of the challenge in overcoming this barrier may be the product-centric organizational structure that is quite common in many financial services companies.

A financial institution may not be able to directly address all a consumer's financial needs under one umbrella. But broadening the discussion beyond retirement savings and income considerations and helping consumers to think through their often conflicting concerns could transform a financial institution from a product provider into a financial facilitator and enabler, which may help them capture a greater share of the retirement piggy bank in the long run.

Establishing marketing partnerships with other providers, such as health or long-term care insurers, is one way to possibly expand the dialogue and deal more holistically with clients on retirement

2 – 5.4 The Communications Barrier

Many consumers, even those who might be considered more lucrative from an asset-gathering perspective, are not being actively engaged by financial services providers. Most Canadians have not had interactions in the past two years with any financial institution about their retirement savings and income needs, whether via in-person meetings, phone conversations, e-mail communications or seminars.

This lack of communication even applies to Canadians between ages 56 and 64 — those presumably with the greatest need for assistance given their proximity to retirement.

Not surprisingly, financial institutions appear to be concentrating most of their marketing efforts at the affluent segment. The higher a person's household income, the more likely they will be contacted by a financial institution about their retirement needs. This leaves a large segments of the population underserved when it comes to retirement services.

One way to overcome the communications barrier in an economically feasible way might be to bolster workplace marketing efforts. The workplace already has set the stage for holistic financial planning, given the easy access to retirement accounts, life and health insurance, and other financial services delivered via employee benefit plans and funded by payroll deductions.

Many of the diagnostic tools offered through workplace marketing today require the consumer to take the initiative, typically through web-based retirement calculators that offer very broad investment option suggestions.

Enhanced financial planning seminars for employees and their spouses — addressing multiple priorities including retirement — might be one solution to spur greater dialogue with financial institutions.

To generate greater interest in such advisory services, institutions and financial planners might have to entice plan participants with a broader curriculum that addresses retirement planning in a holistic context. Such presentations could be comprehensive and thought-provoking, designed to help individuals deal with a variety of financial priorities while prompting them to start a formal planning process so they may take charge of their own retirement security.

For the long term, financial institutions and employer groups might strengthen this channel for service providers and consumers alike by seeking additional legislative and regulatory reforms giving plan providers more flexibility to address employee retirement needs, while also offering employers more protection from potential liability.

2 - 5.5 The Product Awareness Barrier

Making the challenge for financial institutions worse still, many consumers do not know enough about the most common products marketed to help address retirement savings and income needs. Lack of awareness is consistently high across age and income segments.

This lack of product knowledge extends to annuities and permanent insurance products as well. Close to half of Canadians do not know anything about annuities or understand how they work.

For longstanding product lines such as annuities, more aggressive campaigns to educate consumers about how the products work and what benefits they offer might engage more Canadians over time. But consumers also might respond in greater numbers to more simplified, repackaged or even rebranded versions of these standard product lines.

In the spirit of holistic retirement planning, a dynamic portfolio approach to product allocation that accounts for changes in life goals, risk aversion and life stage both in the asset accumulation and decumulation phases could be the next frontier.

Canadians care a lot about “easy access to money,” principal protection and guaranteed income. While there are individual product sets that address these needs separately, the industry does not yet appear to be at a place where such product attributes can be bundled and sold.

As noted earlier, no one provider may be able to accommodate all the various features sought by consumers because of their business focus and concentration on related capabilities.

This is where the value could be emphasized of having a professional advisor to offer comprehensive advice and coordinate products and services from multiple providers under a single, holistic financial plan.

If consumers are not aware of all the options at their disposal in planning for retirement, or do not comprehend how some of these products function, the chances of consumers making sound choices for their retirement planning are likely to be reduced. The same can be said of those who choose to “do-it-myself” without understanding what solutions are available in the market.

2 – 5.6 The Trust Barrier

Lack of trust is another major reason why a large segment of consumers may be reluctant to allow financial services providers to help them with their retirement planning.

Lack of trust for some may stem from a fear of losing control over their retirement portfolio, perhaps out of concern that financial services institutions and their intermediaries might be motivated to guide them towards investments benefitting the provider rather than the client. Such motivations might be commissions earned on investment transactions, placement with a favoured provider or the marketing of an affiliated product.

About one in five survey respondents do not trust intermediaries (such as financial planners and insurance agents) to provide objective advice to address their retirement savings and income needs.

The trust barrier likely influences product choice as well. Many Canadians are skeptical of institutions promising guaranteed income in terms of being able to deliver on their commitment when they retire.

Complicating efforts to overcome the trust barrier is the widespread skepticism towards advertising about retirement products and services.

There may be no real easy or quick way to build something as complex and multi-faceted as trust. But there are several approaches that could be emphasized.

One possible way to engender greater trust is to use personal sources — including family and friends — as channels of communication regarding retirement matters. A significant number of respondents with a plan, but without advisors, said recommendations from a family member or friend might convince them to seek outside help with retirement planning. New social media strategies might be considered to leverage the power of personal recommendations.

Also, talking about retirement in the context of other financial and lifestyle concerns could result in greater trust and willingness to embrace the retirement planning discipline.

Reaching out to prospects at a younger age and establishing a longstanding financial planning relationship might also build greater trust and confidence in a provider's advice, products and services over time. This will allow retirement issues to be raised and addressed sequentially and gradually, rather than taking a more transactional approach that may be viewed as pushing one line of retirement-related products prematurely with the risk of alienating the client.

The preferred medium to overcome such barriers is face-to-face communication. This is where personal relationships can be most easily established, and a wide array of priorities addressed to gain the confidence of consumers. The challenge is to get in the door for such one-on-one sessions.

But the biggest problem might be the costs involved in facilitating these high-touch interactions. Thus, this approach may be viable only for those evidencing strong prospects, and not every segment of the population, who might be more economically reached and serviced via online interactions.

2 - 5.7 The" Do-It-Myself" Barrier

As noted earlier, people with a formal retirement plan are much more likely to feel secure about their long-term financial future. And those who seek professional advice on retirement are much more likely to have a retirement plan.

But most Canadians – for various reasons - do not consult with a professional financial advisor for their retirement needs. Relatively few say that is because they have had a bad experience with an advisor. And even fewer think price is an issue.

So, what is holding most people back from seeking professional advice?

Beyond the trust issues addressed earlier, there are several reasons why many choose not to consult with an advisor. But the main reasons for many represent two sides of the same coin — their higher comfort level in handling retirement planning on their own, and the belief that they do not need professional advice.

This "do-it-myself" mentality — while perhaps valid for those who have the expertise and experience in managing investments on their own — may not be the most appropriate method for many to navigate the potentially bumpy road to retirement, particularly given consumers' apparent lack of knowledge when it comes to retirement products and services.

The challenge for financial institutions may be to effectively identify, target and educate more of these "do-it-yourselfers" about the benefits of professional advisory services.

Targeting non-consumers of professional advice presents some interesting challenges for financial services firms. Obviously, only a subset of this segment might be persuaded to engage with professional advisors. But converting these do-it-yourselfers to advice-seekers could be rewarding if executed in the right manner.

The key might be to determine that the client feels they will remain in full control of their retirement portfolio. Once again, by serving as facilitators and enablers, providers could emphasize that while consumers are ultimately in charge of their own investment decisions, there is value in having expert advice, so they are able to make more informed decisions, based on all the available options.

Also, to drive home the need for professional advice, new marketing and advertising campaigns could be deployed to point out the risks of "doing-it-myself" when it comes to something as critical and potentially complex as retirement planning.

2 - 5.8 Moving Forward

The retirement challenge facing many Canadians seems increasingly more daunting. Efforts to help consumers meet these challenges appear to have resulted in limited success, judging by the general lack of preparedness, knowledge about the options available, and trust in financial institutions and professionals offering retirement solutions.

This, despite the billions of dollars spent by the retirement industry on sales, marketing and advertising of retirement products and services, presents quite a paradox.

However, the onus might not solely be on the financial services industry — the government, employers and, most importantly, individuals themselves must play a more active role.

But there is more the industry could do. There is perhaps no one easy solution for overcoming the barriers outlined above. But one of the first steps potentially is to convince more people to be more disciplined and take the initiative to put a retirement plan in place. Such changes in attitudes and behaviours are not easy to achieve and will likely take time. But the key is probably to initiate these changes sooner rather than later.

To encourage more consumers to initiate the planning process, the industry's approach likely needs to be more holistic in nature, taking into account a broader array of financial considerations that are relevant to most individuals. Retirement goals probably should not be addressed in a vacuum, oblivious to the more immediate, pressing financial demands on most people.

Part of this process could involve addressing a consumer's financial priorities sequentially — conducting a financial triage of sorts, tackling the most immediate priorities without ignoring longer-term concerns such as retirement. This is likely a new way of thinking not only for many consumers, but also for the industry.

2 – 6 PLANNING FACTORS

In planning for retirement one of the first things a person needs to do is determine how much retirement income they will need.

Once a commitment to planning is made, there are a variety of variables will have a dramatic impact on the financial plan developed and they need to be monitored with regularity. Some of these variables are discussed below.

2 - 6.1 Demographics

The study of demographics looks at changes in the composition of the population. These changes can have a huge impact on the economy, employment, government taxation and expenditures and social programs.

The biggest change currently affecting Canada is the rapid aging of our population - something that is poised to have a dramatic - possibly catastrophic - impact.

2 - 6.2 Interest Rates

Interest rates represent the single most important factor when making investment decisions. Prevailing rates affect the interest charged on loans, credit cards, and mortgages.

On the other side of the ledger, they also affect the returns generated by such investment vehicles as GICs, savings accounts, annuities, etc.

2 - 6.3 Inflation

Inflation is currently a minor irritant. Still the purchasing power of $1.00 will shrink to 67¢ in 20 years with 2% inflation and to 31¢ in 20 years with 6% inflation. Small numbers can product big reductions in purchasing power over time. Any financial planning approach needs to address the time value of money and the increasing cost of living over extended periods of time.

People are living longer and elders rely on what they set aside while they were working to provide an income when they are not. Inflation, if not properly accounted for, can impoverish an unsuspecting elder in short order.

2 - 6.4 Income Tax Laws

Changes in income tax laws have made many financial plans invalid or necessitated major changes in strategy. As with the other factors discussed above, they must be closely monitored.

2 - 6.5 Other Planning Factors

Among the other factors which must be taken into consideration are:

- ❖ At what age does the elder want to retire?
- ❖ What is the elder’s current net worth?
- ❖ What is the elder's current budget?
- ❖ What is the present income flow?
- ❖ Can the elder save money?
- ❖ What - if any - family obligations exist?

2 – 7 ELDER SPECIFIC CHALLENGES

The good news is that Canadians are living a lot longer. Unfortunately, this is also the bad news. Historically the biggest financial threat that Canadians faced was "dying too soon." Today, however, the greatest risk to Canadians might very well be "living too long."

In short, people are retiring earlier and living longer. In order to manage, retirees either must set aside more money, or ensure that the money that they do have is working more efficiently.

2 - 7.1 Cautious Investors

History and investment logic clearly dictate that most long-term investors should own equity investments (i.e., common stocks, mutual funds, etc.).

And yet, elder investors still maintain a high percentage of their money in fixed income assets like GICs, term deposits and government savings bonds.

There are several reasons for this phenomenon. Most savers, for example, do not understand that they are assuming risk. The major long-term risk they face is the loss of purchasing power (inflation), not long-term market loss. Older investors also tend to fear capital loss and have little understanding of the benefit of asset allocation and diversification and the more competitive long-term returns available from non-guaranteed investments.

The fact that many older investors have a strong relationship with a bank has also tended to keep them in safe guaranteed investments. Until quite recently, banks had little incentive or inclination to recommend securities or funds to their customers - since securities were unavailable from the bank. Recommending securities involved sending money to the bank's competitors.

This was also true in the insurance industry. Representatives met client needs primarily through the sale of life, annuity, disability, and other types of insurance products. Historically equity investments were not a part of the mix.

Times have, however, changed. Both banks and insurance companies are now major distributors of more aggressive financial products and services (either directly or through subsidiaries).

Low interest rates have also helped to spur interest in equity investments.

Mature investors are now more receptive to investing a portion of their assets in funds and stocks/equities.

Equity type investments are suitable for most long-term investors. The investor's sophistication and available capital determine the approach and type of investing. Sophisticated investors, with ample capital, may consider developing a diversified portfolio of individual stocks in addition to a portfolio of funds.

2 - 7.2 The Female Connection

Most elders - particularly at very advanced ages - are female. Unfortunately far too many of these women have relied too heavily on either their husband or children when it comes to financial matters.

They also tend to invest less and participate less in company sponsored pension programs. As a rule they are also in the dark when it comes to investment basics. Not surprisingly, they are generally less prepared for retirement - and must often live on significantly reduced pension and other benefits down the road.

To make matters worse, many women are afraid to admit they do not have a thorough understanding of personal finance. Their knowledge base often does not extend beyond the basics of money management (i.e. paying the bills, balancing the cheque book, etc.)

A longer life span means women should be investing more - not less - to meet their needs post-retirement.

2 – 8 INVESTMENT BASICS

We have looked at the importance of developing a financial plan and will now turn our attention to investing. What follows are some of the basic rules of investing that should be broadly understood by any one with assets - and by the people who provide them with advice.

As simple and straightforward as many of these "basics" are - they are very poorly understood in most circles.

2 - 8.1 Presenting Risk and Realistic Returns

A direct correlation exists between the investment risk assumed and the financial reward expected. Accepting some risk is important to elders seeking to maintain purchasing power. The thesis of Modern Portfolio Theory (MPT) supports this hypothesis by stating that a relationship that is measurable and predictable exists between risk and reward. Intuitive investors agree. This being the case, why do conservative savers expect unrealistic returns when they become investors? It is a matter of education.

Savers seeking rates that are more competitive always express a willingness to accept a higher return. What they do not appreciate is that a higher rate of return may well entail a willingness to accept a greater amount of risk and greater volatility in the rate of return experienced along the way.

The most common risk issue and issue of most concern to potential investors is the fear of "losing all their money in the market." This is particularly true for the shrinking group of elders who experienced the 1930s depression and for investors who experienced the market meltdowns of 1987, 2000,2008, 2018 and the roller coaster ride brought on by the COVID-19 pandemic in 2020. Elders who had already retired, or those who planned on retiring during these periods, faced ongoing challenges in replacing lost earnings and assets.

However, market risk is in fact, not the greatest risk faced by investors. They need to understand the following:

- The real long-term risk that investors face is inflation (i.e., loss purchasing power)
- While short-term market swings can be dramatic, risk dissipates over the long-term
- Diversification also reduces risk. By investing a portion of assets in several types of investments, risk is reduced and return increases (the efficient frontier)
- Finally, investors should have realistic expectations about what are competitive returns, when it comes to guaranteed returns

Over the long term, stocks have always out-performed other types of investments that are not exposed to market risk. While, not guaranteed, it is reasonable to expect quality stocks to return 6-8% over the long-term.

Nevertheless, remember returns on stocks vary from year to year. Some years will be better, some worse. Overall, however, you should receive a competitive long-term return.

2 - 8.2 Real Rates-of-Return and Inflation

A couple purchased a home in Ontario for $200,000 twenty years ago. They have decided to sell their home and retire in British Columbia. The Real Estate Company has recommended that the couple list their home for $800,000.

How is it possible that the couple can realize a 300% profit (i.e., a $600,000 gain on a $200,000 investment) from the sale of their home?

Well first, the return they have received is not nearly as spectacular as you might think. In fact, their average annual return is only slightly above 7%. At an average 7.20% increase each year, the value of their home will double every ten years (the rule of 72 states that you can find out how long it takes to double your money by dividing the number 72 by the rate of return).

Initial Cost	$200,000
Cost Doubled after first 10 years	$400,000
Cost Doubled after next 10 years	$800,000

To make matters worse, this couple will soon find out that $800,000 does not go nearly as far (in terms of purchasing power) as it used to. If the overall rate of inflation during this twenty year period averaged 4%, the real annual rate of return on their home was a paltry 3.20% (7.20% growth, less 4.00% inflation, equals 3.20%).

Hence, a quadrupling in the value of their home produces a very pedestrian real rate of return of only 3.20%.When both inflation and taxation are worked into the mix, sometimes the results can be nothing short of devastating.

Consider the following example:

Table 2 - 2 Real Rates of Return and Inflation – Assuming Federal & Provincial Taxation at 40%

What is an elder’s real return on a $10,000 Term Deposit yielding 4.0%?		
Annual Interest	**$10,000 x 0.040**	**$400.00**
Taxes (40% Federal & provincial)	$400.00 x .40	$160.00
Net Return	$400.00 – $160.00	$240.00
Assumed 2.5% CPI inflation rate	$10,000 x 0.25	$250.00
Change in Purchasing Power	$240.00 - $250.00	($10.00)
Note that the elder's money has actually lost value (i.e., purchasing power)		

2 - 8.3 The Correlation between Time and Risk

Market Risk will generally decrease as an investor's time horizon for investing expands

Investors are most comfortable when investment performance is predictable. Equity investment performance tends to be quite unpredictable over the short term, but relatively predictable over longer periods of time.

In short, the longer an investor has an equity investment, the more predictable its performance becomes. This is important because consistent long-term performance enhances both wealth accumulation and strategic financial planning opportunities.

2 - 8.4 The Importance of Time

Time is a key ingredient in the success formula for meeting long-term financial objectives. An expanding time horizon reduces an investor's capital requirements and need for higher rates of return, makes funding more manageable, and increases the probability of meeting a financial objective or objectives.

Elder investors generally have one or several investment goals in mind, other than simple wealth accumulation. The most common objectives are the funding of retirement, and long-term care expenses.

Elders are often a lot more hazy when it comes to the question "how much will this cost?" Followed by "and how long will it take?" And finally by "you've got to be kidding?"

Working with investors to meet their long-term investment objectives is simplified when the advisor understands the time value of money. The principle is straightforward. If an investor receives a dollar today, it is more valuable than a dollar received in the future. Conversely, a dollar received in the future is worth less than a dollar received today.

What are the reasons for this? A dollar received today can immediately be invested and earn a return. A dollar received in the future not only does not earn an immediate return; it is also worth less in purchasing power when received because of inflation. Understanding the time value of money has very practical applications.

2 - 8.5 The Cost of Procrastination

The following illustration outlines the annual investment required to be a millionaire at 65.

Table 2 - 3 Annual Contribution Required to Become A Millionaire at Age 65 - Assuming A 10% Tax Deferred Rate-Of-Return

Age	Years to Retirement	Annual Contribution
25	40	$2,259
30	35	$3,690

Age	Years to Retirement	Annual Contribution
35	30	$6,079
40	25	$10,168
45	20	$17,460
50	15	$31,474
55	10	$62,745

2 - 8.6 Simple versus Compound Interest

The concept of simple interest is another investment basic. It is important that investors understand how to calculate simple interest, as it is the basis for their certificate-of-term deposit (GIC or GIA) returns.

Consider the following example:

Table 2 - 4 How Much Will A Saver Receive On $10,000 At 5.00% For One Year? Do Not Assume Compounding

What you know	Factors
Formula: I=PRT	
I= Interest P= Principal amount invested R= Rate at which invested T= Time	 $10,000 5% Once a year
Solution	$10,000 x 0.05 x 1 year = $500.00
Therefore the elder would receive $500.00 return for one year from the $10,000	

Investors and savers seldom fully appreciate the importance of compounding returns on their long-term investments. The practice of investing and "letting your money grow" rather than spending the earnings may be the sole difference between accumulating wealth and living well versus struggling during retirement. The "magic of compounding" approach is straightforward. An investor purchases an investment and reinvests earnings when they are received.

Financial advisors should educate their clients on the fact that compounding is a critical ingredient in their goal of wealth accumulation. They should also include information on how small differences in investment returns are very important over long periods.

Table 2 - 5 Example of Compounding and The Difference Between Interest Earnings Using $100,000

Year End	Total Amount 8% Compounding	Total Amount 10% Compounding	*Total Amount 10% Simple Interest
1	$108,000	$110,000	$110,000
2	$116,640	$121,000	$120,000
3	$125,971	$133,100	$130,000
4	$136,049	$146,410	$140,000
5	$146,933	$161,051	$150,000
6	$158,687	$177,156	$160,000
7	$171,382	$194,872	$170,000
8	$185,093	$214,359	$180,000
9	$199,900	$235,795	$190,000
10	$215,892	$259,374	$200,000
*Accumulation when the assets do not compound.			

The above illustrates that a 2.00% difference over a ten-year period can be significant. In this case the difference is $43,482. Longer periods produce results that are even more dramatic.

2 - 8.7 Dollar Cost Averaging

Just as time and diversification can reduce market risk, so too can strategies like dollar-cost-averaging. Here an individual invests a fixed sum periodically, regardless of market conditions or price fluctuations. The result is that the average unit cost is reduced.

During periods of lower prices, more shares are purchased. During periods of higher prices, fewer shares are purchased. This takes the guesswork out of market timing and supports a consistent process of investing.

A program stressing dollar-cost-averaging is a good long-term investment strategy. It does not guarantee profits; it does, however, reduce risk.

Table 2 - 6 Dollar-Cost-Averaging

Assume a $1,000 a month investment for six months. The total investment is $6,000			
Month	**Investment**	**Price**	**Units Purchased**
1	$1,000	$20.00	50.0
2	$1,000	$18.00	55.5*

Month	Investment	Price	Units Purchased
3	$1,000	$16.00	62.5*
4	$1,000	$14.00	71.5*
5	$1,000	$16.00	62.5*
6	$1,000	$18.00	55.5*
Total	$6,000		357.5

In the above example, after six months, $6,000 has been invested and 357.5 units (each worth $18.00 at the end of the period) have been purchased. The value of these units is $6,435. Even though the investment dropped in value over the six month period, the investor still made a profit of $435 - thanks to the power of dollar cost averaging.

2 - 8.8 Measuring Investment Results

An elder client states that he is doing well with his blue chip growth mutual fund. He states that last year he received a total return of 8%. How is he doing? On the surface, a 8% return is certainly impressive.

After research, however, you determine that similar growth funds had an average return of 12.5% and that the elder's fund ranked in the lower quartiles of performance. Now how do you feel about the investment? It had a good return, but most of the similar funds performance better.

Performance can only be evaluated if there is some context. Comparing results to other similar finds or to market indices is the only sure way of distinguishing good performance from bad.

2 - 8.9 Types of Return

Total Return: This is the annual return that includes gains, losses, dividends, and interest.

<u>Example:</u>

In one year, a stock's price increases from $20.00 to $22.00. It also pays a 50¢ per share annual dividend.

Total Return = ($2.00 + 50¢)/$20.00 = 12.50%

Positive Net Return: This is a return that is positive - even when taxation and inflation are considered. Here is an example of positive net return.

Table 2 – 7 Positive Net Return – Example

An investor holds 100 shares of a $20.00 stock that grows by 12.50%. Assume a tax rate of 50% and inflation rate of 2.5%.	
Annual Total Return	**Calculations**
12.50% growth on 100 $20.00 shares	$250.00
Taxes of 50%	-$125.00
Net Return	$125.00
Less 2.5% x 2,000 Inflation	-$50.00
Positive Net Return	$75.00

Negative Net Return: This is a return that is negative when both taxation and inflation are factored into the equation.

The return after taxes is an important factor to consider and one that is frequently not considered. A 2017 survey of Canadian investors found that almost half of investors reported that the financial advisor had not discussed the tax impact on returns.

2 - 8.10 The Importance of Diversification and Asset Allocation

The secret to successful investing is to start early, invest regularly, buy quality, maintain a modest lifestyle, have an emergency fund, have patience, and use common sense.

Clients understand personal asset allocation. They use it in their everyday lives by disbursing assets in order of their priorities. Asset allocation, as it relates to securities and investments, is the disbursement of assets among three primary areas: stocks, bonds and cash. This assures that a portion of an investor's assets will be "in the right place at the right time."

Diversification deals with the allocation of assets among various security classifications. The true test of asset allocation is meeting investor needs for returns that are more consistent and predictable. There is a relationship between risk and reward. For every unit of risk taken by an investor, a proportionate unit of reward should be received. Risk, the exposure to the chance of loss, is measurable, though not an exact science.

Many research sources are available for measuring performance, asset allocation, and risk assumption investment decisions. Their use is highly recommended. Risk and reward should be considered and measured together. The appropriate level of risk-reward is an individual decision, but it is made easier by proper research and evaluation.

Asset Allocation

In preparing for retirement, the assets you choose to invest in will vary depending on several factors, primarily your risk tolerance and investment time horizon. The two factors work hand in hand. The more years you have left until retirement, the higher your risk tolerance.
If you have a longer-term time horizon, say 30 years or more until retirement, investing all your savings into common stocks is probably a reasonable idea.

If you are nearing your retirement age and only have a few years left, however, you probably do not want all your funds invested in the stock market. A downturn in the market a year before you are all set to cash out could put a serious damper on your retirement hopes. As you get closer to retirement, your risk tolerance usually decreases; therefore, it makes sense to perform frequent reassessments of your portfolio and make any necessary changes to your asset allocation.

Generally speaking, if you have a limited time horizon, you should stick with large-cap, blue chip stocks, dividend-paying stocks, high-quality bonds, or even virtually risk-free short-term GICs.

That said, even if you have a long-term time horizon, owning a portfolio of risky growth stocks is not an ideal scenario if you are not able to handle the ups and downs of the stock market. Some people have no problem picking up the morning paper to find out their stock has tanked 10 or 20% since last night, but many others do. The key is to find out what level of risk and volatility you are willing to handle and allocate your assets accordingly.

Of course, personal preferences are second to the financial realities of your investment plan. If you are getting into the retirement game late or are saving a large portion of your monthly income just to build a modest retirement fund, you probably do not want to be betting your savings on high-risk stocks. On the other hand, if you have a substantial company pension plan waiting in the wings, maybe you can afford to take on a bit more investment risk than you otherwise would, since substantial investment losses will not derail your retirement.

As you progress toward retirement and eventually reach it, your asset allocation needs will change. The closer you get to retirement, the less tolerance you will have for risk and the more concerned you will become about keeping your principal safe. Once you ultimately reach retirement, you will need to shift your asset allocation away from growth securities and toward income-generating securities, such as dividend-paying stocks, high-quality bonds and T-bills.

Diversification

There are countless investment books that have been written on the virtues of diversification, how to best achieve it and even ways in which it can hinder your returns.

Diversification can be summed in one phrase: Don't put all of your eggs in one basket. It is really that simple. Regardless of what type of investments you choose to buy - whether they are stocks, bonds, or real estate - do not bet your retirement on one single asset.

As you contribute savings to your retirement fund month after month, year after year, the last thing you want is for all your savings to be wiped out by the next BreX.

And if there is anything we have learned from the BreXs and Enrons of the world, it is that even the best financial analysts cannot predict each financial problem.

Given this reality, you absolutely must diversify your investments. Doing so is not really that difficult, and the financial markets have developed many ways to achieve diversification, even if you have only a small amount of money to invest.

Active vs Passive Management

Consider buying mutual funds or exchange-traded funds (ETFs), if you are starting out with a small amount of capital, or if you are not comfortable with picking your own investments. Both types of investments work on the same principle - many investors' funds are pooled together and the fund managers invest all the money in a diversified basket of investments.

This can be useful if you have only a small amount of money to start investing with. It is not possible to take $1,000, for example, and buy a diversified basket of 20 stocks, since the commission fees for the 20 buy and 20 sell orders would ruin your returns. But with a mutual fund or ETF, you can simply contribute a small amount of money and own a tiny piece of each of the stocks owned by the fund. In this way, you can achieve a good level of diversification with very little cost.

There are many different types of mutual funds and ETFs, but there are two basic avenues you can choose: active management and passive management. Active management refers to fund managers actively picking stocks and making buy and sell decisions in attempt to reap the highest returns possible.

Passive management, on the other hand, simply invests in an index that measures the overall stock market, such as the TSE. In this arrangement, stocks are only bought when they are added to the index and sold when they are removed from the index. In this way, passively managed index funds mirror the index they are based on, and since indexes such as the TSE essentially are the overall stock market, you can invest in the overall stock market over the long term by simply buying and holding shares in an index fund.

If you do have a sizable amount of money with which to begin your retirement fund and are comfortable picking your own investments, you could realistically build your own diversified portfolio. For example, if you wanted to invest your retirement fund in stocks, you could buy about 20 stocks, a few from each economic sector. Provided none of the companies in your portfolio are related, you should have a good level of diversification.

The bottom line is that no matter how you choose to diversify your retirement holdings, make sure that they are properly diversified. There is no exact consensus on what number of stocks in a portfolio is required for adequate diversification, but the number is most likely greater than 10, and going to 20 or even a bit higher is not going to hurt you.

2 – 8.11 Asset Allocation Strategies

As noted above, asset allocation is the practice of dividing resources among different categories such as stocks, bonds, mutual funds, real estate and cash.

The theory is that the investor can lessen risk because each asset class has a different correlation to the others; when stocks rise, for example, bonds often fall. At a time when the stock market begins to fall, real estate may begin generating above average returns.

The amount of an investor's total portfolio placed into each class is determined by an asset allocation model.

These models are designed to reflect the personal goals and risk tolerance of the investor. Furthermore, individual asset classes can be sub-divided into sectors (for example, if the asset allocation model calls for 40% of the total portfolio to be invested in stocks, the portfolio manager may recommend different allocations within the field of stocks, such as recommending a certain percentage in large-cap, mid-cap, banking, manufacturing, etc.)

2 – 8.12 Asset Allocation Model Determined by Need

Although decades of history have conclusively proved it is more profitable to be an owner of stocks, rather than a lender to corporations (i.e., bonds), there are times when equities are unattractive compared to other asset classes (think 2008 when stock prices had risen so high the earnings yields were almost non-existent) or they do not fit with the goals or needs of the portfolio owner. A widow, for example, with one million dollars to invest and no other source of income is going to want to place a significant portion of her wealth in fixed income obligations that will generate a steady source of retirement income for the remainder of her life. Her need is not necessarily to increase her net worth but preserve what she has while living on the proceeds.

2 – 8.13 Asset Allocation Models

Most asset allocation models fall somewhere between four objectives: preservation of capital, income, balanced, or growth. Obviously, retirees are most interested in the first two models and to a lesser extent, the third.

Preservation of capital model

Asset allocation models designed for preservation of capital are largely for those who expect to use their cash within the next twelve months and do not wish to risk losing even a small percentage of principal value. Cash and cash equivalents often compose upwards of eighty-percent of these portfolios. The biggest danger is that the return earned may not keep pace with inflation, eroding purchasing power in real terms.

Income model

Portfolios that are designed to generate income for their owners often consist of investment-grade, fixed income obligations of large, profitable corporations, real estate, and to a lesser extent, shares of blue chip companies with long histories of continuous dividend payments. The typical income-oriented investor is one that is nearing retirement. Another example would be a young widow with small children receiving a lump-sum settlement from her husband's life insurance policy and cannot risk losing the principal; although growth would be nice, the need for cash in hand for living expenses is of primary importance.

Balanced model

Halfway between the income and growth asset allocation models is a compromise known as the balanced portfolio. For most people, the balanced portfolio is the best option not for financial reasons, but for emotional. Portfolios based on this model attempt to strike a compromise between long-term growth and current income.

The ideal result is a mix of assets that generates cash as well as appreciates over time with smaller fluctuations in quoted principal value than the all-growth portfolio. Balanced portfolios tend to divide assets between medium-term investment-grade fixed income obligations and shares of common stocks in leading corporations, many of which may pay cash dividends. Real estate holdings via REITs are often a component as well. For the most part, a balanced portfolio is always vested (meaning very little is held in cash or cash equivalents unless the portfolio manager is absolutely convinced there are no attractive opportunities demonstrating an acceptable level of risk.)

Growth model

The growth asset allocation model is designed for those that are just beginning their careers and are interested in building long-term wealth. The assets are not required to generate current income because the owner is actively employed, living off his or her salary for required expenses. Unlike an income portfolio, the investor is likely to increase his or her position each year by depositing additional funds. In bull markets, growth portfolios tend to significantly outperform their counterparts; in bear markets, they are the hardest hit. For the most part, up to one hundred percent of a growth modeled portfolio can be invested in common stocks, a substantial portion of which may not pay dividends. Portfolio managers often like to include an international equity component.

2 – 8.14 Changing with the Times

An investor that is actively engaged in an asset allocation strategy will find that his or her needs change as they move through the various stages of life. For that reason, some professional money managers recommend switching over a portion of your assets to a different model several years prior to major life changes. An investor that is ten years away from retirement, for example, would find himself moving 10% of his holding into an income-oriented allocation model each year. By the time he retires, the entire portfolio will reflect his new objectives.

2 – 8.15 Asset Allocation Alone is not Enough

Many investors believe that by merely diversifying one's assets to the prescribed allocation model is going to alleviate the need to exercise discretion in choosing individual issues. This is a dangerous fallacy. Retired investors that are not capable of evaluating a business quantitatively or qualitatively must make it clear to their portfolio manager that they are interested only in defensively selected investments.

2 – 9 INVESTMENT VEHICLES - STOCKS

The conventional wisdom and statistical data indicating why long-term investors should include common stocks in their investment portfolios is as follows:

- Over the long term, equities have outperformed all other types of investments. Common stock returns will outperform inflation and produce a net positive rate-of-return over the long-term.
- Allocating assets to common stocks and fixed income securities, rather than designing an undiversified portfolio of 100% stocks or 100% bonds, reduces investment risk. Portfolio diversification that includes common stocks will produce a more consistent, and more competitive long-term total return. Making the macro decision to include equities in a portfolio is easy, fundamental, and uncomplicated. Determining equity (asset) allocation and the investment risk parameters is more complex. Selecting individual stocks is a sophisticated, demanding, precise, and a micro decision-making process.

However, individual stock selection does follow a predictable and structured procedure. The investment advisor process for recommending individual stocks (or stock mutual funds) to clients is a four-step decision-making procedure.

2 – 9.1 Stock Selection Using a Four-Step Decision-Making Procedure

- The suitability of stocks for the individual client
- The percentage of capital allocation to stocks.
- The vehicle: individual stocks or mutual funds
- The selection of specific stocks or mutual funds

From a financial advisor's perspective, when recommending stocks, the first consideration is always client suitability. This should be looked at from two levels. From a macro perspective: are stocks suitable? And from a micro approach: which specific stocks or stock mutual funds are appropriate for the client? Money managers define their specific investment philosophy and management style in their investment policy statements.

2 - 9.2 Investment Objectives

Money managers use two basic approaches for selecting common stocks. Qualitative analysis—evaluation of factors that cannot be precisely measured—and quantitative analysis (MPT), which deals with measurable factors.

- Common stock research focuses on the potential growth of dividends and capital appreciation (rising stock prices) and the evaluation of potential risk
- Common stock investors seek capital appreciation, income, or a combination of both. Investors with the primary objective of capital appreciation invest in stocks with good growth potential. Income from dividends is not a primary objective

- ❖ Conversely, investors with the primary objective of income invest in common stocks paying higher dividends. Their secondary is usually modest capital appreciation

Historically elder investors - in selecting suitable common stocks - have opted to buy large, widely held, blue chip dividend paying stocks.

2 – 9.3 Stock Characteristics

Growth of principal

Equity investments, such as common stocks, allow for growth of principal and increasing dividend income, usually because of increasing earnings per share.

Potentially higher returns

Although past performance is no guarantee of future performance, over longer periods, stocks can outperform other financial investments and provide returns well above the rate of inflation.

Risk

Risk is measured in terms of how much a stock price changes over a period. Some stock prices have a high degree of volatility, or risk, while others are more predictable and do not change much on a day-to-day basis.

Tax advantages

Under current tax laws, capital gains earned on long-term stocks are not taxed until the stocks are sold. In addition, only 50% of the gains are taxable.

Liquidity

Stocks can be bought or sold on any business day at their current market value, which may be more than, equal to, or less than initially invested.

2 – 9.4 Common Sense Stock Investing

There is no magic formula for elders to quickly become wealthy in the stock market. Successful investors understand that the biggest "secret" to financial success is to purchase quality stocks, maintain a long-term strategy in terms of buying, holding and selling, and diversifying, then monitoring their progress, and evaluate the results.

For most investors, purchasing mutual funds or hiring asset managers is appropriate.

For investors purchasing individual stocks certain basics should apply:

- ❖ Purchase quality stocks. Successful investors understand that quality stocks perform well and offer competitive total returns over the long term
- ❖ Take a long-term perspective. Few individual investors ever make money "trading" the market

- Diversify your portfolio. Purchase several quality stocks to reduce risk and gain more consistent overall performance
- Study market trends. An educated investor is more likely to be successful
- Never buy "hot tips." Most never work out. This is especially true of low priced "penny stocks" touted by high-pressure sales representatives
- Have realistic expectations. Most professional money managers are comfortable with an 6-8% long-term return on stocks when using forecasting in their financial planning assumptions
- Monitor your stocks. Economic and market conditions may adversely change for individual stocks, even when the general market is performing well
- Establish purchase guidelines. Investors should research investments to make sure they meet their investment objectives
- Know when to sell. Over the long term many stocks lose their potential to remain stellar performers. Taking profits is a prudent approach
- Hire a professional advisor. Most investors lack the knowledge, energy, commitment, and emotional stability to manage a stock portfolio

2 – 10 INVESTMENT VEHICLES - BONDS

The two main types of long-term securities are stocks and bonds. Common stock represents ownership in a corporation. Bonds issued by corporations (i.e., corporate bonds) represent the debt of the issuer.

Bonds can also be issued by various levels of government (i.e., government bonds).

In plain terms, a bond is the IOU of the issuer.

The issuer borrows a specific amount of money, promises to pay interest at a predetermined rate, and promises to repay the amount borrowed when the loan matures. Bonds represent debt. Stocks represent ownership.

Investors buy bonds because they offer a specified income (interest payments) over the life of the bond plus the repayment of principal upon the maturity of the bond. It is not difficult to become knowledgeable about bonds and other fixed income securities.

However, it is important to have the knowledge necessary to determine the suitability of various bonds and bond funds.

2 - 10.1 Why Investors Buy Bonds

Most investors buy bonds for two reasons: first, they receive a specified and predictable income stream for the life of the bond; second, their money is returned when the bond matures.

A third reason, that is generally less important to individual investors, is the opportunity for capital appreciation.

Most individual bond investors are mature and conservative. They are comfortable with investments that offer predictable returns and the return of principal. In other words, most bond buyers are like Guaranteed Investment Certificate (GIC) savers.

Investors should, however, understand that bond prices will fluctuate with interest rates. Investors should also understand that bond prices are not guaranteed and that it is quite possible to lose money in the bond markets.

Bond prices are inversely related to interest rates. When interest rates increase, bond values decrease; when interest rates decrease, bond values increase.

- Interest rates decline – bond prices rise
- Interest rates rise – bond prices decline

The reason for this is quite straightforward. If a bond is guaranteed to pay out 6% interest annually and prevailing interest rates go up to 10% - a lot less people will be interest in that bond … and they would only be willing to buy it at a discount. If prevailing interest rates dropped to 2%, however, investors would be willing to pay a premium to acquire a bond that guaranteed a 6% pay out annually. Individual bonds are purchased either as a new issue or in the secondary market. The secondary market is where bonds that are already issued are traded between investors through brokers.

The price of a new issue bond will be at face value, usually $1,000. The variable will be the coupon rate. The rate will depend on the current interest rate market.

2 – 11 INVESTMENT VEHICLES: INTEREST BEARING

The safest of the many investment options available (at least in terms of market risk) are such interest bearing vehicles as: GICs, Term Deposits, money market funds, high interest savings accounts and provincial and federal savings bonds.

Although described as "bonds" the products issued by governments (e.g., Canada Savings Bonds, Ontario Savings Bonds) are not really bonds at all.

2 - 12 INVESTMENT VEHICLES - MUTUAL FUNDS

Mutual funds have become the investment and retirement income choice for most investors because they offer professional management, diversification, competitive performance, and easy access for investing either modest or large sums of money. There are many and varied reasons for the tremendous growth of mutual funds over the last twenty years. Investors realize that funding their retirement is increasingly an individual's responsibility.

Savers realize that inflation is a more significant risk than long-term stock and bond market risk. GIC rates are less competitive. Whatever the reason, mutual funds are, and will probably remain, the investment of choice for most investors.

Since mutual funds are the choice of most investors seeking competitive returns and consistent long-term performance, it is important to understand how mutual funds work and why they are compatible with most investors' financial planning objectives.

2 - 12.1 Mutual Fund Definition

A Mutual fund is an investment vehicle that pools money received from shareholders and invests the money in securities such as stocks, bonds, and cash in order to achieve a specific investment objective, such as growth or income. Professional money managers who receive a fee for their services manage the assets.

Technically, a mutual fund is a trust—a trust that invests the pooled assets of its investors with the goal of reaching a specific investment objective, such as growth or income.

Mutual funds offer a convenient alternative to owning a portfolio of individual securities.

When investors buy mutual funds, they make macro decisions—determining their investment objectives and their selection of mutual funds that meet those objectives—rather than micro decisions about buying individual securities.

Mutual fund investors buy units in a fund. The units represent ownership in the fund's portfolio. The underlying securities earn money from capital gains, interest income, and dividends. The money earned is distributed in proportion to an investor's ownership. Mutual funds have a specific objective, which is outlined in the fund's prospectus. Investors select investment objectives that match their goals. Decisions on how to invest the fund's assets are made by the fund's money managers.

The major advantages of mutual funds are professional money management, diversification, convenience, competitive and consistent performance, choice, and economies of scale. Professional money management is particularly beneficial to average investors since they gain access to many of the world's outstanding money managers for very modest sums.

These and numerous other features and benefits are the reasons investors choose mutual funds to accumulate wealth. It is important that financial advisors have a working knowledge of mutual funds in order to make suitable recommendations to their clients regarding their wealth accumulation and retirement funding.

Mutual funds give all investors, large and small, access to professional and proven money management. Professional management eliminates investor participation in the individual security selection process. In turn, this removes investor emotion and adds professional logic and expertise. Fund managers are responsible for which securities to buy sell or hold. Investment decisions are made after extensive fundamental and technical research, and the fund managers select securities to meet their fund's investment objective. The primary mutual fund objectives are growth, income, or a variable combination of both growth and income.

The investment objective is important to fund managers because it determines which securities are appropriate for meeting the fund's investment objective. The fund's investment objective is also important to investors because it determines which funds are suitable for meeting individual investment objectives.

Fund managers invest in many securities to gain diversification. Portfolio diversification reduces risk and enhances the opportunity for more consistent and competitive investment returns. It is not unusual for stock mutual funds to contain 100 to 200 different common stocks. Bond funds also diversify among many-fixed income securities to reduce risk.

An investor can make money with mutual funds in three ways. First, as a fund's holdings increase in value, a fund's unit price also increases in value. Second, stocks held in the fund pay dividends and the fixed income securities (bonds) pay interest. Finally, when stocks and bonds are sold at a profit, the fund realizes capital gains. Mutual funds are a conduit for the money earned.

All income and capital gains flow directly to the investor's without taxation at the fund level. Investment companies also provide record keeping and year-end statements, which report dividends and capital gains. In addition, all the profits may be reinvested in mutual funds, usually without paying an additional commission. The investors own the mutual funds and have voting rights.

Almost without exception, investment companies have a family of mutual funds that offer various investment objectives. The primary emphasis is on bonds, stocks, and money markets. There are also numerous sub-categories.

As an example, an investor may choose between fixed income funds offering government, corporate or municipal bonds.

Stock funds may offer aggressive growth, growth, or blue chip stocks. The investment advisor is compensated for managing the assets of the mutual fund. The fee is usually a percentage of the assets under management.

2 - 12.2 Mutual Fund Benefits

Mutual funds have several features and benefits that make them suitable for long-term investors. Among these benefits:

Accessibility

Mutual funds are easy to buy. They are available from representatives at insurance companies, banks, brokerage firms, and financial planners. "No-load" fund companies also sell them directly to the public.

Mutual funds are sold primarily through registered representatives, although no-load funds comprise an estimated 30% of the market. Representatives earn sales commissions or fees by providing the information necessary for investors to analyze their financial needs and objectives, and then recommending the mutual funds that are suitable for meeting those investment objectives.

There are three sales channels for mutual funds. One is comprised of representatives who are employees or independent contractors of major financial institutions such as insurance companies or banks; they are responsible for most mutual funds sales.

Commissions expressed as a percentage of the total purchase price into the fund usually compensate these representatives. Representatives sell a variety of funds. The funds sold are most often from independent investment companies.

A second primary mutual fund distribution channel is the proprietary (in-house) channel. In this case, the mutual fund (investment) company is often a subsidiary of the financial institution. The institution's sales representatives sell the funds. For example, ABC insurance company owns a mutual fund company. ABC insurance company agents sell the funds of the ABC investment company.

Finally, some mutual fund companies distribute directly to the public. These funds typically advertise in magazines and newspapers to encourage investors to write or call for additional information. Because the investor buys directly from the investment company, the funds do not charge a sales commission or "load." In exchange for not paying a sales charge, investors are responsible for making their own investment decisions. These are no-load funds.

Choice

A fund investor has more choices than ever before. In December 2013, there were approximately 85 fund management companies in Canada sponsoring close to 4,000 mutual funds to individual and corporate investors through their network of dealer firms. The number of funds continues to grow.

Many funds are available to meet very specific investment needs, enhance asset allocation strategies, or add diversification. Examples are funds that invest in specific regions, individual countries or specific industries such as biotechnology, banks, housing, and real estate. Choice is important because intelligently assuming risk creates the opportunity for greater returns. By having a wide choice of mutual funds available, financial advisors can meet the investor objectives within acceptable risk levels and in keeping with the investor's biases, preferences, and styles.

Liquidity

Having money available to meet emergencies is important, especially to mature and/or retired investors. Mutual fund shares may be redeemed at any time. The investor will receive the current share price value of his investment. The share price may be than the original cost. The investment company redeems the shares. Investors receive the value of the shares the day the notification for liquidation is received. A cheque is mailed within seven days of the liquidation date.

Financial advisors must make it very clear to clients that mutual fund investing requires a long-term commitment, because mutual funds are long-term investments (except for money market funds). Short-term funding needs should be met with savings accounts, short term GICs or money market mutual funds.

Diversification

Diversification is the practice of not risking everything on one endeavour - of not putting all one's eggs in a single basket. By investing shareholder assets in numerous securities, a mutual fund diversifies its holdings.

A diversified portfolio reduces risk and enhances the opportunity for a mutual fund to produce a consistent and competitive investment return over the long-term.

Mutual funds are particularly beneficial for investors lacking either the assets or the expertise to diversify their assets.

Investors receive institutional investing benefits even when investing modest sums of money.

Flexibility

Modern asset management techniques are best utilized when investors can select from mutual funds with different investment objectives. Knowledgeable and prudent investors do not place all their assets in any one investment or in any single mutual fund.

To meet the various allocation and diversification demands of investors, all major mutual fund companies offer a family of funds—several funds with varying degrees of risk and different investment objectives.

This gives investors the flexibility to exchange one fund for another as their investment objectives change yet stay within the same fund family and company. Equally important, the exchanges (switches) are made immediately since investment companies provide "telephone switching." The exchanges are done the day the order is received by the investment company.

Professional Management

Many investors consider gaining access to highly qualified money managers as the most important reason for purchasing mutual funds. The managers make their investment decisions based on extensive research into the financial performance of the economy, specific industries, and individual companies.

Money managers also analyze market trends, interest rates, and other applicable data combine it with their fundamental analysis, and select investments deemed most suitable for achieving their fund's investment objective.

Most current money managers approach asset management from a definable and measurable perspective (Modern Portfolio Theory), in which every effort is made to maximize the return for the risk assumed.

Emphasis is also placed on competitive long-term investment performance since most investors consider the preservation of capital and consistent performance their top priorities. See the following charts on the benefits of consistent performance.

Having a comfort level with an investment program has strong appeal for long-term investors because few have the resources to hire an institutional manager.

In addition, few possess the expertise or temperament to effectively manage assets to maximize returns for the risk taken.

Table 2 – 8 Consistent Performance versus Volatile Performance

Consistent Portfolio showing Average Annual Return of 10% for each portfolio						
Consistent Performance versus Volatile Performance (Based on a $1,000,000.00 initial investment)						
	Years and Performance					
Portfolios	1	2	3	4	5	Total Return
Consistent	10%	10%	10%	10%	10%	$1,610,510.00
Volatile	20%	(40%)	50%	(30%)	50%	$1,134,000.00

Table 2 - 9 Consistent Portfolio

Year	**Annual Percent**	**Earnings**	**Total Value**
1	10%	$100,000	$1,100,000
2	10%	$110,000	$1,210,000
3	10%	$121,000	$1,331,000
4	10%	$133,100	$1,464,100
5	10%	$146,410	$1,610,510

Table 2 - 10 Volatile Portfolio

Year	**Annual Percent**	**Earning**	**Total Value**
1	20%	$200,000	$1,200,000
2	(40%)	($480,000)	$720,000
3	50%	$360,000	$1,080,000
4	(30%)	($324,000)	$756,000
5	50%	$378,000	$1,134,000

Mutual fund money managers offer investors the same services as their institutional clients.

Mutual fund money managers deliver more consistent and competitive long-term investment results than most individual investors do.

They also have the qualifications, knowledge, and resources to produce competitive and consistent returns. Freedom from paperwork, record keeping and research.

As investors who purchase individual stocks and bonds are aware, keeping records of purchases, sales, gains, losses, dividends, and other tax and performance information can be a monumental task.

Investment companies keep all the mutual fund account records and report each transaction to the investor.

Mutual funds also make available their documented performance records for various periods. This gives investors the ability to evaluate and compare their fund's performance against the performance of other funds. Fund performance is readily available for year-to-date and one, five and ten year periods.

Investors find it informative and reassuring that mutual fund financial information is available daily in financial and local newspapers. Television cable channels offer continuously updated financial news and analysis during market hours, and extensive analysis of market events after-market hours. The availability of financial news both assures active investors and raises awareness for potential investors.

Documentation of performance and record keeping is an important benefit for investors. Abundant mutual fund information reassures investors and adds credibility for financial advisors presenting the mutual fund concept to clients.

2 - 12.3 Types of Equity Funds

Most investors buy stock, or equity, mutual funds to make money from their increase in value (capital gains). Receiving dividends is also a major consideration for stock investors. Common stocks have no guaranteed returns. By assuming higher risks, investors gain the opportunity for higher returns. Sophisticated investors purchase individual stocks and bonds because they have the resources to both diversify and to assume a higher degree of risk. However, most investors lack the resources and the expertise to manage assets or diversify in an effective manner. Hence, most stock investors purchase mutual funds and have professionals manage their assets.

The obvious question is: why do investors buy stock mutual funds? The answer is that stocks have always out-performed all other securities over the long haul, especially bonds and term deposits. Funds offer the type of diversification that spreads risk so that returns can be more predictable, and volatility lowered. Investors and financial advisors should also be aware that mutual funds are not just for small investors.

Most affluent investors and major corporations place large percentages of their investment assets, particularly retirement plan assets, with professional money managers either directly or through investing in mutual funds.

2 – 13 MUTUAL FUND SUMMARIES

- A mutual fund is an investment that pools investors' money to be managed by professional asset managers.
- When buying mutual funds investors make the macro decision of which investment objective is suitable, and which investment company will manage their money. Mutual fund companies make the micro decisions on how to manage investor assets.
- The investment objective is important to the money manager because it determines what securities are appropriate for meeting the fund's investment objective.
- Mutual fund shareholders make money three ways: capital gains, dividends, and interest paid by fixed income securities.
- All income received by mutual funds flows directly to the shareholders without taxation at the fund level. The holder of the fund / investor is then taxed on earnings received according to the type of earnings generated, i.e. capital gains, dividends, and interest.
- The investment company is the corporation responsible for investing mutual fund shareholder money and co-ordinating the daily operations of the company.
- There are mutual funds to meet virtually every investment objective. The three major categories are stocks, bonds, and cash.
- The major fixed income (bond) sub-categories include corporate, government, and municipal bonds.
- The major sub-categories of stock funds include aggressive growth, growth, growth/income, balanced, and income. Foreign and domestic issues further divide the groups.
- Stock mutual funds are evaluated primarily on their investment objective and their long-term risk.
- Bonds have three significant features: maturity date, face value, and coupon rate.
- Bond maturities are defined as short, intermediate, and long-term depending on the length of maturity.
- Corporate bonds are taxable. They are rated in two broad categories: investment grade and speculative. Corporate bonds are either domestic or foreign.
- The three major Canadian Government securities are Treasury bills, notes, and bonds. All are without credit risk but have varying degrees of market risk. Their classification depends on their maturity.
- Strategic income funds combine foreign, domestic, corporate, and government bonds, to offer enhanced yields and broad diversification.
- No-load funds charge no commissions but do charge management and investment fees like load funds.
- Investors can often receive commission discounts by using Rights-of-Accumulation and Letters-of-Intent.

Mutual funds offer a variety of advantages:

- ❖ Professional management
- ❖ Broad diversification of investments
- ❖ Variety of types of funds
- ❖ Variety of purchase plans
- ❖ Various special options
- ❖ Liquidity
- ❖ Transferability
- ❖ Economies of scale for investors
- ❖ Loan Collateral
- ❖ Risk can match investor profile

And some notable disadvantages:

- ❖ Unsuitable for short-term investment
- ❖ Unsuitable as an emergency reserve
- ❖ Taxation treatment on purchases made later in the year
- ❖ Professional investment management is not infallible

2 – 14 SEGREGATED FUNDS

These funds are the Insurance Industry's version of Mutual Funds. They were launched in 1961 in order to attract investment assets to insurance companies. Some segregated funds rank in the top long-term performers of all funds combined.

The conservative nature of their fund managers, and the fact that they were used initially for the pension industry, has had a large influence on the returns they yielded. These funds are held in a "separate and distinct investment" and are not mixed with other investments or general assets of the insurance company; hence the term "segregated." Many of the long-term funds have been characterized as conservative in nature; the funds offer a mixture of equities, cash, and bonds.

Like mutual funds, these funds tend to be operated in "families of funds," each with their own investment strategy and philosophy in addition to individual segregated fund options. They have a long-term, historical reputation for dependability and have a very respectful history of returning value for the money invested. Most segregated funds are valued daily, although weekly or no less once a month is also done. They operate in much the same way as a mutual fund.

Historically, investors with segregated funds were only taxed on interest, dividends, and realized gains from the time they purchased units in the fund each year, unlike mutual funds. This could make a huge difference when investing late in the year during a rising market. However, with the advent of daily valuation, many segregated funds use the same method as mutual funds.

That is, the flow through of taxable income and gains is based on the number of units on the distribution date.

Segregated funds flow through capital losses as well as gains, allowing the investor, rather than the fund itself (as with Mutual Funds), to use or carry over capital losses.

Keeping track of investments in segregated funds is as easy as with mutual funds, via daily reports in national newspapers and online. The method used is described in the Information folder.

Reporting is arguably for segregated funds since the insurance company does all the work including calculations, offering the necessary information a taxpayer needs on a tax slip.

2 - 14.1 Guarantees

Segregated funds operate under the Insurance Act because of their basic guarantee of 75% return of deposits paid at death or the maturity date, provided the maturity date chosen is at least 10 years after the purchase date.

A guarantee of 100% is the norm at death; some companies even offer a 100% guarantee at maturity.

For the elder consumer / investor these guarantees become increasingly important. They provide investors and their families with a level of financial security that is not available with other types of pooled investments like mutual funds.

2 - 14.2 Creditor Protection and Control

Segregated funds will usually be protected from seizure by creditors, and unexpected lawsuits, provided the proper beneficiary designation is filed. This holds true provided that the investor is not trying to defraud creditors by moving monies into segregated funds in contemplation of or after insolvency.

Investors may have control or tax reasons where they wish to have an investment owned by someone else in the family but maintain control to guard against inappropriate spending. The investor can name him or herself as irrevocable beneficiary.

This ensures that the owner cannot make major changes to the investment or withdraw monies without the investor's written consent. This is a great feature of segregated funds and does not cost any money to set up or administer.

2 - 14.3 Beneficiary Designations

Naming a beneficiary enables an investor to continue to save taxes and exercise control over assets long after death. For example, proceeds can be left to a discretionary trust for the spouse and children without affecting the fund's creditor protection. The investor can place conditions on how the money is to be invested, who gets it, when they get it, and under what circumstances.

This can be a great advantage if there are concerns about the money management abilities or spending habits of heirs.

2 - 14.4 Confidentiality

There may be instances or situations where elders want to provide funds for certain individuals but they do not want it to become public knowledge. The naming of a beneficiary on a segregated fund keeps the distribution out of the estate and avoids probate.

2 – 15 TAX ADVANTAGED PROGRAMS

As noted above, to ensure a comfortable retirement Canadians need to plan, and invest. In addition they need to consider the best possible vehicles to accommodate their invested assets. Specifically, should their retirement savings be place in a Registered Retirement Savings Plan; a Tax-Free Savings Account, or should it be held in a non-registered product. The following material examines these vehicles and provides some guidelines and considerations.

2 – 15.1 Registered Retirement Savings Plans (RRSPs)

RRSP is an acronym for Registered Retirement Savings Plan. RRSPs are the Canadian government's way of helping citizens save their money for retirement. Saving for 30 to 40 years of retirement may seem like a daunting task, but well-planned contributions and withdrawals from your RRSP can be a great way to get the best bang for your retirement buck.

An RRSP is a retirement savings plan that you establish and is registered with the Government of Canada. Both you or your spouse or common-law partner can make tax deductible contributions to the plan within the limits set by the Government of Canada each year.

Any income you earn in the RRSP is usually exempt from income tax as long as the funds remain in the plan. You generally have to pay tax when you receive payments from the plan. There are exceptions when making withdrawals under the Home Buyers' Plan or the Lifelong Learning Plan.

Approved assets include savings accounts, guaranteed investment certificates (GICs), bonds, mortgage loans, mutual funds, income trusts, corporate shares, and foreign currency.

The main advantage of an RRSP account, as compared to a regular investment account, is the tax benefits it offers. The contributions made to an RRSP - which can be made up to a certain limit - are tax free and the money within an RRSP can compound without your having to pay taxes on the gains.

2 – 15.2 What an RRSP is Not

An RRSP is not an investment. You will often hear people talking about the "RRSP they bought"; however, technically, this is both incorrect and impossible.

An RRSP is simply an account that holds other investments. It is the same as a regular brokerage account - you do not *invest* in your brokerage account at Royal Bank or TD Canada Trust, you open an account in which you hold investments. You cannot "buy" an RRSP: you buy an investment in the RRSP account to which you contribute.

Here is a summary of some of the features of an RRSP account:

- Registered with the Canadian federal government
- Legally recognized as a trust
- Offers tax benefits over regular investment accounts
- Can hold many different types of investments

2 – 15.3 Tax Considerations

1. Contributions are tax deductible within prescribed limits.
2. Taxes on earned income (i.e., income from employment or self-employment to the extent contributed to the plan), are deferred until the eventual withdrawals from the plan. Taxes are deferred through a deduction claimed in calculating taxable income (i.e., amounts contributed are not subject to income tax in the year they are contributed).
3. Income earned inside the plan is not taxed while within the plan
4. The contributor's marginal tax rate when withdrawing funds may be higher (or lower) than the tax rate the contributor paid when making the original contribution.
5. A variety of programs available to retired people (OAS, GIS, etc.) have benefits that decrease as income increases. By deferring the income from an RRSP until later in retirement, the additional income not created at that time may not impact those government net income tested benefits.

You can find your RRSP or pooled registered savings plan (PRPP) deduction limit by going to:

- Form T1028, Your RRSP Information for the current year
- CRA may send you a Form T1028 if there are any changes to your RRSP deduction limit since your last assessment.
- My Account
- My CRA mobile app
- Tax information Phone Service (TIPS)
- the "Available contribution room for the current year (2020)" amount found on the RRSP Deduction Limit Statement, on your latest notice of assessment or notice of reassessment

Because of the tax benefits provided by RRSPs, the Canadian government has capped the amount of money that can be contributed. (Note: the contribution limit is sometimes called the deduction limit). The deduction limit is calculated as the unused deduction limit from the prior year (which includes all unused deductions going back 10 years), plus 18% of a person's earned income from the previous calendar year up to a specified maximum, minus any pension adjustment (PA) and past service pension adjustment (PSPA), plus pension adjustment reversals (PAR).

For the 2020 tax year, the Canadian government will allow people to contribute 18% of their yearly earned income for the previous year up to a maximum of $27,230(whichever is the lesser amount), to their RRSPs. The limit for the 2021 taxation year is scheduled to be $27,830, rising to $29,210 for 2022.

The CRA calculates the RRSP deduction limit for the next year and prints it on every Notice of Assessment or Reassessment, provided the taxpayer is aged 71 years or younger. It is also recalculated, and a copy mailed in certain cases such as when a PSPA or PAR is issued.

While it is possible to contribute more than the contributor's deduction limit, it is generally not advised as the excess amount ($2,000 over the deduction limit) is subject to a significant penalty tax removing all benefits (1% per month on the overage amount).

RRSP contributions within the first 60 days of the tax year have the option of being reported as tax deductible contributions for either the current calendar year) or on the previous year's return, according to the Income Tax Act. Note that reporting and using are two different things. All other contributions may be used in the same tax year or held for future use.

2 - 15.4 Types of Account

Individual RRSP

An Individual RRSP is associated with only a single person, called an account holder. With Individual RRSPs, the account holder is also called a contributor, as only they contribute money to their RRSP.

Spousal RRSP

A Spousal RRSP allows a higher earner, called a spousal contributor, to contribute to an RRSP in their spouse's name. In this case, it is the spouse who is the account holder. The spouse can withdraw the funds, subject to tax, after a holding period. A spousal RRSP is a means of splitting income in retirement. Note that if you contribute to a Spousal RRSP in the year of the withdrawal or the two preceding years by your spouse, then you, not the annuitant spouse, may be required to include the withdrawal amount as income. This is known as the attribution rule.

By dividing investment properties between both spouses each spouse will receive half the income, and thus the marginal tax rate will be lower than if one spouse earned all the income.

Group RRSP

In a Group RRSP, an employer arranges for employees to make contributions, as they wish, through a schedule of regular payroll deductions. The employee can decide the size of contribution per year and the employer will deduct an amount accordingly and submit it to the investment manager selected to administer the group account. The contribution is then deposited into the employee’s individual account and invested as specified.

The primary difference with a group plan is that the contributor realizes the tax savings immediately, instead of having to wait until the end of the tax year.

Pooled RRSP

Legislation was introduced during the 41st Canadian Parliament in 2011 to create Pooled Retirement Pension Plans (PRPP). PRPPs are aimed at employees and employers in small businesses, and at self-employed people.

An account holder can cash out an amount from an RRSP at any age. However, any amount withdrawn qualifies as taxable income and is therefore subject to withholding tax.

2 – 15.5 Withdrawals

Before the end of the year the account holder turns 71, the RRSP must either be cashed out or transferred to a Registered Retirement Income Fund (RRIF) or an annuity.

2 – 15.6 Tax-Free Savings Accounts

The Tax-Free Savings Account (TFSA) is a flexible, registered, general-purpose savings vehicle that allows Canadians age 18 years of age and older to earn tax-free investment income to meet lifetime savings needs more easily. In certain provinces and territories, the legal age at which an individual can enter into a contract is 19. In these jurisdictions, a person age 18 who would otherwise be eligible to set up a TFSA, accumulates TFSA contribution room for that year and carries it over to the following year. The TFSA complements existing registered savings plans like the Registered Retirement Savings Plans (RRSP) and the Registered Education Savings Plans (RESP). No earned income is required. Individuals must be Canadian residents with a valid social insurance number.

2 – 15.7 How the Tax-Free Savings Account Works

- As of January 1, 2021 Canadian residents, age 18 and older, can contribute up to $6,000 annually to a TFSA. This is unchanged from 2019. TFSA annual contribution room limit will be indexed to inflation and rounded to the nearest $500.
- For those individuals who have been eligible to contribute since the program was launched in 2009 and have never contributed to a TFSA, the total contribution room is 75,500 as of 2021.
- Contributions are not tax-deductible; neither are administrative or other fees nor interest on money borrowed to contribute to a TFSA.
- Investment income earned in a TFSA is tax-free.
- Withdrawals from a TFSA are tax-free.
- Unused TFSA contribution room is carried forward and accumulates in future years.
- Full amount of withdrawals can be put back into the TFSA in future years. Re-contributing in the same year may result in an over-contribution amount which would be subject to a penalty tax.
- Choose from a wide range of investment options such as mutual funds, Guaranteed Investment Certificates (GICs) and bonds.

- Neither income earned within a TFSA nor withdrawals from it affect eligibility for federal income-tested benefits and credits, such as Old Age Security, the Guaranteed Income Supplement, and the Canada Child Tax Benefit.
- Funds can be given to a spouse or common-law partner for them to invest in their TFSA and any earnings on monies invested are not attributed back to the contributing spouse.
- TFSA assets can generally be transferred to a spouse or common-law partner upon death either by naming the spouse or common law partner as successor annuitant (outside of Quebec) or as beneficiary where permitted.

2 – 15.8 Which Program is best for Retirement Savings?

Is it preferable to contribute to a Registered Retirement Savings Plan (RRSP) or a TFSA?

Since these plans are not mutually exclusive you should consider contributing to both if you have the financial resources. If you have limited financial resources and you must choose between contributing to either a RRSP or a TFSA, what factors should you consider?

The first issue to consider is: which of these plans will generate a higher after-tax income when the funds are withdrawn?

Where the current tax rate is higher than the tax rate at the time of withdrawal, the RRSP strategy will produce a higher after-tax income. Conversely, where the tax rate at the time of withdrawal is higher than the current tax rate, the TFSA strategy will produce a higher after-tax income.

Where the tax rate is the same at the time of contribution and withdrawal, the RRSP and TFSA strategy will produce the same after-tax income. In this scenario, the TFSA strategy may be more advantageous because TFSA income does not affect your federal income-tested government benefits such as Old Age Security (OAS), the Guaranteed Income Supplement (GIS) and the Age Credit (more on this in the next chapter).

Other factors to consider when determining whether to contribute to an RRSP or a TFSA:

- If you anticipate that you will need to access the funds on a repeated basis rather than just for retirement, the TFSA may be a better choice. TFSA withdrawals will not increase your tax liability and amounts withdrawn can be re-contributed.
- RRSPs and Registered Retirement Income Funds (RRIFs) are creditor protected in the event of bankruptcy (except for contributions made in the previous 12 months), but not the TFSA.

2 – 15.9 Tax Strategies

With the introduction of the TFSA, you now have a choice of three savings vehicles in which to invest – non-registered (taxable), RRSP (tax deferred), and the TFSA (tax-free). If you make use of all three investment accounts, how should your investments be structured to make sure that your overall investment portfolio is tax efficient?

The common practice today is to put interest generating investments such as GICs, bonds and bond mutual funds inside your RRSPs/RRIFs and capital gains generating investments such as stocks and equity mutual funds in your non-registered accounts as much as possible.

This is because interest income is fully taxable and accrued annually (i.e. each year whether you receive the interest or elect to reinvest it) whereas only 50% of capital gains are taxable and included in income when realized.

With the addition of the TFSA, it probably still makes sense in many cases to position the fixed income portion of an investment portfolio inside the RRSP/RRIF and the equities portion in the non-registered account or TFSA.

Should there be a need to allocate some fixed income investments outside the RRSP, it may be worth considering putting these investments in the TFSA rather than in the non-registered account where possible.

This will not only shelter the more heavily taxed interest income from tax but also, better preserve your ability to make TFSA withdrawals/re-contribute to your TFSA.

One exception and consideration to this general rule of thumb concerns dividend income for aging Canadians who become eligible for government benefits like OAS, GIS and the age credit. Eligibility for these benefits is net income tested. Dividend income serves to increase reportable net income by up to 38%. If this could impact eligibility for these benefits, consider moving dividend earning investments into a TFSA where none of the income is reportable.

2 – 15.10 Registered vs Non-Registered – The Debate

As only 50% of capital gains are considered taxable income under current legislation, some financial planners question the value of RRSPs and suggest that Canadians save for their retirement with non-registered investments. The choice between an RRSP and non-RRSP investment has become one of the most debated issues in the financial community.

Critics of RRSPs point out that RRSP withdrawals are fully taxed as income at rates of up to 54% — versus capital gains, which are taxed at half an individual's tax rate (based on the current inclusion in income of only 50% of gains). To generate mostly capital gains and take advantage of the lower tax rate, some financial advisors recommend that people invest outside their RRSPs in a diversified portfolio of small-cap and other growth-oriented equity mutual funds and stocks, and then hold them for the long term to maximize tax deferral.

Both quantitative and qualitative issues should be considered in determining an appropriate saving strategy. On a quantitative basis, the following general conclusions can be drawn. If individuals:

- Reinvest their RRSP tax savings into their RRSP, an RRSP will be significantly favourable
- Reinvest their tax savings into non-registered investments, an RRSP will be favourable
- Use their tax savings to pay down non-tax-deductible debt (e.g., their mortgage), an RRSP will likely be favourable

- ❖ Spend their refunds, they are likely better off investing in equities in their non-registered plans

Given these scenarios, RRSPs still make sense for most people. Because of tax-deferred compounding of all types of income within an RRSP, it is difficult to beat the amount that may be accumulated within a registered plan over time.

How RRSPs stand up against non-RRSPs will vary from individual to individual based on several factors, including expected returns and marginal tax rates — now and upon retirement. Recent tax changes now allow retirees age of 65 and over during the year who receive RRIF and pension income to split the reporting of up to 50% of their RRIF and other pension income with their spouse or common-law partner. This form of income splitting can potentially save a couple a significant amount in taxes. Individuals should explore several scenarios taking into account their personal circumstances to determine the best option from a quantitative perspective.

Qualitative issues such as risk tolerance, investment knowledge and ability and willingness to monitor investments will also play a role in deciding whether to choose a registered or non-registered account. Keep in mind that shifts in an individual's personal and professional situations will influence the types of products that best suit their goals.

2 – 15.11 Non-RRSPS and RRSPS: A Case for Both

Now, more than ever, Canadians may want to consider using a combination of registered and non-registered investments to save for their retirement. As noted above, if individuals have both non-registered and registered assets, it is more tax-efficient to structure the investments so those that generate interest income are held within the RRSP and those that generate capital gains are held outside the RRSP. Individuals may want to set up their portfolios as follows.

Non-RRSPs

- ❖ Hold growth-oriented stocks and equity mutual funds outside RRSPs
- ❖ Consider index funds, which have low securities turnover (and management fees); choose physical-based index investments to generate capital gains, as opposed to derivative-based index funds, whose earnings are fully taxed as ordinary income

RRSPs

- ❖ Hold bonds and other fixed-income instruments inside RRSPs
- ❖ Consider actively managed equity mutual funds and portfolios (no tax implications as securities are traded)
- ❖ Invest a tax refund as part of the following year's contribution to maximize tax deferral

2 – 15.12 Creating a Tax-Free Legacy

Here is another strategy worth considering. If you are a retiree and you receive more RRIF or pension income than you require to meet your lifestyle needs, you can contribute the excess to the TFSA and benefit from the continued tax-free growth of your investments. The funds accumulated in the TFSA can be withdrawn tax-free later to enhance your retirement lifestyle.

Alternatively, if the funds in the TFSA are not required for your retirement needs, you may be able to provide a tax-free legacy to your heirs. This could be a consideration of significant importance especially if you do not have a spouse to whom you can transfer your investments on a rollover basis at death. You can name your heirs as beneficiaries of your TFSA. They will receive the value at your death tax free.

Many individuals who are not currently in high tax brackets but possess large RRSP or RRIF portfolios are concerned about having a significant portion of their RRSP/RRIF taxed at the highest tax rate on death. A common strategy utilized by them is to increase their current RRSP/RRIF withdrawal so that the income can be taxed at a lower rate.

A drawback of this strategy is that, if the additional income is not required for lifestyle needs, it will generally be reinvested in a non-registered account where the earnings will be subject to tax. If, instead, this additional income is reinvested in a TFSA, the funds will grow on a tax-free basis.

Another option for those who are reasonably healthy is to use excess funds to purchase a life insurance policy. The sum insured will be far greater than the contributions. The legacy on your death can be paid out tax free to the people and organizations of your choice by naming them as beneficiaries. When you do that, assets pass outside of the estate and are not subject to probate and other estate settlement costs.

2 – 16 A FEW FINAL INVESTMENT TIPS

In managing their financial affairs every elder is well advised to consider the following broad pointers.

Choose a risk talker, not a risk taker

A good investment advisor should disclose and outline risks clearly and should never downplay them.

If the advisor seems to be avoiding any discussion about risk, you should avoid that advisor.

Do not deal with anyone who claims a particular investment is risk-free. Always remember, if the return on a suggested investment seems too good to be true, then it probably is.

Tell buzzwords to buzz-off

An expert investment advisor should be able to explain each investment to you in simple, clear, and understandable language. If the presentation is full of jargon, deal with someone else.

Object if there are no objectives

Avoid advisors who do not ask you about your investment objectives. This discussion should involve more than just how much money you would like to make.

It should include an examination of how much risk you can tolerate and what sort of mixture of investments you want.

It should also include an examination of your financial circumstances (i.e. income, net worth) and personal circumstances (i.e. age, number of dependents, employment, and investment experience). A legitimate advisor needs this information to determine what investments are suitable for you.

Issue no blank cheques

If the advisor asks you to sign any form or document that is not filled in, you simply refuse to do so. You would not sign a blank cheque, so do not sign a document in blank.

You should never be told that something is merely "standard documentation." Read before you sign. Understand what you are getting into. Make sure all the information about you on the document is accurate.

Get a copy of everything you sign. Also, ask your advisor's firm to send you copies of all their documents that show your investment objectives and risk tolerance. Write to the firm immediately if this information is incorrect.

Discretion is not the better part of investment valour

"Discretionary" trading – where an advisor buys or sells investments for a client without first obtaining the client's authorization for each transaction – is prohibited unless the advisor is specially licensed as an investment counsel or a portfolio manager, or the client signs a specific "managed account" agreement.

An advisor should never ask you to authorize or go along with a trade that took place without your prior knowledge and approval.

Insist on a good night's sleep

You should not find yourself losing sleep over the risks in your investment portfolio. Therefore, do not agree to buy anything you feel is too risky, even if your advisor recommends it highly.

If you feel something in your portfolio should be sold because you are uncomfortable with the amount of risk, your advisor certainly can explain the outlook for that investment, but the advisor should not try to talk you out of selling. Your advisor should never refuse to implement a sell order. Insist, and, if necessary, do so in writing.

The importance of being objective

"I put some of these stocks in my own mother's account," is not good investment advice. Although you may feel safe buying what your advisor personally invests in, you should understand that the advisor might have lost his or her objectivity about that investment. If so, the advisor may fail to recommend selling when the investment falls in value or when the risk becomes unsuitable for you.

Your advisor should not suggest that you invest in private deals in which he or she is a participant; and in general you should be cautious about buying an investment where the advisor, or the advisor's firm has any sort of financial stake in the investment itself.

Ask yourself: “Am I getting truly objective advice based on what’s best for me, or do they stand to gain more if I buy this particular investment rather than a difference choice?”

The firm confirm…with the firm

If you notice anything that troubles you, demand an explanation from your advisor and then confirm what they have told you by letter to the advisor, with a copy to their manager or to the compliance department of the advisor’s firm.

Silence is not golden

Your advisor should never give you a personal guarantee that an investment will make money. Similarly, your advisor should never promise to personally reimburse you for investment losses. If you agree to stay silent about a problem in your account in return for such a guarantee or such a payment, and your advisor later fails to pay, you may have lost the ability to claim against the advisor’s firm for any wrongdoing.

You have got mail – for a very good reason

Read the account statements that the firm mails to you. Read them as soon as possible after they arrive. If you notice anything that concerns you, call the advisor right away and ask for an explanation. If the explanation is not clear, or does not seem to make sense, or leaves you uncomfortable, call the advisor’s manager or the compliance department at the firm and ask them to explain everything to you.

Reading the statements is critical, only you can spot trades that you did not authorize. Also, you need to know if the investments are falling in value, so you can assess whether the risks are too great for your comfort. And finally, since mistakes can be made even by the best of advisors, you need to check your statements for errors.

In short, scrutinize for scruples and anything screwy.

If there’s smoke, use the “fire-escape”

Should you encounter any of the problems noted above, you may be dealing with an unscrupulous advisor who is mishandling your investments or is exposing you to too much risk. Do not ignore these warning signs. Notify the advisor’s firm of your concerns in writing immediately, give them one week to straighten everything out to your complete satisfaction, and if they fail to do so, use the fire-escape: fire the advisor, and the firm, and get your money out of there as fast as possible.

2 - 17 CONCLUSION

Life is filled with many wonderful things. The 80 or 90 years we anticipate living may not seem long enough to enjoy them all. With all the opportunities ahead of us, it seems a pity to waste a single minute worrying about money.

But we do worry. Ironically, financial worries derive not necessarily from lack of money, but often from lack of planning. Solid financial planning can take the uncertainty out of an elder's financial future, leaving him confident that what he does today will help him acquire what he wants tomorrow. Many factors affect a person's future financial security.

People are living longer, healthier lives than ever before. But to ensure that we all can enjoy our longer, more active retirement years we need to make a plan.

Rising health care costs, changes in employer-sponsored benefit plans, and potential future changes in Old Age Security and Canada Pension Plan benefits all will affect the quality of our retirement. Today, more than ever, planning for a financial future depends on staying ahead of the financial factors that shape our economy. For many, this requires a change of thinking, and a willingness to include equities and other growth-producing investments in their financial plans. Elders can take this step without undue risk. The key to making the financial plan work is to ensure that it keeps ahead of future increases in the cost of living. It is also important that elder investors have a good understanding of investment strategies, and the patience to become long-term investors.

And remember, once the elder understands the basics, they are strongly advised to seek the advice of tax, legal and financial experts.

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Chapter 3

Generating Retirement Income

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3 – 1 KEY OBJECTIVE OF THIS CHAPTER

There was a time when many Canadians retired right at age 65—whether they wanted to or not. It was a full-stop kind of retirement: you worked for the same company for most of your career, they threw you a party on your last day, and the next morning you woke up to a life of hobbies and doting on grandkids. Government benefits and traditional employer pensions kicked in immediately and they were often enough to take care of you, even if you had no other savings.

For most Canadians, the above version of retirement is pretty much dead.

Defined benefit pension plans are dying out, except in the public sector. And the government has considered scaling back senior's benefits such as Old Age Security, which was going to be delayed until age 67 instead of starting at age 65. Increasingly, retirement income will depend on how much a person has saved and how he manages his own money. Unfortunately, just as Canadians are being forced to rely on their own resources in retirement, they are being hit with low interest rates and uncertain stock markets. All this helps to make retirement more precarious.

The primary focus of the previous chapter was on how to accumulate wealth for retirement purposes. In this chapter we turn our attention to the various sources of retirement income and how they can be effectively managed.

3 – 2 SOURCES OF RETIREMENT INCOME FOR CANADIANS

Having a variety of income sources can make it much easier to retire in comfort – here are some of the most common sources of retirement income.

3 - 2.1 Government Sources

- ❖ Canada Pension Plan/Quebec Pension Plan (CPP/QPP)
- ❖ Old Age Security (OAS)
- ❖ Guaranteed Income Supplement (GIS)

3 – 2.2 Employment-Related Sources

- ❖ Salary
- ❖ Pension plans
- ❖ Other savings plans

3 – 2.3 Personal Sources

- ❖ Registered investments
- ❖ TFSAs
- ❖ Non-registered investments
- ❖ Reverse mortgages
- ❖ Other

3 – 2.4 Guaranteed Income Sources

As Canadians, we enjoy a secure social benefit system. Guaranteed retirement benefits that are fully indexed to inflation have contributed to Canada's consistent ranking as one of the finest places in the world to live. The following provides a brief summary of some of the guaranteed sources of retirement income that Canadians can count on:

Canada Pension Plan (CPP)/Quebec Pension Plan (QPP)

CPP is administered by the Government of Canada. The QPP is the Quebec equivalent of the Canada Pension Plan. Payments are guaranteed and indexed to inflation.

In 2020 the maximum benefit at age 65 was $1,175.83 per month. If benefits are delayed until age 70, the monthly benefit increases to $1,669.68.or $20,036.14 annually.

Old Age Security (OAS)

OAS is paid to eligible Canadian residents, age 65 or older. Benefits are guaranteed and fully indexed to inflation.

To receive OAS benefits, you must be a Canadian citizen or landed immigrant and have resided in Canada for at least 10 years since the age of 18 (benefits are reduced if residency requirements are not met).

In 2020 the maximum monthly benefit was $614.14. If OAS benefits are delayed until age 70, the monthly benefit increases to $835.23 or $10,022.76 annually.

Guaranteed Income Supplement (GIS)

The Guaranteed Income Supplement is available to all eligible OAS recipients who have little or no other sources of income.

In 2020 single recipients could qualify for up to $916.38 monthly and married recipients could qualify for up to $551.63 monthly.

Defined Benefit Pension Plans

A shrinking number of Canadians are also entitled to the benefits available under an employer or government sponsored defined benefit pension plan. As with such government programs as CPP and OAS, defined benefit pension plans offer payments that are fully guaranteed.

3 – 2.5 Words of Caution

OAS, CPP, GIS and Defined Benefit Pension programs are unique insofar as they guarantee a specified retirement payment for life. Most other potential sources of retirement income do not offer guarantees of this nature. The money set aside can, and often does run out. In order to mitigate this risk careful planning is necessary.

3 – 3 DETERMINING RETIREMENT INCOME NEEDS

To determine how much money will be needed to retire, you must first estimate retirement expenses - how much will be spent each year, along with an estimate of the taxes that will be applied to this retirement income.

Once you have determined retirement expenses, the next step involves determining how much money will be available from guaranteed sources.

As noted above, guaranteed retirement income includes things like Old Age Security, Canada Pension Plan retirement benefits and defined benefit pension income.

In Canada, most Canadians can count on receiving the maximum Old Age Security of $614.14 monthly, for an annual total payout of $7,369.68 (2020). In addition, most Canadians will also receive Canada Pension Plan Retirement Benefits.

The maximum CPP retirement payout (at age 65) in 2020 was $1,175.83 monthly for an annual total of $14,109.96. A person receiving both maximum OAS and maximum CPP would have an annual guaranteed and indexed income of $21,479.64.

Even low income elders in Canada can rely on a reasonable amount of guaranteed retirement income thanks to the Guaranteed Income Supplement. Retired Canadians who qualify for OAS and who have little or no other income receive GIS of $916.38 per month (for singles) and $551.63 (for spouses and common law partners). As a result, most single retirees will receive a minimum of about $18,366 in guaranteed retirement income; and retired couples can count on roughly $14,000 each (for a combined total guaranteed annual income of almost $28,000).

More well-heeled Canadians will, of course, be able to rely on other sources of guaranteed income – the most common being a government or company pension plan.

3 – 3.1 Mind the Gap

Once you have determined retirement income needs and available sources of guaranteed retirement income, you have enough information to determine if any "gap" exists.

Suppose, for example, that a person determines that they will need $64,097 annually in retirement, but their only guaranteed sources of retirement income are OAS at the maximum ($7,370 annually) and ***the average*** current CPP retirement benefit ($8,200 annually in 2020).

$64,097 – (7,370 + 8,200) = $48,527

The retirement income "gap" for this individual is $48,527 annually. This gap must be covered by outside investments. So, how much money will be needed to generate almost $50,000 per year of income?

That depends on three things:

1. The rate of return earned
2. Whether the retiree is willing to spend principal
3. How much of that income needs to be guaranteed?

If investments are earning a rate of return of 5% per year, the retiree would need $1 million to generate $50,000 per year of income, and not spend any principal. This means 25 years later he will still have $1 million in principal.

If the retiree determines that it is okay to spend principal down to zero by the time he dies, then he would only need about $704,000 earning 5% a year to last for 25 years. At the end of 25 years all the money would be gone.

In this simplified calculation used to determine how much is needed to retire, the answer ranges from about $700,000 to $1 million.

Keep in mind to simplify things, we have ignored two additional factors that are used to determine how much an individual requires to retire. They are:

1. Inflation
2. Life Expectancy

Unless a person knows exactly how long he will live, what he will spend each year, and how much of an impact inflation will have, he cannot know *exactly* how much money will be needed to retire.

Since no one knows exactly how much will be needed to retire, the next best thing is to develop both a best case and worst case scenario. In the best case scenario we will assume average investment returns, low inflation and controlled spending. In a worst case scenario we will assume below average investment returns, high inflation and unanticipated expenses.

Best Case

In the best case scenario we might make the following assumptions:

- 2% inflation rate
- 25 year life expectancy
- 7% return on investments
- Okay to spend principal down to nothing

In this case almost exactly $700,000 is needed to provide this $50,000 per year of inflation adjusted income for 25 years.

Worst Case

In a worst case scenario we might make the following assumptions:

- 4% inflation rate
- 35 year life expectancy
- 5% return on investments
- $700k of principal to be retained to pass along to heirs

Now the retiree will need $1.8 million to provide $50,000 per year of inflation adjusted income for 35 years.

In this more complex example, the amount of money needed will be somewhere between $700k and $1.8 million. And if real life throws a few additional wrenches into the works, even more money may be required.

Since no one knows what inflation will be in retirement, what their rate of return will be, or how long they will live, it is hard to come up with an *exact* answer. The next best thing is to come up with a reasonable set of assumptions, and make sure that the plan is re-evaluated every few years.

To help determine the right assumptions to use, and to accurately factor in tax consequences, it may be necessary to seek the assistance of a qualified financial planner.

3 – 4 TURNING ASSETS INTO INCOME

Your age and proximity to retirement have a lot to do with your investment choices - or, at least, they should. When you are a young, spry 30-something, investing for retirement is easy. Put most of your money in equities and - if all goes well - watch your returns climb over the years.

It gets more complicated as retirement looms. When you are 10 or 15 years out, you need to start thinking about preservation of capital, volatility risk, and how you will keep generating cash after you retire and how you will live on the money you have saved.

There are numerous investment options that soon-to-be-retired Canadians can employ to preserve capital, reduce risk and still meet their goals. Which route to take depends on how much money a person has available from pension programs RRSPs, TFSAs and other accounts and on the nature of a person’s retirement goals.

Here are a few investing options retirees should consider:

- Annuities
- Guaranteed Investment Certificates (GICs)
- Bonds
- Dividend stocks
- Guaranteed Withdrawal Benefit Plans

3 – 5 ANNUITIES

With an annuity - in exchange for a single lump sum investment - an insurer makes guaranteed regular income payments to an investor that contain both interest and a return of principal. Annuity payments can continue for the lifetime(s) of one or two people, or for a chosen period.

Annuities can be ideal for investors who:

- Want the highest guaranteed income amount possible from their investments
- Wish to help cover essential expenses in retirement
- Are concerned about outliving their savings
- Wish to minimize tax on their investment income
- Value security and peace of mind while reducing the need for ongoing investment decisions

- Want to subsidize early retirement income
- Need income until pension and government benefits become available

Among the unique benefits offered by annuities: they remove the risk of outliving one's assets (what actuaries like to call "longevity risk"), they eliminate the hassle of making investing decisions after retiring and the income stream they provide is super safe.

Annuities buy you peace of mind as well as a regular flow of income. With some retirement savings annuitized, a retiree will have fewer investing decisions to worry about. He may also feel more comfortable with whatever stock market exposure he has in the rest of his portfolio.

3 -5.1 Longevity Risk

As noted above, life annuities can provide significant protection for individuals who live for long periods of time … since proceeds are guaranteed to be paid until death … whether that occurs in 5 years, or 10 years, or 60 years. Anyone worried about outliving their financial resources should consider an annuity contract. As described in the chart below, a significant number of Canadian elders will live beyond as 90: or more than 25 years beyond the traditional retirement age of 65.

Table 3 - 1 Probability of Surviving Beyond Age 90

Present Age	Males	Female
60	31 in 100	46 in 100
65	31 in 100	46 in 100
70	32 in 100	46 in 100
75	34 in 100	47 in 100
80	41 in 100	52 in 100

3 - 5.2 Types of Annuities

A **deferred annuity** pays you after a set period, typically after retirement.

An **immediate annuity** starts to pay out income immediately. Some deferred annuities can be turned into immediate annuities after a given period.

Life Annuities will provide you with guaranteed, regular income for life. They can be purchased as a single life, based on one person's life, or as a joint and survivor, based on the lives of two people.

Life annuities can also come with a guaranteed minimum payout (in the event of early death payments continue for a specified period).

Term Certain Annuities provide investors with guaranteed, regular income for a selected period. Once this period is over, income payments cease, and the annuity contract ends.

Prescribed Annuities offer preferential tax treatment if you are investing using non-registered funds. Each payment includes the same amount of interest and capital. This evens out the amount subject to tax and provides some tax deferral.

3 – 5.3 Term Certain Annuities

Other names for this type of annuity are annuity certain and fixed term annuity. These types of annuities will pay the annuitant a periodic income for a specific period.

This payment can be for 5, 10, or 20 years, or over a period that will end with a specific age, such as 90. Term certain annuities are always based on only one annuitant. If the annuitant dies within the specified period, any remaining income payments continue to be paid to a named beneficiary.

The remaining proceeds can also be "commuted" and paid to the beneficiary in a single payment. If this option is chosen, then the present value of the balance of the guaranteed income payment is used.

A term certain annuity can be purchased with either a single sum or premium, with the income payments beginning immediately. Quite simply, the income will begin at the end of the first interval after the initial purchase. The payments received can be monthly, quarterly, bi-annually, or annually, as directed by the annuitant. This type of annuity can also be issued on a deferred basis, with the first income payment not being paid to the annuitant until after a specific number of years, or until they reach a specific age. A deferred annuity may be purchased with either a single sum or with premiums over a specified period.

When RRSP funds are used, the annuity must run to age 90 (or the annuitant can take a term certain which runs to their spouse's age 90, if the spouse is younger). Once the period expires, the contract terminates. Life insurance companies and trust companies can issue term certain annuity contracts.

All the following apply to Term certain annuities:

- The interest rates offered are guaranteed for a specific period
- The contract guarantees the return of principal
- Contracts guarantee a minimum overall return
- The credit of the insurance company and Assuris guarantee safety of the contract. The insurance company assumes the investment risk

3 – 5.4 Life Annuities

Life annuity payments are for the lifetime of the annuitant. Payments will stop as soon as the annuitant dies (if there is no guarantee period). A guaranteed period of any length (as short as one year and to a maximum of age 90 if using RRSP funds) may be stipulated. The annuitant's estate (unless a beneficiary has been designated) will receive the remainder of the payments during the guaranteed period, should the annuitant die during the period.

Unless the beneficiary is the spouse, and RRSP funds are being used, any remaining guaranteed payments must be commuted.

The most common type of life annuity is the straight life annuity that will pay a guaranteed income for life but makes no provision for the return of any unused premium after death. If the annuitant is alive, the insurance company will make any contractual payments to them.

If the annuitant lives longer than expected, then the insurance company makes up any shortfall. Life annuities can be arranged so that some unused premiums can be returned to the beneficiary after the annuitant's death. Just like term certain annuities, all life annuities may be ether immediate or deferred annuities.

An immediate annuity is bought with a single premium with income beginning immediately. A deferred annuity is bought with a single premium, or a series of premiums to pay an income that will start at a specified future date.

A wide variety of Life Annuity options are available. Some of the more popular variations are described below.

Life annuity with no guarantee

Annuity income from this type of annuity is the most basic. This type of annuity provides a regular income for as long as the annuitant is alive. Any payments will cease with the last regular payment preceding the annuitant's death, and nothing further will be paid. Life annuities with no guarantee will pay the highest amount of income per $1,000 of purchase price. This is because the insurer does not have to pay any guaranteed income to the beneficiaries of the annuitant who die younger than their life expectancy. This form of annuity would appeal to retirees who desire the highest income and have no dependents to support.

Life annuity with a guarantee

These types of annuities provide a level income payable for as long as the annuitant lives and provides that if the annuitant dies before the end of the guarantee period, the income continues to any named beneficiary for the balance of the guaranteed period. If RRSP funds are used, and the beneficiary is not the spouse, then the commuted value of the remaining payments will be payable in a lump sum.

Life annuities with a guarantee will pay a lower income than a straight life annuity, because the insurer is obligated by contract to pay out a specified number of payments regardless of when the annuitant dies.

Increasing life annuity

This type of annuity will provide an income stream that increases at a fixed rate, compounded annually, if the annuitant lives. This can result in a built-in inflation protection factor. It can also contain a guaranteed period for pay out as described above. In the past Canada Revenue Agency has restricted the increase to 4% annually if RRSP funds were being used.

Joint and last survivor with no guaranteed period

This form of annuity will provide a level income during the lifetime of two annuitants. On the death of the first annuitant, the income continues in full to the survivor and ceases on the second death.

No death benefits are payable to the estate after the second death occurs. This is the common arrangement for a husband and wife, but other variations of annuitants can be arranged.

Joint and last survivor annuity with a guaranteed period

In some cases, if the premium to purchase a joint and last survivor annuity is substantial enough, a guaranteed period might be selected. This annuity will provide a level income while both annuitants are alive. If both pass away before the end of the guarantee period, the installments continue to the named beneficiary for the remainder of the period. If RRSP funds are used, then a lump sum settlement is done.

Joint and last survivor with income reducing

This annuity provides a level income while both annuitants are alive. The income reduces on the first death, or at the end of the guarantee period, whichever occurs later. The reduction can be up to any percentage of the original income. The most common plans will provide for a reduction to 50% – 66%.

If both annuitants die during the guarantee period, the full income is paid to the beneficiary until the guarantee period expires. If RRSP funds are used, a lump sum settlement will be made after the second death.

Increasing joint and last survivor annuity

This type of annuity arrangement will provide the advantage of increasing the income at a fixed rate of interest compounded annually if either annuitant lives. This can result in a built in inflation protector. It may also include a guaranteed period as previously discussed.

Impaired annuity

An impaired annuity will pay more to those individuals who have serious health problems that will shorten their life expectancy. Examples of these health problems could be a history of serious coronary or circulatory disorders. Normally there is a minimum premium required to buy this type of annuity.

The annuitant must supply a physician's letter and other medical evidence to the underwriters, who will use this as the basis for determining the life expectancy. For example, if the underwriters decide that a 65-year-old elder has a life expectancy of six or seven years, an older age could be used to determine the actual pay out. This way, the elder will receive more income, since the annuity payment is based on the assumption that the payout period will be shorter.

If a long guarantee period is requested, any additional income due to poor health is reduced, as the guarantee period may exceed the life expectancy, and the income will be related more to the guarantee period than to the life expectancy. Likewise, if a joint and last survivor annuity is requested and only one is in very poor health, the income level will be related to the life expectancy of the healthy annuitant.

3 – 5.5 Which Annuity is best?

The type of annuity that is chosen by the elder should depend on the following four factors:

1. Time Horizon

Time Horizon is when the elder plans on using the investment proceeds. The longer the elder is willing to live with an investment, the more they should consider equity building products that over time will outstrip inflation, cost of living, and other investments.

2. Other Investments

Other Investments should be considered when looking at annuity investing. If the elders have no other investments, a variable annuity may be too risky for them and their future income levels. On the other hand, they may feel they can invest well enough to better their income. One thing to keep in mind is that things can change in the marketplace—suddenly. Diversification has always been a fundamental in successful investing. If the elders' investments are tied up in debt instruments, they should look at equity options within a variable annuity.

3. Goals and Objectives

Goals and Objectives would include how much the elders want for retirement, sending their grandchildren or their own children through college, or just to buy a retirement home or vacation property in a few years. Whatever the elders' goal may be it is important to turn these into dollar objectives—something that can be attained.

Everyone can dream, but once a goal is set, it is important to plan and meet that goal.

4. Risk Level

Risk Level is what the elders accept in certain investments. This level can go up or down depending on the investment chosen. An elder needs to be comfortable with the risk levels of the investments he chooses. This means they need to be aware of their risk tolerance and the appropriate mix of investments that will help them attain their goals, while allowing them to sleep comfortably at night.

3 – 5.6 Annuity Disadvantages

Annuities are not sexy. You hand over your money to an insurance company who then puts you on a seemingly stingy allowance for the rest of your life." Even though annuities offer a variety of unique benefits, hardly anyone buys them. Economists have come to refer to this phenomenon as the "under-annuitization puzzle."

Part of the problem is the current low interest rate environment. Low interest rates depress the amount of annuity income one can buy these days. But annuities were not in vogue even when interest rates were much higher a dozen years ago.

One reason is that no one wants to enrich the insurance companies at their expense and this fear is not completely illusory. Research on annuity prices in the United States in the 1970s to 1990s found that annuities, on balance, did not provide very good value as they returned only 80% to 90% of premiums paid, in present value terms. That left a lot on the table for the insurance companies to cover their operating expenses and make a profit.

In recent years, however, the economics of annuities have improved greatly. Annuities in Canada now generally return 95% to 100% of premiums paid. In fact, with the recent fall in long-term government bond yields, annuities now return more than 100% of premiums paid in many cases. The economics, then, can no longer be blamed.

Another often-cited reason for not annuitizing is that the retiree wants to leave a large lump sum to a survivor in the case of early death. This argument, however, does not hold up on closer examination.

Even when people have little or no interest in leaving assets behind for their heirs, they tend not buy annuities. Moreover, annuities can come with generous survivor income options if one is prepared to pay for them. Another excuse shot down.

There are other explanations for this puzzle. One of the biggest problems people have with annuities is lack of control. You hand over a sum of money to an insurance company and it commits to paying you on a monthly, quarterly or annual basis for as long as you live. The money is locked in. Annuities cannot be cashed in or sold to someone else.

Other issues with annuities include the fact that: retirees often have the desire to have money on hand in retirement for a rainy day; the recognition that income needs might vary and the fixed income from an annuity might not match up well; and a reluctance to give up the chance to do better by investing in equities within a RRIF if stock markets do well.

3 – 5.7 Annuity Strategies

To mitigate the risk of annuities in the current low interest rate environment, retires could opt to buy annuities a bit at a time, just as you might buy stocks a bit at a time if you were nervous about jumping into the stock market all at once.

For example, you could buy three separate annuities at age 65, 75 and 85. Interest rates have a diminishing role in pricing annuities as the retiree ages.

Basically, annuities get better as you age because insurers do not expect to have to pay you for as long a period as if you had bought earlier.

An additional benefit of buying annuities in separate batches is that you will be able to capitalize if interest rates rise from today's low levels. Also, you can limit the already minimal risk that the insurance company issuing your annuity will fail.

When it comes to addressing the perceived loss of control associated with annuities, retirees could opt for a joint annuity, where for a substantially higher cost you can arrange for an annuity to pay your spouse in full or in part after you die.

Investors with a balanced RRIF portfolio are also advised to consider the use of an annuity. Suppose a retiree's RRIF is invested 50% in equities and 50% in fixed income. Why not buy an annuity with half the money and then invest the remaining portion 100% in equities? The annuity replaces the fixed income investments and provides a perfectly stable income stream at the same time. You can do this at the point of retirement or later, say at age 75, as a variation on the first strategy.

3 – 5.8 Annuities at Advanced Ages

Many retirees like the idea of annuities and in the past, people often purchased annuities as soon as they retired in order to replace their employment income, especially if they had no pension. That may not be such a good idea any longer.

Annuity payout rates are affected by interest rates, and current payouts are low. That does not mean you should shun these investments altogether—it just means it pays to wait. There is always a trade-off when you delay buying an annuity. The annuitant will receive payments for a shorter period, and they will need another income source to bridge the gap. But those payments will be larger, so the annuitant will also have a higher stream of reliable cash flow to protect them if they live well into their 90s.

Many experts say the current sweet spot for annuities is about age 70. It also makes sense to “ease in” over five years starting at that age. For example, if a person wants to annuitize $500,000, they might purchase a $100,000 annuity each year for five years. This gradual approach makes a person less dependent on payout rates at any moment.

At advanced ages annuities also become relatively more attractive compared to other payout alternatives. That is because annuities become increasingly attractive later in your retirement (one of the few things that does).

Consider the minimum payout at age 75 under a RRIF.

If the RRIF held $100,000 in assets at age 75, the minimum amount that would have to be withdrawn that year is about $5.820 (regular 2020 rules). Many retirees are upset about this because they feel the minimum withdrawal rules force them to deplete their assets too quickly, especially in the current low-interest rate environment.

By contrast, an annuity that is purchased at age 75 with a single premium of $100,000 would produce (in 2020) annual income of about $8,700, despite low interest rates. Not only is this about $2,200 more than the minimum RRIF income, the annuity is payable for life and thus removes any chance the money will run out too soon. More income and less worry is a hard combination to beat.

Finally, for people that are concerned about the apparent loss of an asset when it is converted into an annuity and who wish to leave a legacy beyond what may be left under any guarantee under the contract, consider the following strategy.
An individual may have a significant amount of money sitting in GICs. They intended to live off the interest only, leaving the principal to heirs. The problem is that interest rates have been dropping for decades and the income is now insufficient to support aging Canadians’ lifestyles.

An insured annuity using non registered monies, takes surplus cashflow compared to a GIC and uses some or all of it to purchase a life insurance policy equal to the total amount placed into the annuity. The annuitant owner gets a guaranteed, lifetime flow of income at reduced tax rates vs. a GIC. On death, the beneficiaries get the full amount of money placed into the annuity tax-free. This strategy has been a longstanding, popular one promoted particularly by the bank owned investment firms.

3 – 6 GUARANTEED INVESTMENT CERTIFICATES

Thirty years ago, retirees could put their savings in government bonds, Guaranteed Investment Certificates and other “safe” interest bearing investments and earn 10% to 15% interest. Today 10-year Government of Canada bonds are yielding about 2%—which makes it hard to keep up with inflation, let alone earn a healthy income.

But retirees still need to keep a good portion of their portfolio in low-risk investments, so they are not devastated if stocks head south.

Plain old GICs are among the best low-risk investments, but it is important to shop around for the best rates. Top yields for a handful of five-year GICs are around 2%, compared with less than 1% on federal bonds of the same maturity. The highest-yielding GICs are offered by small financial institutions you may never have heard of.

It is also possible to find higher-yielding GICs through an adviser or by going to the institution directly. It most cases retirees should stay within deposit insurance limits: usually $100,000 per institution.

The chief peril that most retirement investors should be wary of - particularly younger investors - is inflation. Although GICs typically pay higher interest rates than other types of bank deposits, such as savings accounts, their interest generally fails to outpace inflation over the long term.

Getting stuck with a low interest rate on a long-term GIC while market interest rates are rising is another potential hazard. To mitigate that risk, most advisers recommend either opting for a cashable GIC or laddering a portfolio of GICs with a variety of maturity dates, so a portion of the portfolio matures and becomes available for reinvestment at regular intervals.

3 – 6.1 Laddering GICs

GICs, like other fixed-term investments, suffer from something called “interest rate risk.” If you have $20,000 to invest in GICs, you must decide whether to lock that money up for one year, two years or five years (and everything in between). Thing is, you do not know where interest rates are going.

If longer-term rates are higher, you may be tempted to go with that. But then you run the risk that rates might go up in the interim and you would be stuck earning less. Or maybe rates are good right now, but you are worried that in five years when your GIC matures you will be stuck renewing at some pathetic interest rate.

Investors can eliminate the stress and the guess work by laddering their GICs.

When you “ladder”, you stagger the maturities on a series of investments. Imagine leaning a ladder up against the wall. Each rung up the ladder represents the next longest term available.

If you have $10,000 to invest in a GIC, you could put all $10,000 away for 5 years. Or you could ladder them, $2,000 for 1 year, $2,000 for 2 years, $2,000 for 3 years and so on.

The benefit to laddering is two-fold:

1. You do not have to guess which term will give you the biggest bang since you will have some money invested in each.

2. Since you have some money maturing each year, you can take advantages of upward swings in interest rates. And if the interest rate movement is downward, only some of your money is exposed to the lower rate.

3 – 7 BONDS AND BOND FUNDS

To further boost yields a retiree could consider investment-grade government or corporate bonds – they offer longer terms than GICs which do not usually go out longer than five years. However, that makes a portfolio even more vulnerable to rising interest rates (bond prices fall when rates rise, and the longer the maturity, the greater the decline).

Opinions differ about the best kind of bonds to hold, but if safety and lack of volatility are the most important concerns then government bonds instead of corporate bonds may be best and a retiree should opt for short-term and medium-term bonds instead of long-term bonds. If higher returns are more important, corporate bonds may be the best bet.

Retirees looking for a simple one-stop program should buy a Bond Fund or a Bond Index Fund. Funds of this nature are currently yielding a little over 2%.

Another idea is to create a corporate bond ladder, which can smooth out the effect of changing interest rates.

3 – 7.1 Laddered Bonds

In retirement, bond ladders can be used quite effectively to provide the funds needed for retirement expenses each year. For example, a conservative person might take their entire portfolio and buy individual bonds so that bonds mature each year for the next thirty years to meet their cash flow needs. This would be a thirty year bond ladder. A less conservative person might use a bond ladder to meet only the first five to ten years of expenses and still invest a significant portion of their assets in equities.

Suppose you are an investor with a moderate risk tolerance, retiring with $1 million. You might take $400,000, or 40% of your portfolio, and buy eight bonds with a face value of $50,000 each. The first bond would mature in one year, the next would mature in two years, the next in three years, and so forth, thus laddering the bond portfolio over an eight-year period. This is a simplified example, but it gives you a general idea of how it works.

The remaining $600,000 would be invested in stocks to increase the growth portion of your portfolio. Eight years later, if stocks averaged a 7% rate of return, the $600,000 would grow to just over $1 million, allowing you to sell $400,000 of stocks to create another bond ladder.

As far as harvesting the growth portion of your portfolio, using our example above, it is not likely you would wait eight years before selling off stocks to ladder out more bonds. Instead, in years with strong stock market returns, you would sell equities, and add bonds to the end of your bond ladder.

In years with poor stock market returns, you would not sell equities. If you had several years of poor stock market returns, you may get down to a point of having only two to three years of laddered bonds left. That is ok, as the point of creating the bond ladder is so you have safe investments to meet near term cash flow needs and thus are not forced to sell equities in a down market.

3 - 7.2 Bond Funds

Bond funds work just like stock funds, but they invest in bonds rather than stocks. You can invest in bond funds just like you can invest in stock funds. Low cost bond index funds are also available.

Investing in a bond fund offers some advantages over investing in individual bonds. Among these advantages:

- **Management**: Fund managers provide dedicated management and save the individual investor from researching issuer creditworthiness, maturity, price, face value, coupon rate, yield, and countless other factors that affect bond investing.
- **Diversification**: Bond funds invest in many individual bonds, so that even a relatively small investment is diversified—and when an underperforming bond is just one of many bonds in a fund, its negative impact on an investor's overall portfolio is lessened.
- **Automatic income reinvestment**: In a fund, income from all bonds can be reinvested automatically and consistently added to the value of the fund.
- **Liquidity**: You can sell shares in a bond fund at any time without regard to bond maturities.

3 – 7.3 Portfolio Allocation

One of the trickier questions that every retiree will have to deal with is what percentage of the whole portfolio should be in bonds?

Perhaps the most familiar formula is based on the idea that your age tells you how much of your portfolio should be in bonds. For example, if you are 40, then 40% of your portfolio is in bond funds.

For a 40-year-old investor, that is pretty good. But for a 70-year-old, this restricts the inflation-fighting equity funds to only 30%. Some experts suggest modifying the above formula.

Alternative One: Use the formula above but subtract 10 or 20 percentage points from the result. In other words, if the formula tells you to have 40% in bonds (for a 40-year-old), change that figure to 20% or 30%. This will give you more equities in the early years, when growth is what you need most, while automatically decreasing your stock exposure as you grow older.

Alternative Two: Keep 100% of your portfolio in equities until you are 35. At that time move 10% into bonds (if you consider yourself aggressive) or 20% (if you consider yourself conservative). Every five years after that, increase the percentage of bonds by five percentage points.

At 65, this leaves an aggressive investor with 40% in bonds and a conservative investor with 50%. Those are good allocations that many retirees can live with the rest of their lives.

Alternative Three: Another legitimate allocation, especially for investors who like having professionals make the decisions, is to invest in a target-date retirement fund. These funds are ubiquitous, and this approach makes age-based allocation changes automatic.

Alternative Four: For ultraconservative retirees who are spooked by the stock market, here is another approach. Hold enough of your portfolio in bonds to live entirely off the interest, and then keep the rest in stock funds. When the bond interest is no longer enough, make up the difference by withdrawing money from the stock funds.

Each of these approaches will do the job. They are all imperfect, but each is much better than leaving this choice to whim or emotion or the urgings of salespeople.

3 - 8 DIVIDENDS

While fixed-income investments can protect a retiree's savings, they will not likely grow a person's wealth. To stay ahead of inflation, retiree's need to keep a significant part of their portfolio in equities and focusing on dividend-paying stocks may provide the right balance of risk and reward.

There are two types of dividends in Canada, eligible and non-eligible. Most investors receive eligible dividends, paid out by companies in which they invest that are listed on some stock exchange and are available for direct purchase or are part of a bundle of equities in a mutual fund or segregated fund. Some people have an ownership interest in a small business and are paid dividends in addition to or instead of salary. When dividends are paid from income that has been subject to the small business deduction, then the dividends are designated as non-eligible dividends. A Canadian Controlled Private

Corporation which generates active business income exceeding the small business deduction limit is taxed at the higher general corporate tax rate. Dividends paid from this pool of income are designated as eligible dividends.

The important thing to note is that there is a different gross up and tax credit calculation for eligible dividends compared to non eligible dividends. And the tax on non eligible dividends is higher.

Picking the right dividend stocks is very important. Retirees should focus on reliable dividend-payers that can maintain those dividends even in bad times, while also growing them consistently over time. The companies to look for are well-managed, profitable companies in stable industries with good balance sheets and modest growth. They should also pay out only a reasonable proportion of profits.

Income investors will appreciate that many such stocks currently generate higher yields than 10-year government bonds, the reverse of historical norms. These steady-eddy stocks may lag during booms, but often outperform in bad years.

Please note the potential downside of dividend income discussed in CHAPTER 2 - Retirement Planning & Investment and under the following section 3-12.3 The Problem with Dividends 3-8.1 Dividend Stock Risks

Companies do not have to pay dividends. During recessions companies may lower the dividend they pay on their stocks or stop paying a dividend all together. In that case, the dividend yield could rapidly go to zero. In uncertain times, dividend paying stocks, or dividend paying stock funds, can rapidly go down in value because there is a risk that future dividends will be reduced. If a company announces that they are lowering their dividend, the stock price will react immediately. As the economy improves, the stock price might rise in anticipation that the company will once again increase its dividend. If the economy gets worse, the stock price might fall even further in anticipation that the company will completely stop paying the dividend. If the price of a dividend paying stock rapidly drops, there is a reason. It means there is a very real chance the company may reduce or stop paying the dividend soon. The market will often anticipate these changes, and that anticipation is reflected in the stock price.

For example, suppose a stock has a dividend yield of 10%. (The stock price is $10.00 a share. Last year the stock paid a dividend of $.25 per quarter, or $1 a year). It looks attractive. But a few days later the company announces that they are going to cut their dividend to $.10 per quarter (40 cents per year). The stock price rapidly drops to $5.00 a share.

3 – 8.1 Dividend Yield versus Bond Yield

Bond Yields are calculated in a similar way to dividend yields. However, a company must pay the stated amount of interest to its bondholders whereas paying a dividend to stockholders is optional, so during uncertain times, future investment income is more secure if you own an interest paying bond instead of a dividend paying stock.

3 – 8.2 The Benefits of Diversification

To reduce risk, retires should diversify their dividend paying holdings across a variety of industries, and into non-Canadian companies as well.

The easiest way to build a portfolio of dividend stocks is through mutual funds, segregated funds and ETFs.

Dividend income funds do the work for retirees. They own a diversified selection of dividend paying stocks, and they collect the dividends and pay them out - typically on a monthly or quarterly basis.

Before a person buys a dividend income fund, they should determine the amount of income that will be received by looking at the fund's distribution rate.

This is like looking at a dividend paying stock, where you can determine the amount of income that will be received by looking at the stock's dividend yield. Although similar, distribution rates and dividend yields are not the same, and it is important to understand the difference.

Before buying a dividend income fund learn about the fund's distribution rate policy. Some funds pay out just the dividends collected. This would make the fund's distribution rate an equivalent calculation to the dividend yield on a stock.

Other funds have a policy that states they will pay a specific amount of income, which means there may be times where they will return principal as part of the distribution. The principal returned could be gain earned on the sale of an appreciated stock in the portfolio, or it could be that the fund was forced to liquidate a stock at a loss to fulfill its requirements under its distribution rate policy. There is nothing wrong with this type of distribution rate policy, but like any investment, you want to understand how it works before you buy it.

3 – 8.3 Tax Benefits

A final benefit of dividend paying equities and dividend funds is that dividends are taxed at lower rates than interest when held in non-registered accounts.

3 – 9 GUARANTEED WITHDRAWAL BENEFIT PLANS

The interest in guaranteed lifetime income and its importance to aging Canadians is growing rapidly.

2/3 of people aged 55-75 like the idea of guaranteed lifetime income.

80% of Canadians see it as highly valuable supplement to government benefits. This value held by Canadians for guaranteed lifetime income is in addition to government sponsored plans.

There are gender differences in concerns. For instance, 1/3 of women are highly concerned about being able to maintain their standard of living in retirement.

Almost 4/10 women fret about long term care expenses in old age. These figures are almost double those for men.

This is understandable when you consider that women live longer than men and a higher proportion of elderly women live alone and in poverty.

Although people are living much longer, they are not necessarily working longer or able or willing to work longer. That leads to a longer time frame for people to be financially independent and feel comfortable that they can keep that up. They require more resources that will last longer to cover expenses. Added to that is the fact that only ¼ workers have a defined benefit pension plan. That places the onus on Canadians to set up their own guaranteed income plans, pensionizing some of their assets to make that happen.

Peter Wouters has written and spoken about what he terms "the 90% factors. Over 90% of Canadians want a predictable income that is guaranteed to last their lifetime. And they are willing to pay more to ensure it.

3 – 9.1 What is a Guaranteed Withdrawal Benefit Plan?

The product is available from select insurers and uses segregated funds as the underlying investment choices you can choose from to invest your portfolio. The standard features available from segregated funds are available in addition to annual income base bonuses for each year that an income stream is not generated. When you invest in this type of plan, you are guaranteed to receive a predictable monthly income that is guaranteed for as long as you live. It is always protected from market downturns and it will continue even if the value of your investment goes to zero. This product offers enhanced wealth accumulation before retirement and provides predictable, guaranteed retirement income for life. In other words, investors can deposit money into the plan and let the money grow until they need an income down the road; then begin an income stream that is guaranteed for life while offering the opportunity to remain invested in the market and further grow or maintain the value of their assets in the interim.

This type of plan is available on a registered (RRSP, RRIF) or non registered basis. It may also be used inside a TFSA.

3 – 10 HOME EQUITY INCOME

Many people approaching retirement have good reason to complain about the investment climate they have endured over the last dozen years. But there is one area where they cannot bemoan their bad luck—at least not if they own a house. Real estate in Canada has enjoyed an enormous boom in recent years, and that is allowed many long-time homeowners to build significant wealth without really trying. That can give you more options in retirement.

If you own an expensive home, you could add to your cash savings by downsizing or relocating. Some Vancouver homeowners are selling modest-sized homes in the west end, buying two-bedroom condos nearby, and winding up with $500,000 in their pocket. It is more common for homeowners in other parts of Canada to net $100,000 or $200,000 after costs.

The benefits of downsizing are well demonstrated in the experiences of a retired Toronto couple who recently sold their home and moved to Halifax to be closer to their son and his family. They were not in dire need of extra cash, but they saw a chance to take advantage of Toronto's hot housing market to top up their nest egg. They sold their semi-detached home in Toronto in the spring for $780,000 and bought a renovated detached Halifax house in a desirable neighbourhood near the ocean for $620,000. They netted more than $100,000 after costs, while retaining home equity they hope will at least hold its value.

The equity in your home can also provide a back-up plan if you run low on savings. If you stay put, you can cover essential expenses by borrowing against it with a reverse mortgage or home equity line of credit—albeit only as a last resort. Later in life, if you move into a retirement or nursing home, the proceeds from selling your house can defray those costs for years. Even if you never draw on your home equity, it can provide a great legacy for your kids.

3 – 10.1 Reverse Mortgages

It is no secret that many Canadians are heading toward retirement without much money in the bank. In a recent survey of 1,500 Canadians aged 50-plus by the non-profit Investor Education Fund only two in 10 households said they would have more than $250,000 saved for their retirement. And half of all households surveyed said they believe they will exhaust their savings in the first 10 years of retirement.

Faced with these challenging prospects, many Canadian homeowners are considering the option of a reverse mortgage to access the equity in their home.

If you are a Canadian homeowner older than 55, you can get up to 50 per cent of your home's value through a reverse mortgage. You are not required to make any mortgage payments and do not have to pay any interest or principal until you sell the home or die. The mortgage is paid off from the proceeds of the home's sale.

It is increasingly becoming a popular choice among elders ... especially elders in their early 70s.

Older seniors are generally eligible to receive a higher percentage of their home's value, while younger seniors get less, with the average being about 33 per cent. Another feature of the program is the "no-negative equity guarantee," which means that regardless of how much interest you accrue, you will never owe more than the house is worth.

Because there are no repayments, there are also no credit-checks or income requirements.

The main feature of a Reverse Mortgage Loan is that a senior may carry a reverse mortgage for 5, 10, 15 or even 25 years or more and never be required to make a monthly mortgage payment. Historically, house prices tend to increase. With a Reverse Mortgage the balance of the loan slowly accrues over time ... while at the same time the home's value continues to rise. This process ensures equity in the home over the long term.

Regardless of market fluctuations, the Reverse Mortgage lender guarantees, no matter what, that the loan balance will not exceed the fair market value of the home. In other words, **you can never owe the lender more than the value of the home.** Low interest rates in these types of loans reflect the confidence that a Lender feels in their exposure to loss due to market value fluctuations. Entering a Reverse Mortgage in Canada is a great option for any elder who needs access to their home's equity but does not want to be concerned about their debt exceeding the value of their home.

3 – 10.2 Reverse Mortgage Facts

- You and your spouse (if you are married) must both be at least 55 years old or older.
- The amount of loan that you get varies depending on your age, the house value and the location of your home. The minimum loan is $20,000. The maximum loan is $750,000.
- Eligible amounts are determined through an independent appraisal of the property. Costs associated in obtaining a Reverse Mortgage may be paid from mortgage proceeds at time funding. This means you would not be required to pay for the closing costs of the reverse mortgage out-of-pocket.
- You can get pre-approved for the maximum amount initially, and only have a small amount advanced. You only pay interest on the amount that is loaned to you ... not the amount that you get approved for.
- All money that you receive from Reverse Mortgage is tax-free.
- Canadian reverse mortgages do NOT affect any Old Age Security or Guaranteed Income Supplement government benefits you may already be receiving.
- You make NO monthly repayments while you or your spouse live in your home. Other mortgage products require you to make a monthly payment. With a Reverse Mortgage you do not have to make any mortgage payments.

- ❖ You still get to keep the house in your name; you are still on title (just like you would with any other mortgage). When you sell the home the debt is paid through the proceeds of the sale...however you even have the option to 'transfer' your reverse mortgage to a new property.
- ❖ You keep all the equity that is left in your home. 99% of all homeowners have equity in their home when the reverse mortgage loan is repaid. In fact, on average over 50% of the house value is still equity by the time that the Reverse Mortgage is repaid.
- ❖ Your estate is well protected. The lender guarantees that you or your heirs will never owe more that the home value.
- ❖ You can use a Canadian Reverse Mortgage to take cash out of the home and put it into investments. All the interest charged on the loan is then tax deductible.

3 – 10.3 Why Are Reverse Mortgages So Popular?

After years of diligently paying their mortgages, many Canadians now have significant value locked up in their homes. But although they may be 'house rich', they often do not have enough regular income to pay their other debts, cover monthly expenses or do important things like fix up their home. A reverse mortgage lets homeowners access the value in their home, without having to make any regular payments, until they choose to sell or move.

For homeowners 55 or over, a reverse mortgage is often a better option than a traditional home equity line of credit.

3 – 10.4 Reverse Mortgage Disadvantages

- ❖ Reverse mortgages are subject to higher interest rates than most mortgage types.
- ❖ The equity held in your home will decrease as the interest on a reverse mortgage accumulates.
- ❖ If a reverse mortgage is outstanding at death, the estate must repay the loan and interest in full within a limited time.

The costs associated with a reverse mortgage are usually quite high. They can include:

- ❖ A higher interest rate than for a traditional mortgage or line of credit.
- ❖ A home appraisal fee, application fee or closing fee
- ❖ A repayment penalty for selling the house or moving out within three years of obtaining a reverse mortgage
- ❖ Fees for independent legal advice

3 – 11 RRIFs

One of the options allowed for a maturing RRSP fund is a RRIF. A RRIF is a trust fund registered with Canada Revenue Agency, with the express purpose being to receive RRSP funds, and then provide a retirement income for the beneficiary. RRIFs are arrangements between you and the carrier that may be invested in the same type of investments as RRSPs. RRIFs allow unused income and assets to accumulate on a tax-free deferred basis like an RRSP.

Liquidity becomes a very important factor in RRIF situations, more so than for RRSPs, because a percentage of the funds are withdrawn each year.

RRIFs allow an elder to:

- Control & manage his/ her investments after retirement
- Take advantage of tax sheltering after the maturity of his/her RRSP
- Have greater income flexibility on the amount of funds available for withdrawal
- Maintain investment flexibility just as he/she had with their RRSP

If an elder purchases a RRIF with his or her RRSP, the tax advantage of the RRSP is maintained because he continues to defer tax on the accumulated funds that are reinvested in the RRIF, while income received most likely attracts a lower marginal tax rate.

- A RRIF may be set up at any time before the end of the year which you turn 71
- Early retirement can be accommodated by a RRIF
- Several RRIFs can be set up for diversification purposes. There is no minimum or maximum withdrawal amount in the first year, but there is a minimal withdrawal limit thereafter
- There is no maximum withdrawal limit in the second year but each year after you are required to withdraw a minimum percentage of the January 1 value of the fund
- The entire year's minimum can be withdrawn in a lump sum or periodically throughout the year
- By the end of the year, the minimum requirement must be withdrawn

All withdrawals from a RRIF are fully taxable, but any withdrawals up to the minimum amount for that year are not subject to withholding tax except for non-registered annuitants. Payments in excess of the minimum amount are subject to withholding tax at the same rate as that of RRSP lump sum withdrawals. If you want to defer taxes further, and your spouse is younger than you, then you can base the RRIF minimum pay out on your spouse's age when the RRIF begins.

3 – 11.1 Choosing the Right RRIF

Most Canadians choose a Registered Retirement Income Fund (RRIF) as their retirement income option. A RRIF is a comfortable transition because of its similarity to an RRSP. As noted above, a RRIF provides a high level of control over the investments in your retirement plan, the advantage of tax-free growth of assets within the plan, as well as maximum flexibility in establishing an income stream. RRIFs come in several shapes and sizes.

3 – 11.2 Income Decisions

The first thing you will need to determine is how much income you need or want. This decision will have the greatest impact on the longevity of your money. If you spend too much too fast, you will run out of money. Even if you do not need or want the extra income, you have the minimum income rules to contend with.

You can tailor your income to your needs, subject to minimums imposed by the federal government. If you need steady monthly, quarterly, or annual income, it is available. If you require a large lump sum for a major purchase, travel, or some other purpose, that is available too.

3 – 11.3 RRIF Withdrawal Rules

The table below outlines the regular minimum RRIF withdrawals as of 2020, as set by the government. Before age 71, the minimum percentage payout is worked out in the following way: 1÷ (90 – your current age). So if you are 65, your minimum withdrawal would be 1÷ (90-65) =4%. With a $100,000 RRIF, that amounts to $4,000.

Age at Start of Year	**Minimum Withdrawal**		**Age at Start of Year**	**Minimum Withdrawal**
65	4.00%		80	6.82%
66	4.17%		81	7.08%
67	4.35%		82	7.38%
68	4.55%		83	7.71%
69	4.76%		84	8.08%
70	5.00%		85	8.51%
71	5.28%		86	8.99%
72	.5.40%		87	9.55%
73	5.53%		88	10.21%

Age at Start of Year	Minimum Withdrawal		Age at Start of Year	Minimum Withdrawal
74	5.67%		89	10.99%
75	5.82%		90	11.92%
76	5.98%		91	13.06%
77	6.17%		92	14.49%
78	6.36%		93	16.34%
79	6.58%		94	18.79%
80	6.82%		95+	20.00%

Please note that the Government of Canada reduced the minimum withdrawal rate by 25% for withdrawals made for the year 2020 as part of its COVID-19 Economic Response Plan.

3 – 11.4 Investment Decisions

Financial institutions offer plans that can hold Guaranteed Investment Certificates (GICs), mutual funds, cash, or other financial instruments. Alternatively, you can establish a self-directed RRIF to include a combination of individual securities in your plan, such as stocks, bonds or Treasury bills (in addition to the investments mentioned above). RRIFs offer investment flexibility. You can hold the same investments that are eligible for an RRSP. Shares of Canadian corporations, corporate and government bonds, Canada Savings Bonds, Treasury bills, mortgages, GICs, term deposits, covered call options, warrants, rights, and mutual funds that invest in eligible securities are all qualifying investments. You can also hold foreign investments in your RRIF. Just like an RRSP, a RRIF lets you retain control over your investments, rather than handing over your money to a third party.

The longevity of your RRIF is simply based on how much money you make in investment return and how much you take out for income. It does not take a lot of mathematical know how to figure out that if you earn more money than you withdraw in income, the RRIF will grow. For example, if you invest in a GIC RRIF at 6% and you take out the minimum (4.76%) at age 69, your RRIF should grow by 1.24%. At age 82 given the same investment return, the minimum is now 7.38%. This means your RRIF will deplete in value by 1.38% (7.38%-6.00%).

3 – 11.5 Who Should Consider RRIFs?

Individuals should consider a RRIF if they want control over their money and how the funds are invested. They offer an attractive alternative to clients who do not want to invest their retirement savings in "traditional" annuity products.

They may already own an annuity and want to supplement their annuity income with a flexible, inflation-sensitive program. They may want to achieve some investment growth. Most institutions provide a wide variety of options and competitive returns.

Some people may want maximum tax deferral. RRIFs can provide a lump sum pay out, enabling your clients to change their retirement income from year to year as their needs change. RRIFs can be collapsed at any time and transferred to an annuity, another RRIF, or withdrawn in cash. Finally, if your clients and prospects are concerned about leaving an estate, the RRIF option is a good way to achieve the flow of money to the named beneficiary. Depending on who the beneficiary is, will determine whether the RRIF becomes fully or partially taxable on deregistration.

3 – 11.6 What Will Happen to Your RRIF When You Die?

You can leave your remaining RRIF assets to your heirs upon your death by designating the proper beneficiary. Not all other retirement income options provide for this. Naturally, your desire to provide an estate for your spouse, beneficiaries or charities may have an impact on how you set up your RRIF. While this may or may not be an issue, income and investments should remain the priorities.

3 – 11.7 RRIF Flexibility

One of the benefits of the RRIF is the flexibility you have in dictating income. These are some common types of RRIFs.

Minimum income RRIF

This RRIF provides the minimum level of income. Typically, people who choose the minimum income RRIF are those who do not need the money and want to defer taxable income for as long as possible. Remember, if this is the case, you can base the RRIF on the age of your younger spouse.

Furthermore, remember the RRIF minimum income is based on the value of the RRIF on December 31 of the previous year. Sometimes this can make income planning difficult because you really do not know what your income will be until the last minute.

Capital preservation RRIF

Preserving capital and paying out a fixed level of income are the goals of this RRIF type. In this case, you will withdraw your investment returns each year (subject to minimums). If you are using mutual funds, you might elect a reasonable target return like 8%, for example, with the hopes and intentions of earning 8% to maintain the capital.

Level income RRIF

If you want to provide income for a specific period such as to age 90, this RRIF would be the right choice. In this instance, you would determine the amount of income you could derive so that the entire asset would be depleted by the time you reach 90 years of age. You can use age or time frame.

3 – 11.8 Multiple RRIFs

You can have as many RRIFs as you want. You can have one that pays a level income for the next 5 years to bridge income until government benefits. You can have another that is a capital preservation RRIF for a more stable long-term level of income. Generally, many people consider consolidating into one RRIF. With a single RRIF, you can easily manage your investments and you will only have to worry about one minimum withdrawal. Several RRIFs require more time and energy, and you will have to arrange to withdraw at least the minimum from each one.

3 – 11.9 Withholding Tax

RRIF income is subject to government withholding tax rates. Just like your employer withholds taxes and remits them directly to the government, your RRIF administrator is required to do the same. Minimum income RRIFs are not subject to withholding tax, but you can request any level of withholding tax desired. In all other circumstances, there is a 10% withholding rate on withdrawals less than $5000, 20% on withdrawals between $5000 and $15,000 and 30% tax on withdrawals over $15,000.

As you can see, there are a lot of issues to deal with when it comes to planning your RRIF income. Take the time to plan wisely

3 – 12 TAX-FREE SAVINGS ACCOUNTS

Before 2009, RRSPs were really the only way for Canadians to shelter their retirement savings from taxes. But the introduction of the Tax-Free Savings Account (TFSA) has added another option.

When it comes to generating retirement income, TFSAs offers retirees several key advantages:

- They are self-regenerating (Contribution room is "regenerated" after a withdrawal – in an RRSP it is lost)
- There is no upper age limit on contributions
- Withdrawals are entirely at the owner's discretion (i.e., there are no minimum withdrawal requirements starting at age 71)
- Earnings and withdrawals within the TFSA are tax free (as opposed to merely tax deferred in an RRSP)

The TFSA provides seniors with a tax-efficient savings vehicle to help meet ongoing savings needs, even after they reach age 71 and are required to convert their registered retirement savings into a retirement income vehicle.

Neither the income earned in a TFSA nor withdrawals from it affect eligibility for federal income-tested benefits and credits such as Old Age Security, Guaranteed Income Supplement benefits and the Goods and Services Tax Credit.

3 – 12.1 RRSP vs TFSA

TFSAs are catching up to the RRSP as the tax-sheltered investment of choice.

The Household contribution rates for selected registered savings accounts released in September 2017 found that. the two vehicles are in a neck-and-neck race for Canadians' cash in terms of annual contributions. Evidence since that time has found that certain cohorts, Millennials in particular and individuals age 55+, are putting more money into a TFSA than a RRSP.

An RRSP gives a person an up-front tax deduction that they do not get with a TFSA. But the federal government then snags its share in income tax assessed on the back-end cash withdrawals, typically after the taxpayer retires.

Commonly held thinking is that, at its most basic level, the decision between an RRSP and TFSA comes down to your marginal tax rate today and your expected rate in retirement when you start to draw money from the plan. If you expect to have a higher marginal tax rate in retirement than today, then contributions to a TFSA make more sense since you will not face tax on withdrawals later. If you expect your marginal tax rate to be lower when you retire then an RRSP generally makes more sense.

How does this apply in real life? If you are a lower-income individual, perhaps because you are younger and in an earlier stage of your career (perhaps a student), or you are on parental leave or on sabbatical, and you expect to earn a higher income in the future, you are a good candidate for a TFSA contribution. Further, your RRSP deduction will not save you as much tax today as it might later, so contribution to an RRSP later may make the most sense if you cannot contribute to both plans today (you can always contribute to your RRSP and save the deduction for a future year if you have the means to contribute to both).

If you receive income-tested benefits such as Old Age Security, the Guaranteed Income Supplement, child tax benefits, or GST credits, withdrawals from a TFSA will not affect your income and therefore will preserve your benefits. Withdrawals from an RRSP will impact these benefits, so a TFSA may be a good option here.

Other than considering your marginal tax rate, there are other things to think about when contemplating an RRSP or TFSA. TFSAs may be more appealing to seniors since there is no age limit for contributions.

Also, if you are expecting "supernormal" rates of return on an investment, a TFSA will be appealing because you will not face tax on the disposition and withdrawal of those funds. TFSAs are also appealing if you are not going to need the funds in the plan since you are not required to make withdrawals, unlike an RRSP which matures at the end of the year in which you reach age 71. The assets in a TFSA can also be used as collateral on a loan (not so with RRSP assets). Finally, if you are saving for short-term consumption then TFSAs offer greater flexibility.

RRSPs offer a psychological advantage in that many people are hesitant to make withdrawals due to the tax that will apply, which could result in greater savings. It is also generally possible to contribute more to an RRSP than a TFSA. Confused? The fact is, both plans are effective. Most Canadians should have both, and the plan you contribute to may change from time to time depending on your income or purpose for saving.

Although deciding between a TFSA and an RRSP can be confusing, the following basic guidelines may be helpful.

If an individual is making less than $50,000 per year (which minimizes the tax savings of an RRSP contribution) they may be much better off with TFSA when you consider future taxation on their RRSP withdrawals (at a potentially higher tax rate) and the claw back of government benefits. Both the principal and the return of their RRSP could end up taking a big tax hit when the investment is taken out. Low-income people could lose a lot of GIS (Guaranteed Income Supplement) while middle-income people could lose some of the benefit of the age credit and the GST/HST credit. So it may make sense for both groups to maximize a TFSA before looking at an RRSP.

People in their peak earning years (paying income tax at 40% or more) are likely better off with an RRSP since there is less risk that future withdrawals will be taxed at a higher rate (and a very good chance the withdrawals will attract less tax).

In an interesting twist, TFSAs also make great sense for those who have a good defined benefit pension plan at work, no matter how much they make. These individuals are almost always better off with a TFSA. Mandatory withdrawals required by RRSPs at age 72 could boost them into a higher tax bracket and result in claw backs to Canada Pension Plan (CPP) and OAS –payments. They can help to avoid this problem by opting for a TFSA.

Finally, if you are a high-income earner and you expect to max out your RRSP contribution limits, a TFSA makes a great second savings vehicle.

3 – 12.2 Other Uses for a TFSA

Health care expenses are a major concern for retirees. And their uncertainty is not helped by the ongoing strains on the public healthcare system. Partly it is a question of information. People need to understand what is and is not covered by government programs.

For example, many types of prescription drugs and basic hospital services are covered while newer drugs and services or quality of care options such as rehabilitation, upgraded accommodation in nursing homes or certain therapeutic devices are not.

Retirees are not going to be able to fully anticipate their future healthcare needs, but they should know how TFSAs could eventually help. Withdrawals can be made at any time for any purpose, including unanticipated healthcare expenses without incurring unexpected tax bills.

The basic risks of retirement are not going away. If anything, they are becoming more acute as the global economy attempts to recover from the 2008-2009 recession. Indeed, there is more onus than ever on individual investors to assess their risks and commit retirement plans to paper.

In this regard, TFSAs are not a cure all, but they can be very useful. Annual contribution room may not seem extraordinary, but the potential for growth is considerable. And as these accounts grow, they will become an integral part of any investor's retirement planning arsenal. Their tax advantages in coping with a variety of risks are simply too potent to ignore.

3 – 13 TAX EFFICIENCIES

One indispensable element of a successful retirement income plan is achieving tax efficiencies, but how many retirees are aware of how to do so? The more one can minimize taxes, the greater the after tax retirement income flow.

Managing taxes during one's working years, when employment income is the principal income source, tends to be focused on maximizing RRSP contributions and allocating investments strategically to attract the least tax possible on investment income for the current year. However, as we transition into retirement, the tax planning spotlight shifts to withdrawing assets in the most tax-efficient manner. There is also a need to be aware of the tax benefits and credits that do not apply until one reaches the age of 65.

To succeed in achieving tax efficiency in retirement, a mindset change may be required – the preoccupation with minimizing current year taxes will have to be substituted by the longer-term objective of maximizing after-tax income for the entire retirement period. This in turn requires a good understanding of how various income sources are taxed, a keen awareness of the tax brackets and threshold amounts for tax credits and making shrewd decisions as to allocation of investments, whether in terms of asset types or in terms of investment vehicles.

As the much publicized demographic phenomenon of the "tsunami" of baby boomers moving into retirement continues, retirement income planning has become one of the hottest topics in the financial world. There is mounting appreciation of how rising life expectancies, market volatility, constant inflation and unplanned-for expenses pose serious threats to the ability of many a retirement portfolio to last a lifetime.

For some, the antidote is to tone down lifestyle expectations in retirement. For others, it is to amass as large a retirement nest egg as achievable. In effect, the former strategy focuses on trimming down the expense side of the equation, while the latter focuses on magnifying the asset side. Still others opt to postpone retirement, a strategy that is a bit of both – boosting the number of income-producing years and shrinking the number of spending years at the same time. But a better strategy – one that more people should be paying attention to – is one that focuses on achieving tax efficiency.

The tax efficiency strategy is a variation of the expense reduction approach. Often, when asked what their major expenses in retirement will be, the instant response of most people will be food, shelter and lifestyle expenses (such as travel and entertainment). It may not be readily apparent that, even in retirement, taxes can (still!) be one of the biggest expenses.

3 – 13.1 Asset Allocation

One of the most common strategies employed by elder Canadians is to allocate assets efficiently between registered and non-registered accounts. For Canadians with sizable, registered accounts, these assets will represent a substantial portion of their retirement income. Since the entire amount of such withdrawals constitutes taxable income managing these withdrawals in a tax efficient fashion is critically important.

3 – 13.2 Tax Differences

When it comes to the taxation of assets, not all assets are created equal. Interest income, dividends and capital gains are all taxed differently – so it is possible to create tax efficiencies by carefully structuring one's asset mix.

As a general rule only, assets that are most punitively taxed (e.g., interest income) should be held in tax sheltered vehicles (e.g., RRSP, TFSA), while investment that receive more favourable taxation should be held in taxable accounts.

This strategy applies across the board, but with one notable exception: eligible dividend income can be a double edged sword in retirement.

3 – 13.3 The Problem with Dividends

Dividends are payments that you, as an investor, receive as a share of a corporation's earnings. Some of the dividends you receive may be eligible dividends, while others may be called ordinary, or ineligible dividends. Receiving dividend distributions from Canadian public companies qualify for the dividend tax credit which makes investing in dividend paying companies extremely tax efficient. However, the dividend gross up and tax credit can cause problems.

Dividend income is “grossed up” by 38% for eligible dividends (and this gross up is subsequently offset by a tax credit). This does not create a problem for elders not receiving Old Age Security. However, for seniors who are receiving OAS, the higher grossed up amount is used when calculating the OAS threshold for claw backs. The gross up for ineligible dividends is 15% for 2019 and later years.

With the gross up, for example, $20,000 in eligible dividend income becomes $27,600 of reportable income which, in certain circumstances, could be just enough to push a senior in to a position where OAS income could be clawed back.

Elders should consider structuring their portfolios accordingly to reduce potential OAS claw backs. They could, for example, consider shifting some assets into a TFSA since withdrawals are not taxed and do not affect income tested seniors benefits.

The Gross up in reportable dividend income could also adversely impact an elder’s GIS and Spousal Allowance income.

3 – 13.4 Tax Efficient RRIF Withdrawals

The usual advice for retirees is to draw income from their non-registered accounts, such as regular savings accounts, first. When that money runs out, they are then told to go after the funds in their RRSP or Registered Retirement Income Fund (RRIF). That is because all the money withdrawn from an RRSP or RRIF counts as income, and you must pay taxes on it. So you want to put off drawing down that money—and paying those taxes—if possible.

But It turns out the conventional wisdom is often dead wrong. A more balanced approach makes more sense.

To see why, consider that if you draw down all your non-registered accounts first, you will eventually be left with a nest egg made up entirely of RRSP or RRIF money. Then when you reach 71, you are suddenly forced to convert your RRSP to an annuity or RRIF and start taking minimum withdrawals. This can drive up your income, and because higher incomes are taxed at higher rates, you are liable to pay much more tax than you would have if you had spread out your RRSP withdrawals more evenly.

It is usually especially wise to draw on your registered accounts first if you retire before age 65, since you will need to bridge your income needs before Old Age Security and other benefits kick in. This can also help you avoid OAS claw backs later.

At the very least, convert some of your RRSP assets into an income stream at age 65 so that you and your spouse or common law partner can optimize access to the $2000 Pension Credit each. That could amount to up to $28,000 in pension credits ages 65-71.

The bottom line is, it often makes more sense to withdraw some RRSP money before exhausting your non-registered accounts, even if you take a small hit, because it can help you avoid a much bigger tax bill later.

Overall, Canada is quite generous to seniors, thanks to Old Age Security and tax breaks such as the Age Credit. But for higher-income seniors, the system often gives benefits with one hand and claws them back with the other. So any time you consider how much tax you will pay when you draw down your portfolio in retirement, you also need to consider the claw back of these benefits.

Determining the right drawdown strategy depends on your personal situation—in particular, the amount of income you expect to receive in retirement. Let us look at the opportunities for retirees with low, moderate, and high incomes and help you determine what's right for you.

Low-income seniors

If you do not have much saved up for retirement and you expect to depend on the Guaranteed Income Supplement, then your best bet is to draw down any RRSPs quickly, preferably before you turn 65 and become eligible to collect GIS. That is because each $1 of RRSP income after age 65 results in a claw back of roughly 50 cents from your GIS—equivalent to a 50% marginal tax rate. Since this claw back rate is so high, you are better off pulling out RRSP money earlier, even if you must pay some tax on it. It will undoubtedly be at a much lower rate than 50%. If you do not immediately need the money to live on, transfer your early RRSP withdrawals to a Tax-Free Savings Account (TFSA). When you take out TFSA money later, it will not have costly GIS consequences.

Moderate-income seniors

If you are a senior with less than about $30,000 a year in income, you can earn a surprisingly large chunk of that income tax-free. That is because the combination of the Age Credit and the Pension Income Credit (which only seniors get) plus the basic personal credit (which every taxpayer gets) can shield you from federal taxes on the first $20,000 or so of your taxable income. (The provinces offer similar credits, but their tax-free zone is not usually as large.) Once your income moves beyond $20,000, you leap into the first federal and provincial tax bracket. There you will pay a combined rate of 20% to 28%, depending on your province.

Because of that jump in your tax rate once your income crosses the $20,000 a year threshold, the objective for seniors with moderate income is simple: take out as much of your RRSP and RRIF money as you can while remaining in the tax-free zone.

The following example shows how it can work: Say you are a retired senior living in a province where the tax-free zone is your first $19,000 of income, and you need $28,000 (after taxes) to cover your expenses this year. You receive $12,000 in income from Old Age Security, the Canada Pension Plan, and interest from bonds and GICs in non-registered accounts. That means you will need to withdraw an additional $16,000 from your portfolio to cover your cash flow needs. So, do you take that $16,000 from your non-registered account (which is not taxable) or your RRSP or RRIF (which would be reported as income in the current year)?

If you followed the conventional advice and took everything from your non-registered account, then you would be passing up a golden opportunity to take out some of your RRSP or RRIF money tax-free. Here is why: because your income from other sources is just $12,000, you can withdraw up to $7,000 in RRSP and RRIF money and still stay within the $19,000 tax-free zone. If you do not make that withdrawal now, you may have to pay a substantial amount of tax down the road, when your non-registered funds are depleted, and you are forced to make larger concentrated RRSP and RRIF withdrawals. You can meet the rest of your spending needs by taking another $9,000 from your non-registered accounts.

By taking this balanced approach, you not only pay no income tax in the current year, you also shield yourself from tax that would have been payable on future RRSP and RRIF withdrawals.

High-income seniors

When you are a retired senior with taxable income beyond $35,000 or so, you have left behind the pleasant vistas of the first tax bracket and entered more rugged fiscal highlands. Now the tax rates increase, and the claw backs of government benefits begin.

There are several major tax bumps to look out for. The specifics vary depending on your province, but in most cases you will cross into the second provincial tax bracket somewhere between $30,000 and $44,000, at which point your marginal tax rate jumps two to five percentage points.

As well, you will see some of your federal Age Credit clawed back starting at about $33,000. This claw back is equivalent to increasing your marginal tax rate by more than two percentage points. You jump to the second federal tax bracket around $46,000, causing you to suddenly pay an extra seven percentage points in taxes.

In short, the next big income threshold you will hit after $20,000 is at $46,000. At about $46,000 you go from a 24% to 31% tax bracket if you live in Ontario. In other provinces, your combined marginal tax rate at $46,000 jumps to somewhere between 30% and 38%. So your goal should be to smooth out your taxable income from year to year in order to keep it below that threshold.

Beyond $46,000, there are two more thresholds to keep in mind. The next is when your income reaches $79,000, because that's when Old Age Security begins to be clawed back. Each dollar of income over that amount results in a claw back of 15% from OAS benefits, so it is equivalent to adding 15% to your overall tax rate.

The final threshold we will look at here hits at $93,000. At that point, you will have reached the third federal tax bracket and you will begin paying a combined marginal rate of somewhere between 36% and 46%, depending on your province. When you add in the impact of the OAS claw back, you are in for a shock. At $93,000, you are effectively paying a 51% to 61% marginal tax rate.

You may think that you will never have to worry about finding yourself in these high tax brackets. But not so fast: if you draw down your non-registered accounts first, then your untouched RRSPs can grow remarkably large. Then you are forced to convert them to an annuity or RRIF at age 71 and start taking minimum withdrawals. (You must withdraw 7.38% from your RRIF the year you turn 72, and the percentage rises with your age.) That can easily push you into a much higher tax bracket than you anticipated.

What is more, when one spouse dies, his or her RRSPs and RRIFs are typically transferred to the survivor. The prescribed withdrawals could now apply to a combined amount that is suddenly twice as large, which effectively doubles the minimum drawdown. When the surviving spouse dies, then any remaining RRSPs or RRIFs become taxable. If these balances are large, the estate will pay a hefty tax bill.

3 – 13.5 TFSAs and Tax

As noted above, if you are saving for retirement with limited funds, whether you sock money away in your RRSP or TFSA depends on your tax bracket now compared with when you withdraw the funds. If you have a high income today, it makes most sense to place money into RRSPs first, since you get a juicy tax refund and you will eventually pay less when you withdraw money at a lower tax bracket. If your income is low today and you expect your tax bracket to be higher in retirement, then you are better off with TFSAs, because your RRSP refund will not be as large as the future tax hit and you will avoid a larger tax hit down the road. What is more, your unused RRSP contribution room accumulates for future use when you are in a higher tax bracket and you have tax deductible cash to invest.

The problem is it is hard to know what tax bracket you will wind up in. But retirees typically live on 50% to 60% of the income they had in their peak working years; if they have been savers, the percentage of lifestyle income drops to 30-40%. RRSPs should be the first choice for those with average salaries or better. If your income in retirement will be about the same, a tie should go in favour of the TFSA because it is more flexible. If you need the money for an emergency you can withdraw TFSA money without tax consequences, whereas RRSP withdrawals might cause you to pay hefty taxes if you are still working. TFSAs are also better if you expect to end up with sufficiently low income in retirement to be eligible for the Guaranteed Income Supplement (GIS). Withdrawals from an RRSP reduce GIS payouts, whereas TFSA decreases do not.

Later, you will need to figure out how to withdraw the money without paying too much tax. If you have substantial RRSPs and non-registered accounts, it is even more complicated. The best strategy may be to take a balanced approach to withdrawing money from both sources. That is because of our progressive tax system, where higher incomes get taxed at much higher levels. Seniors who defer RRSP withdrawals in their 60s are often forced to make large withdrawals after age 71, when they are required to convert RRSP money to a RRIF or an annuity. That can often push them into a higher tax bracket.

3 – 13.6 TFSAs and Inefficient Investments

TFSAs come into the picture here because their tax free status allows investors to hold tax inefficient investments in them in order to maximize after-tax yield. Advisors can help clients not only by reviewing their overall asset allocation but also by encouraging them to consider the after-tax yields of investments and then making sure the tax inefficient ones are held in TFSAs. That way, clients will keep more of their money.

3 – 14 SAFE WITHDRAWAL RATES

One of the more perplexing questions face new retirees is simply this: how much money can be safely withdrawn from one's retirement nest egg.

You need retirement income. The question is how much money should you take out each year? You want to make sure you do not spend down your accounts too fast.

3 – 14.1 What is a Safe Withdrawal Rate?

A safe withdrawal rate is the amount of money that you can withdraw from your investments each year, with the ability for future year's withdrawals to increase with inflation, and with a high likelihood that this money will last for the remainder of your life expectancy, even if investments are delivering below average returns.

3 – 14.2 Calculating a Safe Withdrawal Rate

If you spend $4,000 for every $100,000 you have invested, you would have an initial withdrawal rate of 4%. Traditional calculations say this withdrawal rate is about right; you can spend about 4% of your investments each year and never run out of money.

The latest research (described below), however, provides a different answer, and a set of clear cut rules to follow that will give you the greatest probability for increasing your retirement income.

What happens if you follow these new rules? You may be able to have a withdrawal rate as high as 6 – 7% of your initial portfolio value, or $6,000 - $7,000 per year, for every $100,000 you have invested.

3 – 14.3 Six Withdrawal Rate Rules

So what are these rules that allow you to maximize your withdrawal rate, and thus your retirement income?

Withdrawal Rate Rule 1: Your Portfolio Can Deliver a Higher Withdrawal Rate When the Market Has a Low Price to Earnings Ratio

A price to earnings ratio is a tool that can be used to estimate the future long-term returns (15+ year cycles) of the stock market. Please note it is not very useful in predicting short term stock market returns.

For a retiree, it can be used in determining the right starting withdrawal rate; an amount that could safely be withdrawn each year, with the ability for subsequent year's withdrawals to increase with inflation.

- When the price to earnings ratio of the stock market is below 12, safe withdrawal rates range from 5.7% to 10.6% depending on the time period studied.
- When the stock market's price to earnings ratio is in the range of 12 – 20, safe withdrawal rates range from 4.8% to 8.3%, depending on the time period studied.
- When the price to earnings ratio of the stock market is above 20, safe withdrawal rates range from 4.4% to 6.1% depending on the time period studied.

The point to remember, if you retire when the stock market has a low price to earnings ratio, your portfolio will likely support more income over your lifetime than someone with the same amount who retired when the market had a high price to earnings ratio.

Withdrawal Rate Rule 2: Have the Right Proportion of Equities to Fixed Income So Your Retirement Income Can Keep Pace with Inflation

Your portfolio must include some equity exposure.

If you avoid all equity exposure, you run the risk of running out of money. Too much in equities, and volatile markets may scare you away at the worst time. Too much in fixed income, and your retirement income will not keep pace with inflation.

Withdrawal Rate Rule 3: Use a Multi Asset Class Portfolio to Maximize Your Withdrawal Rate

Think of building a multi asset class portfolio just like creating a well-balanced meal. Imagine, for example, sitting down to a sumptuous dinner of steak, shrimp, and baby back ribs. Although the meal has variety, it is not well balanced.

In the investment world, instead of food groups, you have asset classes. A well balanced portfolio contains, at a minimum, an allocation toward each of the following asset classes: Canadian equities (stocks or stock index funds), international equities, real estate and fixed income (cash, GICs and bonds).

Withdrawal Rate Rule 4: Take Retirement Income Withdrawals in a Prescribed Order

When you take withdrawals, your retirement income must come from each category in a order. For the new investor, these rules can be complex. To simplify the idea, picture three buckets.

Retirement Income Bucket 1

Bucket number one is filled with cash; enough to cover one year's worth of living expenses, perhaps more.

Retirement Income Bucket 2

Inside bucket number two you stack your fixed income investments (sometimes called a bond ladder). Each layer represents one year's living expenses. Every year, one year's worth of spending money "matures", and moves from the "fixed income" basket to the "cash" basket. This assures you always have enough cash on hand to cover your upcoming expenses.

Retirement Income Bucket 3

The third bucket is filled mostly with equities. You may only take money from the equity bucket when it overflows. An overflow year is any year when equities have above average returns; roughly an annual return in excess of 8 - 10%. At the end of an overflow year, you sell excess equities, and use the proceeds to refill the fixed income and cash buckets. Take surplus earnings not used to replenish Buckets one and two and invest them into other equities.

There will be many years where the equity bucket does not overflow. It will take discipline to realize it is okay to let the fixed income and cash buckets get to a low level during these years. Eventually, an overflow year will come along, and all buckets will be refilled.

Following this rule will prevent you from becoming a victim of your own emotions and selling investments at an unfavorable time.

Withdrawal Rate Rule 5: Take Retirement Income Pay Cuts during Bear Markets

This capital preservation rule functions as a safety net to protect your future retirement income from erosion during bear markets. It is triggered when your current withdrawal rate is 20% greater than your initial withdrawal rate. Sounds confusing? The best way to explain this rule is to use an example.

Assume you have a $100,000 and you start withdrawing 7% or $7,000 each year. The market goes down for several years and your portfolio value is now at $82,000. The same $7,000 withdrawal is now 8.5% of your current portfolio value.

Since your withdrawals now represent a bigger piece of your portfolio, the capital preservation rule kicks in, and says you must reduce your current year's withdrawal by 10%. In this example, your withdrawal would go from $7,000 to $6,300 for the year.

Much like real life, where some years you receive a bonus and other years a pay cut is required, this rule adds the flexibility you need to endure changing economic conditions.

Withdrawal Rate Rule 6: When Times Are Good, you are Eligible for a Raise

The final rule is most people's favourite. The opposite of the capital preservation rule, it is called the prosperity rule. It says that if the portfolio had a positive return in the prior year, you may give yourself a raise.

Your raise is calculated by increasing your monthly withdrawal in proportion to the increase in the consumer price index (CPI). If you were withdrawing $7,000 per year, the market had a positive return, and the CPI went up by 3%, then the following year you would withdraw $7,210.

Following these rules takes discipline. The reward is a higher level of retirement income, and an increased ability to maintain purchasing power.

It is important to make informed decisions about your money. If all this investment "mumbo jumbo" gets overwhelming, then take a step back, and think of it like a new career. It takes time to learn new skills. Remember, the right decisions will help you generate retirement income that will last.

3 – 15 RETIREMENT INCOME FUNDAMENTALS

So you have saved diligently and carefully for retirement—now it is time to turn your savings into income. The transition from saving to living off of your nest egg may seem difficult at first, so we will give you some fundamentals and steps to help. By following the following nine fundamentals, you will take control of your retirement and create a solid retirement income plan.

Of course, no single path will fit every investor. This is especially true when shifting to living in retirement from saving for it, when there are different sorts of challenges. But everyone should start with a plan, and then stay flexible.

Fundamental 1: Review your situation

Know where you are before you decide where you are going. Determining exactly what you have is a great place to start, no matter your situation. And you will be well ahead of most retirees if you take the time to figure out what you have got before making any big decisions. No matter what you have already saved, you need to take a careful look at what you have, where you have it, and what you expect to spend.

Do you have enough? Based on what you have, how do you create an income plan?

Think carefully about what you currently spend, and plan for "must haves" (what you really need) and "nice to haves" (what you have worked hard to have so you can live a comfortable retirement). Breaking out a budget this way, and looking at your existing portfolio and income sources, can help you create an investment plan. Estimate monthly and annual expenses and how much you have earmarked for retirement.

Fundamental 2: Maintain a year's worth of needed income in cash

Every good plan starts with the question, "What do I need now?" Then you can plan your investments to keep up with your lifestyle, inflation, unexpected future expenses or the "nice to haves" later in retirement. Set aside enough cash to cover your spending needs (after non-portfolio income sources like Old Age Security, Canada/Quebec Pension Plan and company pension plan benefits are considered) for the next 12 months.

Treat this money as "spent." It is the first "bucket" of your cash-flow plan—a cash reserve for your current expenditures. The second bucket will be the rest of your portfolio.

Consider putting cash from the first bucket into a single, easily accessible place. This could be a checking account, a money market account or a combination of accounts, maybe even short-term GICs, depending on your personal preferences. This money can be invested to seek to generate a bit of return, but that is not its primary purpose—it is there to help meet your expenses throughout the year.

Fundamental 3: Consolidate income in a single account

All income sources should funnel into a single account. These income sources include OAS, CPP, pension income, etc. This account should be the first source of cash flow to support your expenditures.

You may also choose to deposit portfolio income (such as interest and dividends on stocks and bonds, dividends paid from mutual funds or periodic RRSP withdrawals) into this account as well.

Note that your personal preference may be to continue reinvesting those interest and dividend payments, taking withdrawals when you need them or based on a systematic withdrawal plan. That is okay too—some investors prefer that approach. But building more predictable portfolio income sources to support your cash-flow needs can be a good first line of support to your income plan.

For now, depositing any regular sources of income you rely on into an easily accessible place makes it easier to measure your cash flow and track income and spending over time.

Fundamental 4: Match your investments to your goals and needs

You have already saved to get here, so you most likely have a plan for your investments, including an asset-allocation plan that makes sense for you. You do not necessarily need to change that now, but it is a good time to revisit it.

Now that you have set aside a cash cushion, you can redirect your focus back toward staying invested for the long haul. Investors entering retirement may want to start with a moderate allocation—a mix of roughly 60% stocks and 40% bonds and cash investments.

The combination of stocks and bonds, along with an appropriate allocation to cash investments, can help protect you against market volatility while keeping you invested for long-term needs. Bonds provide a cushion that's generally less volatile than stocks and provide a regular source of income. Stocks provide potential for growth, as well as dividends that may increase over time.

If you have a shorter time horizon or are less comfort with market risk, consider a more conservative allocation. Unless you have large estate or bequest motives, you will want to adjust your allocation to be more conservative over time.

Fundamental 5: Cover essentials with predictable income

Now you can start to look at individual investments in your portfolio to put them to work for you. Some retirees may choose to take a systematic approach to planning withdrawals from their portfolio, whatever the source. It could be capital gains, interest and dividends, or cash.

Others choose to build up more predictable sources of portfolio cash flow, starting with regular interest payments from bonds and other fixed income investments. Having these relatively predictable sources of income can help increase confidence in an investment plan and build a solid "baseline" of income to support your needs.

Bonds and fixed income investments, as well as any returns on cash investments such as money market funds or GICs, are generally the first source of predictable income for most portfolios. Consider dividend-paying stocks as well, either though income-oriented stock mutual funds or individual blue-chip stocks, to add fluctuating income sources of income that can grow. This will be part of your allocation to stocks, based on your risk tolerance.

Stocks will be more volatile, generally, than more conservatively invested bonds. Even blue-chip stocks bought at a good price can be volatile, and they do not promise to pay a fixed amount at maturity. But they can also grow to help cover discretionary expenses and future income needs.

You may also add annuities that pay out guaranteed income for a lump sum (immediate fixed annuities) or that guarantee a fixed withdrawal rate on a portfolio that stays invested (variable annuities with guaranteed living benefits) to help create reliable cash flow.

Finally, consider Guaranteed Withdrawal Benefit Plans. These plans offer contractually guaranteed lifetime income. Underlying investments are in segregated funds. You select an investment portfolio in line with your risk tolerance and objectives.

Fundamental 6: Don't be afraid to tap into your principal

Some retirees with very large portfolios may be able to live comfortably just off interest and dividend payments spun off from predictable income sources alone. But that is difficult to achieve unless you have a very large portfolio, especially in a low-interest-rate environment.

Most folks may need to tap into a portion of the money that has been saved to support their cash-flow needs. Having a portfolio well-balanced among stocks, bonds and cash investments, and knowing when to use those investments, can help you tap your portfolio appropriately.

This gives you more control and can reduce uncertainty caused by interest rates or market conditions. It will also help you stay invested in an appropriate mix of investments for money that will be needed later. The key is to have a smart way of tapping your portfolio, to keep your investments working for you.

Fundamental 7: Follow a smart portfolio drawdown strategy

If you have created some predictable sources of interest and dividend payments from your bond and stock portfolio, you have started to lay the baseline for a tax-efficient drawdown strategy. These can be the first source of withdrawals from your portfolio if you have not chosen to reinvest them.

The next source of withdrawals, if needed, can be principal from maturing short-term bonds, GICs or cash investments. Consider investing two-to-four years' worth of annual expenditures in a short-term GIC, bond ladder or short-term bond funds (which are generally less volatile than stocks or intermediate or long-term bonds). When bonds or CDs mature, you can tap the proceeds first or withdraw funds from short-term bond funds.

You should also watch for other tax issues, such as required minimum withdrawals from RRIFs, or capital gains (or losses) on other investments in taxable accounts.

Fundamental 8: Rebalance to stay aligned with your goals

Part of a tax-smart drawdown strategy will likely involve regular re-balancing. You may sell investments that have appreciated in value to generate cash. But you will still want to make sure you re-balance at least annually to stay in line with your longer-term goals.

Your needs, risk tolerance and time horizon may change as well. So now's a good time to make sure your targeted balance between stocks, bonds and cash still makes sense for you.

Fundamental 9: Stay flexible and re-evaluate as needed

Fundamental 1 was to review where you are currently. This process will continue throughout your retirement. Your new life of living off your nest egg is not a single point in time, where you create a plan, set it and forget it.

You will want to continue to watch and revise your plan as needed. When markets are down, you may choose to reduce your discretionary spending, or you may wish to change your balance of stocks and bonds to decrease risk in your portfolio over time. You may also consider annuities, which can act like a personal pension by turning a portion of your investments into lifetime income or can help to provide a reliable, guaranteed source of portfolio withdrawals.

3 – 16 RETIREMENT INCOME DANGER ZONES

Retirement killers are the things that can destroy your plans for a lovely, comfortable retirement. There are things you can do before and during retirement to defend yourself against the retirement killers. Here are the biggest risks to your retirement and how to avoid them.

An Early Cash Out

Are you the type to withdraw money from an RRSP before retirement age? Maybe you change jobs often and have cashed out more than once. Control that itchy trigger finger! Your money is like fine wine, it gets better as it ages.

If you withdraw your retirement funds early, you do not just miss a few years of savings, you also miss out on years of compounded growth. And as much as you may need it the money today, think how much you will need it in retirement when your income has stopped.

A Long Life

According to Statistics Canada, about one out of every four 65-year-olds today will live past age 90. One out of 10 will live past age 95. Today's 25-year-olds will likely live even longer. So your first consideration is retirement age. Do you need to retire in your 60s or do you simply need a career change? Starting a small business, taking on consultancy work, or just trading your full-time job for a part-time one may be just the thing you need to revitalize this stage in your life.

Also remember that your chances of outspending your savings lessen if you live both a long and ***healthy life,*** so do what you can now to reduce your retirement healthcare costs. Save as much as you can in your tax-deferred retirement accounts while you are still working and earning income, so you have more savings to tap. When it is time to retire, develop a conservative RRIF distribution plan that allows you to make the most of your income and your investments.

Excessive Debt

No matter how much you save, too much debt will impact your retirement lifestyle. Plus, if you are spending beyond your means today you will be unprepared to live on a reduced income in retirement.

Regardless of your age, you can develop a plan that will help you get out of debt. If you have good standing with your credit card issuer, you may be able to negotiate a lower rate, or consolidate your debt at low or no interest. Aim to pay more than the minimum balance each month.

Ignoring Investments

You do not have to be the type of loud mouth who talks incessantly about his portfolio at cocktail parties to be a successful retirement investor. You could do just fine (or even do well) in the market without ever watching *Mad Money* or reading a copy of *Money Sense*, if you have created an asset allocation and rebalancing plan for your own money. That plan may change over time with your risk tolerance, especially if you are within five to 10 years of your retirement. At that point, many investors shift additional assets into more liquid or cash-like investments, to cover any gaps in income that may occur as they transition to retirement. Otherwise, make a date to check in with your portfolio periodically and ignore it the rest of the time.

Overindulging in Retirement

Some people think of retirement as the time to start living their dreams. Maybe so, but you still must do it on a budget. Many financial professionals agree that taking 4% a year from a portfolio can sustain your income needs in the short and the long term. What does 4% look like for you? What would it look like if you spent a big portion of your savings today and had to live on 4% of the rest? If you eat away at your savings early on, it can quickly put your long-term plan out of whack.

Tune out the Joneses and practice living a sustainable lifestyle. Make financial common sense a part of your personality, kind of like your grandmother did.

Sequence of Returns Risk

Potentially, one of the biggest and most under-appreciated factors that can affect retirement income is the pattern of rates of return that occur in the approximately 10-year span overlapping retirement age.

Averages, when applied to rates of return, can be misleading and deceptive, when used both for accumulation and decumulation, or when comparing the period when someone is saving money vs. spending it.

As noted in the many articles and webinars conducted by Peter Wouters over the years, “The 5 to 10 years before and after the onset of retirement or the time when cash-flow begins, represent a very fragile and critical period in the investor’s financial lifecycle.

It is called the retirement risk zone. When planning for retirement, retirees need to really review their portfolios and see how much exposure they have to market risk during this period when the retirement nest egg is most vulnerable to market downturns. The retirement risk zone should be important to investors and advisors alike because short term portfolio losses due to market performance during this time can have significant, long term, negative effects on the longevity of the investment portfolio."

What is most important to note is the pattern of returns that make up the average. The average rate of return over time may meet or exceed what an elder is relying upon to generate sustainable income. The actual rates of return making up the average can have a marked influence on how long income lasts during retirement.

The pattern or order of investment returns may not matter when someone is saving or investing money for the long term. No withdrawals are being made. It's simple multiplication. For example; 2x3x4 yields the same total as 4x3x2 or 3x2x4. All equal 24.

A pattern of lower than expected or negative returns during these 5 to 10 years before and after retirement, reduces the size of the investment portfolio. This is because lower than planned or negative returns are accompanied by withdrawals needed to provide cash flow to the retiree. The elder is taking money out and earning less at the same time. There is now, less money working for the investor.

Later, very positive years of investment performance that bring the average back up to long term target levels, don't rebuild the investment portfolio to levels that can provide sustainable income. The result is that the investment may well run out before the elder passes away or much less is left for heirs when the elder dies. We call this; sequence of returns risk.

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Chapter 4

Legacy Planning

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4 – 1 KEY OBJECTIVE OF THIS CHAPTER

A key principle in legacy planning is that you cannot eliminate the big mistakes in an estate plan until you have identified them. Every elder should stage a financial fire drill with the assistance of trusted professionals. The same caution should be exercised with estate planning as with financial planning—work with someone who has a high level of expertise.

This chapter will investigate the process of planning the accumulation, conservation, and distribution of an estate in the manner that most efficiently and effectively accomplishes the elder's personal tax and non-tax objectives.

4 – 1.1 How Will This Objective Be Achieved?

We will look at the major areas of estate and legacy planning and such related topics as: lack of liquidity, improper disposition of assets, inflation, inadequate income, or capital at retirement / death / disability, stabilization and maximization of the value of assets, excessive transfer costs, and special problems.

4 – 2 INTRODUCTION

Estate planning is the process of making formal arrangements to convey a person's assets to beneficiaries. Distributions can be made after a person's death or distributions can be made during a person's lifetime. A combination of both is also common.

The concept is simple. However, designing an estate plan that meets individual goals, objectives, and needs may be more complex. It often requires a sophisticated approach, particularly for individuals owning significant assets.

The major objective of estate planning is designing a complete strategy that assures the appropriate handling, administering, and disposition of the estate assets according to the wishes and the needs of the estate owner.

4 – 2.1 Estate Planning Versus Legacy Planning

Before talking about the process in detail, it is important to draw a distinction between basic estate planning and what is referred to as "legacy planning". The goals of estate planning are specific, such as:

- Maximizing and preserving the value of assets
- Minimizing and deferring tax and other costs that will arise at death
- Allowing for an orderly transition of assets to beneficiaries, and
- Providing for dependants

Doing this properly helps provide peace of mind for all concerned.

Legacy planning takes estate planning one step further by dealing with other issues, such as:

- Educating the next generation on issues surrounding wealth management
- Improving communications within the family, ensuring that the deceased's intentions hopes, and concerns (and with specific instructions) have been shared
- Setting some family values and perhaps even a mission statement, and
- Establishing philanthropic goals (where desired)

The planning process takes your financial and personal situation into account to develop a comprehensive plan that reflects your wishes. Your legacy plan should also contemplate inter vivos transfers (passing along assets while you are still alive), potential future incapacity and explore options including powers of attorney and/or inter vivos trusts.

Although some might see this sort of process as setting the stage for "ruling from the grave," this process may help avoid this issue. For example, where an individual has accumulated wealth and is concerned that the next generation may not properly plan for financial issues (including tax) or make unwise investment decisions, one approach is to try to control this issue by using a trust. Under such an approach, investment decisions are deferred to trustees and restrictions may be placed on the ability of the beneficiaries to access income and capital from the trust. One negative by-product of such planning can be the reinforcement of a child's perception that a parent does not trust them, as they continue to receive "an allowance" well into their adult life.

The idea behind legacy planning is that adverse events can also be managed by way of shared values and increasing the knowledge level of the surviving family members. This allows them to make decisions for themselves while understanding how the wealth was established and taking the deceased's values and desires into account.

That said, it is important to remember that we are not questioning the value of trusts. They are an important tool to safeguard the interests of beneficiaries.

For example, a trust is critical where a family member is simply not capable of managing their inheritance due to an infirmity. Trusts can also produce substantial tax savings, especially when combined with an incorporated owner-managed business.

Legacy planning helps create a balance between safeguarding specific risks and reducing taxes while allowing the surviving family to deal with the deceased's wealth as adults.

4 – 2.2 What is an Estate?

In estate planning it is important to understand what an estate is. A general definition of an estate is all the assets a person possessed at the time of death. This includes the obvious, such as stocks, bonds, cash, business ownership, and property, including residence and investment property.

Often less obvious, but still included, are tangible assets such as coin collections and automobiles, and intangible assets such as copyrights, patents, mineral rights, print royalties and digital assets.

Planning for the estate during one's lifetime is essential if income taxes and probate fees are to be minimized on death. Planning will also help ensure that estate assets are distributed in accordance with the wishes of the deceased. Estate planning should be an ongoing process, well organized at the beginning, and reviewed periodically to ensure it is correct.

4 – 2.3 Canada's Stealth "Estate Tax"

Canada is generally viewed as a country with no estate tax. While that is true, what many people do not realize is that a "deemed disposition tax," which is like an estate tax, applies when you die.

Deemed disposition tax is so-named because your investments are deemed to be sold at death. Any capital gains and recapture triggered by their sale are included in a final income tax return filed in the year of death. A final tax return also includes the value of any retirement accounts and income received from stocks, bonds, real estate investments and even life insurance proceeds in the year of death, from January 1 up to the date of death. With Canadian federal income tax rates of up to 33% (and provincial tax on top of this), this final taxation can be substantial.

The good news is the tax is deferred if the assets are transferred to a surviving spouse. Taxes are deferred even if the assets are held in a spousal trust, which provides income to the surviving spouse. However, if the spouse sells the assets, then the tax applies.

While this "deferral" is helpful, it is important to remember that when the spouse dies, and the assets are passed on to other heirs, 50% of the capital gains (based on current inclusion rates) of any stocks, bonds, real estate investments and other assets are taxable at the personal income tax rate.

More troubling still, for elders who have significant "registered" assets at death (RRSP and RRIF assets) – barring a rollover – the full value of these assets is taxable as income, often at the highest marginal tax rate.

4 – 2.4 The Science of How to Disperse Wealth

If financial planning is the art of creating wealth, estate planning is the science of how to disperse it. This enables the estate owner to direct assets to where they should go, while at the same time minimizing the tax implications so as not to suffer exorbitant estate shrinkage. Unfortunately, it is not an exact science, and when taxation and human emotions and desires are added into the chemistry, it may produce results other than the optimum. In addition, nothing frays family ties like inherited wealth or future expectations of receiving money.

It is not uncommon for larger estate settlements to work with a law firm, accounting firm and a Trust Officer. In small cases, a lawyer and the Executor (usually the spouse or children) will be the only participants.

The Estate Planning process starts well before it is needed. Due to substantial taxes at death, conservation is a problem that must be dealt with before death, and disposition must be planned for in order to facilitate an orderly passing of the estate assets.

Estate Planning may not start with a Will, but it always ends with a Will, and so careful thought and counsel is required to properly set one up. It requires legal advice from a competent lawyer and sometimes, from an accounting firm.

In large estates, Trust Companies may be utilized to provide administration and to act as a vehicle of transfer.

Wills lay out an orderly dispersal of the estate assets according to the deceased's wishes, keeping in mind certain regulations outlined in law.

If the deceased did not file a Will, the courts will arrange the passing of the assets under the law of intestate provision. The laws pertaining to Wills vary from province to province. Other laws that influence the estate settlement are the Family Law Act and The Succession Law Reform Act.

4 – 2.5 The Law of Intestacy

Under inheritance law in Canada, most provinces set aside a certain portion of the estate specifically for the spouse, and a few make provisions for common law spouses.

Any remaining balance in the estate is also passed on to the spouse if there are no children. However if there is a single child, in most provinces and territories the estate is split 50/50 between the surviving spouse and the child (notable exceptions: Alberta, Manitoba and Quebec).

If there are two or more children, in most provinces and territories, the spouse receives 1/3rd of the estate and the children receive 2/3rds (notable exceptions: Alberta and Manitoba). The definition of "child" varies across provinces.

A summary of the various laws of intestate is provided in the following chart.

Table 4.1 Provincial and Territorial Laws of Intestate Succession – 2020

Province/ Territory	Spousal Share*	Spouse and one child**	Spouse and children**	Can common law spouses inherit?
British Columbia	$300,000if both the deceased and the spouse are parents of the descendants. $150,000 if the spouse is not parent to all the descendants	½ each	1/2 spouse 1/2 children	Yes (min. 2 year cohabitation)
Alberta	no preferential share	All to spouse, where all of the children are also children of the surviving spouse. Otherwise, prescribed amount or 1/2 (whichever is greater) to spouse, and remainder to child.	All to spouse, where all of the children are also children of the surviving spouse. Otherwise, prescribed amount or 1/2 (whichever is greater) to spouse, and remainder to child.	Yes
Saskatchewan	$100,000	½ each	1/3 spouse 2/3 children	Yes (min. 2 year cohabitation)
Manitoba	Greater of $50,000 or 50% of estate	All to spouse where all of the children are also children of the surviving spouse. Otherwise, 1/2 to spouse, 1/2 to child.	All to spouse where all of the children are also children of the surviving spouse. Otherwise, 1/2 to spouse, 1/2 to child.	Yes (min. 3 year cohabitation, or 1 year together with child)

Ontario	$200,000	½ each	1/3 spouse 2/3 children	Extends only to legally married spouses
Quebec	Nil	1/3 spouse 2/3 child	1/3 spouse 2/3 children	Includes those joined in a civil union; Where a marriage contract or a notarial civil union contract exists, any relevant provisions in it will supersede the rules on intestate succession
New Brunswick	Marital Property	½ each "Child" does not include a stepchild	1/3 spouse 2/3 children "Child" does not include a stepchild	Extends only to legally married spouses
Nova Scotia	$50,000	½ each	1/3 spouse 2/3 children	Extends only to legally married spouses; Excludes spouses "living in adultery", i.e. in another conjugal relationship whether registered or not
Prince Edward Island	Nil	½ each "Child" does not include a stepchild	1/3 spouse 2/3 children "Child" does not include a stepchild	Extends only to legally married spouses
Newfoundland	Nil	½ each “Child" does not include a stepchild	1/3 spouse "Child" does not include a stepchild 2/3 children	Extends only to legally married spouses
Yukon	$75,000	½ each	1/3 spouse 2/3 children “Child" does not include a stepchild	Yes (min. 1 year cohabitation)
Northwest	$50,000	½ each	1/3 spouse ,2/3 children. “Child" does not include a	Includes common-law partners

			stepchild	Excludes legally married spouses who were cohabiting with someone else at the date of death,
Nunavut	$50,000	½ each	1/3 spouse 2/3 children "Child" does not include a stepchild	Includes common-law partners Excludes legally married spouses who were cohabiting with someone else at the date of death,

*A spouse receives the first portion of the estate. The size of this share varies according to province. Others inherit only if the estate is larger than the amount of the spousal share. In some provinces and territories, a common-law relationship is treated the same as a marriage for estate purposes. In other parts of Canada, common-law relationships, although equal under other areas of the law, are not treated as equal to a marriage for estate purposes. Also, separated spouses may still be considered spouses for estate purposes. That may mean that a separated spouse would receive the first share of the estate. In some situations, more than one person could be considered a spouse under estate law.

** Only biological or adopted children can inherit under estate law. If a person wishes to leave any of their estate to stepchildren, they must indicate this in a will.

Where there is no surviving spouse but there are surviving children, the estate is divided equally among the children.

Where there is no surviving spouse or children, the estate devolves according to the rules of consanguinity.

Where no heir can be determined, the estate is declared bona vacantia and escheats to the Crown.

Source: Inheritance law in Canada, 2020

4 – 2.6 Some Estate Planning Terminology and Issues

In this chapter, we will refer to some processes and estate planning techniques that will be explained in detail later in the chapter.

Probate, the judicial process whereby a local court authenticates a will, is a major estate planning consideration.

Probate is designed to settle the affairs of the deceased. This includes an asset evaluation, payment of debt, taxes, and last expenses, and the distribution of property. The probate process can be expensive, cause delays in the distribution process, and is time consuming for the executor. Hence, trusts are often used to avoid probate, and to utilize other estate planning techniques.

A trust is a fiduciary relationship between a trustee and an entity holding the title to property for the benefit of another, called a beneficiary. The most common trusts are living trusts and testamentary trusts. Living trusts avoid probate; testamentary trusts are subject to probate. Trusts are further defined as revocable or irrevocable. Revocable trust assets are included in the taxable estate; irrevocable trust assets are generally not included in the taxable estate.

Life insurance is another important estate planning tool. It is also an instant estate builder in the case of the death of the insured. It accumulates tax-deferred, avoids probate, and the proceeds are not subject to federal income taxes. It can also provide needed estate liquidity.

While estate planning primarily addresses inheritance and tax planning, there are other significant considerations. Because life expectancy has increased dramatically, long-term care planning is now considered second in importance to retirement planning.

Most individuals fail to realize that Canadian Medicare, Employee Benefits and private medical insurance limit benefits for nursing homes. Furthermore, it is estimated that 43% of the individuals over 65 will require nursing home care at some point in their future.

Examples of other estate planning decisions include charitable giving, living wills, being an organ donor, buy-sell business arrangements, funeral instructions, "right-to-die" letters, estate administrator and/or executor selection, and guardianship designations.

4 – 2.7 Where to Start?

Before developing a combined estate and legacy plan, a person needs to gather some information, and give thought to several key questions. The goal is to come to some conclusions on important issues and draw a clear picture of both financial and non-financial goals.

Key Questions

- What am I most proud of accomplishing over the course of my life?
- What are the top 3 impressions that I want my family and/or my community to associate with me?
- Is my family prepared to assume full responsibility for the business and financial matters currently under my management? If not, could they with specific learning and development?

- Does my family have the skills and the confidence to ask the questions and make good decisions? If not, could they with more information or development?
- Does my family know all my key trusted advisors? Are they comfortable with them?
- If I own a business, do family members have the interest and ability to take over the business?
- Which family members will share in my estate (spouse, children and possibly grandchildren)? Is there an extended family?
- Have I provided financial assistance to some family members more than others in the past? Should I consider this when determining how my wealth will be shared?
- Where a vacation property is owned, do we want to keep this in the family, or should it be sold?
- Do I have philanthropic interests?

The second part of the process is to take this information and develop a plan that will meet the deceased's goals. For example, if there are complex financial holdings, likely beyond the abilities of family members to manage, the plan should deal with this. Possible alternatives could be simplification or ensuring that the family has access to trusted advisors.

As the plan is developed, key components may include:

- Setting a process for open communication (including how wealth will be divided and why)
- Building financial and investment knowledge and skills
- A will, which is reviewed and updated regularly
- Assessing whether the family will be capable of managing the deceased's financial affairs when the time comes and determining the best course of action if they will need help
- A determination of the tax issues that will arise on death, and setting a plan in advance
- Reviewing the tax planning alternatives available including family trusts, testamentary trusts arising after death and other ideas
- Reviewing and addressing insurance and retirement needs
- Where a business is owned, ensuring that there is a specific succession plan for the business
- Where a vacation property will be retained in the family, a plan for the use of this property
- If the person has philanthropic interests, setting a plan to identify the charities to benefit while ensuring the plan takes advantage of the significant tax incentives that are available

With these preliminary issues out of the way, we now turn our attention to the specific process that is followed in formalizing an Estate and Legacy Plan: The Six Steps to Legacy Planning.

4 – 3 THE SIX STEPS TO LEGACY PLANNING

1. Consult and retain appropriate professionals
2. Setting objectives
3. Collecting and analysing data
4. Exploring strategies for transferring the elder's estate
5. Implementing the plan based on appropriate strategies and solutions
6. Monitoring the plan

4 – 3.1 Step One – Consult and Retain Appropriate Professionals

The complexity of an individual's situation will determine the assistance required from professionals in creating a legacy plan. The team may include an advisor, lawyer and tax planner. It is recommended that the elder make time to interview each practitioner thoroughly before retaining his/her services, as he/she will have access to some of the most intimate details of the elder's life. The most logical place to start, therefore, is with a professional that the elder already has established a trustworthy relationship with and who knows the intimate details of their life and personal goals. This professional can recommend a lawyer and if necessary, a tax professional with whom he or she shares a working relationship.

The advisor's role

- Help estimate the size of the estate
- Help develop estate goals
- Liaise with other practitioners on estate planning team
- Perform cost-benefit analysis
- Outline strategies to maximize size of estate
- Provide direction on various strategies and their implementation
- Confirm the timely planning and implementation of the plan including helping with implementation
- Ensure competent management of assets
- Provide support to the elder in creating the plan
- Communicate with beneficiaries and help with administration

Legal advisor's role (includes notaries in Quebec)

- Review estate goals
- Draft legal documents: Wills, powers of attorney and trusts
- Provide direction on various strategies and tactics
- Draft, review and interpret trusts
- Represent the estate in litigation of Wills and estate disputes
- Mediate or arbitrate any estate disputes
- Serve as trustee, executor or agent, if asked
- Assist estate and trust administrators to interpret the elder's wishes

Tax planner's role

- Assess estate goals from a tax perspective and advise accordingly
- Reduce the tax payable during lifetime and at death
- Advise on tax implications of various strategies and tacti**cs**

4 – 3.2 Step Two - Setting Objectives

The next step in any legacy plan involves setting objectives. Here are some of the objectives that many elders are interested in:

- Ensuring that their property is used and distributed, both during life and after death, according to their wishes
- Minimizing tax on their income, savings, and investment returns both during life and after death
- Ensuring the estate is large enough to provide financial security in retirement or in the event of disability
- Paying all just debts, including taxes and final expenses
- Ensuring that the family and their needs (if desired by the elder) are provided for in the event of the elder's death or disability

Objectives in estate planning vary from family to family because of differences in resources, number of children, and values. Clarifying objectives is one of the first steps in logical, systematic estate planning.

The fact that two or more objectives conflict should not deter elders from making plans; it is in such cases that planning is most needed. Usually some compromises among the conflicting or competing objectives must be made and it may be impossible to develop fully satisfactory plans. However, the results of good planning are superior to unplanned property transfers.

4 – 3.3 Step Three - Collecting and Analysing Data

The next step in the legacy planning process involves:

- ❖ Identify assets and the form of ownership
- ❖ Identify liquid and non-liquid assets

Determining cash needs at death to cover such things as:

- ❖ Administrative costs
- ❖ Funeral Expenses
- ❖ Outstanding Debts
- ❖ Personal Income Taxes
- ❖ Family Living Expenses
- ❖ Cash Bequests
- ❖ As well as determining income needs of spouses/partners and dependents

In the process of collecting and analysing data, one of the key first steps will be calculating the value of the estate. This evaluation is the basis for determining tax liabilities, selecting asset transfer methods, establishing a timeline for implementing the plan, and deciding when assets will be distributed among the beneficiaries.

In evaluations for estate planning purposes, it is very important to differentiate between the individual's net worth and their distributable estate. Net worth is the amount that assets exceed liabilities. Distributable estate is the amount that remains after the payment of funeral, administrative and professional fee expenses, estate taxes, and any losses incurred from the sale of assets to meet any Provincial liquidity or distribution needs.

This is an important distinction. Except for large estates, most distribution decisions are made for practical rather than altruistic reasons. Sponsoring scholarships for a university might be desirable but passing estate assets to a spouse and/or children to ensure their well-being is more important. Hence, estate planning first requires determining the gross taxable estate so that the distributable estate value can be determined, or at least reasonably estimated.

This, in turn, leads to decisions such as:

- ❖ What property is in the estate, but outside the will (probate estate)?
- ❖ Is a living trust necessary?
- ❖ Is insurance appropriate?
- ❖ Should the property be held jointly?
- ❖ Are survivors and heirs competent and able to handle assets and income flows?

Once the value of an estate is determined, the estate owner can determine how the assets will be distributed, the methods to be used, and the potential tax liability. When the asset evaluation is completed, the initial estate-planning steps have been taken.

The client has determined a reasonably accurate estate value; the next step is to use the information to design and implement an estate plan that meets the needs and objectives of the client.

4 – 3.4 Step Four - Exploring Strategies for Transferring the Elder's Estate

This step requires careful planning and needs to be integrated and balanced with the elder's long-term goals and needs.

4 – 3.5 Transfers of Property While Alive (Inter-Vivos)

There are three primary ways to transfer property while still alive: by sale, by gift, or through an inter-vivos (or living) trust.

1. By Sale

This is a transfer of ownership for a consideration. A consideration is the exchange of values, such as deeds, money, or property by the parties to the contract. The sale of an item worth $50,000 for $100 may still be classified as a sale, not a gift with a notable exception.

The sale is considered by Canada Revenue Agency (CRA) to be one of the following:

- At arm's length - this means the parties are independent of each other
- Non-Arm's length - this means the parties are related or operating in collusion

When CRA determines a non-arm's length transaction, they deem the sale to be for Fair Market Value when assessing capital gains to the seller regardless of what consideration is paid for the asset.

2. By Gift

This means transferring ownership (or part ownership) to another person for no consideration. CRA deems the gift to have been disposed of at fair market value in assessing capital gains to the person giving the gift. In a non arms-length relationship, the person receiving the gift is deemed to receive it for the consideration paid. This can result in double taxation.

3. Inter-Vivos Trust

The taxpayer could set up a trust during his or her lifetime and transfer property to the trust for the benefit of children, spouse, or whomever. At death, the property does not form part of the estate.

The trust document will dictate how the property is to be distributed, much like if the property was left to be distributed from a will. However, a taxable disposition will arise when the property is transferred to the trust, and the attribution rules may apply to income earned in the trust, if the income is allocated to a spouse or minor child.

4 – 3.6 Transfers of Property at Death

Most common methods are:

1. Tenancy in common
2. Joint tenancy
3. Rights or things
4. Testamentary Trust
5. Designation of a specific beneficiary

1. Tenancy in common

Two people or more share ownership rights in the property. Each owner may hold a different percentage of the total property. On the death of one of the Tenants in common, their share passes to their own respective estate and then to those heirs or assigns, not to the other tenant(s).

2. Joint tenancy and joint ownership

At the death of one tenant, the full title to the property passes to the surviving tenant(s).

Joint Ownership applies when property is owned with a spouse or child in joint tenancy with right of survivorship. At death, the deceased's interest in the property disappears and is totally owned equally by the surviving joint owner(s). No part of the property is included in the deceased's estate. Care must be taken when setting up this arrangement.

A taxable disposition may occur when transferring partial ownership to another person. In addition, if the new joint tenant (spouse or minor child) does not pay for their interest in the property, any income earned from this person's portion of the property may be subject to the attribution rules and taxed in the hands of the original owner.

3. Rights or things

This is a special election so that the value of rights or things may be taxed as if earned by another person. The estate has the right to make this decision for up to one year, after death. If the rights or things are transferred to a beneficiary (within that year) it will be taxed at the beneficiary's rate.

This gives rise to two tax planning techniques:

1. The deceased's tax credits can be claimed twice
2. It transfers the income from the deceased's high tax bracket to a lower tax bracket

4. Testamentary trust

A testamentary trust, sometimes referred to as a will trust, is a trust that arises upon the death of the testator, usually under his or her will. Since the settlor of the trust is deceased, he usually does not have any influence over trust management unless duties and limitations are spelled out in the trust document. Itis common to leave a letter of wishes for the trustees.

Testamentary trusts offer some income splitting opportunities for beneficiaries. These trusts "benefit" from graduated tax rates like individuals. This is unlike" *inter vivos* trusts" (which are trusts other than testamentary trusts) whose taxable income is not subject to graduated rates and instead are subject to taxation at the highest marginal rates applicable to individuals.

The Department of Finance announced that the Canadian government eliminated graduated tax rates for testamentary trusts except for estates of deceased persons for a limited period.

Under the revised rules, an estate will be subject to the highest marginal tax rate for individuals after 36 months from the date of death (then considered a "flat top-rate estate"). These measures have been passed into law and apply to existing and new arrangements for the 2016 and later taxation years.

5. Designation of a specific beneficiary

Designating a beneficiary can:

- ❖ Save time: claims paid directly to a beneficiary reach the heirs much more quickly than if flowing through the estate
- ❖ Save money: legal fees are often calculated as a percentage of the value of the estate. Money paid by a life insurance company to a named beneficiary does not form part of the estate
- ❖ Save more money: probate filing fees, payable to the provincial government, are assessed against the value of the estate. There are also estate settlement costs include legal, accounting and valuation fees which may be far higher than any probate fees. Proceeds paid by a life insurance company to a named beneficiary do not form part of the estate, and therefore, are not subject to these probate filing fees

Naming a beneficiary through a life insurance plan or an annuity may be an effective estate-planning tool. Upon death of the life insured or annuitant, the proceeds are paid directly to the named beneficiary rather than passing through the estate.

Insurance monies payable to the policy owner or the estate of the insured are not afforded the same protection as insurance monies payable to a named beneficiary. In common law provinces, creditor and beneficiary protection is based on the relationship between the life insured and the beneficiary. In Quebec, the determinant is the relationship between the policyowner and the beneficiary. Furthermore, in Quebec, the beneficiary must be a family member, including the spouse, the ascendant or the descendant of the policyholder or an irrevocable beneficiary. This class is larger than the one prescribed in common law that limits the list to the spouse, child, grandchild or parent of the life insured.

With respect to the payment of probate fees, there can be a difference of opinion as to whether RRSPs etc. issued by non-insurers with a named beneficiary are included in an individual's estate and in the calculation of probate fees.

If you deal with a non-insurer you might be told that if you name your spouse, when you die the money could be rolled to his or her RRSP or RRIF without getting taxed. This statement is true under the Federal Income Tax Act. Nevertheless, that is not the end of it.

Each province has legislation governing which plans can have beneficiaries designated outside a will. Depending on your will – or lack thereof and where you live, the designation on the RRSP or RRIF form you fill out at the bank, trust company, or credit union may or may not determine who gets the money when you die.

Alberta's law does not specifically include RRSPs and RRIFs among the plans for which beneficiaries can be named outside a will.

The Alberta Law Reform Institute has, however, recently recommended that RRSP and RRIF designations be included and recognized.

The other common-law provinces already do recognize the designations. But even when an over-the-counter designation is recognized, the money still passes through your estate and could be subject to probate tax and creditor's claims. The only exceptions at the current time are Prince Edward Island and British Columbia.

Tax Free Savings Accounts (TFSAs) may permit the naming of designated beneficiaries. Designated beneficiaries may include a survivor who has not been named as a successor holder, a former spouses or common-law partner, children, a designated subsequent survivor holder who is the new spouse or common-law partner of the successor holder, and qualified donees.

You are able to designate a successor holder for your TFSA account. A successor holder may only be your spouse or common-law partner.

Québec allows beneficiary designations outside a will only in life insurance contracts, and for fixed term annuities issued by provincially chartered trust companies. Again, if you live in Quebec, you generally cannot name a successor holder on your plan documentation; you must do so in your Will.

Across Canada, beneficiary designations for RRSP and RRIF accounts at life insurers are governed by a uniform set of provincial statutes in common law provinces. Money can pass outside your estate if a proper beneficiary is named.

4 – 3.7 Step Five - Implementing the Plan

To carry out the plan requires the naming of those people who will act on the elder's behalf.

Selecting the individual or company who will carry out the terms of the Will may be one of the most important decisions an elder ever makes. The personal representative (called an executor in most provinces, a liquidator in Quebec or estate trustee in Ontario and collectively called "executor" in this chapter) is responsible for settling and managing one's affairs after death. This is more than an honour being bestowed upon a family members or a friend. The elder is selecting the person who will be best suited to and capable of handling all matters after death or overseeing their administration with the assistance of knowledgeable professionals. The appointment may be an imposition as the designate must:

- Commit time to carry out all duties and responsibilities – may include taking time off from work or sacrificing other personal responsibilities
- Deal with your family members, perhaps for several years if the estate assets are not immediately distributed

The elder needs to make sure he knows what he is doing, and that the executor completely understands the responsibility being entrusted to him. It is an appointment for life or until removed by the court. If a person is not appointed as executor, the court or the elder's heirs will supervise the distribution of any property.

Some of the responsibilities the elder's executor assumes are:

- Locate and review Will
- Make funeral arrangements
- Solicit professional counsel
- Notify the beneficiaries of their bequest
- Secure estate assets
- Arrange for probate
- Open estate account
- Submit Will for probate
- Advertise for estate creditors
- Convert residual estate assets
- Convert investments and other property into cash
- Pay financial obligations/debts

- Complete final tax returns/obtain clearance certificate
- Distribute inheritance
- Make trust arrangements
- Prepare estate accounts
- Close estate accounts
- Keep a complete accounting record of the administration of the estate

Some of the considerations the elder needs to take into account when appointing an executor or executrix are:

- The value and complexity of their assets—what business and financial experience is required
- The length of time required to administer the estate—for example, is there a business to wind up or property to sell? Will the person be able to follow-up on all the details either directly or with the assistance of a professional?
- Any circumstances which demand tact and discretion
- Any preferences. For example, if a business is involved, does the elder want the details handled by their spouse or a relative, or a person or persons who have no direct connection?
- Willingness to accept the job—obtain permission before the elder appoints an individual or corporation to be their executor
- Integrity and good judgment – Will the person be able to act fairly in dealing with family members?
- Time, patience and organization skills – Will the person be able to follow up on all the details, either directly or with assistance from professionals?
- Accessibility – Will the person be around to talk to family and advisors? Does he/she live nearby?
- Familiarity – Can he/she deal with the family dynamics?
- Legal and financial awareness – Will he/she understand where professionals may be needed for investment, tax and legal advice?

residency of the appointee. It may be impractical to appoint a non-resident of Canada to this position because of domestic laws there, the need to post a bond in Canada (Ontario for example) and the challenges in administering the estate and dealing with professionals who may not be legally able to deal with individuals outside of the jurisdictions where they are licensed or registered.

The more complete and orderly the elder's records are, the easier, and faster it will be to settle the estate upon death. There is no hard and fast rule about choosing an executor. Many people select a spouse, relative, friend, or other person on whose judgement they rely.

The executor can always obtain additional legal, accounting, and investment advice.

Again, this may be a challenge if the executor is a non-resident of the province (or country) where the estate is located. The elder may want to consider having more than one executor if they have a large or complicated estate. For example, the elder could appoint a trust company, or your legal advisor, to act as a co-executor with your spouse. An alternative executor or executors are also a good idea. It means there will be another person with authority to act on their behalf if the elder's "first choice" executor dies, or, for any reason is unable or unwilling to settle their estate.

4 – 3.8 Step Six - Monitoring the Plan

Estate planning, in order to be effective when it is needed most—at the moment of death—requires reviews on a regular basis.

Some of the changes that may require adjustments are:

- Changes in marital status due to marriage, death, or divorce
- Significant changes in the value of estate assets
- Birth or death of family or near family members
- Changes in health
- Changes of specific bequests
- Changes in business conditions, including execution of a buy-sell agreement
- Changes of Life Insurance coverage or beneficiaries
- Necessity to change executor or trustee or guardian
- Change in any form of ownership

Changes in priorities

Estates, by their very nature, are asset based, not cash based, and so liquidity will be the first and largest problem the executor/executrix must deal with. To sacrifice a business, force the sale of property, or forego solid investments are not wise choices when much easier and suitable answers are available. A proper estate plan should be monitored on a regular basis.

4 – 4 THE WILL

American inventor Ben Franklin is attributed to saying; "Nothing is certain but death and taxes," . While you cannot control either of these two inevitable events, you can make a will to ensure your financial affairs are managed according to your wishes once you are no longer able to, due to incapacity or death.

It is surprising, the number of people who neglect to complete a will or, if they do have a will prepared, put off having it reviewed to ensure it is up to date.

It is estimated that over ½ of adult Canadians do not have will and upwards of 70% do not have a current will and up to date Powers of Attorney documents.

Completing a will and having it reviewed periodically makes good sense. Not only does it give the personal representative the power to make decisions that will minimize income taxes, but also it gives specific instructions as to how the estate should be administered. Being an executor is a hard enough job without having to guess the wishes of the deceased.

A Will is a written declaration of a person's intent for dispersing property and other assets after they have died. It outlines the guardianship of children and trustees for incompetent heirs or where there are concerns over the heirs' ability to handle finances, and finally who is to administer the estate. The law requires a person to have legal capacity to make the Will, and to follow certain requirements as laid out by the law. The Will can be changed at any time provided the testator is competent, since it does not activate until death occurs and its instructions only deal with the Estate handling after death.

The Will generally will include such things as:

- The person's name and address
- The province in which the will was prepared
- A statement revoking all previous wills
- Instructions for settling the estate and paying final expenses
- Naming an executor (sometimes referred to as an Estate Trustee)
- The names and addresses of witnesses

What assets are to be included

- The instructions on how the residue (remainder) of the estate will be distributed

4 – 4.1 Three Types of Will

A formal will is drawn up by lawyers who are trained to draft documents that are complete, meet a person's needs, and accommodate family births and deaths without becoming obsolete. Only the original, signed document is valid. For a will to be legally valid, several technical requirements must be satisfied. Each province has different requirements. These may include execution of the document in the presence of two proper witnesses. To ensure a will is legally valid, elders should obtain the assistance of a legal professional.

Usually a lawyer will require the two witnesses to sign additional documents known as affidavits. Affidavits establish the identity of the witnesses and may be useful if there is any question later about the will's validity. People who are named to receive gifts from a will (often known as beneficiaries) or their spouses should not sign as witnesses. Doing so may disqualify them from receiving an inheritance from the estate.

A second type of will is call a holograph will. It is written entirely in one's own handwriting and signed without any witnesses. This type of will is valid in most but not all provinces. Writing a holograph will is not advisable, because it may not have all the information needed to make it clear or complete. If the instructions are not clear or are incomplete, the will may be partly or entirely ineffective, which could result in much higher costs in wrapping up the estate, and result in assets not being distributed as wished.

A third type of will is the prepackaged typed will kit where a testator can fill in the blanks and add some modest comments. Proper witnessing is required in line with a will drafted by legal counsel.

4 - 4.2 The Executor

An Executor / Executrix are defined as the person named in the Will to oversee its terms and to settle the estate. It can be an individual or a Trust Company.

Most individuals and Trust Companies will request that fees be paid. Individuals may simply ask to be reimbursed for out of pocket expenses but are not restricted to that. A will may reference what may be charged. Here is an illustration of such fees based on the Fair Market Value of the estate assets as of the date of distribution:

- Up to $250,000 - 5%
- On the excess over $750,000 - 4%
- Over $1 million - 3%

Each province in Canada may have recommended guidelines that they publish, and which individuals can use as a reference.

All income received and any disbursements could be subjected to a fee of up to 6% for the executor or executrix of the estate (half for gathering assets and half for disbursements). Annual Management based on the average market value of assets under management 3/5 of 1% up to $250,000/year. A Judge of the surrogate court must approve any additional special service fees.

4 - 4.3 Changes That Necessitate a Will Review

Many people do not but should review their will on a regular basis. As a rule of thumb, it should be looked at whenever they experience a major change.

1. Relationships change

Marriage but not divorce generally invalidates your previous will. Special provisions can be made to state that marriage is being contemplated, to whom and when. In a divorce, the provisions in the will that refer to the former spouse are revoked and without any other direction, become part to the residue of the estate. The appointment of the former spouse as executor or estate trustee is revoked.

Do you have a new will? Has the elder fallen out (or in) with a relative? Has an alternate executor or estate trustee been named? Is the elder's favourite charity still their favourite? Is that charity still a registered charity?

2. Divorce does not revoke beneficiary designations made in favour of the former spouse on plan documents filed with financial institutions. Needs and scenarios change.

Is the elder's 15-year-old daughter now a 28-year-old lawyer? On the other hand, does the elder have a new addition to the family (new grandchild, etc.)? Is a formerly independent family member now disabled or have a drug or alcohol dependency?

3. Situations change

Does the elder have business partners now? Do they have substantially larger (or even different) assets? Is their spouse in a care facility?

4. Times change

Is the elder's current will still tax-effective? The government does have a tendency to change the rules every year or so; some may be substantive.

5. People die

If the elder decides to leave part of their estate to someone who dies before them, complications arise. In addition, what happens if the chosen executor dies before the elder - the elder could end up with their executor's executor—any idea who that will be? Implementation of the will should do what the elder testator wants it to do and make things easier for their family. How will the elder guarantee that it does? Fortunately, a variety of rules govern how wills are managed and modified.

4 - 4.4 Codicil

A Will can be changed without eliminating the old Will, by simply dealing with the change desired by way of a codicil. It is a separate legal document and must meet the same criteria as the original Will in a stand-alone fashion.

4 - 4.5 Capacity

In Canada to make or change a valid Will, one must have the capacity to do so. In effect, this means they have reached the legal age of majority (Age 18 or 19, it varies in different provinces), and that they are of sound mind.

This requires that they have the mental capacity to understand the effect of their actions in terms of making the will and its conditions.

The legal counsel may request a medical examination by one or more doctors who will then make a statutory declaration as to the soundness of mind.

4 - 4.6 Execution

As noted, in most provinces it is permissible to make a handwritten Will. The Holograph Will must be in the testator's handwriting, complete with signature and does not require witnesses. In all other provinces, if the handwriting is not the testator's or not totally written in the testator's hand (as with on-line wills or will kits), it requires two witnesses, and the testator and the witnesses must sign the Will in each other's presence.

4 - 4.7 Appointing an Executor/Administrator

For the Provinces that still utilize an administrator, the court will appoint one if:

- There is no valid Will
- The deceased failed to name an executor in the Will
- The named executor declines to act in that capacity.

The executor has broad powers of investment and the right to continue the business, or to wind it up at their discretion.

4 - 4.8 Intestacy

Intestacy is the condition of dying without a valid Will. Even if a Will has been drawn, but it does not cover all the property to be passed, they are said to have died "intestate" for that portion of their estate.

A deceased leaving a valid will dies testate with respect to included assets. A deceased not leaving a valid will, dies intestate entirely or with respect to assets not deemed to be included under the will. Dying intestate has a significant disadvantage. As noted earlier in this chapter, the law of descent and distribution of the deceased's resident province will decree how the estate assets will be distributed. The rules of a province may apply only to those assets located in that province. Intestate Succession dictates who will receive the assets, in what proportion, and under what conditions. It often has other unintended results, including higher taxes, fees and expenses, unfair distributions, unnecessary delays in distribution, and loss of control through an administrator appointed by the court.

Many people incorrectly assume that if they were to die without a Will their estate would simply pass to their spouse. However, this would only happen for assets that were held jointly with right of survivorship with the spouse (except in Quebec).

It is also important to remember that the definition of "spouse" varies from province to province, which can cause difficulty for non-traditional families. The same holds true for the definition of children.

For example, without a Will, someone who has both a legal spouse and a second, common-law partner could leave a legacy of litigation to their heirs. Step children or children who are only the natural children of one spouse may be excluded under provincial intestate succession rules.

Most provincial intestacy rules do not recognize common-law spouse status, so he or she may be left out of the estate entirely. However, in most provinces, a common-law spouse may petition the courts for support as a dependent, leading the estate into litigation and further costs.

Intestacy does not take into consideration any intentions a person may have for the distribution of their estate. To create peace of mind for everyone concerned - a Will is an easy, inexpensive solution.

4 - 4.9 Revoking a Will

A Will can be revoked at any time before death. A Will can be revoked by:

- Physical act, such as destroying the Will
- By law, remarriage in most jurisdiction, unless the Will was drawn in contemplation of said marriage
- A new Will (usually the first statement in a Will revokes any previous Will)

For a Revocation to be valid it must be done with soundness of mind and without undue influence or fraudulent intent.

4 – 5 LETTERS OF LAST INSTRUCTION

Death creates stress, uncertainty, and confusion. The emotional strain is compounded when significant decisions must be made under difficult circumstances. Having final instructions and documents in order is important for helping survivors endure the loss. Though not legally binding, these instructions are generally followed as they document the final wishes of the deceased.

A letter of last instruction should include the following types of information. As with all estate planning, the list will be personal and it should address specific needs.

- The Funeral. The deceased (testator) should leave specific disposition instructions. Is a service requested? Is cremation or burial appropriate? When and where should the service be held? Is it a public or private service?
- Who should be notified? The names, addresses, and telephone numbers of people to be notified immediately to attend the service, or later, as a matter of courtesy.
- Where the will is located. This should include the name of the attorney involved. The names of other advisors should also be included.

- A list of assets and their location. Also included should be business information and any company benefits available or remaining resulting from death (insurance coverage, medical insurance, etc.).
- Documents required for submitting notification of death claims and changing titles and ownership.
- Any other necessary information to make the process flow smoothly.

4 – 6 DISTRIBUTION OF PERSONAL EFFECTS

When a person passes away, she or he usually leaves personal possessions (items such as furniture, household goods, clothing, collections, photo albums, books, and tools) to be distributed to others or to be disposed of.

Although not legally binding if written outside of a will, leaving written instructions that clearly explain what is to be done with one's things will help make one is wishes clear to the executor and beneficiaries.

Most often, an executor will oversee the distribution of personal possessions. If there are no specific instructions in the will, the executor will likely allow family members (children, grandchildren, parents, and siblings) to divide your personal items among themselves. This could lead to misunderstandings or disappointment.

Studies show that disputes arising from an estate's distribution are more often over items that have sentimental value than over money.

If an elder has no family or the family is not interested in the things left behind, the executor may sell what is of value and add the proceeds to the estate.

A carefully prepared will can go a long way toward reducing the chance of arguments among those who have a claim to the estate. Giving items to the people who enjoy them most and ensuring that the beneficiaries see the process as fair are both important considerations when deciding who will receive personal effects.

Here are some ways to deal with the distribution of personal possessions:

- Write specific distribution instructions into the will. Some choose to designate certain items, such as family heirlooms, to be given to persons so they stay within the family. However, this might cause issues with distribution in the event some of these items have been sold or otherwise disposed of during the deceased's lifetime and the will has not been changed
- Give away those items no longer needed to family members, friends, or thrift stores while still living. This can save the executor and family much time and energy. It will also give pleasure to both the recipients and the donor

- ❖ Put name tags on items that are to be given to particular people. The problem with this is that the tags may fall off, become unreadable, or be switched between now and when the time comes for the items to be distributed. An alternative would be documenting an inventory of final bequests.
- ❖ State wishes in writing in a letter or memo separate from the will and file it where the executor will find it

If there is no spouse, children, or grandchildren, naming a charity (or a thrift store) to receive personal possessions might be an excellent option. The charity will turn good quality, salable, personal effects into money it can use in its programs, and the executor will have less work to do.

4 – 7 PROBATE

"Probate" is the recognition by the provincial or state court of the validity of your Will and the appointment of the person named as Executor.

Granting of the "letters probate" is notice to the public that the Will complies with the basic formal requirements and that the Will was not being challenged at the time of application. Probate fees are a tax on a person's estate and except for the provinces of Quebec and Alberta, there is no limit to this tax.

In Common Law provinces, executors will often get a letter of probate from the Surrogate Court before the assets are distributed from the estate. The purpose of a grant of probate is to invest the executor with lawful authority to deal with the estate.

The grant protects the validity of all acts done under the authority of the probate. The problem with getting a will probated is the fees that are charged by the provincial governments. The fees are based on the value of the assets in the estate.

The larger the estate, the larger the fees incurred. To a lesser extent, probate fees are a form of estate tax or succession duty.

In Québec, notarial wills do not need to be verified by the Superior Court and no fee is charged to the estate. English-form wills (in other words, wills made in the presence of witnesses, other than notarial wills) and wills hand written, dated, and signed, must be verified by the Superior Court to have an effect, and a small fee is charged.

This verification only attests that the will is accepted, but it is not a guarantee that the will is authentic; it can be contested.

The Executor applies to the court for "letters probate" which gives the court's approval of the Will and the appointment of the named Executor.

If there is no Will, the courts name an administrator and the document issued is called "letters of Administration."

4 - 7.1 Costs

The cost of probate is generally based on the fair market value of all property that you own at the time of your death.

Some assets are excluded from valuation for probate purposes. These include

- Assets registered in joint names and which, on the death of the first person; automatically pass to the survivor(s) by right of survivorship
- Real estate you own that is located outside the province of residence
- Life insurance and, in most provinces RRSP/RRIF holdings for which you have named a beneficiary (other than your estate)

Probate fees vary from province to province. Probate fees are administration fees levied by the Provincial courts to grant the letters of probate or letters of administration. It is possible to decrease the effect of these fees by planning your estate.

The following information is general in nature and your final reliable source is your local probate office.

Table 4 - 2 Probate Fees in Canada

Province	Fees
Alberta current to Oct. 2020	Under $10,000 – $35 fee $10,000 to $24,999 - Progressive to $135 $25,000 to $124,999 - Progressive to $275 $125,000 to $249,999 - Progressive to $400 $250,000 and over - $525 (maximum)
British Columbia current to Oct. 2020	First $25,000 - no fees $25,001 to $50,000 $6 per $1000 over $25,000 (0.6%) Over $50,000 - $350 + $14 per $1000 over $50,000 (1.4%)
Manitoba current to Dec. 2019	First $10,000 - $70 Over $10,000 - $7 per $1000 over $10,000 (0.7%)
New Brunswick current to Jan. 2019	First $5,000 - $25 $5,001 to $10,000 - $50 $10,001 to $15,000 - $75 $15,001 to $20,000 - $100 Over $20,000 - $5 per $1,000 or portion (0.5%)
Newfoundland & Labrador current to Jan. 2019	First $1,000 - $60 Over $1,000 - $6 per $1000 (0.6%)
NWT current to Jan. 2019	first $10,000 – $30 fee $10,001 to $25,000 - $110 $25,001 to $125,000 - $215 $125,001 to $250,000 - Progressive to $325 Over $250,000 - $435

Nunavut current to Jan. 2019	$10,000 or under - $25 More than $10,000 and up to $25,000 - $100 More than $25,000 and up to $125,000 - $200 More than $125,000 and up to $250,000 - $300 More than $250,000 - $400
Nova Scotia	First $10,000 - $85.60 $10,001 to $25,000 - $215.20 $25,001 to $50,000 - $358.15 $50,000 to $100,000 – $1,002.65 Over $100,000 – first $100,000 - $1,002.65 plus $16.95 per $1000 on amount over $100,000 (1.695%)
Ontario current Jan. 2020 for estate certificates requested Jan. 1, 2020 or later	First $50,000 no tax Over $50,000 $15 per $1000 on amount over $50,000 (1.5%)
Prince Edward Island current to Jan. 2019	First $10,000 - $50 $10,001 to $25,000 - $100 $25,001 to $50,000 - $200 $50,001 to $100,000 - $400 Over $100,000 - $400 + $4 per $1000 on amount over $100,000 (0.4%)
Quebec current to Jan. 2019	court filing charges for verification of wills: $202 for a natural person $202 for a legal person
Saskatchewan current to July 2019	All Estates - $7 per $1000 (0.7%) note that for real estate, fees are only paid on the equity in the property
Yukon current to Jan. 2019	There may be a fee charged for an estate estimated to have a value of not greater than $25,000Over $25,000 - $140 filing fee

Table 4 - 3 Sample Probate Calculation of $625,000 Estate

	Ontario		Saskatchewan		PEI	
First	$50,000	$250	$50,000	$350	$100,000	$400
Remaining	$575,000	$8,625	$575,000	$4,025	$525,000	$2,100
TOTAL		$8,875		$4,375		$2,500

4 – 7.2 Onerous New Rules

Acting as an estate trustee can be an onerous task. Amendments to *Ontario's Estate Administration Tax Act* changed the filing process for paying probate fees clarifying and adding to the obligations of estate trustees.

Most other Canadian provinces and territories have probate regimes requiring some level of valuation of assets. We can expect that most of these jurisdictions will also seek to maximize probate revenue over the years to come.

The amendments to the Ontario Act have the following results:

- New filings will need to be made with the Ministry of Finance within set time lines and must include much more detail of estate assets including their value at the time of death.
- Audit and assessment powers will be enhanced for four years from the date probate is obtained, or indefinitely if there has been neglect, carelessness or willful default or fraud.
- There are criminal offence provisions for false or misleading statements, subject to a due diligence defence.
- Estate trustees will be required to keep records that "enable the accurate determination of tax payable."
- There will be no clearance certificate provision.
- Fees will be payable by estate trustees only in their representative capacity, which is intended to protect them from personal liability. However there remains potential exposure to trustees for their negligence, breach of trust, and the criminal offence sanctions noted above.

These changes highlight the increasingly onerous task of estate trustees and their advisors. Here are some brief statements of best practices for trustees to keep in mind considering the new amendments:

- Assets should be valued carefully, and appraisals obtained where there is no other clear determination of fair market value.
- Good records must be kept to substantiate values.
- If actual values vary from estimates, filings and payments must be updated.
- Trustees should consider retaining holdbacks for longer periods.
- Testators might consider avoiding the probate process altogether using such devices and structures as Joint Spousal Trusts, Alter Ego Trusts, direct designation of beneficiaries, multiple wills, and perhaps joint tenancies where appropriate if doing so covers all assets.

4 - 8 ESTATE LIQUIDITY

All the above information begs the Questions, “Have you made a Will and is it current?” When the Will’s order of content is examined, the first thing that is evident is the need for liquidity—CASH! Debts and taxes come first.

There are four basic ways to provide liquidity (cash) at death:

1. Sale of estate assets - forced sales usually mean depressed prices, bad timing or both
2. Borrow the Cash - even if a loan is available, it must be paid back

3. Cash in the bank - the deceased may believe cash is best, but the best use of cash is investments, not in bank interest & Life Insurance
4. Life Insurance

4 - 8.1 Life Insurance

Besides being the least expensive of all the alternatives, it has many other advantages. The proceeds are available exactly when needed. Proceeds are generally paid tax-free. The size of the policy can be tailored to the size of the need. Life insurance enables the efficient transfer of assets, without increasing taxation or administrative costs.

The fact that it is paid for annually or monthly in advance of the time required, makes it far more advantageous than a large tax bill that has a six-month payment limit.

Life insurance can be used to replace income. An elder's family may lose income if the elder dies or becomes unable to work. The insurance money can be invested to produce income to replace some or all the lost earnings.

It can be used to equalize inheritances, particularly when dealing with hard to divide assets or certain assets are designated for a particular individual.

Life insurance can also be used to pay estate expenses. People often underestimate the cash required to meet a variety of expenses, including funeral expenses, income taxes, estate administration and probate fees, and other debts payable. The proceeds from an insurance policy can help to ease these burdens.

Every estate, large and small, requires liquidity. Asset accumulation attracts taxation. Life insurance proceeds are not taxable, so large sums of money can be transferred just when needed most, at the death of the estate owner. That is quite an advantage over all other forms of estate assets.

Life Insurance can be inflation-proofed to deal with death, taxes, and bequests long after the policy was acquired. Life Insurance policies combined with equity products provide a double-barrelled approach to offsetting inflation. Inflation results in a diminished future value. Life Insurance and equity products result in indexed future gain, all without taxation or in the case of equity products, tax-favoured results.

Finally, life insurance can be used to leave an inheritance. If the elder does not own a lot of assets, this is one of the best ways to provide for loved ones.

Life insurance offers several tax advantages. First, the beneficiaries receive the benefit income tax-free. Second, policy cash values accumulate tax-free inside the contract. Third, a policy loan repaid by a reduction in the death benefit is not a taxable event.

Life insurance, when used properly, provides an opportunity for positive results in an estate plan. When used improperly, it can create unnecessary liabilities and taxes. While life insurance proceeds are income tax free, they are not automatically estate tax free.

Proper planning must be implemented to assure maximum utility to the beneficiaries.

4 - 8.2 Liquidity and Final Obligations

Debts and taxes must be paid, in cash, before any other estate requirements are met. A variety of different situations can create a need for ready cash.

Terminal illness

Even with Government Health care Plans and Group Insurance, terminal illnesses can be costly - to say nothing of the loss of income or no income, the longer the illness, the bigger the balance.

Funeral costs

Many people do not plan for funeral and cemetery costs - which means the family and/or executor must make these major decisions in short order. Even with plans arranged, both require cash.

To meet these costs, money can come from one of two places—your estate, or a life insurance policy. Funeral expenses currently run from $5,000 to $15,000.

Unpaid taxes

Property taxes, not paid on the instalment plan, will be required to be paid in full at the time of death.

Legal Fees

A lawyer generally is required to settle an estate. Their charge can run to 7 or 8% of the estate value.

Cash bequests

Everyone wants to get a legacy in cash from Uncle Charlie's estate. Uncle Charlie's estate will require cash to pay this bequest.

Capital gains

One area that can be a major debt and drain on the estate is capital gains. Proper planning helps minimize the capital gains tax at death and ensures enough estate liquidity to pay income taxes and other estate costs. Capital gains have been taxable in Canada since 1972.

Canadians tend to believe that most, if not all, capital gains arising on death will be offset by exemptions, so income taxes will not represent a significant problem for the estate. Watch out for recapture of any depreciation which will be brought back into the estate and taxed as ordinary, passive income.

The taxation of capital gains may not be a problem in relatively small estate situations, but they certainly must be considered in larger estates.

Unless proper planning is done well in advance of death, including a pre-arranged funding mechanism, the capital gains tax can seriously erode estate values.

The capital gains rules are complex. Clients with a potential capital gains problem are encouraged to review their estate plans with their tax and legal advisors. Capital gains arise on the disposition of "capital property."

A disposition includes an actual sale of the property and deemed sales that occur in the event of death and certain non-arm's length transfers.

Capital property includes real estate (e.g., principal residence, cottage or other vacation property, rental property, business property), portfolio investments (e.g., shares of corporations, bonds, mortgages), shares in small business corporations, farm property and personal property such as vehicles, art, and jewellery.

4 – 9 CHARITABLE GIVING

Gift planning is an important part of legacy planning. Many of us can make a gift from our estate to help support charities we care about.

Some people hesitate to make end-of-life charitable gifts because they feel an obligation to leave their whole estate to their family and/or dependants. Often, however, it is possible to provide for family and dependants and to make an end-of-life charitable gift.

There are considerable tax benefits to making an end-of-life charitable gift. While there are no estate taxes in Canada, any taxes that apply during one's lifetime also apply at death. If an elder leaves a gift to a registered charity, his estate can use the receipts issued to reduce or eliminate taxes owing.

During an elder's lifetime, charitable receipts can be used against up to 75 per cent of net income in a year to offset taxes owing. However, an estate can use charitable receipts for up to 100 per cent of net income in the year of death. An executor may re-file the deceased's tax return for the year prior to death if there are more charitable receipts than are required to eliminate taxes in the year of death.

Tax laws also allow a person to minimize or eliminate taxes to the estate through in-kind donations of mutual funds or stocks, as well as direct designation of life insurance policies, RRSPs or RRIFs, or TFSAs.

Charitable gifts made through a will, also known as charitable bequests, are the most common form of end-of-life gifts. Many elders leave charitable bequests as a testimony to their values and to make a final show of support for causes they care about.

Ways to give include the following:

- Cash gifts
- Life insurance
- Registered Retirement Savings Plan/Registered Retirement Income Fund
- Tax-Free Savings Account (TFSA)
- Publicly traded stocks, mutual funds, and bonds
- Property

The residual value of the estate is the amount remaining after payment of all outstanding debts, expenses, income taxes, and any specific bequests.

4 – 9.1 Life Insurance

If an elder has a life insurance policy that is no longer needed to protect family or an asset, he could it to make an end-of-life gift. If they are whole life or universal life policies, they may have a substantial cash surrender value.

If an elder makes a charity the beneficiary and owner of a policy, the charity will issue a charitable receipt when it is notified by the insurance company that it has become the beneficiary and owner of the policy. The receipt will be for the donated policy equal to the value of the policy (cash value plus dividends on deposit plus interest). The donor may have to report a portion of the policy value as ordinary income if the cash surrender value exceeds the adjusted cost base of the policy. This information will be provided by the insurance company.

When a charity is named as a beneficiary of an insurance policy, the policy is not considered a part of the donor's estate and so is not subject to probate. As a result, the proceeds will be forwarded to the charity more quickly than if the money were to go through the estate, which is another advantage of making a gift this way. Whether a charitable gift or not, a life insurance benefit is not subject to tax.

4 – 9.2 RRSPs, RRIFs, and TFSAs

An elder can direct assets such as RRSPs, RRIFs, and TFSAs to charity. Although the estate must still declare the registered retirement funds as income, the tax credit generated by the charitable receipt can offset any taxes that are due on the income. As is the case with life insurance policies, making a charity the beneficiary of a retirement fund means that the money will usually get to the charity much more quickly than if it flows through an estate and is not subject to probate.

4 – 9.3 Publicly Traded Stocks, Mutual Funds, and Bonds

An elder can make a gift of publicly traded shares (stocks), mutual fund units, and bonds through his estate. This can provide the estate with significant tax savings if these investments are worth more at the time of passing than when purchased. The Will should give the executor the option to make donations in-kind.

4 – 9.4 Property

An elder can make a gift of property (for example, real estate or art) to a charity, either while alive (called a life interest) or at death. If an elder makes a life interest gift of property, he can continue to use that property during his lifetime. Gifting property, particularly in a life interest arrangement, can be a complex process that should not be undertaken without carefully considering all the implications and consulting various professional advisers.

When thinking about when to make a gift of property, the elder must consider whether it would be more useful to use a charitable receipt now by making a gift while alive or for the estate to use the receipt after death. The decision will depend on the elder's tax situation.

4 – 9.5 Endowments

If an elder wants to continue to support causes he cares about for years after his death, he should consider setting up a long-term family endowment fund, also known as a family foundation. The money is invested, and the annual earnings are distributed to chosen charities each year.

Provisions can be made for their children or grandchildren to be involved in decisions about annual distribution of endowment earnings. In many cases, subsequent generations will also make gifts to the endowment.

4 – 10 DOCUMENTING ADVANCED WISHES

This is the era of "prolonging life," but do not make any mistake - many people want to put restrictions on how far they will go when it comes to life support, nursing care and other medical procedures. Legal documents that help the elder ensure that decisions are made that respect their wishes are an integral part of the legacy planning process.

These documents (sometimes referred to as advance directives) serve many purposes:

- To help record personal preference for health care during incapacity and illnesses
- Helps to prevent family anxiety, conflict, and uncertainty about what to do

- Let the Doctors know what the elder wants and who is in control
- Give authorization and protects the medical staff, and any people who are working with the elder
- Provide evidence that the elder’s personal values and interests regarding any medical treatments have been considered in the decision making process

4 - 10.1 Living Wills and Advance Medical Directives

There can be some confusion as to what a "living will" is. The basic concept is quite simple. The living will (also known as an "advance directive") allows people to leave instructions about their possible medical treatment for doctors and family members in case there comes a time when they are no longer capable of making decisions, or of communicating them. This usually occurs at the end of your life (although not exclusively so) and is specific as to how you want to be treated during your final days.

The living will is not unlike a “power of attorney” that one appoints to manage their finances once they become incapacitated. The difference is that a living will is a medical directive.

The living will appoints another person of your choosing to make the decisions that you cannot. This is commonly referred to as a "proxy directive" or a "durable medical power of attorney." Alternatively you may just need your chosen person to list your instructions pertaining to the procedures that may need to be undertaken, should you be unable to make decisions yourself at the time.

The elder should be sure to distribute copies of their living will to their spouse or significant other, and their doctor(s). It is advisable to carry some sort of notification card in their wallet that indicates that there is a living will in place.

The elder may alter the contents of their living will at any time; be advised though, that they do need to destroy all the copies of the original to make it valid and to avoid any legal complications.

Although it is easy to think that some people are too young to start considering their wills, it is a good idea to make a living will if you are over 18 years of age.

Decisions about personal care can involve things such as where they live, what they eat, and the kind of medical treatment they will receive. Legal recognition of living wills and durable powers of attorney for health care varies from province to province. Provinces that recognize living wills require health care workers to respect an individual's wishes.

Living wills are recognized in British Columbia, Saskatchewan, Manitoba, Nova Scotia, Québec, and Ontario. Even though the law of Saskatchewan does not recognize a living will, it is still a valuable method of directing how you are to be cared for in the event of disaster. If it does not carry legal authority, it certainly carries moral authority.

The person the elder appoints is called your "attorney for personal care." They may appoint more than one attorney if they wish. The elder may give their attorney special instructions about the kind of care you want—or do not want—in certain situations.

A durable power of attorney for medical care allows the elder to appoint someone to make medical-care decisions on their behalf if you are unable to do so. They can appoint just about anyone to act as their agent—although not their doctor. Experts recommend choosing someone whom the elder trusts and who will be a strong advocate on behalf of their wishes.

The elder should talk to their family about any decisions and ask them to support the person who will have durable power of attorney for their health care. Discuss their wishes with the family physician while they are still in good health and ask their doctors to place copies of the living will and durable power of attorney for health care in the elder's medical files.

Elder's do not need to have a lawyer to create a living will. It should be noted, though, that the legislation that applies to living wills can be quite complex, and to avoid any legal strangleholds it may be advisable to have the assistance of a lawyer.

Table 4 – 4 Sample Living Will – A Medical Directive

Full Name: ____
Address: ____________________________________City: ________________________
Province: _____________ Postal Code: _________________ Phone: ____________
Doctor's Name: ____
Doctor's Address: ____________________________________ Phone: _______________

At this time I, ___________________________________ am of sound mind and capable of making these decisions. I have carefully considered the ramifications if I refuse certain medical treatment should I become seriously incapacitated. It is my wish to die with dignity without the use of extraordinary measures. If, in the opinions of two or more doctors, I am terminally ill and there is no immediate hope of recovery, I expect that no artificial means be used to keep me alive, such as antibiotics, resuscitation, tube feeding, hydration or other life-support systems.

I expect to receive basic palliative care, however, and I request that drugs be used to keep me pain-free even if my life is further shortened.

I have the following wishes regarding autopsy: _________________________

I have the following wishes regarding organ/tissue donation:

The following person is hereby appointed by me to act as my medical power of attorney in the event he/she is consulted about my wishes.

Full Name: ____

Address: _____________________City: _________________Prov. ____________

Postal Code: __________ Phone: _______________________

My Signature: ___________________________Date: _______________________

Witness Name: ________________ Signature of Witness: ______________________

Address of Witness: ____

Signature of Notary Public: ____

4 - 10.2 Powers of Attorney

Powers of attorney may be specific or general and may be springing or enduring.

A specific power of attorney enables one to act for another for a specific purpose; for example to sell a car. A general power of attorney enables one to act for another for several purposes.

Springing powers of attorney operate upon the occurrence of a springing event. For example, a springing power of attorney may become operable if the maker leaves the country. Normally the maker's subsequent mental incompetence terminates a power of attorney. Enduring powers of attorney are designed specifically to survive the maker's subsequent incapacity.

For the powers of attorney you should consider the following matters:

- Would they like their power of attorney to be specific or general?
- Would they like their power of attorney to be springing?
- Would they like their power of attorney to be enduring?
- Who would they like to have as their POA?
- Would they like to appoint more than one person to act as their POA?
- If they would like to appoint more than one person as their POA, then are they to act jointly or successively?
- Is their power of attorney to be revocable during their mental competence?
- Who would they like to nominate as the party capable of declaring their mental incompetence?
- Who would they like to nominate as the person to whom their lawyer is to account? This could be in conjunction with their executor or executrix.

In more serious circumstances, such as mental illness, which renders the elder even temporarily incapable of making decisions, it is reassuring to know that someone they know, and trust will be handling their affairs, instead of a court-appointed person or a government official.

It is a good idea for spouses to give power of attorney for both property and personal care, naming an adult child or children as alternates, in case the other spouse is also incapable of acting.

While there are do-it-yourself forms available to allow individuals to appoint a power of attorney for both property and personal care, there are special rules involved, which dictate whether a power of attorney is validly signed, and whether it survives the "donor's" mental incapacity. A lawyer will ensure that these rules are properly followed and that your power of attorney is in fact a valid one.

Furthermore, giving a power of attorney is a very serious matter. The elder is giving the person they appoint significant power over their property—or person, and there is always a risk that the person appointed could misuse this power.

Although they are not required to consult a lawyer in order to make a legally binding power of attorney, it is a good idea to do so. Consulting with other expert advisors is also a good idea, providing they are impartial and concerned only with your best interests. Unfortunately, there are a lot of misconceptions when it comes to Powers of Attorney. Among them:

- Powers of Attorney and Living Wills are not the same thing as a Last will and testament? The PA and or Living will expire when the person dies. Thereafter, instructions are taken from the last will and testament
- PA and living wills do not have to be registered with the government

- A lawyer required is not required to make a PA or Living will - however if the elder's affairs are complicated; they should consider that option
- If an elder does not have a PA or Living Will, the government will not step in and manage their affairs. Family members have the right to make health care decisions or apply to become "'guardian" of property in the absence of a PA or Living Will. Close friends can also make application. The Office of the Public Trustee only acts in situations where no other suitable person is available, able and willing.

4 – 11 MEDICAL PROXIES

When an individual does not have a medical power of attorney or a guardian appointed by the court, and they have become medically incompetent, the individual's family can appoint a medical decision maker to speak on the person's behalf. The main difference between a proxy and an agent is that the agent is someone the individual has chosen. A proxy has limited power.

4 - 11.1 Proxy Advance Directives

These directives name alternative persons, called surrogate decision makers, if one is found to be incompetent to make his or her own decisions.

The proxy Advance Directive should be someone close to the elder, a person who is aware of the elder's wishes. If the family does not agree who the proxy should be, or if they disagree with any of the proxy's decisions, then any one of them can petition the court to request guardianship. A lawyer's help can be beneficial in starting a guardianship proceeding.

Advance directives, including the role and function of proxy decision makers, vary by province.

A Health care Agent makes decisions only in the area of withholding or withdrawing life support measures, while a Durable Power of Attorney for Medical Decisions makes all other health care decisions except that which the Health care Agent decides. One person can fill both roles. A surrogate decision maker is best empowered when preferences have been shared and discussed with the person he or she is to represent.

In Canada there is legislation supporting Advance Directives in the provinces of Nova Scotia, Québec, Manitoba, Ontario, Alberta, and British Columbia.

Not many people complete Advance Directives for a couple of reasons. First, patients without preparation are hit with a barrage of questions, information, and Advance Directives upon being admitted. This often results in patients avoiding discussion of this issue while during the uncertainty of hospitalization.

Hospitalization can be an overwhelming experience, and this often predisposes patients against discussing end-of-life issues. In addition, physicians are, for the most part, reluctant to engage patients in discussing issues germane to establishing Advance Directives.

4 - 11.2 Guardianship for Minors or adult infirm dependents

It is common for today's elders to have teenagers and young children at home who require a guardian upon the death of one or both parents. Some may have adult, infirm children.

Even in two-parent households, it is important to suggest a guardian—an accident could leave the family orphaned.

A guardian should be also chosen if you have a child or other dependant who would be unable to function independently because of a mental or physical disability.

Although the appointment of a guardian may need to be confirmed by a court at the time the guardian wishes to act, the recommendation made in your will is usually followed. Before naming a person as a guardian, ensure that this individual is willing to take on the role. The potential responsibility of a guardian is enormous, involving the care, support, education, and upbringing of your children. It is an appointment, which you will need to consider carefully because the happiness and well-being of your family is at stake.

A guardian may be named in a Will, but must be appointed by the court. The guardian oversees the interest of minor children as to their person or property and is usually the surviving spouse. The appointment, usually approved by the court as requested, may be contested by an opposing application. A point to consider is in the event of a disability, who will look after the children if they cannot look after themselves?

4 – 12 LEGACY PLANNING FOR BUSINESS OWNERS

Special estate planning considerations exist for business owners; particularly if that business represents the bulk of the owner's net worth, which is often the case.

While the owner is actively engaged in the management of the business, the enterprise is successful. The business has a real value because it produces income and security for the owner and his family.

However, the value of most closely held businesses is reduced at the death of the owner, as he/she is usually the driving force behind the success. Thus, the primary estate planning objective of most business owners is to preserve the business or maintain its value for the beneficiaries. Usually, that is easier said than done.

The first thing that should be determined is whether it is worthwhile to continue the business or does the success of the business depend solely on the owner's active involvement?

If the business is to continue, either with the family or with outsiders, plans must be made to provide liquidity and a reserve. The liquidity and reserves are usually necessary to meet both the needs of the business because revenues usually decrease, and for estate taxes and administration expenses, which are usually immediate requirements.

Selling a business at the death or retirement of the owner requires a different approach. If the full value is to be realized, there must be a market for the business. How much is a business worth? It is worth what someone is willing to pay for it? A discussion on evaluation methods is beyond the scope of this section.

However, there are several ways to sell a business.

A business owner often prefers that the business remains in the family. One method to retain family ownership and remove the subsequent growth of the asset from the estate, is a lifetime transfer. The simplest method is an outright sale. Other options include instalment sales and gifting.

If there are partners in the business, an instalment sale or a buy-sell agreement may be appropriate. If there are no partners, a sale to key executives or a group of employees may be an option. Larger businesses may consider going public to sell the business.

The real issue is not the immediate sale of a business. The issue is that owners of small businesses have estate-planning issues that are specific, unique, and should be addressed.

4 – 13 LEGACY PLANNING & INVESTING

An integral part of legacy planning is building the estate. The methods used by a prudent investor are just as applicable to estate planning as for other types of investing.

The participant should take the long-term approach to wealth accumulation. The emphasis should be on taking advantage of tax-advantaged investments, particularly retirement plans that accumulate tax-deferred until withdrawal such as an RRSP, RRIF, etc.

For participants having an investment horizon of ten years or more, the emphasis should be on growth, and investing as an inflation hedge and retirement funding vehicle.

The strategy should be diversified, well designed and meet the specific needs of the participant. Investment opportunities that are suitable for most long-term investors are stocks, mutual funds, government, corporate and municipal bonds, and variable and fixed annuities.

The choice depends on one's time horizon, risk tolerance, investment goals, and objectives, and overall strategy. This investment strategy is as important to estate planning as taxation and distribution strategies.

4 – 14 U.S. LEGACY PLANNING ISSUES

With the changing of the law to allow Free Trade, many Canadians are now doing more investing in the United States than ever before. This can bring about some complex estate planning when a death occurs.

This section, along with the chapter on Travelling or Moving Abroad will provide a very valuable foundation for your interaction with the elders who spend time in the United States.

4 – 14.1 Is the Elder Exposed to US Estate Taxes?

U.S. securities held in RRSPs/RRIFs are subject to U.S. Estate Tax upon the death of the annuitant. This is because the U.S. tax authorities appear to 'look through' RRSPs/RRIFs to the underlying assets, on the basis that RRSPs/RRIFs simply represent deposit accounts or perhaps revocable trusts. The Canada-US Tax Treaty may provide relief so that income taxes are triggered when the asset is actually sold, or monies are withdrawn.

The annuitant of an RRSP/RRIF may not be entitled to treaty relief, and thus may be exposed to double taxation (i.e. any income inclusion will be taxed in Canada and exposed to Estate Tax in the U.S. with no foreign tax credit relief).

Maintaining a brokerage account in Canada to hold U.S. securities will not avoid exposure to U.S. Estate Tax. (It does not matter where the U.S. securities are held and as a result, U.S. securities held in Canada are still subject to U.S. Estate Tax upon the death of the shareholder).

If the estate is subject to U.S. Estate Taxes, there are several planning strategies available to assist the elder in reducing their U.S. Estate Tax exposure. For example, holding U.S. assets through a Canadian holding company, or using non-recourse mortgages on U.S. real estate (non-recourse mortgages stipulate that the lender has recourse only to the mortgaged property and not to the mortgagor personally, in the event of default). The most effective solution may very well be that the elder simply sell their U.S. assets to other family members or to third parties prior to death. To help ensure the completion of such sale transactions, it is desirable for others to hold Powers of Attorney, effective in the relevant U.S. jurisdictions, in the event the elder becomes incapable of following through on their own.

The effectiveness of any of these measures is not clear in law, and under no circumstances should action be taken without careful consideration and consultation with experts. There are significant risks and potentially adverse income-tax consequences in both Canada and the United States if these strategies are improperly or inappropriately used.

4 – 14.2 Interests in U.S Real Estate

What interests in U.S. real estate does the elder own, whether directly or through a U.S. Corporation, partnership or trust? Income from and gains on such property are generally subject to U.S. income tax, even if earned by a non-resident. Further, the value of such property is generally subject to U.S. estate tax. Do they have any interests in such property through non-U.S. Corporations, partnerships, or trusts?

Such interests may be subject to U.S. income and estate tax.

4 – 14.3 Personal Property & Investment Securities Located in the US

What other U.S. assets do they own; including personal property located in the U.S. and U.S. securities (whether held directly, in a trust or through an RRSP)? Some of that property may be subject to U.S. estate tax.

4 – 14.4 Life Insurance

What are your assets outside the U.S., including the death value of life insurance that you control, pensions, and RRSPs? Calculation of estate tax depends, in part, on the ratio of U.S. assets to worldwide assets. Life insurance proceeds on death and the cash value of third party policies are added to the value of the world wide estate, even if the proceeds themselves are not taxed. They boost the value of the estate and the applicable rate of taxation on the other included assets.

4 – 14.5 Recently Disposed Assets

Has the elder disposed of or transferred any assets including U.S. assets but retained rights to use the property? Some of that property may be subject to U.S. estate tax even though they do not own it on death. Further, the disposition may have triggered U.S. income or gift tax. If it is an income producing asset, interest and dividends may be attributed back to the giver.

4 – 14.6 Liabilities

What are their liabilities? For each liability, is the recourse of their creditor limited to a U.S. asset (the creditor can take the asset if an individual fails to pay but cannot get anything else from the elder)?

What are the Canadian and U.S. tax costs of assets that the elder owns in the U.S.? Have they made any gifts of U.S. property?

If these factors suggest a significant net U.S. estate tax exposure, then they should consider options such as changing the way in which they hold U.S. property, disposing of the property before death and changing the non-U.S. assets and liabilities of the estate.

4 – 15 INCOME TAXES AT DEATH

Although we will look at Income Tax in another chapter, we will touch briefly on some key points.

In estate planning as in life, two things are certain: death and taxes. At death, the decedent's property is transferred to his/her heirs.

How much and how quickly the process takes depends on the decedent's estate plan. The ideal plan is one that meets the best interests and needs of the beneficiaries.

Income Tax at death is somewhat more complicated than while alive. Income taxes arising on death can be a significant drain on estate assets. Estate planning will help to conserve the estate and ensure that estate assets are distributed in an orderly manner.

4 – 15.1 Income Tax Rules

The personal representative of the deceased (i.e. the executor, trustee, or administrator) is responsible for administration of the estate, including the filing of income tax returns.

One or more personal income tax returns for the deceased (called terminal returns) must be completed for the period from January 1 to the date of death. The number of terminal returns required to be filed will depend on the nature and timing of the income, which had been earned by the deceased before death.

Income earned, and deductible expenses incurred are reported on the terminal return(s). Income tax is calculated, and any resulting liability for tax is due at the time the return is required to be filed. Income taxes are paid from the estate.

4 – 15.2 Income Sources for Final Tax Return

Income relating to the period before the date of death is generally taxed to the deceased in the year of death. Income earned following the date of death is usually taxed to the estate or the beneficiaries of the estate.

Completing the final personal income tax return for the deceased can be simple. Income reported on the tax return will often include, for example, employment income earned in the year up to the date of death, pension income received during the year prior to the date of death, and / or interest income received or accrued from the last reporting date to the date of death. These amounts are usually determined without difficulty. While most estate situations are straightforward, others can be complicated if the deceased owned RRSPs (matured or un-matured) or capital property at the time of death.

Capital property includes, for example, farm property, rental property, vacation property, or shares in a small business. The estate can be further complicated if the deceased have been self-employed through a proprietorship or partnership.

4 – 15. 3 Filing of Tax Returns

The terminal return(s) must be filed by the later of April 30 following the year of death, or six months following death. For example, if the taxpayer died on March 5, the return is due by April 30 of the following year. However, if death occurs Dec. 5, the return would not be due for six months after the date of death, i.e. June 5 of the following year.

4 – 15.4 Clearance Certificates

Before a final distribution of estate assets, the personal representative should obtain a clearance certificate from Canada Revenue Agency (CRA). If assets are distributed and the clearance certificate is not obtained, the personal representative is responsible for payment of any outstanding income taxes.

4 – 15.5 Getting Professional Advice

Income tax legislation, as it relates to deceased persons and their estates, can be very complex. Accrual basis reporting of income in the year of death, deemed dispositions of capital property immediately before death, filing of special elections and multiple income tax returns are just a few of the many rules that can apply. There are many opportunities for tax planning after death occurs, but there are also serious traps for the unwary!

In virtually all estate situations, the representative of the deceased should seek professional advice. Certainly, a lawyer should be involved in the settling of the estate. A tax accountant will generally be involved in the preparation of the required income tax returns for the deceased and the estate in all but the simplest of estates.

4 – 15.6 The Elder Contact List

The following form provides a convenient way of reviewing and recording the essential details of an elder’s personal financial plans.

Table 4 – 5 Estate Planning & Administration Professional Contact List

ADVISOR	PHONE NUMBER
Financial Consultant -	
Lawyer -	
Accountant -	
Banker -	
Trust Officer -	
Investment Counselor -	
May we have your permission to consult your professional advisers to request information that will be necessary to ensure that your estate planning is complete? Yes ___ No ___ Date: _________________ Signature of Client ___________________________	

4 – 15.7 Legacy Planning Checklist

To help implement an estate/legacy plan, here is a checklist that can be used to keep things on track:

- Set goals for what you want to accomplish
- Chose an executor
- Chose a guardian(s) for minor children or adult dependants
- Review tax considerations for the estate and make appropriate choices or changes
- Review insurance needs and make appropriate choices or changes
- Create a personal information directory
- Speak to executor and family about wishes and location of important papers
- Made list of assets and liabilities
- Speak to family about who will receive personal effects
- Have a lawyer draw up a will (self and spouse)
- Have a lawyer draw up incapacity documents (self and spouse)
- Review trust considerations and make appropriate choices or changes
- Do succession planning and review legacy plan

4 – 16 LEGACY PLANNING MISTAKES

Smart people who have worked hard all their lives to achieve financial success often make dumb estate planning mistakes. Those mistakes can result in their families losing over half of their assets when they pass between generations. They can destroy much of a lifetime's work. And they can inflict a great deal of pain and heartache to the people they love.

Two separate surveys of older Canadians conducted in 2012 identified several frightening issues. Among them:

- 84 per cent of the Canadians surveyed had named a friend or family member as their executor - a potentially risky move.
- Close to 80 per cent of respondents said they had no prior experience in administering a will.
- Two thirds of respondents thought an estate could be wrapped up in a year or less, while 38 per cent thought that it would take less than six months. When all goes smoothly it can take from a year to 18 months, but complications such as tax errors can delay the process by months or even years.
- 37 per cent of respondents had not updated their will in over five years – an extremely risky thing to do. A review of the will is especially necessary whenever a major life event such as a marriage, divorce or birth of a child occurs.
- Most of the respondents felt that having a will was enough to protect them in rough times – not taking into consideration that a time may come when power of attorney and other concerns will likely be needed before a will is invoked.
- 81 per cent of retired boomers had a will, but only 49 per cent had a current health directive - that explains how they would like to be treated medically if they are no longer able to communicate.
- Only 39 per cent were found to have a current financial directive - which appoints someone responsible for their financial affairs.

The irony is that most of the mistakes are easily avoided. With a little forethought, people of average intellect can construct estate plans, which can perpetuate their estates for generations.

In preparing an estate and legacy plan, elders should also attempt to avoid the following traps:

- Procrastination
- Trying to Take it with Them
- The "I love you" Will
- Lack of Liquidity
- Unbalanced Property Ownership

- Equal Distribution to Heirs
- Property Transfers Based on Non-Will Provisions
- Saddling Children with Debt
- Improperly-Owned Life Insurance
- "It's all been taken care of..."

4 – 16.1 Procrastination

Everybody has an estate plan. If you do not create one, on purpose, through carefully drafted wills, trusts and other documents, then your state legislature will step in with a plan of its own.

This plan, called the laws of intestacy, dictates who will get your assets, how they will get them and guarantees that your estate will pay the highest possible estate taxes in the process.

If you are happy with your provincial legislature deciding who will receive your assets after you are gone and especially if you want to pay the federal government any extra estate taxes, then no additional work on your part is required. But if you are not, then you must develop estate plans of your own and they must be developed now.

4 – 16.2 The "I Love You" Will

Most people have very simple wills. They say that when one spouse dies, all his/her property goes to the surviving spouse and, when they are both gone, all the property goes to their children. Very straightforward, but for people with modest estates, these wills work fine. For elders with large estates, these wills can create thousands of dollars of probate and other taxes. The solution is to have provisions in your wills or living trust agreements, which will become effective at the death of the first spouse.

4 – 16.3 Unbalanced Property Ownership

If each spouse owns substantially equal property, then trusts can function neatly to avoid any extra estate costs of any additional assets going through the estate.

However, if one spouse owns millions and the other spouse has only a small estate; spouses should consider the benefits of balancing their property ownerships.

4 – 16.4 Property Transfers Based on Non-Will Provisions

Most people think that their wills control who will get what when they die.

Surprisingly, many assets are transferred based on provisions, which can contradict but supersede those of a will.

Bank accounts, certificates of deposit, retirement plans, RRSPs, annuities, life insurance policies, real estate and countless other assets are often not controlled by wills. In the case of jointly owned assets—bank accounts, stock accounts, and real estate are often owned this way—the surviving joint owner often becomes the sole owner of the assets. And retirement plans, RRSPs, annuities, and life insurance proceeds transfer to named beneficiaries, not necessarily to the people named in a will.

Property ownership forms and beneficiary designations need to be coordinated with your will planning. If they are not, your carefully drawn will can become meaningless and the estate tax savings that it tried to create will be defeated.

4 – 16.5 Trying to take it With Them

There are only three ways to reduce estate taxes: spend the money, have a trust, and give it away while alive.

Affluent people, especially the self-made variety, often do a very poor job of either spending it or giving it away. They got where they are, financially, by being "accumulators" and they have a hard time with not continuing that lifetime habit.

The Government essentially wants the elder to stop you from taking advantage of a whole range of laws which can result in their estate paying zero taxes while the elder maintains their financial independence forever. The CRA collects millions and millions of estate taxes every year, which could have been legally avoided, from the estates of people who never quit being "accumulators."

4 – 16.6 Lack of Liquidity

Many affluent people create estates of great value, which, at death, are very illiquid. Holdings of real estate and family businesses often represent 90% or more of affluent estates. But, if those estates are subject to any taxes, those assets often must be sold at fire-sale prices to pay them. Estate taxes are generally due within nine months of death. Forcing your family to choose between sacrificing a treasured asset and / or taking on an enormous burden of debt to pay estate taxes is simply stupid. It is also totally avoidable.

4 – 16.7 Equal Distribution to Heirs

Most people have great love for all their children, and they want them to share equally in their estates. An admirable intent, but "equal" is not the same thing as "equitable."

While dozens of examples exist, a common problem, often mishandled, is when a person owns a business in which some of the children participate.

Giving both participating and non-participating children equal shares of the business is a near guarantee for disaster. This blunder has destroyed more businesses and families than probably any other estate-planning mistake.

If you have a business, a farm or some other income-producing asset, and some of your children participate in its management; do not carve it up equally between all your children. Provide the business to your participating children and give your non-participant children non-business assets. If this creates an unbalanced distribution, consider creating additional assets through life insurance.

4 – 16.8 Saddling Children with Debt

The same kind of people who would blanch at a $500 MasterCard bill often leave their children with a range of estate problems that can only be solved by thousands of dollars of new debt. Illiquid but substantial estates often must borrow great amounts of money to pay any final estate taxes. Those borrowings can come from a bank or, in some cases, from the CRA, but they all require complete repayment of principal plus substantial interest. Too often, the assets, which triggered the tax and the loan, cannot generate enough income to cover it.

Enormous debts are also created when children who participate in a family business are compelled to buyout their non-participating siblings' interests.

This not only creates great financial pressures but the process of negotiating a buyout can create much acrimony. Many families have been destroyed by just such a challenge.

Life insurance is frequently the best solution to these financial problems. Too often, however, affluent people and their advisors do not adequately explore this option because of ignorance and misunderstanding.

4 – 16. 9 "It's All Been Taken Care Of . . ."

Good estate planning is never truly "done." As the elders circumstances change and evolve over the years, their plans need to be kept current and apace with them.

Few attorneys call in their clients for an annual estate plan review. Fewer clients sit down, annually, and take stock of their situation. But if they did, thousands of dollars can be saved, and much heartache can be avoided.

4 – 17 SUMMARY OF LEGACY PLANNING

- Estate planning is necessary for an individual to convey his/her assets to beneficiaries, both in his/her lifetime, and after death. Individuals should consult advisors competent in estate tax laws and financial planning skills in designing an estate plan, making certain that tax advantages are considered.
- The value of the estate must be determined to determine tax liabilities and to select asset transfer methods, and to develop timelines, both for implementation and distribution.
- A well-designed estate plan will reduce estate shrinkage by minimizing federal and provincial estate and inheritance taxes, and keeping transfer costs to a minimum.
- Life insurance is an excellent estate-planning tool as it can provide cash to meet obligations of estate taxes, probate costs, and family needs. An individual should seek legal counsel and tax advice from qualified advisors before making estate planning insurance decisions.
- Probate is a judicial process designed to settle the affairs of the deceased. It can be expensive, time consuming, and cause delays in distribution.
- Since the will is a matter of public record once it is filed with the probate court, loss of privacy may be a significant issue.
- The most common instrument for avoiding probate is a living trust. The living trust provides a vehicle to manage property and avoid probate but does not avoid taxation.
- A trust is a contract that separates property ownership. One person has legal title and manages the assets; another person retains the beneficial ownership.
- A living trust is created during the maker's lifetime; a testamentary trust is established by the will at the maker's death. A revocable trust can be amended or revoked any time during the grantor's lifetime.
- A will is a legal document, which declares a person's instructions on his/her property distribution after death. A properly prepared will, containing instructions as to how and to whom assets are distributed, is usually the first document prepared in estate planning.
- Other documents essential to estate planning include durable power of attorney, medical power of attorney, living will, and letter of last instruction.
- Business owners have special estate planning considerations. Should the business be continued, or should it be sold on the death of the owner?
- Each option requires planning, in the case of continuation, providing liquidity and reserves, in the case of a sale, determining the value of the business and considering different ways to transfer ownership. Investment strategy to increase the value of an estate is just as important as taxation and distribution strategies.

4 – 18 CONCLUSIONS

It makes good sense for all elders to take the time to develop a comprehensive estate and legacy plan. In doing so they are taking thoughtful, caring steps to provide for their family and possibly even their community.

Putting solid plans into place is an intentional act of stewardship that expresses a person's values and shows what was important to them in life. It helps an elder to leave a meaningful legacy.

Once an elder puts an estate and legacy plan into place, he invariably feels a well-deserved sense of satisfaction.

But remember, estate and legacy planning is not a one-time exercise. It is an ongoing process because circumstances and needs will change.

Good planning will reduce the complications and expense of dealing with the estate. Planning may also increase the assets an elder leaves to the people and causes that are nearest and dearest to him.

Today's elders are far different from their parents. Today's 55-year-old may have children still in elementary school, they likely have changed jobs enough to not have locked in any decent retirement pension, and they may well be left with the responsibility of caring for a parent or two. This is quite a contrast to the 55 year-olds of the prior generation.

These changes may put even more emphasis on the need for careful estate and legacy planning.

We leave you with the following valuable tips:

- Take careful consideration when deciding who is best for the task of executor. The chosen person should have the time, knowledge and skill to take on these numerous duties.
- Be sure to discuss with your family and advisers exactly how you want your estate to be distributed so everyone is on the same page.
- Consider contacting a lawyer to help explain all your options and ensure your documents are in order.
- Make sure you have a will as dying without one increases cost, adds stress on your family and takes away control of your family's assets.
- Keep all your valuable papers together - insurance policies, wills, bonds, investment records, birth certificates, marriage certificates and social insurance numbers – and make sure your family knows where they are.

- Review your life insurance regularly and be sure to name a beneficiary. Naming your estate slows down receipt of money and increases executor fees, giving more opportunity for the proceeds to end up in the wrong hands.
- Do not forget to name a beneficiary for your RRSP or RRIF, or alternatively, put an RRSP-RRIF clause in your will. This removes the possibility of a big tax bill. The total value of your RRSP/RRIF can be added to income and taxed at the highest rate and reduce income to survivors. A spousal beneficiary defers this tax.
- Keep some assets liquid so there is cash available to pay bills upon passing.
- Fill out a Net Worth Statement each year that details what your assets are, and what they are worth.
- Most importantly, do not wait until it is too late to get your estate in order. Planning makes everything easier for your family and friends.

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Chapter 5

Travelling or Moving Abroad

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5 – 1 KEY OBJECTIVE OF THIS CHAPTER

Many Canadian elders decide, for a variety of reasons, to move to the U.S. Many more travel there - often for extended periods of time. This chapter looks at some of the fundamental similarities between the two countries - as well as some of the differences - information that should be of keen interest to anyone who works closely with elders, especially well-heeled elders. Elder Canadians who travel to the U.S., expose themselves to several potential pitfalls - that need to be planned for and managed.

5 - 1.1 How with This Objective Be Achieved?

We will examine, in some detail, how Canada and the U.S. compare on several important fronts, including:

- Income taxes
- Estate taxes
- Health care
- Social Security

We will also look at some of the strategies that can be employed to protect Canadians who travel to the U.S.

5 – 2 INTRODUCTION

In many ways Canada and the U.S. are not all that different. There are many similarities and areas of common interest and concern with respect to health and welfare issues, end of life planning, chronic illnesses, bereavement, nutrition, caregiving, marketing, fraud, funeral planning, etc.

Though the issues may be similar, the options, strategies and solutions available to deal with the various issues can be quite different. This is certainly the case when it comes to moving - or even travelling - from one jurisdiction to another.

The dynamics of working, living, or moving between countries, demands that the plans be reviewed carefully to ensure they continue to do the job they were designed to do when they were first set up.

Some Canadians decide to move out of the country to avoid, or at least reduce, the amount of income taxes they pay. Others find out that they have become residents of another country by accident and they face substantial tax costs as a result.

Many Canadian elders spend time out of the country, particularly in the United States, during the winter months. These snowbirds may plan on moving to the U.S. permanently, or look forward to spending certain months of the year south of the border as an integral part of their retirement plans and lifestyle. In either case, their time spent in the USA may cause them to be deemed as residents of the U.S. for income taxes, estate taxes, or both.

Conversely, they may no longer be deemed to be residents of Canada, and put at risk government benefits, income tax breaks, deductions, and credits. Those wanting to take advantage of lower income tax rates in another country may find that the CRA still considers them to be residents of Canada for income tax purposes. In a worse-case scenario, they may be determined to be residents of both countries for tax purposes.

Many advisors working with elders do not ask or adequately consider the impact on plans, programs, and lifestyles for elders retiring or spending retirement time in the U.S. Elders, and the advisors working with them, owe it to themselves to be cognizant of the ramifications of becoming or being deemed to be a U.S. resident.

5 – 3 MOVING TO THE U.S.

Many elder Canadians - particularly those with substantial assets and income - are often tempted to make a move to the U.S. They are attracted by, among other factors, the warmer climate (in places like Florida, Arizona, etc.), a lower cost of living, and lower taxes.

Unfortunately, moves of this nature are far from easy. Establishing residency is not necessarily straightforward. There is a significant risk of "double taxation." And, despite perceptions, U.S. taxation can often be even more punitive than Canadian taxation.

5 - 3.1 Establishing Residency

Individuals wishing to establish non-residency status for income tax purposes are responsible for ensuring that any determination of residency by a government or court authority supports their (taxpayer) position that they are not or have ceased to be residents of a country.

"Residency" is not defined in the Canadian Income Tax Act, and there is no "standard list" of easily identifiable residency criteria. There is also no mandatory application process through which an individual can undertake to request and be granted non-resident status.

Each situation is judged on its own merits, or to use the Canada Revenue Agency (CRA) terminology, each one is considered a "question of fact." The situation is equally ambiguous in the U.S. Tax authorities reserve the option of assessing everyone's situation, and the facts provided, on a one-off basis. The matter is further complicated by the fact that an individual can be either factually resident or "deemed" resident for income tax purposes (by virtue of living arrangements, economic ties and/or travel patterns). This makes determining precisely what U.S. connections exist (in terms of family, economics and property) extremely important.

Residency is of significant importance from an income tax perspective. Canada only taxes non-residents on their Canadian-source income. But in the U.S. all citizens (whether at home or abroad) - and all residents - are taxed on their world-wide income.

Giving up Canadian residency may not make a person immune from paying Canadian income tax. This will be influenced by the degree to which they have been effective in severing their ties and what they have left behind in Canada such as pensions, retirement income, investment holdings, business income, employment income and family and organizational ties. Aside from interest or dividend income, such things as employment or paid service work, carrying on a business, real estate investment income and disposing of rental properties - can all necessitate that a tax return be filed in Canada - and tax paid. To help address these potential tax liabilities, elders should explore the use of corporations and trusts to protect assets from both income taxes and estate taxes.

The potential ambiguity with respect to residency can, however, create far more serious problems. It can open the door to potential double taxation - where a Canadian, who resides in the U.S., pays both U.S. and Canadian tax on Canadian-source income; or where a Canadian is deemed to be resident in both countries (and required to pay tax on worldwide income in both).

This is particularly troubling. Determining when residency begins, if spending a lot of time abroad, and conversely when residency ceases in Canada (if in fact it ceases at all) is vital. To confuse matters even further, other jurisdictions are also a part of the mix. Taxes are not just the purview of federal authorities - most provinces and states have separate income taxes and there are substantial differences between jurisdictions. Fortunately, there are opportunities to challenge situations where Canadians are subjected to income tax in Canada and the U.S. on the same income. Certain exemptions and reductions are available.

There are also some key exit strategies that can be employed to minimize the tax burden associated with giving up residency in Canada and gaining residency status abroad (specifically the United States).

5 - 3.2 Canadian Departure Taxes

Once an elder either intentionally takes up U.S. residency or has been "deemed" to be a non-resident of Canada, he or she is deemed to have sold most of his or her assets at fair market value. Exceptions to this treatment include Canadian real estate, pension entitlements, property used in a Canadian business, certain interests in Canadian trusts and Exempt life insurance (but not segregated funds). Special filing rules apply for Canadian emigrants who own property with a total value of $25,000 or more (again with certain exclusions).

An elder who has taken up residency in the U.S. can, however, elect to defer payment of tax from this deemed disposition of taxable capital property. They must post acceptable security (unless the total tax from deemed dispositions of both taxable and non-taxable Canadian property is less than or equal to $100,000 in capital gains) but they do not incur any interest charges as a result of this deferral, Note, that if you post security, no interest is charged for the time up to earlier of the actual disposition of the property or death of the owner. Valuation costs are incurred, however, since CRA will expect a current market valuation of all taxable Canadian property. Elders must report all applicable property subject to the deemed disposition rules on Form T1243 - "Deemed disposition of property by an emigrant of Canada."

Further gains on taxable Canadian property are also taxable (gains after valuation and deemed disposition on the departure date from Canada up to the actual disposition of the assets).

Taxable Canadian property includes assets like:

- Shares of private Canadian companies and those not listed on a designated stock exchange
- Share interests in public Canadian companies where you and other non-arm's length owners control 25% or more of any class of shares
- Over the counter stock not listed on a prescribed stock exchange
- an interest in certain trust and partnership arrangements, which hold Canadian real estate, Canadian resource property or timber resources that makes up more than half of the value of all assets held at any time during the previous five years

Unlike Canadian real estate and property used to carry on a business in Canada, shares in public corporations, foreign corporations/real estate, and interests in mutual and segregated funds are deemed to be sold at fair market value as of the date of departure and gains are included in the final tax return. Gains accruing afterwards are not subject to tax in Canada.

People must report all property subject to the deemed disposition rules on Form T1243, including it with their tax return for the year they cease to be Canadian residents.

Elders interested in disposing of any or all their taxable Canadian property can complete Form T2061A. When this form is filed as part of an elder's tax return it can realize gains, use capital losses or create losses to offset gains realized on other dispositions.

One restriction is that dispositions creating losses can only be used against gains realized on deemed dispositions at the time of departure.

Since the deeming rules do apply to Canadian private company shares, it is especially important to crystallize any unused capital gains exemption. This applies equally to farm corporations.

Once an individual is deemed to be a non-resident of Canada, the capital gains exemption is lost as are spousal rollover strategies aimed at deferring capital gains taxes. What is more, the capital gains exemption available in Canada does not protect U.S. taxpayers from U.S. tax on the entire gain. In any event, the individual in question must post security for any tax liability due when the assets are sold. Elders holding Canadian private company shares must arrange to have their shares valued properly or have CRA fix the value. CRA may accept the shares as security for taxes owing on the same basis as a commercial lender regarding warranties, covenants and representations to safeguard the stated value of the shares as security. This may affect shareholder agreements and collateral arrangements.

Careful planning is needed to avoid or minimize double taxation, created by the difference in timing between the deemed disposition of assets in Canada and the actual disposition which can generate taxes in the new country.

Individuals who have left Canada need a clearance certificate from the CRA (and Revenue Québec if applicable) to sell their principal residence while a non-resident of Canada. Otherwise, there will be an automatic 25% withholding on the gross proceeds to CRA plus 12% to Revenue Quebec if applicable. The purchaser must remit this directly to the tax department or become liable for any amounts owing. Keep in mind that if the principal residence is sold after having been out of the country for more than one year, only part of the gain in value on the principal residence will be exempt from capital gains tax.

5 - 3.3 Safeguarding RRSPs and RRIFs

There are some things that Canadian residents can do to safeguard two cornerstones of their retirement program, their RRSPs and RRIFs, should they decide to become non-residents of Canada or be deemed to be residents of the U.S. These plans are not subject to the deemed disposition rules.

An elder who wishes to leave Canada for the U.S. should leave his or her RRSP or RRIF intact until they have left the country. Withdrawals made from either plan will attract less tax in Canada if the recipient is afforded treatment as a non-resident. Withdrawals made after leaving Canada attract a 25% withholding tax. A series of withdrawals is not treated as an income flow.

If the withdrawals are part of a periodic payout program, this withholding tax can be reduced to 15%. Elders need to convert their RRSP to either a RRIF or annuity first in order to be eligible for the reduced 15% withholding tax in Canada. The conversion can be done either before or after the elder leaves the country.

In either of the above situations, the tax paid (i.e., 15% or 25%) is a bargain compared to the 40-54% tax that often applies to the withdrawal of RRSP holdings.

The reduced withholding tax applies to periodic payments up to certain thresholds (not more than two times the minimum amount each year from a RRIF, or 10% of the fair market value of the plan assets at the beginning of the year, whichever is greater).

Since the IRS does not recognize a RRSP, RRIF or TFSA as a tax-sheltering instrument, any and all contributions are considered after-tax contributions - so no deductions are allowed for U.S. income tax purposes. All growth is subject to tax in the year it is earned. The Canada- US Treaty permits monies in a RRSP and RRIF to grow without being taxed until withdrawals are made. Any withdrawals made from an RRSP or RRIF are subject to tax in the U.S. and Canada. The Treaty ensures that tax is triggered in both countries on a federal basis at the same time. Canada taxes all withdrawals and income coming out of these plans. The IRS does not, however, tax a recipient on the original deposits into the plan, only the growth on those deposits. Elders residing in the U.S. can withdraw the book value or cost of the plan tax-free.

An elder can fix the highest cost or book value of his/her RRSP/RRIF holdings only before leaving Canada for the U.S. The elder can sell and repurchase their assets within the registered vehicle before leaving the country.

No taxes are triggered in Canada as a result of this exercise since it was done under the umbrella of the tax shelter. On emigration or deemed U.S. residency, this stepped up value becomes the book value from which the IRS will calculate growth, which becomes taxable on withdrawal.

The second step an elder needs to take if he or she intentionally or accidentally is deemed to be a U.S. resident is to file a special relief election form with the IRS each year to avoid having the growth within his or her RRSP or RRIF taxed by the federal government annually in the U.S. This tax relief applies to contributions, transactions, and any "income and gains," protecting all from U.S. federal income tax.

The plan must be identified as a Canadian RRSP or RRIF and include personal information like name, address, social security number, plan custodian and address, account number, amount of contributions made during the year, undistributed plan earnings during the year, and so on. The beneficiary (in whose name the RRSP or RRIF is held) must remit annually such details as the balance in the account(s) at year-end, the total and taxable amounts of any distributions to the IRS. Affected individuals would do well to seek expert advice from a qualified CPA or accountant versed in U.S. and Canadian Treaty arrangements dealing with RRSPs and RRIFs.

Significant penalties can be imposed on individuals who fail to file appropriate annual forms with the IRS.

An important point deals with the U.S. State harmonization with the Canada/U.S. Tax Treaty. U.S. states are not parties to this treaty, making their own decision on whether to impose a state tax or adopt the treaty provisions. For example, California treats RRSPs and RRIFs as non-registered savings plans. It does not permit a resident of that state to defer tax on earnings within these Canadian registered plans.

Plan holders pay tax on earnings each year and, if eligible to contribute, are considered to do so on an after-tax basis. (i.e., No tax deduction from income for contributions). Subsequent withdrawals and payouts from these plans become tax-free on a state-level.

5 - 3.4 Deemed Residency

Canadian residents or citizens can be deemed to be U.S. residents according to the "183-day rule" or "physical presence" test. To see if an elder is affected by this, simply do the following calculation.

- ❖ Add up the total number of days spent in the U.S. in the current year
- ❖ 1/3 of the days spent in the U.S. in the previous year
- ❖ And 1/6 of the days spent in the U.S. the year before that (i.e., the second previous year)

If the elder's "physical presence" in the U.S - based on the above formula - totals 183 days or more, that person will be deemed to be a U.S. resident. Part days, even for a very brief time count as full days.

There are steps an elder can take to avoid being deemed a U.S. resident after meeting this physical presence test. If the total number of days spent in the U.S. in the current year is less than 183 days, an elder can attempt to establish a "closer connection" to Canada than the USA.

A special filing (Form 8840, Closer Connection Statement) with the IRS must be completed. The form includes information like the source of the majority of an elder's income for the year, family ties and location, driver's license, location of personal belongings, automobiles, and whether the elder is a registered voter (and where).

Some elders spend more than 183 days in the U.S. virtually every year, yet still wish to be treated as Canadian residents, not U.S. residents for income tax purposes. This may also apply to those carrying a Green Card though Green Card holders cannot use the closer connection exceptions. Green Card holders, also known as permanent resident cards, are considered US residents for US federal income tax purposes regardless of where they live. They must report their worldwide income each year as well as the Return of Foreign Bank and Financial Account form each year. The obligation continues even if the green card expires until it is surrendered to the US.

In situations of this nature, under the Canada-U.S. Treaty, a Canadian resident can file information with the IRS, again within certain time limits on tie breaking rules. The information includes declaring that the elder has a permanent home in Canada, not the U.S., or in situations where there are permanent dwellings in both countries (or for that matter none in either country), that there are closer economic and personal ties to Canada. If successful, these people would only have to declare US source income to the IRS. However, it could jeopardize green card status. Special care must be taken in all cases where the elder owns a significant or controlling interest in a Canadian controlled private corporation (CCPC) to ensure that the company does not lose its status and the preferential tax treatment associated with such companies. Regular reporting rules would apply to Canadian residents taking advantage of these tiebreaker provisions under the Canada-U.S. tax treaty, like reporting ownership of non-U.S. corporations, transfers into and out of non-U.S. trusts and the receipt of any foreign bequests and gifts.

Keep in mind that the obligations and exemptions for income tax and reporting are for federal tax purposes. Individual states may well have their own rules since many do not follow the treaty. The cost of compliance ... and non-compliance can be extremely high.

5 - 3.5 Proposed Changes

As noted above, Canadian retirees cannot stay in the United States for extended periods of time (more than 120 days per year) without making immigration officials testy.

But that limit could change in the immediate future.

In the summer of 2013, the U.S. Senate passed immigration legislation that stated Canadian retirees 55 and older who were willing to spend at least $500,000 on a residence could spend up to 240 days in the United States without a visa – almost two months longer than the current limit. While the legislation eventually died in the House of Representatives, many tax experts are convinced that the JOLT Act will eventually become law. It is just a matter of time. The so-called “Canadian retiree visa,” a revenue raiser for the American economy, was initially proposed in 2011 (and carted out each year since) to sweeten the pot for wealthy Canadians who might be tempted to buy real estate south of the border. The JOLT Act was resurrected in 2015 but it still has not been passed into law.

Perhaps the delay is not such a bad thing, however. According to some financial advisers and tax lawyers, there could be some potentially serious and financially brutal repercussions for snowbirds who are unaware of all the tax and health-care issues that go along with the legislation.

The primary problem is this: the tax laws are not lined up with the immigration laws. In other words, just because from an immigration standpoint, you are allowed to stay in the United States for up to eight months, it does not necessarily mean the taxman will turn a blind eye. In short, Canadians travelling to the U.S. under this so-called Canadian retiree visa could still be subject to the 183 day rule for income tax reporting.

Although there are ways to offset tax in another jurisdiction (Form 8840), it does not always work out cleanly. Some people are unaware they are U.S. residents and fail to file a foreign bank account report. That can generate a $10,000 penalty. It is not the taxes that hurt you, it is the penalties for failing to file that are the killer.

And there are other serious issues as well. Among them, potential estate taxes and departure taxes. The new retiree visa may also bring into question a person's eligibility for provincial health coverage.

Trying to fudge one's time away will not be easy either. Starting in the summer of 2014, as part of the new joint entry/exit system between Canada and the United States, border officials will be tracking not only when you enter each country by land, air or sea, but also when you leave. Until now, countries only tracked entry.

5 - 3.6 Opportunities for Wealthy Canadian Elders

Despite the pitfalls described above, moving offshore can - with careful planning - be an extremely attractive proposition for wealthy Canadian elders. This is particularly true in situations where the move is - not to the U.S. - but to one of numerous "tax-free jurisdictions." The program is relatively straightforward. The wealthy elder simply declares that he is moving to a tax-free jurisdiction and then pays the 25% departure tax (on everything except his principal residence and Canadian-based corporations). He then puts the direct management of his money into the hands of a financial intermediary or trustee.

The CRA regards this as an arm's-length offshore trust and its' proceeds are un-taxed - even if they are directed back to Canada. In short, the elder is never taxed again in either his new home, or in Canada. The elder also has the option of setting up a separate offshore trust for the benefit of his children or grandchildren. Distributions from this non-resident trust can be sent to beneficiaries in Canada - tax-free - in perpetuity.

Two other matters also help to make arrangements of this nature highly attractive. First, the elder can - with careful planning- still live in Canada for up to 181 days each year (e.g., the cold months in the sunny south, the warm ones, back home). Second, the elder Canadian can return permanently to Canada, later, without penalty. This may be an attractive proposition when the elder's health begins to fail - he could return to Canada to access free health care and subsidized nursing home care.

5 – 4 ESTATE TAX CONSIDERATIONS

The laws with respect to estate and tax planning are numerous, cumbersome, and complicated. Elders should deal with specialists on both sides of the border to optimize the benefits and minimize the negative impacts of estate taxes.

As noted above, whether a Canadian must pay U.S. income taxes, or not, is based on whether he is a U.S. resident - or deemed to be a U.S. resident. The situation with respect to estate taxes also brings into play "domicile." When a Canadian who was merely "resident" in the U.S. dies, only his or her U.S. situs property is subject to estate taxes. World-wide assets are not affected. The situation changes if it is determined that the deceased had "domicile."

5 - 4.1 U.S. Domicile

U.S. domicile requires two criteria to be in effect for the Court to enforce estate tax liability. The first is residence in the U.S. regardless of whether there is a legal right to be there.

The second criterion is whether there is an intention to remain in the U.S. for an indefinite or permanent basis, notwithstanding a closer connection or tie to another country, like Canada.

If it is determined that a Canadian has "domicile" then not just U.S. situs assets are included in the estate for tax calculations, but the entire world-wide assets of the estate. The following is an excerpt from the IRS regulations which authorities use to consider and apply the domicile test:

"A resident decedent is a decedent who, at the time of his death, had his domicile in the United States … A person acquires a domicile in a place by living there, for even a brief period, with no definite present intention of moving from there. Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intent to change domicile affect such a change unless accompanied by actual removal (Treasury reg. Section 20.0-1 (b) (1))."

This makes the determination of domicile a highly subjective exercise. Various steps and positioning exercises can be implemented that the IRS can consider for Canadians intent on maintaining Canadian residency for U.S. estate tax purposes. Again, the final determination will be a question of fact.

5 - 4.2 Current Estate Taxes

Given the increases in federal estate tax exemptions and the fact that many states do not even have estate taxes - you might wonder why an elder Canadian who is resident in the U.S. should be concerned about estate taxes. Well for one thing - even though very little or nothing may be owed - the executor of an estate of a Canadian resident who owns or controls U.S. situs property with a value in excess of $60,000 must file a final return. This requirement extends to anyone receiving such property, even in situations where there is no executor or administrator appointed. According to U.S. regulations, every person who possesses U.S. situs either actually or constructively is considered an "executor" for U.S. estate tax purposes and is required to make and file a return.

The executor may be held liable for unpaid taxes.

5 - 4.3 Future Estate Taxes

Prior to the 2001 U.S. Tax Act, affluent American residents and citizens faced a maximum combined rate of 55% estate tax on the value of their estate. Of this amount, 39% was payable to the U.S. federally and the Code allowed for up to a 16% estate tax paid to the state. Many but not all states imposed this tax.

The U.S. Congress passed legislation (the Economic Growth and Tax Reconciliation Act, 2001) that gradually repealed the estate tax over the ensuing ten years. A sunset clause was set for the year 2010. If an elder's death occurred in 2010, no estate tax liability would exist at the federal level, but on January 1st, 2011 everything was to revert to the way it was in 2001.

However, on December 17, 2010, Congress passed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. Section 301 of the 2010 Act reinstated the federal estate tax. The new law set the exemption for U.S. citizens and residents at $5 million USD per person, and it provided a top tax rate of 35 percent for the years 2011 and 2012.

On January 1, 2013, the American Taxpayer Relief Act of 2012 was passed which permanently establishes an exemption of $5 million USD (as 2011 basis with inflation adjustment) per person for U.S. citizens and residents, with a maximum tax rate of 40% for the year 2013 and beyond.

The permanence of this regulation is not ensured: the fiscal year 2014 budget called for lowering the estate tax exclusion, the generation-skipping transfer tax and the gift-tax exemption back to levels of 2009 as of the year 2018. This failed. Another challenge may come up following the 2020 elections. It may not fail given the state of the US government debt.

Federal estate tax was codified in the Internal Revenue Code in 2013. The Tax Cuts and Jobs Act of 2017 doubled the estate tax exemption which has been indexed since then. The $11.58M USD exemption per person in 2020 is continues to be indexed until the sunset clause takes effect in 2026. It then reverts to the pre 2018 rules of @5M USD indexed through to 2026. A married couple would be able to shield $23.16 million USD in 2020. The exemption amount is scheduled to increase to $11.7M USD per person in 2021.

The $5 million exemption specified in the Acts of 2010 and 2012 apply only to U.S. citizens or residents, not to non-resident aliens. Non-resident aliens have only a $60,000 exclusion (although this amount is higher for Canadians since a gift and estate tax treaty applies). Canadians are eligible for the full exemption amount in proportion to the value of their US holdings to their worldwide holdings.

For estate tax purposes, the test is different in determining who is a non-resident alien (NRA), compared to the one for income tax purposes (the inquiry centers around the decedent's domicile). This is a subjective test that looks primarily at intent. The test considers factors such as the length of stay in the United States; frequency of travel, size, and cost of home in the United States; location of family; participation in community activities; participation in U.S. business and ownership of assets in the United States; and voting.

For Canadians with domicile in the U.S., these calculations will include their world-wide estate. This means the executor must factor in the value of retirement plans, many types of trust interests, a principal residence, life insurance proceeds, and other assets that might not be subject to Canadian income tax or included in the deceased's probated estate under provincial regulations. Ownership of all these assets must be reported to the IRS where the prorated credit is claimed.

A key point to remember is that U.S. securities held in RRSPs or RRIFs are subject to U.S. estate tax. Again, these vehicles are viewed as non-registered savings plans, a revocable trust, which belongs to the decedent. This increases the exposure for double taxation with no offsetting relief under the Canada-U.S. tax treaty.

The value of life insurance policies held at death can also serve to increase the size of the estate for estate tax calculation purposes. This includes all interests in life policies, whether as owner, beneficiary, and rights to access monies or change beneficiaries. The planning opportunity that exists to avoid inclusion of life insurance policies in the calculations of estate taxes is to set up an irrevocable life insurance trust.

The elders also need to be aware of some of the significant differences that exist from state to state. Some states like Florida, California and Arizona have no inheritance or estate tax.

As of July 1, 2018, eighteen states had either an inheritance or estate tax (or both). These states tend to be in the Northeast, Northwest and Mid-West. Among them: New York, Pennsylvania, New Jersey, Massachusetts, Connecticut, Illinois, Washington and Hawaii.

This means that Canadian residents (and non-U.S. persons) will need to plan for potential U.S. federal and state estate taxes on real and tangible personal property located in a state. These also include shares/debt in U.S. corporations and the debt of U.S. persons. Canadians deemed to be domiciled in the U.S. at the time of death could face at least estate taxes at the state level in many jurisdictions.

5 - 4.4 Implications for Canadians

What makes the above scenario particularly frightening is the fact that the estate tax applies to the full value of the assets held. Income taxes are largely concerned with an "increase in value" - estate taxes are concerned with "value."

Consider the treatment of capital gains on death in the U.S. versus Canada. In Canada, the increase in value of a property may be subject to capital gains treatment and capital gains on death represent a tax on income.

In the U.S., the value of property is used in the calculation of possible estate taxes, not just gains in the value of property.

Canadians also need to be wary of the following:

- ❖ According to U.S. regulations, the executor is personally liable for any taxes and penalties owed by the estate until the IRS grants official clearance. Advisors should ensure that elders and the executors they have appointed are aware of this accountability if they intentionally or could "accidentally" become U.S. residents or domiciliaries.
- ❖ The Canada-U.S Tax Treaty does not offer true harmonization - and this exposes elders to what can amount to double taxation. The Treaty does permit deductions from Canadian taxable income, but not net income. This can affect elder eligibility for Canadian government tax credits. The issue of double taxation on growth property is somewhat addressed by permitting a deduction from income tax in Canada on estate taxes paid on U.S. situs assets. The credit though is only for the Canadian income tax related to the decedent's U.S. source income in the year of death for the same property. This may not eliminate the problem of double taxation.

Elders should also be careful of any strategies that pass on or dispose of U.S. assets, but where they retain the use of the assets. These assets can be included U.S. estate tax calculations, particularly if the retained use or power over the property is either held within three years of death or transferred in that same period.

No Canadian foreign tax credit exists for estate taxes except for restricted credits on triggered capital gains.

On the positive side, there are some estate tax exemptions and estate planning strategies that can be employed to help offset the effect of future estate taxes. A number of these opportunities are covered below.

5 - 4.5 Exemptions for Non-Residents

The general exemption for non-residents remains unchanged at U.S. $60,000 (i.e., a U.S. credit amount of $13,000 against estate tax).

The Canada-U.S. tax treaty permits the credit amount for Canadian residents to be increased dramatically. Under the treaty Canadian residents only have a U.S. estate tax liability if their worldwide assets are valued at more than approximately $11. 58 million U.S D. (2020). If worldwide assets exceed $11.58 million USD, estate taxes will be payable. These taxes start at 18% and can go as high as 40% for U.S. assets exceeding $1,000,000.

Under the Canada-U.S. tax treaty a credit applies. For 2020, it is the greater of:

- 13,000 or
- $4,577,800 million USD x (value of U.S. assets divided by world-wide assets converted to USD value)

If an elder's U.S. stock portfolio, for example, accounted for 10% of his worldwide estate, he would be entitled to an enhanced unified credit of $457,780 ($ 4,577,800million X 10%).

The key point is this: so long as a non-U.S. resident Canadian has worldwide assets of under $11.58 million USD, they will not have to pay any U.S. estate tax.

5 - 4.6 Exemptions for U.S. Residents

Canadians who are residents, or deemed residents, of the U.S. are offered the same estate tax relief as U.S. citizens. Among the benefits available are a lifetime estate and gift tax exemption of $11.58 million USD(2020); a unified credit of $4,577,800; an unlimited marital deduction (to a U.S. citizen spouse) or a marital credit of $13,000 (for a non-U.S. citizen spouse).

Elders may set up plans that do not include funding provisions for estate taxes, and not factor in the time spent in the U.S. and associated deemed residency calculations - but they are taking a huge risk. They may be faced with unexpected and onerous demands for liquid assets and cash to meet death tax obligations.

5 - 4.7 Marital Credits

The executor of an estate of a U.S. domiciliary must choose between claiming the marital credit available under the Canada-U.S. tax treaty or set up a qualified domestic trust.

If a Canadian citizen is domiciled in the U.S. they can qualify for a marital credit under the treaty of up to $4,577,800.

However, if this same Canadian citizen is not domiciled in the U.S. – but merely there on a temporary basis and a resident for income tax purposes only - any U.S. property owned would only qualify for a marital credit of $13,000.

An unlimited marital deduction allows you to leave all or part of your assets to your surviving spouse free of federal estate tax.

To use your late spouse's unused exemption—a move called "portability"—you must elect it on the estate tax return of the first spouse to die, even when no tax is due.

A Canadian citizen who relocates temporarily to the U.S. must be cautious because at death, any U.S. assets will be subject to U.S. estate tax federally and potential state estate taxes with the possibility that there will be no treaty relief (via the enhanced unified credit). If you are transferred to the US on a temporary work assignment, you may not be viewed as domiciled in the US for US transfer tax purposes because you will not have the intent to permanently reside there. However, if you have cut sufficient ties with Canada, you will be viewed as a resident of the US and a non-resident of Canada for income tax purposes under the residency rules in the Canada-US Tax Treaty (the Treaty).

This planning opportunity also brings up the issue of a lack of harmonization in the definition of spouse between Canada and the U.S. and the possible frustration of certain planning strategies between spouses.

The executor has nine months to decide whether to use the marital credit and forego any estate tax marital deduction or set up a qualified domestic trust. In either case, any estate taxes on transferred property are deferred until the spouse dies.

5 - 4.8 Qualified Domestic Trusts

This trust instrument can be used to reduce exposure to U.S. estate tax on the first death of spouses. Several conditions must exist to qualify the trust as a qualified domestic trust. At least one trustee must be a U.S. citizen or U.S. Corporation. The trustee(s) must ensure the payment of any estate taxes deferred as a result of the transfer.

The U.S. trustee must be able to withhold estate taxes from any distribution of capital from the trust. Income from the trust is not subject to estate taxes of the decedent spouse.

The executor must elect to treat any transferred property as assets of the Qualified Domestic Trust in the decedent's estate tax return. This of course must normally be declared and filed within 9 months of death. Properly set up, a Qualified Domestic Trust may also qualify as a spousal trust under Canadian tax laws.

The penalties for not filing Form 706NA - U.S. Estate Tax and Generation Skipping Transfer, not filing on time or understating the value of the properties caught by the regulations can be punitive. A 5 % penalty per month up to 25% of the taxes owing is assessed on late filings alone. Every one of these submissions is reviewed manually and 60% are chosen for further review and examination.

5 - 4.9 Jointly Held Property

On the death of an elder, and when the surviving joint tenant is a non-citizen, the full value of jointly held U.S. property is considered U.S. situs property for the purposes of calculating any applicable estate tax on the first death. A surviving spouse who can prove he or she made an independent contribution to the purchase of the property can get an exception ruling. Special treatment is afforded to spouses who purchased property jointly prior to July 14, 1988. Couples generally hold real property as joint tenants.

Joint tenancy does have the benefit that upon the death of the first spouse, probate can be avoided but not applicable estate tax. Title passes to the surviving spouse upon proper filing of a death certificate and appropriate affidavits by the surviving spouse. Advisors should discuss the problematic nature of joint tenancy regarding U.S. properties.

5 – 5 U.S. GIFT TAXES

This brings us to U.S. gift taxes. Gifts of up to $15,000 (2020) per year can be made to any number of individuals. This figure remains the same for 2021. Gifts of this amount do not impact the $11.58 million (2020 lifetime exemption. Remember that gift and estate taxes are integrated to come to the total amount that may be subject to tax.

Any gifts in excess of $15,000 per year will reduce the lifetime exemption.

No gift tax applies to transfers between spouses if both are U.S. citizens. It does not matter if the testamentary transfer between spouses is outright or via a trust. Generally, when a trust is set up it is designed to provide a life income for the surviving spouse only. In the U.S. this is called a qualifying terminal interest trust (QTIP), an irrevocable trust providing a life interest to a surviving spouse with testamentary beneficiaries entitled to proceeds after the surviving spouse's death.

In 2020 the tax rate for taxable gifts and bequests is 40% at the federal level. The giver or donor is liable for payment of this tax.

In the U.S., estate taxes and gift taxes are integrated. Furthermore, taxes can be levied on both inter-vivos made over the lifetime of the donor as well as testamentary gifts. The tax on inter-vivos or lifetime gifts is based on the cumulative value of all gifts made during lifetime and at death and is a graduated tax. Certain exemptions apply like donations to charities, political parties, and institutions to fund someone else's tuition or medical expenses.

A generation skipping tax is also levied in situations where say a grandparent wishes to make a gift or bequest to grandchildren. The result is to affect a similar treatment had the gift or bequest first gone to the child or children then on to the grandchild (ren). Again some exemptions are available. There is no relief under the Canada-U.S. tax treaty for credits for these types of taxes. The generation skipping tax is imposed in addition to any applicable gift or estate taxes. The tax rate is 40%. You will be entitled to a lifetime exemption of $11.7million USD (2021) indexed annually. It is in addition to the $11.7 million exemption for estate and gift tax.

For 2020 and 2021, elders interested in passing on assets to their children can give up to U.S. $15,000 to any one donee each year on a tax-free basis provided that the recipient can use the gift without restriction. Couples are each entitled to take advantage of this. Excess amounts must be reported, including transfers to a trust or receipts from a trust. The failure to file can result in a penalty of up to 25% of the tax due and a separate failure to pay penalty of up another 25% of the tax due.

For minors, elders can set up a "Uniform Gift to Minors Act" account or a trust with specific powers for the child if ongoing control is desired and the exclusion from gift tax is wanted. For gifts, the adjusted cost base plus a portion of the tax paid on the gift becomes the new stepped up adjusted cost base for the donee.

The annual gifting limits to children can be repeated for any number of donees so long as in all cases the gifts have no restrictions on their use by the donee.

Care should be taken to account for the fact that the cost base for property gifted will be carried forward to the child or spouse. This means that although the donor avoids estate taxes, there could be substantial capital gains taxes on disposition and estate taxes on death for the donee. Property, which passes on after death, is acquired by the donee child at fair market value.

The amount of a non taxable gift increases to $157,000 for a non-U.S. citizen spouse in 2020 increasing again to $159,000 in 2021.

Canadian elders who are both non-U.S. residents and non-U.S. citizens are subject to the gift tax regarding their U.S. situs property only. U.S. citizens must report all gift and inheritance receipts greater than $100,000.

Elders need to watch U.S. assets disposed of but to which they retain beneficial use. Such assets may be clawed back into the estate for estate tax purposes.

A couple of additional points that must be kept in mind:

- ❖ No Canadian foreign tax credit exists for gift taxes
- ❖ Watch Canadian attribution rules on U.S. gifts if people are resident in Canada

5 – 6 OTHER TAX DIFFERENCES IN THE U.S

The income tax structures in the U.S. and Canada are similar, although the Canadian tax rates with added provincial taxes are somewhat higher than comparable tax rates in the U.S. when state taxes are added in. A U.S. non-resident alien may be liable for federal income tax but not state income tax. Conversely, the same person may be excused from paying U.S. federal income tax and still be liable for state income tax.

The U.S. has certain jurisdictions such as Nevada and Florida, which are very popular with retirees, which do not have state income taxes.

This makes Nevada and Florida popular locations for wealthy Canadians to retire to, as well as wealthy Americans from the North, Midwest, and East Coast.

Certain investment products in the U.S. provide tax benefits not available in Canada. There are tax-exempt and tax-deferred accumulation plans to supplement retirement and medical expenses.

In the U.S., one can defer income taxes on a deferred annuity until the payout period, whereas in Canada one must pay taxes on the accumulated value within the annuity on an annual basis. With respect to interest deductibility on investments, the U.S. limits investment expense deductions to the investment income earned. Interest expenses cannot be deducted from employment or business income.

In the U.S., people filing income tax declare the actual dividend (no gross up and credit system) and total capital gain on appreciable property that is sold (no 50% inclusion and capital gains exemption) as income for the year. Appreciable property that is sold within one year of acquisition does not receive capital gains treatment. The gain is treated as ordinary income.

The tax issues related to Canadians working in the U.S. and/or U.S. citizens working in Canada are complex and require competent tax counsel with knowledge of both the complex U.S. income tax laws as well as Canadian income tax laws. It is very important to ascertain how the differing rules affect a citizen or resident of the other country temporarily working in the sister country.

The Canadian elder with assets and potential U.S. retirement plans may desire asset protection based on U.S. laws not available within Canada. For example, in Texas and Florida an individual has an unlimited homestead exemption as a creditor protection strategy unavailable in Canada.

As such, he or she may need to consider U.S. citizenship and/or residence to meet such an objective.

Keep in mind that under U.S. tax rules, taxpayers do not have an unlimited exemption on the gain arising from the sale of their principal residence. The exclusion is limited to U.S. $250,000 for an individual filing singly or $500,000 for spouses filing jointly. The exemption is only available for a place where you normally reside. Other conditions exist in order to be able to claim the exemption.

The Canadian anticipating retirement in the U.S. must understand the periods required to be protected and vested in the Canadian retirement system and the medical benefits system. Alternatively, he/she must get enough tax advice to be vested under the U.S. system.

Similarly Canadian who has worked in several provinces and/or abroad for a Canadian company must know the issues such employment in multiple locations can do with his or her rights to vest in Canadian social security and elder medical benefits and must comply with these rules.

Mortgage interest is deductible in the U.S. and personal property taxes are usually deductible as well. A U.S. resident or citizen can choose to file joint or separate tax returns each year and flip flop back and forth, provided the spouse is a U.S. citizen.

If the spouse is not a U.S. citizen the decision to file jointly can generally be made once only. The rules governing whether to file joint returns or single returns are complex and can impact entitlements to certain credits and deductions, tax brackets. The disclosure requirements for financial information are more expansive and onerous in the U.S.

There are also various tax-exempt and tax-deferred accumulation plans outside of life insurance that individuals can use to supplement their retirement holdings and income in later years.

5 - 6.1 Tax Breaks Available to U.S. Deceased Taxpayers

Deceased U.S. taxpayers also qualify for certain tax breaks. Funeral and administrative expenses are deductible, as are claims and obligations of the decedent. Losses incurred during the estate settlement process due to fire or storms, and not compensated for by state or federal relief programs, are also tax-deductible when preparing final tax returns.

Donations to charities in the U.S. are deductible and there is a marital deduction for the value of property passing on to the decedent's surviving U.S. citizen spouse.

5 – 7 MEDICAL BENEFITS

There are significant differences between Canada and the U.S. when it comes to health care coverage. In Canada, everyone is covered by a universal health care program that requires - at worst - very modest premiums. The situation in the U.S. is dramatically different. No universal health care program exists. Most health care is tied to employment and premiums are steep.

In a typical employer based plan the average cost for healthcare for a family in 2013 was $16,351 (according to a survey conducted by the Kaiser Family Foundation). .

Rates have been increasing at a rate of about 10% per year, which could mean a doubling of premium costs in the next seven years.

Significant changes have taken place in the past several years. The Patient Protection and Affordable Care Act (Public Law 111-148) was introduced and signed into law by President Barack Obama on March 23, 2010. Along with the Health Care and Education Reconciliation Act of 2010 (passed March 25), the Act is a product of the health care reform agenda of the Democratic 111th Congress and the Obama administration.

The law includes a large number of health-related provisions to take effect over the next four years, including expanding Medicaid eligibility, subsidizing insurance premiums for low income families, providing incentives for businesses to provide health care benefits, prohibiting denial of coverage and denial of claims based on pre-existing conditions, establishing health insurance exchanges, prohibiting insurers from establishing annual spending caps and support for medical research. The costs of these provisions are offset by a variety of taxes, fees, and cost-saving measures.

5 – 7.1 Programs for Elders and the Poor

Since most Americans over the age of 65 are unable to access employer sponsored health care plans, the government introduced Medicare in 1965. It is a government run insurance program that provides medical care - primarily to elders. Premiums are required, and participants must also pay a deductible for hospital and other costs.

U.S. Medicare currently covers approximately 80% of medical expenses. But there is a trend toward reducing the services that are included, due to the strain created by government fiscal policies and budgetary deficits. It is, as a result, financially dangerous to assume Medicare will cover all or even most health care expenses at age 65 and beyond. Many elders elect to also purchase a "Medi-gap" policy - which is designed to cover what Medicare does not.

A separate program, called Medicaid, is available for low income people of all ages. Since Medicaid is jointly funded by the federal and state governments, there is a great deal of variation in terms of qualifications and benefits (largely based on differences between states when it comes to the tax base, resources and fiscal policy). To further assist low income elders, a separate Supplemental Security Income (SSI) was introduced back in 1972. Designed largely to help cover medical costs, it is a form of welfare for the retiree.

To qualify for Medicaid an individual must be "indigent." U.S. Federal law stipulates that only citizens, legal immigrants who have been in the country at least five years and individuals granted asylum are eligible for Medicaid. Forty-six states accept a signed declaration as proof of U.S. citizenship. The others, New York, New Hampshire, Montana and Texas require applicants to submit documents verifying citizenship. This requirement that beneficiaries provide proof of citizenship went into effect July 1, 2006 pursuant to a bill signed by President Bush in February of the same year.

As indicated above, when it comes to health care, there is relatively little help for the middle and upper classes - people who have been diligent and successful at building retirement savings and assets. Canadian elders can, however, purchase good quality health coverage through private insurance carriers - and if they are blessed with good health, the premiums are not onerous.

5 - 7.2 Advice for Elder Canadians

Provincial health care plans typically cover out of country treatment and services up to the amounts funded by the province for services performed provincially. The potential gaps between incurred costs and covered costs can be immense. As well, the residency rules to maintain eligibility for provincial and territorial health insurance are different amongst jurisdictions and are different from residency rules for income tax purposes. Although participation in a government health insurance plan is one of the ties that can hold a person to Canadian residency, getting the benefits at claim time can be quite difficult or impossible.

Considering this, Canadian visitors to the U.S. should investigate supplementary medical insurance - even for short periods spent in the U.S. or abroad.

With respect to these supplemental medical insurance policies: limits exist with out of country coverage, maximum coverage per benefit or time spent, travel time to, from the U.S., and within the U.S., business vs. personal travel and so on. Policy offerings can be wide ranging, from basic to luxury, providing coverage for in-patient hospital care, out-patient coverage, home nursing and home visits and trips to the doctor. There may be user fees, deductibles or co-insurance features. Pre-existing conditions may not be covered at all or only within certain parameters. Prescription drugs and dental coverage, income replacement and accidental death or dismemberment benefits, travel costs for family members accompanying the patient and evacuation costs may be included or available as supplementary benefits.

As for elders who plan on residing outside of Canada for extended periods of time: a complete package of private health coverage providing hospital and medical benefits will be required.

Several resources are available in Canada to help prospective travellers and emigrants maintain good health while abroad, including travellers' clinics, books, advice on immunization, portable medical supplies and precautionary measures. Research and planning should account for family pets travelling or moving with elders.

5 - 7.3 Long Term Care

Long term care in the U.S. can be very costly. According to a Genworth Financial survey the average cost of a one-year stay in a nursing home in the U.S., in 2018, was over $85,000.

There is, however, a wide range of costs from state to state, anywhere from around $62,000 in Louisiana to over $290,000 in Alaska. Costs are higher in or near large metropolitan areas in any given state. Unfortunately, one cannot gauge the quality of care by either cost or proximity to a large metropolitan centre.

More frightening still, U.S. Medicare only pays for the initial stay in a nursing home - usually only up to a maximum of 30 days!

Since these costs can rapidly exhaust an elder's financial resources, it often makes sense to consider bestowing assets upon family members or placing them into a special needs trust (i.e. a trust set up in such a way that the grantor could still qualify for governmental assistance). The elder makes himself poor enough to ensure that the state covers his nursing home expenses. This may have to be done far enough in advance of any needs for long-term care so that such assets are in fact protected and will not be totally exhausted by medical and nursing home costs?

In Canada, the current situation, vis a vis long term care, is much brighter. Costs are more in line with those in Louisiana, than those in Alaska. In many cases acceptable nursing home care can be found for as little as $2,600 per month. Nonetheless, the aging of our population will put enormous pressure on the resources of our governments and it is likely that the cost of nursing home care will increase exponentially in coming years.

In both Canada and the U.S., government payments for long-term care are becoming more uncertain. In Canada there is every likelihood that restrictions will be placed on the availability of federal, provincial, or municipal paid or supported long term care.

This necessitates some planning by the elder to either purchase long-term care insurance or put in place an investment program capable of providing the required financial resources.

5 - 7.4 Social Security

Social Security payments are quite generous in the U.S. The maximum benefit is substantially higher than the combined maximum of CPP and OAS available in Canada. That is the good news. The bad news is that Social Security is grossly underfunded and - barring significant changes - headed for collapse.

Special treatment is afforded to certain government benefits in both countries to residents entitled to government benefits from Canada, the U.S., or both. In Canada, the Canadian resident recipient of social security benefits from the U.S. reports the income in Canada. Only 85% of the amounts are subject to tax, and there is no withholding. Similar treatment is afforded to Canadian recipients of CPP/QPP under the Canada-U.S. Treaty. CPP/QPP recipient's resident in the U.S. pays tax in the U.S. only.

Canadians must watch the residency requirements for full OAS benefits. Old Age Security benefits are paid indefinitely while outside Canada provided that the recipient has lived in Canada a minimum of 20 years after the age of 18.

If this requirement is not met, benefits cease after 6 months of non-residency.

Part of Canada's international reciprocal social security agreement includes provisions for equivalent to residency.

The individual under consideration must have had residency status in Canada for at least 10 years immediately before applying for benefits. Other income supplements can cease after having left Canada for six months.

5 - 7.5 Summary

The fiscal policies of both the U.S. and Canada have put future old age benefits at risk. Planning strategies would do well to assume the various Medicare and social security programs will become much less generous with benefits in the future, as well as more restricted in terms of access. Elders would do well to plan and provide for their own care and attention, independent of where they live.

Advisors should consider these issues - regarding the requirements for participation in the myriad of programs - as essential knowledge - knowledge that should be considered in any dealings and planning exercises conducted with elder clients and their families.

Advisors should also be well versed in the various and complex issues concerning wealthy Canadians who are considering the possibility of retirement in the U.S. There is the need for the Canadian retiree to fund more of his retirement living and medical costs with his own resources.

5 – 8 THE NEED FOR PROPER DOCUMENTATION

A key question advisors need to ask elders is whether they intend to leave Canada or if there is a risk of being deemed to be a resident of the U.S. In either case, it is important to ensure that any documents (powers of attorney, directives, etc.) are enforceable or recognized in the new domicile. This can be problematic even when moving between provinces, let alone countries.

There is an ongoing need for relevant planning dealing with much of the paperwork and documentation dealing with a loss of independence and the passing of authority over decision making to someone else. This includes wills, Powers of Attorney and Advance Directives. The elder needs to ask himself a variety of key questions. Will I have enough money and resources to maintain my independence and sense of dignity? Will I become financially dependent on my children?

Do I have the proper documentation in place to safeguard my independence and freedom of choice with respect to proxy directives and who will make decisions for me when health impediments prevent me from making my own decisions?

This planning is equally important whether the elder gives up Canadian residency voluntarily, is deemed to be out of the country when some health threatening event or death triggers the need for assistance or implementation.

Co-ordination of any documentation is also critical to ensure that an elder's wishes are enforced in both the U.S. and Canada. Let us look at some of the more fundamental documents.

5 - 8.1 Health Care Power of Attorney

One such document is a health care power of attorney. A properly executed health care power of attorney allows loved ones to make health care decisions should the elder not have the mental capacity or ability to make such decisions. An associated planning tool includes a "health care directive" which documents in writing when and what heroic means and methods to sustain life should be exercised or discontinued. The elder executes both documents when he and she has testamentary capacity.

These documents offer the elder, the family, and those providing medical support, peace of mind knowing that actions are being taken in accordance with what the elder had intended. Furthermore, they provide the elder with the security of maintaining some sense of control over what happens when he or she can no longer make decisions.

5 - 8.2 Powers of Attorney

Other issues also surface for the elder facing debilitating diseases or accidents, which take away mental capacity. These include powers of attorney to manage a person's affairs. These powers, known as durable powers of attorney, must also be put into effect while the individual is competent, so that the expressed wishes in the executed documents can be properly implemented. Medical science continues to make great advances in improving the survival rate of individuals stricken with debilitating diseases or crippling accidents.

Unfortunately, the same general statement cannot be made for improving the quality of life. A durable power of attorney grants an individual (usually a loved one) the power to make management decisions regarding the elder person's financial assets and affairs. It is triggered after a disability has diminished the individual's mental capacities to the point that this individual is incompetent, and no longer able to make sound decisions regarding affair management.

In is important to be aware that in the United States, the alternative to these powers of attorney is a "guardianship proceeding." This is a court supervised and very cost intensive undertaking.

Under a guardianship, the elder is judicially declared incompetent and the court appoints an individual to have sole control and authority of his or her financial assets and health care. The elder, who is now a "ward," forfeits all decisions concerning living and lifestyle including health care decisions. Under guardianship, the ward may have no choice as to who is selected by the court to be his or her guardian.

Guardianships can be used by an unwelcome son, daughter, or other relative to gain control of the elder's assets to the total detriment and total disgust of the elder if such person petitions the court for a guardianship and such guardianship should be approved.

This is a very unwelcome scenario for most elders. Advisors and elders learning this have a great opportunity to protect the elder from such an outcome.

An alternative document in an estate planner's arsenal is an "Alternative Designation of Guardian." The elder executes this when he or she is competent. It states which person or persons in a preferred sequence should be selected alternately as guardian, and which person or persons should not be selected under any circumstances. This document can then be used for "defensive purposes" should a non-desirable relative petition for a guardianship.

It can also assist in those situations when either the Powers of Attorney documents are ruled invalid or a Power of Attorney is removed from his/her position by court order and no contingent exists.

Such a document is important in the U.S. because once the court determines there is a need for a guardianship and appoints a guardian, all powers of attorney are no longer effective or binding. The person granted guardianship is in control. Alternative designations should be prepared as a "fail safe" device to protect the elder from situations like that of a spendthrift child who files a guardianship proceeding solely to get control of his or her parent's monies.

5 - 8.3 Irrevocable Trusts

In addition, this entire issue brings up the need by the elder for trust planning and asset protection planning. Irrevocable trusts can be used to further protect the assets and income flows of elders. A court appointed guardian cannot touch funds or influence provisions placed in an irrevocable trust set up by the elder when he or she was competent. Some elders believe there is a real possibility that one or more of their children may try to get control of their funds to their detriment as they get older and perhaps even develop dementia. Whether this threat is real or imagined, proper safeguards are available as tools to protect an elder's wishes.

The irrevocable trust can be used as an advance-planning tool to protect the assets from any potential guardianship proceeding. This can provide the elder with peace of mind, a sense of maintaining control and address a loss of independence.

Another issue to remember, in an elder's quest to keep free and clear of the guardianship court, is the cost and public display caused by a guardianship action. The guardian must get court orders to sell real estate and/or other substantive assets. The guardian must also file a bond for at least the value of the ward's assets. This can present a problem since a preferred child may not have enough net worth to get a bond.

This would allow some undesirable relative or friend of the court with strong personal monetary objectives regarding the guardianship to gain control. Again, such problems can be strongly mitigated if not eliminated using irrevocable trusts and the completion of an "Alternative Designation of Guardian."

5 – 9 CONCLUSIONS

Historically, the border between Canada and the U.S. has been relatively porous. The societies at large are relatively homogeneous. There are pull factors for Canadians as well as Americans living in the northern states that draw them to certain southern locations. These pull factors include the weather, perceived cost of living and lifestyle, conveniences, and friends and family (who have already moved there). The deeming rules on residency and domicile are not black and white. Planning becomes more problematic when one considers that there may be no harmonization in treatment between the U.S. Federal authorities and the State authorities vis a vis treaty with Canada. Several exit strategies should be explored, duly considered, and incorporated into the overall lifestyle planning with elders to safeguard the assets, incomes, and expectations they have, regardless of where they spend their time.

Most of the states south of the border have granted some degree of relief in the form of registration requirements for Canadian financial advisors. This permits these advisors to provide cross-border advice and to transact business with Canadians living in most of the U.S. states without the requirement for full registration with American regulators. The regulatory relief extends to what the SEC (Securities and Exchange Commission) terms Canadian Retirement Accounts. These include self-directed RRSPs, RRIFs DPSPs and defined-contribution Registered Pension Plans by beneficiaries who had a business relationship with the advisor prior to becoming U.S. residents. The extension does not include solicitation of these types of accounts from U.S. residents.

The situations, issues, and complex nature of tax and estate planning for Canadians who intentionally or accidentally take on the status of U.S. residents or domiciliaries show the importance of planning ahead and reviewing those plans. The subjective nature of some regulations point out the need to ask lots of questions, to determine rather than assume the citizenship and/or residency status of elders, in fact, all clients. Clearly, it is very important to seek out and establish relationships with specialists in the field of tax and estate planning, with a firm understanding and access to cross-border issues.

Several the issues that should be considered in cross-border situations can apply equally to inter-provincial movement of elders. The prudent advisor is aware of what they do not know and will seek out help from other professionals in the community, and beyond, for the support and counsel elders expect and deserve to receive.

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Chapter 6

Income Tax Planning

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6 – 1 KEY OBJECTIVE OF THIS CHAPTER

The objective in personal income tax planning is to minimize or defer income taxes payable while optimizing income and legacy planning opportunities. This requires a general understanding of Canada's Income Tax Act and rulings put forth by the Canada Revenue Agency (CRA). This chapter focuses on both.

This chapter will also provide you with a greater appreciation for why proper tax planning is vitally important to elder Canadians. So, how will this objective be achieved?

In this chapter we will also look at which income sources constitute earned income, and which ones do not. We will also look at deductions and tax credits with a focus on elder Canadians.

Finally we will explore a variety of effective tax planning strategies - including:

- Income splitting
- Wealth transfers
- Charitable giving
- Tax shelters

6 – 2 INTRODUCTION

One of the financial planning goals in working with mature clients is to minimize the impact of income taxes. In planning for retirement, people want to generate as much income as possible and pay as little tax as possible. It is all about stretching their retirement dollars.

Taxes - whether direct or indirect - are here to stay. They are required to pay for generous social programs, servicing government debt, and cover the expenses associated with maintaining infrastructure.

Taxes in Canada, however, are largely a moving target - laws and regulations are changing on an ongoing basis and getting more complicated in the process. In order to minimize tax it is necessary to keep abreast of these changes.

6 – 3 THE CANADIAN INCOME TAX ACT

The Income Tax Act is extremely complex and in a constant state of flux. Details and specifics of the Canadian tax system fill volumes of books so taking advantage of subject matter experts in the various sections of the Act and applications is helpful to even modest income earners.

There are, for instance, rules dealing with the inclusion in taxable income of items such as:

- Employment insurance (EI) benefits received
- Annuity payments
- Receipts from deferred income plans
- Certain government benefits available to people over age 60

Some payments, such as workers' compensation (WSIB), federal supplements, and social assistance payments are not included in taxable income, but are contained in the calculation of threshold income when determining entitlement to the:

- Age credit
- Goods and services tax credit
- Old age security (OAS)
- Some provincial tax credits

Legitimate, personal tax planning generally includes a concerted effort to minimize or defer taxes payable, a practice that is accepted by the government. People are entitled to arrange their affairs in such a way to pay a minimum amount of tax. This must be done within the confines of the law. However, tax avoidance or tax evasion, or any other use of the income tax rules in a way that was not intended, is not only disallowed but may be illegal and has led to specific anti-avoidance rules in tax legislation coupled with fining processes and prosecution in the courts.

The Income Tax Act includes a general anti-avoidance rule (GAAR), which allows the CRA to reassess any transaction. Under GAAR, unless a transaction is considered to have taken place primarily for bona-fide purposes other than obtaining a tax benefit, it may be subject to adjustment.

6 – 3.1 General Tax Provisions

Since Federal income taxes were first introduced in 1917, the Income Tax Act has changed many times over the years. These changes are the result of evolving or changing views of the government regarding monetary, social, economic and fiscal policies. The quickly evolving nature of the global economy has had a direct impact on taxes as well.

The lion's share of the government's revenue comes from the taxes that people and companies pay on a yearly basis. Much of the planning process, whether it is Financial Planning or Estate Planning, centres on how to minimize taxes for people without breaking the law.

Income tax must be paid on income received after allowable deductions have been taken into consideration. Individuals who are resident in Canada are liable for income tax on their worldwide income. Non-residents are liable for Canadian-source income (including income from employment in Canada and income from carrying on a business in Canada), and on capital gains derived from taxable Canadian property.

Residence is determined based on the jurisdiction in which a person regularly, normally, and customarily lives, including ownership of a home in Canada, whether other members of the individual's family reside there, and membership in clubs and associations in Canada. Individuals present in Canada for periods totalling 183 days in the calendar year or more are deemed to be residents.

Individuals becoming residents are generally deemed to have acquired all property, other than taxable Canadian property, owned at that time, at a cost equal to the current fair market value. Individuals ceasing to be resident are regarded as having disposed of their property, other than taxable Canadian property, at its current fair market value.

Tax planning is a key process elders should undertake, particularly under an income tax system such as Canada's that incorporates a progressive rate schedule with rules that allow or disallow specific transactions and courses of action.

Furthermore, new federal and provincial laws and policies are constantly being introduced; these often have a direct effect on specific tax strategies, since new opportunities may arise, and old approaches may no longer be appropriate or valid as a result. It is therefore important to be aware of contemporary tax rules that are applicable to specific actions being contemplated, particularly as they impact elder Canadians.

6 – 3.2 Taxable Canadian Property

Taxable Canadian property is defined as including:

- Real property situated in Canada
- Most capital property used in carrying on a business in Canada
- Shares of a corporation (other than a public corporation) resident in Canada
- Shares of a public corporation if, within the five years preceding disposal, the non-resident and persons with which the non-resident did not deal at arm's length owned at least 25% of any class of capital stock of the corporation
- An interest in a partnership if, at any time during the twelve months preceding disposal of the interest, the fair market value of taxable Canadian property held by the partnership constituted 50% or more of the fair market value of all the partnership property
- A capital interest in a trust (other than a unit trust) resident in Canada
- A unit of a unit trust (other than a mutual fund trust) resident in Canada
- A unit of a mutual fund trust if, at any time during the five years immediately preceding the disposal, the non-resident and persons with whom the non-resident did not deal at arm's length owned at least 25% of the issued units of the trust
- Property deemed to be taxable Canadian property

6 – 3.3 Personal Income Tax Rates

Both the federal and provincial governments levy personal income tax. Provincial income tax in all provinces are calculated separately but is collected by the federal government on behalf of the province.

The only exception to this is Québec. For provincial income tax purposes, business income is apportioned between the provinces when corporations carry on business through permanent establishments in more than one province. Sole proprietor or partnership business income, however, is generally considered to have been earned in the province in which the individual resides at the end of the tax year, regardless of where it has been earned.

The following two charts show the top combined Federal and Provincial Tax rates for 2021 and the combined rates reflecting any provincial surtax.

Table 6 - 1 Provincial Surtax Rates for 2021

Provincial Surtax Rates	
Alberta	No provincial surtaxes
British Columbia	No provincial surtaxes
Manitoba	No provincial surtaxes
New Brunswick	No provincial surtaxes
Newfoundland	No provincial surtaxes
Nova Scotia	No provincial surtaxes
Ontario	20% of basic provincial tax payable over $4,874, and 36% for a total of 56% of provincial tax in excess of $6,237
PEI	10% of provincial tax in excess of $12,500
Quebec	No provincial surtaxes
Saskatchewan	No provincial surtaxes
Northwest Territories	No territorial surtaxes
Nunavut	No territorial surtaxes
Yukon	No territorial surtaxes

Table 6 - 2 Top Combined Federal-Provincial Tax Rates for 2021

Province	Provincial / Territorial Rate %	Ordinary Income %	Capital Gains %
Alberta	15.00	48.00	24.00
British Columbia	20.06	53.50	26.75
Manitoba	17.40	50.40	25.20
New Brunswick	20.30	53.30	26.65
Newfoundland	18.30	51.30	25.65
Nova Scotia	21.00	54.00	27.00
Ontario	20.53*	53.53	26.76
PEI	18.37*	51.37	25.69
Quebec	25.75	53.31	26.65
Saskatchewan	14.50	47.50	23.75
NWT	14.05	47.05	23.53
Nunavut	11.50	44.50	22.25
Yukon	15.00	48.00	24.00

*** With Surtax**

6 – 3.4 Tax on Tax System

Effective January 1, 2001, Canada Customs and Revenue Agency (CCRA), now referred to as Canada Revenue Agency (CRA), introduced a new method for calculating provincial taxes based directly on your taxable income. This new method is referred to as TONI (Tax ON Income) and enables each province to determine separate tax rates and establish separate personal tax credits.

Previously, with the "tax on tax" method, the provincial tax was calculated as a percentage of the federal tax. Now both the Federal and Provincial tax calculations will be performed separately on taxable income.

However, taxable income is the same for both provincial and federal tax calculations.

With the introduction of TONI, there are now two separate TD-1's - one for a provincial tax credit and one for federal tax credit.

While the total income on which people are taxed is the same for both federal and provincial tax calculations, the basic personal tax credit and the amount of credit they can claim under various categories on the TD1's is different.

6 – 3.5 Indexing

In 2000 full indexing to the personal income tax system for the year 2000 and subsequent taxation years was restored. Since 1986, amounts were indexed only for increases in the Consumer Price Index in excess of 3%. Low inflation rates had resulted in no changes for many years.

Amounts subject to indexing include the various personal credits, the tax brackets for individuals and the thresholds for repaying government allowances, such as the Old Age Security. The Canada Child Tax Benefit and the goods and services tax credit are also indexed.

6 – 4 BASIC TAX CONCEPTS

Taxation can be a powerful instrument of social policy.

It can promote social objectives by redistributing resources. It can reduce or increase inequality, including inequality between men and women. It can support or hinder parents in their important job of raising children. It can reflect, disregard or strengthen social values.

Many Canadians give little thought on how they can reduce the taxes they pay until (income) tax time rolls around each spring. Unfortunately, most tax-saving opportunities that can reduce tax obligations are gone by this time. The tax planning steps, and processes people go through or should investigate during the year can save them the most tax dollars not only at income tax filing time but for years into the future.

The basic tax calculation for personal income taxes is:

- Income less deductions = **Net Income** *less*
- Other deductions = **Taxable Income**

6 – 4.1 Income

Earned Income

- Employment earnings, net of union dues and employment expenses
- Research grants (net of related expenses)
- Net income from self-employment and active partnership income
- Disability pensions under the CPP/QPP
- Royalties & Net rental income
- Alimony or separation allowances received (if taxable)
- Employee profit sharing plan allocations
- Supplementary unemployment benefits plan payments (not EI)

Unlike the income described above, the following "other income" is not factored in when calculating RRSP contribution limits.

Investment - Interest income

The interest income on compound-interest obligations, such as Canada savings bonds (CSBs) or other instruments like guaranteed investment certificates (GICs) acquired after 1989 must be reported on an annual accrual basis.

Capital gains

A capital gain results from a sale or other disposition of a capital property for more than its adjusted cost base plus any disposition expenses incurred, such as commissions. Unlike ordinary income however, only 50% of the gain is included in income.

Where the investor experiences a loss, the 50% "allowable" amount must first be used to offset any capital gains they may have in the same year.

Any unused allowable amount may be carried back up to three years or forward indefinitely to reduce taxable capital gains of other years.

Dividends

Many people view dividends as a very desirable and tax-effective type of income to receive. One perceived advantage is the lower rate of tax payable on dividends compared to interest income and perhaps the lower risks associated with dividend income vs. capital gains income. A question that should be asked when dealing with elders is this; Are dividends always desirable?

Income earned at the corporate level is subject to both corporate income tax and, on distribution as dividends to individuals, personal income tax.

The personal income tax system provides relief from this "double taxation" through the gross-up and the dividend tax credit system.

The process is designed to take into account corporate tax paid on earnings before being paid out to individual taxpayers. It is very important to remember that dividends serve to increase net income. Net income of course is used to gauge an elder's eligibility or calculations for certain government benefits like Old Age Security, the age amount, guaranteed income supplements and medical expenses.

There are two types of dividends, eligible and other than eligible dividends, that you may receive from taxable Canadian corporations. The gross-up factors for these dividends and the factors used in the calculation for the corresponding dividend tax credit are different:

- Eligible dividends (generally those received from large corporations) are grossed-up by 38% and a federal dividend tax credit is calculated as 6/11 of the gross-up (or 15.0198% of the grossed-up dividends).
- Dividends other than eligible dividends are grossed-up by 16% and a federal dividend tax credit is calculated as 2/3 of the gross-up (or 10.0313% of the grossed-up dividends).

The dividend gross-up inflates net income and can cause greater numbers of elders who receive moderate to high levels of dividends to lose other government benefits or see them reduced.

The improved tax position of dividend income may well be overshadowed by losses in other government benefits as thresholds to receive benefits become artificially inflated.

Elders would do well to review their investment strategy and objectives with a view to optimizing income and optimizing credits and government benefits while minimizing taxes payable.

Other reportable income

- Training allowances
- Employment insurance benefits
- Scholarships
- Payments from a Registered Pension Plan (RPP), a Registered Retirement Savings Plan (RRSP) or a Registered Retirement Income Fund (RRIF)
- Retiring allowances
- CPP / QPP benefits (other than disability pension payments which are included in earned income for RRSP contribution limit calculations)
- Old Age Security pension

6 – 5 DEDUCTIONS

It is important to understand the difference between deductions and credits particularly in planning with elder Canadians. Deductions reduce your net income and your taxable income. The net income calculation is very important since it affects entitlements to several tax credits available to elder. Credits are an actual reduction in the tax someone must pay. Credits may be refundable or non-refundable. Refundable credits are always worth what they say they are. Non-refundable credits can help reduce the tax owed but are not worth anything if no tax is owed at all. In summary then, a deduction reduces taxable income on which tax is calculated. A credit is a direct reduction of tax.

6 – 5.1 Deductions from Earned Income

The following deductions affect RRSP contribution room

- Professional and union dues
- Employment expenses
- Legal fees to recover unpaid salary and wages
- Meal expenses may be deducted up to 50% of the cost incurred.
- Travel expenses incurred in the course of employment if:
- The employee is ordinarily required to carry on their employment duties away from the employer's place of business
- The employee is required under their employment contract to pay travel expenses
- The employee does not receive a tax-free allowance for expenses
- The travel expenses include meals, lodging, and automobile expenses

The following automobile expenses are deductible based on the kilometres travelled for employment purposes in the year:

- Gas, oil, maintenance and repairs
- Insurance premiums; registration and driver's permit
- Lease charges to a maximum of $800 plus taxes per month
- Capital cost allowance calculated on a maximum vehicle cost of $30,000 plus federal and provincial sales taxes
- Interest on monies borrowed to acquire a passenger vehicle to a maximum of $300 per month

6 – 5.2 Other Deductions

The following deductions do not impact RRSP contribution room

- Contributions to registered deferred income plans (pension funds, RRSP)
- Child care expenses (more and more elders are finding that they will be the primary caregivers for their children's children let alone their own)
- Carrying charges
- Canada Pension Plan payments on self-employed earnings
- Canadian Exploration Expenses (CEE), Canadian Development Expenses (CDE)
- Legal fees related to the appeal of the taxpayer's income tax assessment
- Moving expenses if the following conditions are met:
- The taxpayer has moved at least 40 kilometres closer to the new place of work, business or study
- The moving expenses have not been refunded to the taxpayer
- The moving expense deduction is limited to the net income from the new employment, new business, taxable scholarships or research grants received in the year.
  The amount of the moving expenses that exceed the net income received in one year may be carried over to a subsequent year.

6 – 5.3 Other Deductions from Net Income

Capital gains deduction from capital gains reported on disposition of:

- Qualified farm property
- Qualified small business corporation shares

Losses carried over from previous years:

- Net capital losses can be deducted against taxable capital gains for the year and can be carried back 3 years and forward indefinitely.
- Non-capital losses can be deducted against net income for the year and can be carried back 3 years and forward 20 years (as per 2006 Federal Budget).
- Farm losses can be deducted against net income for the year and can be carried back 3 years and forward 10 years (as per 2005 CRA ruling).

6 – 5.4 Registered Retirement Savings Plan Contributions

Contributions to a Registered Retirement Savings Plan (RRSP) are deductible for any given year if they are contributed in the year, or within 60 days after the end of the year.

The maximum dollar limits for RRSP contributions are:

- 2017 - $26,010
- 2018 - $26,230
- 2019 - $26,500
- 2020 - $27,230
- 2021 - $27,830
- 2022 - $29,210

The contribution limit for any given year is calculated based on the previous year's earned income, less the previous year's pension adjustment subject to the maximums noted above.

Contribution limits can be carried forward and deductions claimed up to the accumulated contribution limit in any following year.

Similarly, contributions made in a year may be carried forward at the taxpayer's discretion and claimed in any subsequent taxation year provided the contribution room still exists. There is no limit on the carry-forward period.

For the purpose of claiming a deduction, a taxpayer's contribution to a plan of which the taxpayer is the annuitant is treated the same as a contribution to a plan of which the taxpayer's spouse is the annuitant. The total of contributions to the taxpayer's plan and the spousal plan are subject to the taxpayer's RRSP deduction limit. The spouse's RRSP deduction limit has no bearing on the deduction available to the taxpayer. The spouse can make his or her own contribution to his or her plan, using his or her own contribution limit.

Contributions to spousal plans should be made by December 31 of the taxation year to reduce the effects of the attribution rules for withdrawals from spousal plans. Where an annuitant of a spousal RRSP plan makes a withdrawal from the plan, the total of all amounts paid by the taxpayer in the year, and in the two preceding years into the spousal plan, will be attributed back to the taxpayer and will be required to be reported as income by the taxpayer.

Interest paid on funds borrowed for the purpose of funding a contribution to a Registered Retirement Savings Plan is not deductible for tax purposes.

6 – 6 CREDITS

Tax credits are provided by both the federal and provincial governments in determining tax payable. Under the federal-provincial tax collection agreement, the provinces can top up the federal amounts or add their own credits if they wish, but at a minimum they must offer the same basic credits as those available federally.

A deduction reduces taxable income on which tax is calculated. A credit is a direct reduction of tax. Tax credits are classified as refundable tax credits and non-refundable tax credits. Refundable credits are treated the same as withholdings and instalments and are refunded if the amounts exceed the tax payable. Non-refundable credits reduce the tax payable in a year but are not refunded if the credits exceed the tax payable.

6 – 6.1 Personal Tax Credits

- Basic personal amount
- Age amount available to those over 65. The amount of this credit is dependent on the elder's income level
- Spouse/ common law partner amount if a spouse or partner has income under a specified amount
- Eligible dependant credit

Taxpayers may claim the equivalent-to-spouse credit if, at any time during the year, they were single, divorced or separated and supported a qualified relative who lived with and was dependent on them.

The equivalent-to-spouse credit is calculated in the same manner as the spousal credit and is based on the following factors:

- The dependent, other than a child, must be a Canadian resident
- A dependent child must be either under 18 at any time in the year, or any age if dependent because of mental or physical infirmity
- The claim may only be made in respect of one other person
- Where two or more individuals are otherwise entitled to a credit in respect of the same person, only one can claim the credit
- The credit cannot be claimed for an individual on behalf of whom the taxpayer is required to pay a support amount
- To qualify, the dependent does not need to have lived with or be supported by the taxpayer throughout the entire year

Infirm dependant credit is available for those individuals over the age of majority who are dependent on the taxpayer. The credit is adjusted for the net income of the infirm dependant.

6 – 6.2 Attendant Care Amount

If the taxpayer has a disability, some or all the costs of an attendant needed to allow the taxpayer to earn income, carry on funded research or attend a designated educational institution or secondary school are deductible.

6 – 6.3 Disability Credit

A credit is available to any individual whom a Canadian medical doctor certifies on Form T2201 is suffering from severe and prolonged mental or physical impairment during the year. Other professionals may also certify specific disabilities. For instance, an optometrist can certify sight impairment, or an audiologist can certify an individual's hearing disability. Occupational therapists and psychologists can also certify a taxpayer's physical or mental disability, respectively.

The impairment is considered severe if the disability markedly restricts the person in their daily living activities and prolonged if the disability lasts, or is expected to last, for a continuous period of at least 12 months.

The disability tax credit also extends to individuals that have been certified by a medical doctor to require therapy at least three times a week, averaging a total of at least 14 hours, to deal with a marked restriction in their ability to perform a basic activity of daily living.

The disability credit may also be claimed with respect to certain dependents, provided they do not require the credit to reduce their own tax liability after claiming personal, age, pension credits and any credits relative to EI and CPP premiums paid. The list of relatives to whom the unused portion of an individual's disability tax credit may be transferred under certain circumstances includes: a parent, grandparent, child, grandchild, brother, sister, aunt, uncle, nephew, or niece of that individual, or their spouse/common-law partner (provided the disabled individual is living with the supporting person and is at least partially dependent on them). To qualify, individuals must have supported the relative at some time during the year.

6 – 6.4 Caregiver Amount

A tax credit is available for caregivers who provide in-home care for elderly or infirm relatives. The amount of the credit available to be claimed is dependent on the elderly or infirm relative's income.

6 – 6.5 Other Credits

- Pension income amount - a 15% federal tax credit for up to $2,000 of eligible pension income is available to qualified individuals (2018 tax year).
- Eligible pension income includes:
- Life annuity receipts from a superannuation or pension fund, regardless of the recipient's age
- Registered Annuity payments under an RRSP or DPSP, amounts received from a RRIF, and the interest component of taxable annuities (Life Insurance GIA's), provided the recipient is at least 65 by the end of the year, or the amounts are received because of a spouse/common-law partner's death
- Foreign source pensions, such as U.S. Social security and United Kingdom pension
- Ineligible pension income includes:
- CPP, QPP, OAS
- Lump sum payments from a pension or superannuation plan
- Death benefits
- Retiring allowances
- Amounts received under a salary deferral arrangement
- Payments received out of a retirement compensation arrangement
- Any other qualifying income that has been rolled over to an RPP or an RRSP

6 – 6.6 Charitable Donations and Gifts

The maximum amount of donations that can be claimed in a year is 75% of the taxpayer's net income for that year. In the year of death, charitable donations can be claimed up to 100% of net income in the year of death and the prior year.

Donation credits can be carried forward five years.

6 – 6.7 Credits Transferred from a Spouse

Credits are worth slightly more to very high-income individuals in some provinces because of the surtaxes imposed on individuals with high basic provincial tax.

The credits which can be transferred are:

- Age amount
- Pension income amount
- Disability, Tuition and education amounts

6 – 6.8 CPP/QPP and Employment Insurance Contributions

Employees and self-employed individuals are entitled to the same maximum credit for CPP/QPP contributions. However, since a self-employed taxpayer pays double the contributions of an employee, the taxpayer is entitled to a deduction in the calculation of net income for the portion of contributions not eligible for the credit.

6 – 6.9 Medical Expenses

An individual may claim a credit for any non-reimbursed medical expenses. The federal portion of this credit consists of 15% of expenses in excess of the lesser of $2,268 or 3% of the individual's net income for the year (2017 tax year).

Such expenses may be incurred on the taxpayer's own behalf or that of their spouse or common-law partner. Medical expenses may also be claimed for dependants other than a spouse or common-law partner, but in those instances, the total expenses claimed are affected by the dependant's income.

The list of expenses eligible for the medical expense tax credit includes:

- Attendant care for disabled workers—up to two-thirds of earned income with no maximum
- Full-time attendant care for individuals with severe and prolonged mental or physical impairments, including all expenses with no maximum
- Supervision of an individual eligible for the disability tax credit that is residing in a Canadian group home devoted to the care of people with a severe and prolonged impairment
- Part-time attendant care—up to $10,000, increasing to $20,000 if the individual died during the year
- 50% of the cost of an air conditioner needed for a severe chronic ailment, to a maximum of $1,000
- 20% of the cost of a van that is, or will be adapted for the transportation of an individual using a wheelchair, to a maximum of $5,000
- Expenses incurred for moving to accessible housing, to a maximum of $2,000
- Sign language interpreter fees
- Reasonable expenses incurred for the purpose of renovating or altering a home to provide the patient with added mobility
- Tutoring services from a non-related person for individuals with a certified learning disability or mental impairment
- A portion of reasonable expenses relating to the construction of a new residence that will assist a severely disabled individual gain access to, or be mobile, or functional within that home

- Reasonable expenses for driveway alterations made to enable a mobility-impaired individual to access a bus
- Reasonable travel expenses incurred to obtain medical services not available near the patient's home, to the extent these have not been reimbursed by a provincial health plan, or other source

The list of expenses eligible for the medical expense credit is lengthy. For a review of eligible medical expenses, refer to IT-519R2 or other CRA publications.

The CRA ruled in April 2003 that for the 2002 and subsequent taxation years, seniors that are living in a retirement home and who also qualify for the disability tax credit (DTC), may claim attendant care expenses of up to $10,000 per year (their estate may claim $20,000 for the year of death).

The attendant care component of fees paid to a retirement home includes the salary and wages paid to employees with respect to the following services provided to a senior, including:

- Health care
- Meal preparation
- Housekeeping in the residents personal living space
- Laundry for the resident's personal items
- A transportation driver
- Security, where applicable

The retirement home must provide the taxpayer or their caregivers with a receipt showing the applicable amounts paid for attendant care.

Generally, expenses paid to a nursing home qualify as tax-deductible medical expenses while those paid to a personal care institution do not, because the care provided to patients in a nursing home tends to be more extensive. However, there may be exceptions to that rule.

All or part of the remuneration paid to a personal care facility might, for instance, be deductible in situations where an individual with a severe and prolonged impairment requires specialized equipment, facilities or personnel. Caregivers are also able to deduct reasonable expenses associated with the cost of training required to care for dependent relatives with mental or physical infirmities. Patients who are incapable of travelling without the assistance of an attendant may be able to deduct a full range of reasonable travel expenses on behalf of somebody required to assist them travel to a facility at least 80 kilometres away from home to seek proper medical treatment.

Certain expenses incurred for the purpose of providing care to a disabled person are exempt from the goods and services tax (GST) and harmonized sales tax (HST). These include a government funded homemaker service provided to an individual in their place of residence, various medical devices, and some recreational programs.

For a complete list, consult CRA's guide RC4064, Information Concerning People with Disabilities.

When claiming medical expenses, the taxpayer can choose any 12-month period.

6 – 7 TAX CALCULATION

The tax calculation for a taxpayer is based on the province of residence as of December 31. The tax rates for that province are applied to the taxable income for the year, regardless of the date the move was made during the year. A move to a lower personal tax rate province should be planned to be completed before December 31 of the year. On the other hand, a move from a lower personal tax rate province should be planned to be completed after January 1 of the following year.

Canada assesses income taxes because of residency. The term "resident" is not specifically defined in the Income Tax Act, but paragraph four of Interpretation Bulletin IT-221R3 – Determination of an Individual's Residence Status states:

The most important factor to be considered in determining whether an individual leaving Canada remains resident in Canada for tax purposes is whether the individual maintains residential ties with Canada while he or she is abroad.

The residence status of an individual can only be determined on a case by case basis after taking into consideration all the relevant facts.

An individual is deemed to be a Canadian resident if that individual sojourns in Canada for a total of 183 days (or more) in a calendar year.

Non-residents of Canada are subject to Canadian taxes on:

- Employment income earned in Canada
- Income from a business carried on in Canada
- Capital gains realized on dispositions of taxable Canadian property
- Withholding tax taken on investment income paid to non-residents from a Canadian institution

6 – 7.1 Filing Deadlines

Table 6 - 3 Filing Deadlines

Individual Return	April 30th of following year
An individual who carries on a business	June 15th of following year (Tax is payable by April 30th)
Return of a deceased individual (terminal return)	Death occurs between Jan 1 & Oct 31 - deadline is April 30th of following year. Death occurs between Nov 1 & Dec 31 - deadline is 6 months after the date of death.
Trust or estate return	90 days after the end of the tax year
Corporate return	6 months after the end of the tax year

6 – 8 INCOME SPLITTING

The term "income splitting" is used to describe methods designed to save taxes by shifting income from the accounts of a high tax bracket family member to the hands of another family member who is in a lower income tax bracket. This way, the same income is taxed at a lower rate, or perhaps not at all if the other family member's income is low enough.

The income tax system in Canada is based on progressive income tax rates. The marginal rate of tax increases as taxable income increases. Tax payable by two taxpayers at lower incomes may be significantly less than the tax payable by one taxpayer with the combined amount of income of the two taxpayers. Elders may well want to plan their retirement incomes so that both spouses are receiving incomes rather than one spouse only receiving and paying tax on the family income.

6 – 8.1 Income Splitting Opportunities

Spousal RRSP contributions

The RRSP rules allow a taxpayer to contribute to an RRSP for their spouse and claim the deduction on their own returns. The total contributions to the taxpayer's own and spouse's plan combined are subject to the contribution room limits of the taxpayer.

Contributions to a spouse's RRSP, if withdrawn by the spouse, are taxed in the contributor's hands to the extent of contributions made to the spouse's plan in the year of withdrawal or in the previous two years.

Loans to a spouse

If funds are loaned to a spouse, for the purpose of earning investment income, and interest is charged at the prescribed rate, then, provided the interest is paid to the lender within 30 days after the end of the year, the income earned on the monies lent is reported by the receiving spouse. The yield from the loaned funds in excess of the interest paid on the funds is effectively transferred to the lower income spouse.

The current CRA prescribed rate may be relatively low. The rate is set for each quarter, so if interest rates are rising, there may be an opportunity to lock in the loan interest rate at a low prescribed rate and invest the funds in higher current market rates.

Spousal loans should be considered for the following reasons:

- Lending funds to a spouse for the purpose of financing a business and earning business income
- Invest the lower income spouse's funds

The higher income spouse should pay the household expenses, allowing the lower income spouse to invest their funds earned. The higher income spouse can also pay the lower income spouse's income tax bill as well as the interest on the lower income spouse's third party investment loan. The interest is deductible by the lower income spouse but, if paid by the higher income spouse, does not reduce the amount of funds invested. If the principal amount of the loan is not repaid by the higher income spouse, the lower income spouse's assets will continue to generate income which is reported by the lower income spouse.

Children's employment income

If a child is attending university and working during the summer, the parent could lend the child funds to pay for the tuition and basic expenses. This loan could be interest-free. The child would then invest the funds earned from the summer employment.

As it is the child's funds that have been invested, the income earned on the invested funds would be reported by the child. This plan could be implemented each year and the loan amount repaid upon graduation with the child retaining the income earned on the funds during the period the investments were in place. A graduation gift of forgiveness of the loan could also be made without the attribution rules affecting the transaction.

Split CPP benefits

The entitlement of Canada or Québec Pension Plan payments can be split between spouses provided both spouses are over the age of 60.

Testamentary Trusts

During the first three years, Testamentary trusts are considered a separate taxpayer for income tax purposes. Trust earnings of up to approximately $40,000 are taxed at the lowest federal tax rate. Leaving assets in trusts of this nature can be an attractive option for elders who are paying tax at higher marginal rates.

6 – 8.2 Pension Splitting

Since 2007, Canadian spouses or common-law partners have been allowed to split the pension income one of the spouses receives between the two spouses. No funds are transferred, the split occurs only on paper.

Each year, only one spouse can choose to split his pension income with his spouse. But that choice does not have to be the same from year to year and the elder does not have to split the same percentage of income either. He can choose the best solution for his situation.

As we all know, in Canada, people who make more money pay more income tax. This little-known strategy allows the spouse who has the highest income to lower his tax payable by sharing up to 50 % of his pension income with his spouse.

There are also additional advantages beyond just reducing the income tax payable.

- Pension splitting can be used to give the lower income spouse access to the Pension Income Tax Credit. To benefit from this scenario, the spouse receiving the pension income must be under age 65. For example, the receiving spouse would declare $10,000 in pension income, claim the full amount of the Pension Income Tax Credit ($2,000) and see his federal income tax reduced by $300.
- Reinstate Old Age Security benefits by reducing or eliminating repayment (claw back)
- Reinstate Age Amount Credit by reducing or eliminating repayment (claw back)

Qualified pension income varies depending on whether the pensioner is under or over 65. In general, qualified pension income includes a pension received from a former employer. And if the elder is over the age of 65, he can also split payments from an RRSP or a registered income fund (RRIF).

Some common types of income are not eligible:

- payments from the Canada Pension Plan (CPP) or the Québec Pension Plan (QPP)
- Old Age Security payments
- income from a United States individual retirement account (IRA)

6 – 9 WEALTH TRANSFERS & DEEMED DISPOSITION TAXES

6 – 9.1 Capital Properties

The general rule is that, at the time of death, an individual is deemed to have disposed of all capital property immediately before death for proceeds equal to the fair market value of the property. As a result, accrued capital gains (net of capital losses) are taxable to the deceased in the year of death.

A capital gain results from a sale or other disposition of a capital property for more than its adjusted cost base and any disposition expenses incurred, such as commissions. Unlike ordinary income however, only 50% of the gain is included in income.

Investment portfolios held by the taxpayer at death will be deemed to have been disposed of for the fair market value of the investments immediately before the taxpayer's death. The resulting capital gains (or losses) on the entire portfolio will be included in the deceased's terminal return.

Vacation properties also are deemed disposed of by the taxpayer immediately before death for the fair market value of the property. The fair market value of the property in excess of the original cost to the owner is the capital gain on the property.

Capital gains calculated on the value of the property will be included in income on the terminal return and income taxes calculated accordingly. Without proper planning, the vacation property may in fact have to be sold to raise the necessary funds to pay the tax bill.

Rental properties are treated in the same manner as vacation properties with the capital gain calculated as the excess of the fair market value of the property immediately before death over the original cost of the rental property. Income taxes will be assessed on the capital gain on the property.

6 – 9.2 Maturing Plans

The fair market value of registered retirement savings plans (RRSP) and registered retirement income funds (RRIF) immediately before the death of a taxpayer is reported as income on the deceased's terminal return. Since a tax deduction was obtained for contributions to the RRSP and any income earned in the plan while registered was not subject to tax, the entire amount in these registered plans is taken into income. As most plans have significant values, the chances are the income will be taxed at the top marginal rate in the province in which the deceased resided.

6 – 9.3 Transfer Strategies and Their Limits

Rollover

Property, which is transferred to a spouse, or spousal trust, automatically transfers on a tax-deferred basis. For income tax purposes, the proceeds of disposition are deemed equal to the tax cost of the property. As a result, the capital gain is deferred until a subsequent disposition occurs or upon the death of the second spouse.

While transfers between spouses can be tax-deferred, the executor can elect to have the transfer occur at fair market value. This would create some capital gains on the deceased's final tax return, which may be beneficial if there are unutilized capital losses or the capital gain qualifies for the deceased's capital gains exemption.

Qualified farm property, under specific circumstances, can be transferred to a spouse, child, grandchild, or great-grandchild on a tax-deferred basis.

Joint Ownership

There is a distinction between the legal implications of joint ownership and the income tax implications of joint ownership.

Canada Revenue Agency (CRA) recognizes that a transfer of legal ownership can occur without a transfer of beneficial ownership.

It is the transfer of beneficial ownership that triggers a disposition for income tax purposes.

For example, a parent (last surviving spouse) owns a rental property and wishes to place their child on the title to the property in order to avoid probate on the death of the parent.

If the parent retains beneficial ownership of the property, that is, the parent continues to report the income on the property and make the decisions regarding the operation of the property, then a deemed disposition does not occur with the addition of the child on the title to the property. CRA takes the position that whether beneficial ownership has transferred is a question of fact in each circumstance.

On the death of the parent, from a legal perspective the title to the property passes automatically to the surviving joint owner, in this case the child. From a tax perspective however, there is a deemed disposition of the parent for the fair market value of the property and a subsequent acquisition by the child with the adjusted cost base of the property equal to the fair market value as reported by the parent.

A capital gain (or loss) on the deemed disposition of the property will be reported on the parent's terminal return. In addition, probate could be triggered.

Gifts

Gifts to non-arm's length individuals are deemed to have occurred at the fair market value of the item gifted. The person providing the gift will be required to report a disposition of the asset with the proceeds of disposition equal to the fair market value of the asset at the time the gift was made.

Gifts to spouses do not attract tax on capital gains but instead the asset passes to the spouse at the original cost to the gifting spouse. However, any income earned on the asset transferred will be subject to the attribution rules.

Sales

The rules relating to the sale of assets to non-arm's length individuals are the same as the gifting rules. Even if a sale agreement is made for less than the fair market value of the asset, the seller will be deemed to have sold the asset for fair market value if the purchaser is non-arm's length to the seller. The onus to substantiate the fair market value of an asset rests with the taxpayer. If CRA disagrees with the fair market value of the asset, the taxpayer must prove to the CRA's satisfaction that the taxpayer has reported an accurate amount of the fair market value of the asset.

6 – 10 ATTRIBUTION RULES

While Canada's steeply progressive income tax brackets increases tax rates as income increases, there are several rules designed to restrict the transfer of income from one family member to another.

The rules we will discuss in this section are:

- Income and losses from property transferred or loaned to a spouse or minor
- Transfers and loans of property to trusts
- Loan guarantees
- Interest-free or low interest loans
- Indirect payments and transfers of rights to income
- Split income tax

6 – 10.1 Income and Losses from Property Transferred or Loaned to A Spouse or Minor

If a taxpayer transfers or loans property (including money) to their spouse or family member, who is under 18 years old, then any income or loss from the property is attributed or deemed to be the income of the individual.

Family members covered by these rules include child, grandchild, sibling, niece, or nephew. Spouses include common-law spouses.

Capital gains and losses realized on property transferred or loaned by an individual to their spouse are attributed to the individual. However, capital gains and losses realized on property transferred or loaned to a minor are not attributed to the individual making the transfer or loan.

If the loans made to the spouse or minor have an interest rate equal to or greater than the prescribed interest rate and the interest is paid to the lender not later than 30 days after the end of the year, then the attribution rules do not apply. If the January 30 deadline ever passes without the interest being paid, then that year's income and all future income from the loaned property will be attributed back to the lender. Of course the lender must report the interest income received.

Secondary or second-generation income is not attributed back to the lender as it is not income from property that was transferred. The income on income is taxed in the hands of the spouse or minor receiving the loan or transfer. Over time, significant amounts of secondary income can be built, however accurate records must be maintained that track the primary income and the secondary income. Bank accounts for the original loaned funds and interest thereon maintained separately from the income on income or secondary income amounts helps to keep the amounts segregated for managing and reporting purposes.

6 – 10.2 Transfers and Loans of Property to Trusts

The same attribution rules apply if the property is transferred or loaned to a trust with a beneficiary of the trust who is a designated person of the transferor. A designated person for this purpose is the spouse of the transferor or a family member under 18 years of age who is a child, grandchild, sibling, niece, or nephew.

6 – 10.3 Loan Guarantees

Rather than making a loan to a spouse, minor or trust, an individual may instead provide a guarantee or some other undertaking to ensure the repayment of a loan made by a third party to the spouse, minor, or trust. For the purposes of the attribution rules under the Income Tax Act, the monies loaned by the third party will be deemed to have been loaned by the individual.

6 – 10.4 Interest-Free or Low Interest Loans

This attribution rule is mainly directed at interest-free and low-interest loans to adult children.

If one individual (transferee) has received a loan from another individual (transferor), all the income from the loaned property is attributed to the transferor if the following conditions are met:

- The individuals are not dealing at arm's length; and
- One of the main reasons for advancing the loan was to transfer the tax burden on income earned on the loaned funds to the transferee.

There is an exemption identical to the exemption provided for loans to spouses and minors. If interest is charged on the loan equal to the prescribed rate in effect at the time the loan was made, and the interest is paid by 30 days after the end of the year, the attribution rules do not apply. A loan that did not qualify for the exemption initially cannot subsequently be replaced by a loan that does meet the qualifications.

This attribution rule does not apply to gifts of property. Outright gifts of property to adult family members do not attract attribution. The property must be transferred at fair market value so there may be capital gains that need to be reported by the transferor but income on the property is not attributed back to the transferor.

Gifts of cash to adult family members can be done without tax consequences to the transferor and the attribution rules do not apply.

6 – 10.5 Indirect Payments and Transfers of Rights to Income

There are rules to prevent a taxpayer from transferring the tax burden on an income amount by simply directing that the income be paid to another person. For example, an employee cannot direct the employer to pay part of the salary to the employee's spouse. Similarly, a beneficiary of an estate who is entitled to a share of the income of the estate cannot direct the trustees to pay the share to another individual who is not a beneficiary of the estate.

For private corporations, a shareholder cannot direct that dividends due to that shareholder be paid to the shareholder's spouse when the spouse is not a shareholder of the corporation.

6 – 10.6 Split Income Tax

Beginning in the 2000 taxation year, a special federal tax of 29% was added to certain types of passive income (called split income) received by individuals under the age of 18.

Split income includes:

- Taxable dividends and other shareholder benefits on private Canadian and foreign company shares (received directly by the minor or through a trust or partnership)
- Income from a partnership or trust that is derived from providing property or services to a business carried on by a relative of the minor or a business in which the relative participates

The addition of the special federal tax to the split income effectively eliminates the benefit of splitting the income. If an individual has a split income tax liability as a result of a parent's connection with a business, that parent is jointly and severally liable with the individual for the split income tax liability.

The split income tax ceases to apply to an individual in the year they turn 18. The tax does not apply to income earned by minors from property acquired on the death of their parent or income earned by minors who have no parent resident in Canada for tax purposes in the year.

6 – 11 LIFE INSURANCE

Life insurance can play many roles in estate planning such as:

- Provide replacement income for dependants
- Pay for final expenses such as funeral costs
- Fund the capital gains tax liability on deemed dispositions at death
- Estate equalization especially for family businesses with non-participating children
- Funding business succession plans
- Accumulation of funds on a tax-sheltered basis

Life insurance proceeds received on the death of the life insured are not taxable. Conversely the premiums paid for life insurance policies are generally not deductible.

Earnings on the investments held in the accumulating or tax-exempt account of a universal life insurance policy are sheltered from income taxes during the lifetime of the insured under the life insurance policy and become tax-free on the death of the insured.

6 – 11.1 Taxation of Withdrawals and Loans

The policy gain on dispositions of exempt life insurance policies is calculated as the proceeds of disposition minus the adjusted cost basis (ACB) of the policy. The policy gain is included in the policyholder's income in the taxation year in which the disposition occurs.

Since the life insurance policy is not capital property, the full amount of the policy gain is included in income and taxed at the same rates as interest income. Losses on dispositions of exempt policies are not recognized for tax purposes. Each policy is regarded as a separate entity; therefore a loss from one policy cannot be offset against a gain from another policy.

6 – 11.2 Partial Withdrawals

Partial withdrawals of the balance in the accumulating fund are treated as a disposition for tax purposes. The policy gain is calculated as the excess of the proceeds of disposition over the adjusted cost basis of the surrendered portion of the policy. The adjusted cost basis of the policy must be prorated between the amount withdrawn and the amount remaining in the accumulating fund. The accumulating fund is generally equal to the cash surrender value of the policy. Thus, if 50% of the accumulating fund is withdrawn, then 50% of the adjusted cost basis of the policy is used in the calculation of the policy gain for the partial withdrawal.

6 – 11.3 Policy Loans

Policy loans are also considered a disposition for income tax purposes. The difference with policy loans is that the amount of the loan can be up to the adjusted cost basis of the entire policy before a policy gain occurs. The policy gain is calculated as the proceeds of disposition (the amount of the policy loan) minus the adjusted cost basis of the policy. This means the policyholder may obtain a policy loan up to a maximum of the adjusted cost basis on a tax-free basis.

If a policy loan is repaid in whole or in part, the Income Tax Act allows the policyholder to deduct from income the lesser of:

- The amount of the repayment
- The amount previously included in income as a policy gain minus repayments made in a preceding year that were deductible

These rules are designed so that if a policy loan results in taxable income, an offsetting deduction will be allowed as the policy loan is repaid. Any amount of the repayment in excess of the amount deductible will be added to the adjusted cost basis of the policy. Interest paid on policy can be deductible if the following requirements are met:

- The interest must be paid or payable in a particular year
- There must be a legal obligation to pay the interest
- The borrowed funds must be used for the purpose of earning income from a business or property
- The policy loan interest must be verified by using the prescribed form as to the amount paid and the fact that the interest has not been added to the adjusted cost basis of the policy

6 – 11.4 Collateral Assignment

The assignment of all or part of an interest in a life insurance policy as security for debts or loans other than a policy loan is not considered a disposition for income tax purposes. As the assignment of a policy is not considered a disposition, there are no tax implications for the policyholder. In a corporate situation, for a portion of the premiums of the life insurance policy to be deductible, the following conditions must be met:

- The assignment of the policy must be required by the lender as a condition of the loan
- The lender must be a restricted financial institution (i.e. Bank, trust company, credit union)
- The interest paid on the loan must be deductible to the borrower (with a few exceptions). The money borrowed must be used to earn taxable income from a business or property
- The amount deducted is the lesser of the amount of premiums paid each year and the net cost of pure insurance (NCPI) for the policy. Both items are prorated on a reasonable basis for the taxation year
- The amount deductible is the portion of the amount calculated in above that relates to the amount owing. For example, if the face amount of the insurance policy exceeds the balance of the loan outstanding, then the deductible amount of the premium paid will be prorated for the loan balance in relation to the amount of the policy face value.
- An existing policy may be used but all the above requirements must be met
- The borrower must also be the policyholder. A shareholder cannot pledge a personally-owned policy as collateral for the company's loan and deduct a portion of the premiums

6 – 11.5 Tax-Deferred Insurance Transfers

Section 148 of the income tax act provides for the tax-free transfer of ownership of a life insurance policy from a policyholder to that policyholder's child. There can be no consideration given to the policyholder for the transfer and a child of the policyholder must be the insured under the policy.

For purposes of the income tax act, the extended meaning of "child" as defined in subsection 252 (1) includes:

- A person of whom the taxpayer is the natural parent whether the person was born within or outside marriage
- A person who is wholly dependent on the taxpayer for support and of whom the taxpayer has, or immediately before the person attained the age of 19 years had, in law or in fact, the custody and control

- A child of the taxpayer's spouse or common law partner or a spouse or common-law partner of a child of the taxpayer
- An adopted child of the taxpayer
- A child of a child

While a child of the taxpayer must be the insured under the life insurance policy, the transferee child does not have to be the same person as the life insured under the policy. For example, ownership of a life insurance policy on a taxpayer's child may be transferred to the taxpayer's grandchild.

In response to a question posed at the May 2004 roundtable discussions between CRA and CALU (Conference for Advanced Life Underwriting) representatives, CRA indicated that for the tax-free rollover of ownership of a life insurance policy from a policyholder to a child, there must be only the child insured under the policy. Multi-life policies, even if all the insured's are children of the policyholder, do not qualify for the tax-free transfer of ownership.

6 – 12 CHARITABLE GIVING USING LIFE INSURANCE

Another idea for tax maximization of estate planning is to provide for a planned or charitable-giving donation. The below statistics are from Statistics Canada, the Voluntary Sector Initiative and the insurance industry

Some interesting facts from a survey taken a few years ago:

- Only 44% of Canadians make a Will
- Only 7% of those who have made a Will include a charitable bequest
- When asked, 42% would consider including a charity in their Will
- 27% of the population would consider a charitable bequest, if asked
- 15% of those who made a charitable bequest would be willing to make a higher dollar bequest, if asked

Canadian seniors 65 and older make an important contribution to charitable giving and volunteering. However, different patterns emerge not only among younger and older seniors, but also between seniors and the rest of the population, according to analyses of data from the 2010 National Survey of Giving, Volunteering, and Participating (NSGVP).

Almost nine out of ten (87.2%) Canadians age 65 and older donated to charities for a combined total of over $2.56 Billion.

- Younger seniors between the ages of 65 and 74 were more likely to make in-kind donations such as clothing, and food, than their older counterparts (75 and older). However, 7% of older seniors left a bequest to a charitable, religious or spiritual organization, compared to 4% of younger seniors

- Eighty-eight percent of 65-74 year old has made charitable donations. This declined to 86% of seniors 75 and older
- Older seniors (75 and older) made larger average annual donations than those 65-74 years old ($725 vs. $592). In fact, older seniors made the largest average annual donation, compared to all other age groups

There are three conditions that must be met as per Bulletin IT–11OR2 for a gift to qualify as a charitable donation:

- Property, usually (but not always) cash, is transferred by a donor to a registered charity
- The transfer is voluntary; any legal obligation on payer would cause the transfer to lose its status as a gift
- Transfer is made without expectation of return; no valuable consideration or benefit of any kind may result to the donor or to anyone designated by the donor (excluding any income tax relief)

6 – 12.1 Tax Receipt on Death of Insured

In the year of death on the terminal return, the donor can claim 100% of the income earned in that year as a donation. A carry back of up to 100% of the previous year's income is also allowed for donations made in the year of death.

There are two options available for obtaining tax credits for donations of life insurance policies. An annual tax credit can be claimed for premiums paid on a life insurance policy, the benefits of which are to be paid to a registered charity or a credit can be claimed for the proceeds of the life insurance policy paid to a charity. This credit is available in the year of death of the insured.

A life insurance policy is taken out on the life of the donor with either the donor's estate or the charity named as the beneficiary of the policy.

The donor is the owner of the policy. If the estate is the named beneficiary, then the will must direct the proceeds of the insurance policy be paid to the charity as a donation.

When the gift of insurance proceeds is made under the donor's will, the insurance proceeds pass through the estate of the donor. The funds may be subject to probate fees and creditor claims as well as estate litigation.

The confidentiality of the donation may not be protected if the donation is done through the estate. The strategy for donating the proceeds of a life insurance policy(s) with the donation credit claimed for the proceeds paid to the charity at death would be used in situations where the donor is expected to realize capital gains on deemed dispositions at death or other large income taxes like the inclusion of RRSP and RRIF monies.

After the 2000 budget, the tax benefit of having the insurance proceeds pass through the estate or paid directly to the charity is the same. For deaths after 1998, a donation credit is given to the individual immediately before death for direct beneficiary designations made to charities. The donor retains control over the policy and has the flexibility to change the policy or beneficiary designation. Note that at the CALU 2003 Roundtable, CRA stated that where a charity was designated irrevocable beneficiary of a life insurance policy, no charitable gift will have been made, neither during the policyholder's lifetime nor at death.

6 – 12.2 Tax Receipt During Lifetime

For the donor to obtain a donation receipt for premiums paid on a life insurance policy during his or her lifetime, the life insurance policy must be owned by the charity. The donor would be the insured under the policy and the charity would be the named beneficiary.

As the charity does not have an insurable interest in the donor, consent must be obtained from the donor for the charity to own the policy.

There are two options for payment of the premiums on the life insurance policy:

The donor can make the premium payments directly to the insurance company, and provide the charity with the payment receipt or

The donor can give the money to the charity, and the charity can make the premium payment to the insurance company. In either case, a donation receipt will be issued to the donor for the premium payment.

This strategy would be used in a case where the donor wishes to offset annual taxable income with a charitable donation tax credit.

For insured charitable annuities, the taxable portion of an annuity payment can be offset by a tax credit for the donation of the premiums on a life insurance policy. The policy is owned by the charity and the proceeds on the death of the donor are paid to the charity. There is no further tax deduction on payment of the proceeds to the charity.

The donor can transfer the ownership of an existing policy to a charity. If there is a cash surrender value of the policy, the charity will issue a donation receipt for the cash surrender value at the time of the transfer. Subsequent premium payments made by the donor would generate a donation receipt from the charity. A taxable disposition may be triggered on transferring ownership of the policy but the credit generally more than offsets the taxes due.

Annual charitable donations are limited to 75 percent of net income of the donor in the year. Donations made over the limit in a particular year can be carried forward for deduction in any one of the following five years.

With the ever-increasing gap between a charity's need for finances and the government funding levels, life insurance becomes an important component of charitable giving particularly in helping to create or fund endowment plans by charities. The proceeds of a life insurance policy are not caught by annual disbursement quotas for charities and can be used to fund long-term requirements and endowment projects.

6 – 13 TAX PLANNING OPPORTUNITIES

6 – 13.1 Making Interest Expense Tax-Deductible

Interest expenses on borrowed funds are deductible provided the taxpayer is using the funds to produce income from a business, investment, or property. Many individuals hold substantial debt-free investments while owning personal property such as a home with a large mortgage.

Because of the deductibility rules, they might therefore want to consider whether the following strategy could be of benefit to them:

- Sell the investments
- Use the proceeds to pay down the existing mortgage
- Arrange new financing using the home as collateral
- Use funds from the new financing to purchase investments

Interest on the new mortgage may be tax-deductible as the funds were used to purchase income-producing property.

Decisions handed down by the Supreme Court of Canada (Singleton, Ludco Enterprises Ltd.) in September 2001 reinforced the right of taxpayers to deduct interest where borrowed money was used for earning income from a business or property. Lower courts had earlier denied the taxpayers their respective deductions.

The Supreme Court ruled that in the absence of evidence of a sham, window-dressing, or other similar circumstances, the courts could not question whether other "economic realities" served as motivation behind a subsequent transaction (Singleton), nor could they question the sufficiency of the income expected or received (Ludco).

6 – 13.2 Registered Retirement Savings Plans

Registered retirement savings plans (RRSPs) are registered plans in which individuals contribute savings or eligible investments for future use—typically, but not necessarily exclusively for retirement. Taxpayers can have several different RRSPs and invest each in a variety of eligible vehicles, such as guaranteed investment certificates (GICs) or mutual funds. Eligible RRSP contribution amounts reduce taxpayers' taxable income and thus save tax.

However, any RRSP withdrawal will trigger an income inclusion for that taxation year, regardless of whether some—or all—of the amount withdrawn is re-contributed to the plan later that year.

Earnings on the funds invested in an RRSP are not taxed as earned; rather they are taxed as withdrawn from the plan. This allows an investor to accumulate funds at a greater rate than if held in non-registered plans, as a portion of the earnings in an RRSP does not have to be used to pay income taxes each year. Taxpayers may be entitled to pay certain RRSP-related administrative or management fees outside of their plan. However, such fees are not tax-deductible.

Contributions in excess of $2,000 are assessed a penalty of one percent per month. Transitional rules apply in the unlikely event taxpayers still have excess contributions under the old limit of $8,000 that existed before February 27, 1995. The transitional rules stipulate that as RRSP contribution room becomes available after 1995, it must first be used to reduce the excess contribution balance to $2,000.

Taxpayers may deduct all or a portion of the excess balance in a subsequent year, provided the deduction amount is within their normal contribution limits for that year.

6 – 13.3 Registered Education Savings Plans

This is a good way of providing money for the elder's grandchildren on a deferred basis. It certainly should not be overlooked.

Thanks to recent changes, there is no longer an annual contribution limit for registered education savings plans (RESPs). Total contributions are, however, restricted to a maximum of $50,000 per child. Contributions to registered education savings plans (RESPs) are not tax deductible.

The income earned within this plan may be sheltered from tax for a maximum of 26 years. It is not taxable until used to finance post-secondary education costs, at which time it will be included in the recipient's income, presumably at a lower rate than that of the contributor.

Canada Education Saving Grants (CESGs) of up to a total of $7,200 are available. CESGs of twenty percent of contributions (to a maximum of $1,000 annually - if prior year contribution room is available) are available. Low income Canadians can also access money via the Canada Learning Bond.

Payments to beneficiaries of education assistance payments (EAPs) will only be allowed if they are full-time students enrolled in qualifying post-secondary educational programs. EAPs represent distributions contributions, accumulated income, Canada Education Savings Grants and Canada Learning Bonds. All contributions made to the RESP by the subscriber can be returned to that subscriber when the contract ends or at any time before, subject to the terms and conditions of the RESP. The returned contributions will not be taxable.

Taxpayers may change the named beneficiary or designate more than one subject to the plan issuer's restrictions (although beneficiaries must be named before the age of 21 with respect to plans submitted for registration after 1998). Should the taxpayer designate more than one beneficiary, each must be related to them. Under these so-called "family plans," one sibling's share may be paid to another sibling without attracting penalties. In other words, taxpayers can maximize contributions for two children, but one child can receive all the accumulated income if the other does not attend a post-secondary institution.

Contributions under a family RESP cannot be made for a beneficiary after they turn 21 years of age. Before 1998, RESP-earned income was lost if the beneficiary did not attend a post-secondary institution. Today however, the transfer of RESP income to the contributor is permitted if the RESP is at least 10 years old and none of the intended beneficiaries attend post-secondary institutions by the age of 21 (although both the 10 year and age 21 conditions are waived if the beneficiary is mentally impaired).

Under those conditions, up to $50,000 in RESP income may be transferred to a subscriber's RRSP, or spousal RRSP, provided he or she has the contribution room. Otherwise, RESP accumulated proceeds in excess of the original contributions will be included in the subscriber's income and a 20% charge will apply, in addition to regular taxes.

6 – 13.4 Overlooked Deductions and Credits

Elders and other taxpayers would be well advised to have a qualified professional prepare their personal income tax returns at least on a periodic basis to ensure that all available deductions and credits are taken when preparing their personal income tax returns.

Some of the deductions which may be overlooked include:

- Disability credit
- Medical expenses
- Capital portion of annuity payment
- Alimony and maintenance payments
- Legal expenses incurred in collecting alimony and maintenance payments in arrears
- Annual dues – Trade Union or Professional Association, except the portion levied for pension, annuities or insurance benefits
- Expenses incurred in objection and/or appealing an assessment of tax, interest, or penalties under the Act
- Moving expenses (move must bring taxpayer 40 KM or closer to place of employment, university, college, or post-secondary education institution)

- ❖ Childcare expenses. The child must be under age 15, or if over age 15, must be physically or mentally infirm. Must have been incurred to enable the taxpayer to earn taxable income. Required receipts

Net Income can be further reduced by deductions from:

- ❖ Loss carryovers from previous year as prescribed
- ❖ Capital gain from previous years as prescribed by carrying back allowable capital losses

6 – 14 A FREE TAX SERVICE FOR SENIORS

Service for Seniors allows seniors to file their tax returns for free using a touch-tone telephone. It only requires clients to identify themselves and answer a few "yes" or "no" questions.

Unlike the normal TELEFILE service, clients are not required to enter their income, deductions, or non-refundable tax credit amounts (spousal income may be required). Clients residing in Ontario may have to enter amounts in order to claim refundable provincial/territorial tax credits. During the assessment process, the client's income will be included automatically using Agency information. As well, the client will be allowed the basic personal amount, age amount and, if applicable, the disability amount. Clients do not have to prepare their return prior to using Service for Seniors.

The Notice of Assessment issued to the client will confirm the amount of OAS, CPP/QPP and/or net federal supplements included during assessment.

The client must be over age 65 and their only income must be from the OAS, CPP/QPP, or Net Federal Supplements; and taxable income must be below a specified threshold.

If a person is eligible to use TELEFILE he/she will receive a promotional sheet and an access code with their personal income tax package.

To use Service for Seniors, the client calls the existing TELEFILE service at 1-800-959-1110. Once the client enters their social insurance number and access code, the TELEFILE service will know that the client is eligible to use the service.

6 – 15 CONCLUSIONS

An elder’s tax situation after retirement will probably change. For example, some of their income could be non-taxable, such as the Guaranteed Income Supplement, Allowance, or Allowance for the Survivor benefits payable under the Old Age Security program. They may have to repay part of their Old Age Security pension if their income is high.

They may also begin receiving income that has no tax or not enough tax withheld. In this case, they may have to pay their taxes by instalments during the year.

Non-refundable tax credits reduce the amount of income tax that the elder owes. In addition to the regular non-refundable tax credits that are available to all individuals, they may also become eligible for the age amount and the pension income amount. If their income is lower after retirement, some benefits, like the Goods and Services Tax/Harmonized Sales Tax (GST/HST) credit, may also increase.

If they have a Registered Retirement Savings Plan (RRSP), it must mature by the end of the year that they turn 71. They can also get more information, get a copy of the RRSPs and Other Registered Plans for Retirement guide by calling 1 800 O-Canada.

Taxation can be a very in-depth topic. As an Elder Planning Counselor you are not expected to be an expert in this area, but a good overview of tax planning options that are available to the elder is helpful background information that may help you to provide assistance.

6 – 16 REFERENCES

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