Elder Planning Counselor Designation Program

DESK REFERENCE

Module 3 - Financial Issues
Twelfth Edition

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EPC ELDER PLANNING COUNSELOR®

Module 3 - Financial Issues

In this module, you will find the following chapters:

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Elder Planning Counselor Designation Program

Desk Reference Module 3 – Financial Issues

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Chapter 1

Social Security & Health Care

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1 - 1 KEY OBJECTIVE OF THIS CHAPTER

Approximately 40% 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, 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 Health Care 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 and middle-income elders (e.g., the Guaranteed Income Supplement, the Spousal and Survivor Allowance, and the new Canadian Dental Care Plan).

Canadians, age 65 and older, represent about 19% of the country's population, but they consume close to 50% of all publicly funded health care. Financial pressures on the health care system will worsen dramatically as the number of elder Canadians increases dramatically 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 2024 this figure had increased - by more than 60% - to 12.1% of Gross Domestic Product (or over 260 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. According to the Fraser Institute, between 1997 and 2023, the cost of public health care increased 4.2 times as fast as the cost of clothing, 2.1 times as fast as the cost of food, 1.8 times as fast as the cost of shelter, and 1.7 times as fast as the average income.

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 17.3% in 2022 according to Statista).

While Canadians have managed to contain spiraling 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 7.25 million people in Canada received the Old Age Security pension in 2024. According to Statistics Canada's data this represents over 95 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 $400 in 2024. 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 $145 billion in 2024 and represented more than a third of total 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 to age 70 (and in the process increase the benefit received) came into effect in 2013.
- ❖ In 2022, the Old Age Security (OAS) pension was permanently increased by 10% for seniors aged 75 and over.

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 7.25 million Canadians aged 65 and older with close to 80 billion dollars in benefits (2024).

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 the beginning of 2024, was $713 per month (age 65-74) and $785 per month (age 75 and over).

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

1- 3.5 Application

Most Canadians receive a notification regarding OAS after their 64th birthday and many are enrolled automatically. Canadians who are not notified and enrolled automatically may have to physically apply for benefits.

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.

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 / Pension Recovery Tax

High-income elders must repay some or all the Old Age Security benefits they receive. In the 2024 taxation year, this "claw back" began at a net income of $90,997.

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

An elder with $100,000 of 2024 net income would, for example, have been forced to repay 15% of the difference between $100,000 and 90,997 (or a total of $1,350.45).

Step one - $100,000 - $90,997 = $9,003

Step two – $9,003 x 0.15 = $1,350.45

In 2024, elders under age 75, with a net income of $148,065 or more will have all their Old Age Security benefits clawed back. In the case of elders age 75 and older, the full claw-back will kick in at a net income of $153,771.

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 over $180,000 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 2024 claw backs began as soon as net family income exceeded $34,863.

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.

There are over 100,000 Canadians who 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 - First Quarter 2024 (for illustrative purposes)

	Maximum Monthly GIS	**Maximum Monthly Combined OAS and GIS**
Single pensioner	$1,065.47	$1,778.81*
Married to non-pensioner (someone who does not receive OAS or the Spousal Allowance)	$1,065.47	$1,778.81*
Married to OAS pensioner or Spousal Allowance recipient	$641.35	$1,354.69*

* Plus $71.33 for elders age 75 and over.

Note that the monthly maximum Guaranteed Income Supplement is lower for individuals who have partners who are also receiving benefits ($641.35 versus $1,065.47). 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 ($1,778.81 for single recipients and $1,354.69 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 two notable exceptions: Old Age Security, Guaranteed Income Supplement and the Spousal and Survivor Allowance benefits are not included in the calculation of income; and employment income of less than $15,000 is given special treatment (the first $5,000 is exempt and the next $10,000 is included at 50 cents on the dollar). All other income (Canada Pension Plan benefits, private pension income, employment income (above $15,000), 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 initially reduced by $1 for each $2 of other monthly income (at higher income thresholds the reduction averages 59 cents for every dollar of income). If, for example, a single pensioner was receiving a monthly maximum GIS of $1,065.47 and he subsequently started earning $200 a month in additional other income, his monthly GIS payout would be reduced by $100 to $965.47. At a monthly income of $1,802 this pensioner would receive no GIS. 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 roughly $1 for every $4 of their other combined monthly income (the reduction increases at higher income thresholds). If both were receiving a monthly GIS payout of $500 and they started to earn a combined total of $400 in additional monthly income, then both parties would have their $500 payouts reduced by around $100.

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 roughly $1 for every $4 of combined monthly income (the reduction increases at higher income thresholds), 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 $4,094 (2024).

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	$1,065.47	$1,065.47	$641.35
$24	$1,064.47	$1,065.47	$641.35
$48	$1,063.47	$1,065.47	$640.35
$4,096	$852.47	$1,064.47	$555.35
$21,622	$0.43	$629.43	$144.59
$28,558	Nil	$485.43	$0.59
$51,838	Nil	$0.43	Nil

1 - 5 SPOUSAL AND SURVIVOR ALLOWANCE

The Spousal and Survivor Allowance is designed to recognize 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 (which can be done by filing in an income tax return). 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 (First Quarter 2024)

Spousal Allowance	$1,354.69
Survivor Allowance	$1,614.89

1- 5.3 Reductions in Allowance

In the case of a surviving spouse, the maximum monthly Survivor Allowance is reduced by roughly $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 roughly $1 for every $2 of additional monthly income.

For couples, the maximum monthly Spousal Allowance is also reduced by roughly $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 roughly $1 for every $4 of the couple's combined additional monthly income.

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

Annual "Other" Income	Spousal Allowance
Nil	$1,354.69
$48	$1,351.69
$4,096	$1,098.69
$20,000	$416.59
$30,000	$207.59
$39,982	$0.59

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	Automatic and 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 changes to Old Age Security:

1. 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.

2. 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 an 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)

A significant change to CPP (to be phased in over seven years) began in 2019. This change was designed to address the risk of a projected retirement income shortfall for many Canadians by providing higher benefits, which will be funded through higher contributions.

The higher benefits will come in the form of an increase to the maximum annual pension benefit as well as a new upper limit on pensionable earnings. The higher contributions will come in the form of a phased-in increase in contribution rates as well as a new, additional contribution rate on the increased upper limit portion.

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 New Enhanced Program

Starting in 2019, the Canada Pension Plan (CPP) has been gradually enhanced. This means that today's workers, the seniors of tomorrow, will have higher benefits and greater financial stability through a small increase in the amount they contribute to the CPP.

The CPP enhancement only affects those who worked and contributed to the CPP in 2019 or later.

The enhancement adds 2 additional components to the CPP. These components are not a separate benefit, but a 'top-up' to the base CPP.

The CPP now consists of:

- the base (or original CPP)
- the first additional component, which was phased in between 2019 and 2023, and
- the second additional component, which is being phased in between 2024 and 2025

The CPP enhancement will increase the amount working Canadians receive in the CPP retirement pension, post-retirement benefit, disability pension and survivor's pension. It will not affect eligibility for CPP benefits.

A similar enhancement to the QPP is also being implemented.

Up until 2019, the CPP retirement pension replaced **one quarter** (25%) of a worker's average work earnings. This average is based on earnings from employment or self-employment up to the maximum earnings limit in each year.

The enhancement means that the CPP will begin to grow to replace **one third** (33.33%) of the average work earnings received after 2019. The maximum limit of earnings protected by the CPP will also increase by 14% between 2024 and 2025.

A worker’s pension will increase based on how much and for how long they contributed to the enhanced CPP. The CPP enhancement will increase the maximum CPP retirement pension by more than 50% for those who make enhanced contributions for 40 years.

The enhancement also applies to the CPP post-retirement benefit. *It will be higher if a worker:*

- is receiving the CPP (or QPP) retirement pension, and
- continues to work and make CPP contributions in 2019 or later

The enhancement also increases the CPP disability pension starting in 2019. The increase a worker receives will depend on how much and for how long they contributed to the enhanced CPP.

The enhancement will also increase the CPP survivor's pension, starting in 2019. The increase will depend on how much and for how long the deceased spouse or common-law partner contributed to the enhanced CPP.

Everyone contributes to the CPP if they:

- are over the age of 18
- work in Canada (outside of Quebec), and
- earn more than $3,500 a year

Workers contribute on employment earnings between $3,500 and an annual earnings limit. This is adjusted each year based on changes in the average wage in Canada. In 2024, this limit was $68,500.

Before January 1, 2019, employees contributed 4.95% on these earnings to the CPP. Employers contributed an equal amount. Anyone who was self-employed, contributed both the employee and employer portions, which was equal to 9.9%.

The increase in the amount that employees and employers contribute is being phased in gradually over 7 years in 2 steps:

- Between 2019 and 2023, the contribution rate for employees was phased in by 1 percentage point (from 4.95% to 5.95%) on earnings between $3,500 and the original earnings limit.

- Starting in 2024, a second, higher earnings limit will be introduced. This will allow the CPP to protect a higher portion of earnings. This new limit, known as the year’s additional maximum pensionable earnings, will not replace the original limit, known as the year’s maximum pensionable earnings. Rather, it creates 2 different ranges of earnings that are protected by CPP: the **original range**, which goes to the original limit, and; an **additional range** for earnings **between** the original limit and the new one.

This additional range of earnings covered by the CPP will start at:

- ❖ the original earnings limit (projected to be $71,200 in 2025)

And go to:

- ❖ the new earnings limit which will be 14% higher in 2025 and after (projected to be $81,100 in 2025)

Like the original earnings limit, the new limit will increase each year to reflect wage growth.

This additional range will only affect workers in years when their annual earnings are above the original earnings limit.

Employers will pay the same increase in contributions as their employees (each will pay 5.95 on the original earnings limit and 4% on the additional range).

Self-employed workers will continue to contribute both the employee and employer portions. This means once the phase-in is complete, self-employed individuals will pay:

- ❖ a contribution rate of 11.9% on earnings in the original earnings limit, and
- ❖ 8% on the additional range (the difference between the original earnings limit and the new one)

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. As noted, the enhanced pension is designed to replace roughly 33% 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***

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 65^{th} birthday. For 2024 the maximum monthly CPP retirement benefit at age 65 is $1,364.60. 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.

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 2013, the maximum bonus moved to 42 per cent.

CPP benefit calculations also take into consideration "drop out years." The number of drop out years has been increased in recent years. In 2014, up to eight years of low earnings to be dropped out of the CPP benefit calculation.

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 someone under age 65 continues to work while also drawing a retirement pension, they 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 1-7 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

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 - 8 CPP DEATH BENEFIT

The CPP death benefit is a one-time lump-sum payment of $2,500 to the estate of a deceased CPP contributor.

The estate’s executor may apply for the funds (within 60 days), or it can also go to the surviving spouse or next of kin if there’s no estate.

For a deceased CPP contributor to qualify for the death benefit, they must have contributed to the Canada Pension Plan for the lesser of:

- ❖ 10 calendar years; or
- ❖ One-third of the calendar years in their contributory period.

1 - 9 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- 9.1 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.

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- 9.2 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 - 10 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
- ❖ The benefits for surviving children are substantially lower
- ❖ 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 - 11 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.

Despite broad public awareness that our society is aging, very little has been done by governments across the country to prepare for the marked aging that has already begun. This will create fiscal pressures, specifically the demand for greater spending on seniors-related programming coupled with a weakened ability to generate tax revenues. Statistics Canada estimates that from 2024 to 2063, the seniors' share of Canada's population will increase by roughly 33%. Similarly, unlike most of the period from the early 1970s through to 2010 (or so), labour force participation is now expected to decline. Indeed, expectations are that labour force participation will return to its pre-1970s level by mid-century. More specifically, from 2024 to 2063, Canada's labour force participation rate is expected to fall from about 65 percent to 61 percent.

This decline is akin to millions of fewer Canadians participating in the labour force. This decline in labour force participation will adversely affect growth in per-capita income. Per-capita income grew on average, by 1.3 percent between 1981 and 2024. However, expectations for the 2024 to 2045 period are that per-capita income will grow by only 0.9 percent, and almost the entirety of this decline in growth is expected to be due to lower labour force participation.

The lower rates of per-capita income growth will mean the economy in general will grow more slowly, making it harder for the government to collect revenues compared to its current capacity.

This slowdown in per-person income and economic growth more broadly comes at the same time that governments will face pressure for higher spending on a wide range of programs. Both health care spending and income transfer programs for seniors will increase substantially. Health care spending on a per-person basis is heavily skewed towards a person's first year of life (birth and related) and their retirement years (post 65). The average per-person government spending on health care for Canadians between the ages of 15 and 64 was roughly $3,000 in 2024. In the case of Canadians 65 years of age and older the cost is more than four times greater (over $12,000). The higher proportion of Canadians expected to be in the over-65 category means higher and higher health care costs.

In addition to increased health care spending, an aging population will also require governments to direct more resources to senior income transfer programs like Old Age Security (OAS) and the Guaranteed Income Supplement (GIS). Currently, spending on these programs costs about $80 billion. This cost is expected to increase by close to 40% in the next two decades.

Simply put, population aging will contribute to a large increase in future levels of government spending. When combined, projected government spending increases related to health care and Elderly Benefits are expected to increase by close to 100 billion dollars between now and 2045.

Depending on interest rate assumptions, the accumulation of debt over this period could be substantial. Debt could easily grow to between 170 percent and 250 percent of GDP. These rather worrying fiscal outcomes are not inevitable. Proactive steps can and should be undertaken to reform program spending and encourage stronger economic growth, both of which would mitigate the adverse effects from the aging of our population.

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

1 – 12 HEALTH CARE FOR CANADIAN ELDERS

1 - 12.1 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 - 13 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 recognizable 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 increase 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 “socialized 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 signaling 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, 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 centerpiece 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 hospitalization 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 1-8 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 $112.2 billion in 2004.
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 almost 50 billion in 2023-24 — an annual growth rate of close to five percent. This increase took place over a period of time when GDP growth was less than 3% annually.
2022	Introduction of the Canadian Dental Care Plan (CDCP). Phased in over 3 years, starting with children, then seniors, and then all lower to middle income Canadian families. The plan covers most dental services.
2024	Introduction of Pharmacare. The first phase of the program covers contraception and diabetes medications.

1 - 14 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 - 14.1 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 - 14.2 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 - 14.3 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 prices with the provincial governments regarding the various services they provide.

1 - 15 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 - 15.1 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 - 15.2 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 - 15.3 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 - 15.4 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 - 15.5 Criteria Five - Accessibility

Reasonable access to medically necessary hospitals 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 - 15.6 CHA Services Covered

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

1. 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 anesthetic 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.

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 childcare.

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 2024, Ottawa transferred about $90 billion in cash to the provincial and territorial governments. The three main provincial cash transfer programs are the Canada Health Transfer (close to $50 billion in 2024), the Canada Social Transfer (for child, post-secondary education and social programs) which cost roughly $17 billion, and Equalization (funds for those provinces with a weaker fiscal capacity) which cost just over $24 billion.

2. 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.

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 - 15.7 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 – 15.8 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 - 16 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.

1- 16.1 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 childcare. The CST is made up of both a cash transfer and tax transfer component.

1- 16.2 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 2023–24 six provinces received payments under this program, totaling $23.96 billion.

1- 16.3 Territorial Formula Financing (TFF)

Ensures that territorial governments can provide services to their residents, considering the higher costs in the North. In 2023-24, the three territories received payments totalling more than $4.8 billion.

1 – 17 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.

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.

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.

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 - 18 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.

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." 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 – 18.1 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 – 18.2 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 – 18.3 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 – 18.4 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 – 18.5 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 – 18.6 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 – 18.7 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 - 18.8 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.

1 – 18.9 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.

1 – 18.10 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 – 18.11 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 – 18.12 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 - 18.13 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 - 18.14 Doctor Shortages

While the ban on extra billing has not left physicians impoverished, it has clearly compromised their earning potential.

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 underfunding has been a significant shortage of doctors - particularly primary care general practitioners.

1 – 18.15 Cost Cutting

Funding for Canada’s health care system has changed significantly over the past 50 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 fueled 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.

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 - 19 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 – 19.1 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.

1-20 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- 20.1 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.

1-20.2 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- 20.3 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.

1-21 MEDICARE CONCLUSIONS

The pandemic has made health care, already a pressing issue, a top priority for policymakers in Canada. But in addition to COVID-19, two other phenomena may profoundly affect the financial sustainability of Canada’s health-care system in coming years—Canada’s aging population and the much higher per-person health-care costs for older Canadians than for younger Canadians.

Indeed, Canadians aged 65 and older accounted for roughly 19 per cent of Canada’s total population in 2024 and will account for roughly 25% per cent of the population in 2043.

Moreover, according to the available data, per-person spending on health care is substantially higher for Canadians aged 65 and older than for younger Canadians, with the disparity increasing as average age increases beyond 65 years. For example, per-person spending for the 80 plus age group was more than six times higher than for the under age 65 age group (according to the CIHI).

In fact, health-care spending on Canadians aged 65 and older accounted for 45.7 per cent of total health-care expenditures in 2019. Given the projected aging of the population, that percentage will rise to 71.4 per cent of total health-care expenditures in 2040.

And according to a new Fraser Institute study, the number of Canadians aged 65 and older will increase health-care spending by approximately 80 per cent between 2024 and 2043.

In other words, by 2043, absent policy change, around one-quarter of Canada's population will consume nearly three quarters of the government's (inflation-adjusted) health-care budget. This seems politically unsustainable, and inappropriate from a public health perspective. There's an urgent need for governments to implement policies that improve the efficiency of health-care services for seniors. The alternatives include either a dramatic increase in government spending on health care or a dramatic increase in rationing, which will mean longer wait times for care.

COVID will likely not alter this outlook in any significant way. While the pandemic's tragic death toll has been largely concentrated among seniors, especially those in care facilities, the death rate among Canadians in their 50s and 60s has thankfully been quite low. As a result, by 2043, the proportion of the population in their 70s and 80s will not have changed much.

Spending on medically necessary services, which comprise the single largest budget item for every provincial government in Canada, are affected by other factors besides the age distribution of the population including rising costs of health-care inputs such as new biologic pharmaceutical drugs (although the benefits of new drugs and other health-care innovations may well be worth the additional costs). But our aging population is a major factor.

Policymakers across the country, including in Ottawa, should understand today the likely scenarios of tomorrow, and craft policies with the health and wellbeing of all Canadians in mind.

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

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

During this 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 to optimize the power of investing in a shrinking time period.

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.

Optimizing tax efficiency of cash flow serves to reduce strain on rates of return, how much money to set aside and invest and take advantage of most government benefits that are net income tested.

And, as for the oldest elders, a tax-efficient legacy plan needs to be put in place if there is a desire to pass on as much of the estate that is not spent on the current generation for future generations and the causes elders hold dear.

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. Unfortunately, according to a recent 2023 RBC Financial Independence Poll, Canadians are well behind.

Table 2-1 2023 RBC Financial Independence Poll

Responses	All	Ages 55+
Retire comfortably	51%	54%
Achieve financial independence	34%	33%
Not knowledgeable about investing	48%	46%
Don’t have a financial plan	54%	50%
Haven’t connected with a financial advisor within the past year	71%	63%

The approach for accumulation of wealth during the working years and maintaining assets has evolved over the years. Some tactics are constant; others reflect the times and current environment.

2-3 WORK AND RETIREMENT

Retirement itself, what it means and what it entails, is also changing and evolving. Consider the following growing phenomenon of people working longer featured in Fortune Magazine in April 2024. “The new retirement is no retirement: Baby boomers are keeping their jobs well into their sixties and seventies because they “like going to work”.”

“Retirement to me is a scary thing. How much can you lay on the beach? I like being active and working. It gives me a sense of purpose, it’s what defines me. I may cut back; I don’t want to cut out, at least as long as I am healthy and able, and my spouse is okay too.”

This is particularly true of many college-educated baby boomers. They are continuing to work well past age 65 not because they can’t afford to retire, but simply because they love their work—and don’t want to give it up. In fact, the number of those who have continued to work past 65 has quadrupled since the 1980s, according to the Pew Research Center.

Now, almost 20% of Americans 65 and older are employed, nearly double the share of those who were working 35-40 years ago.

Canadian trends follow our American cousins. In a Globe and Mail article published early in 2024, "Don't blame the boomers for the economy – they put in more than they take", research found the following. In the last 20 years, average retirement age has increased by three years. Average retirement age is now 65 with self employed Canadians working until 68. Boomers continue to contribute more to the economy than any earlier generation. This is the generation who pressured governments some years back to eliminate mandatory retirement at age 65. Nearly one million Canadians were working at age 65 and older in 2022, representing 5% of the workforce. Considering that there are some 7.6 million Canadians age 65+, workers in this demographic represent over 13% of all seniors. *(StatsCan July 1, 2023)*

Be sure to include elders in the gig economy, those who work part-time for money and/or perks like golf marshals. Those income sources should be included in cash flow available to support lifestyle.

On the other hand, 21% of elders ages 65-74 worked in 2022, almost half (9%) by necessity. These figures did not vary much across levels of education, though the number that worked by choice was much higher for those with higher levels of education. *(Employment by choice and necessity among Canadian-born and immigrant seniors, Apr. 24, 2024)*

2-3.1 Planning To Work Longer Vs. Able To Do So

The 2019 RBC Myths & Retirement poll found that among working Canadians ages 50+, half plan to work in retirement but only 11% of retirees returned to work full time or part time. The same study found that while more than half (55%) of pre-retirees aged 50+ expect to know their retirement date more than one year in advance, retirees shared the following statistics. Only 39% of retirees aged 50+ knew this date and 16% had no advance notice at all.

20% of retirees had as little as one month or no notice before retiring. 65% had less than a year to plan the next 30-40 years of retirement. Are these realities and stress testers built into retirement plans in advance?

Recent studies have found that almost half of retirees left the workforce earlier than planned. Downsizing, layoffs, and negative working conditions were some of the reasons. People ages 55 plus spend an average of more than 13 months on unemployment. That's almost 5 months longer than younger people looking for jobs.

The biggest reasons for leaving the workforce early were health related; either the worker's or someone in the family. Working longer is not an option you can count on because staying on the job or getting another job is not a given. Almost two thirds of retired Canadians had less than a year to plan and adjust for what could be 30-40 years of retirement. *(Source: Retirement Myths and Realities Poll, 2017).*

As part of the retirement planning process, ask these questions:

Do your plans include provisions for leaving the workforce early? Do they factor in what could now be a longer retirement? If you leave the workforce because of health reasons, do your plans factor in what could also be a more expensive retirement?

2-3.2 Other Considerations

Before implementing any investment strategy, one should understand both the specific investment requirements, time horizons, priorities, risk tolerance levels and the psychological make-up of the investor. Most investors are savers. Investors willingly assume risk in exchange for the opportunity to increase returns on investments, while savers are more conservative and seek guarantees. Most savers, particularly elders, have an emotional, if not practical need for guaranteed interest rates and guaranteed preservation or return-of-principal. Retirement planning is not a one-size-fits-all approach.

While satisfying an emotional need to avoid risk and loss, eliminating risk places a disproportionate importance on the preservation of capital and relying on interest generating vehicles which historically and over the long term, generate lower rates of return. Few savers understand that the loss of purchasing power (inflation), not market risk, should be a major long-term concern and that very conservative interest-bearing investments require comparatively much higher amounts of capital to get to the same endpoint over longer periods of time. Hence, a key 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.

2-4 FINANCIAL PLANNING BASICS FOR RETIREMENT

Retirement involves new circumstances: reduced income, activated retirement funds, reduced discretionary income, and new or permanent 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:*

- ❖ Documenting and developing a retirement cashflow plan or budget
- ❖ Consolidating income sources and locations
- ❖ Resolving how to pay for care, including comparing the options for financing long term care costs and aging in place
- ❖ Making investment planning decisions
- ❖ Making estate and legacy planning decisions
- ❖ Addressing tax issues during retirement and at death
- ❖ Building in diversity of income generating assets

The good news for most elders is that it is rarely 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 to another community, another province or another country? Will the elder be selling their home? Do they want to age in place? What life goals does the elder plan to pursue? Any timelines? … 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 average life expectancy is increasing, older adults need to plan for a longer retirement. Elders 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 - 4.1 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:*

- Retirement planning is just for older people.
- Expenses will progressively and consistently go up during retirement.
- Retirement will only last for 10 -15 years.
- Government pension plans will cover most basic living expenses.
- Company pension payments will keep pace with inflation.
- Government health insurance plans will cover all medical expenses.
- There is plenty of time to start saving for retirement.
- Saving just a little bit will not help.
- I have an RRSP, stocks, mutual funds and some GICs, so yes, I have a retirement plan.

2-4.2 When To Start Retirement Planning

Retirement planning is relevant for everyone.

The definition of retirement is changing and even though it may seem like a long way off, work that to your advantage and with clients. By beginning your long-term savings/investing early, you will benefit from the following:

You may have to save less each month to reach the same target as someone who delays.

Your money will have more time to earn a larger amount of compounded returns.

Starting a plan and sticking to it are the hard parts, just like diets and exercise. Every little bit helps and makes it easier if people start early enough. Harness the power of compound interest, where planning and saving a little now on a regular basis can let money go to work, 24 hours a day, 7 days a week, for decades. Yes, your savings seem to grow slowly at first, and then starts to balloon as you get older, even if you put in the same amount of money. Every year someone delays before starting to save for the long term means they will need to save more money and perhaps take on more investment risk to reach their goals.

Table 2-2 How Starting To Save Early Means You Need To Save Less Each Month (Financial Consumer Agency of Canada, Jan. 17, 2024)

2-4.3 What Constitutes A Retirement Plan?

One of the statements some people have is this; "I have an RRSP, stocks, mutual funds and some GICs. So yes, I have a retirement plan."

All of these programs and investment products are important, but your investments and registered plans are not your retirement plan. They are some of the tools and product solutions that can help you implement your plan. You need to sit down with a retirement income planning specialist to write down a detailed plan that captures what it is you want to do specifically, when you want to do those things, what those experiences will actually look like, how long you want to do them and whether you want to do them no matter what. It becomes a personalized document that you use to pick the plans and products that will work best for each set of expenses, for each phase of life. Those products need to work together to help you live the life you want and provide contingencies when things go wrong. They also should help you leave the legacies that are important to you.

2-4.4 Do Income Needs Go Up Through Retirement?

Let's consider one myth of retirement that says retirement income progressively increases through retirement. Years of research conducted in Canada and the U.S., including StatsCan have found that this is not what people experience. While the cost of a number of items do increase regularly, they are more than offset by significant drops in expenditures elsewhere as people age.

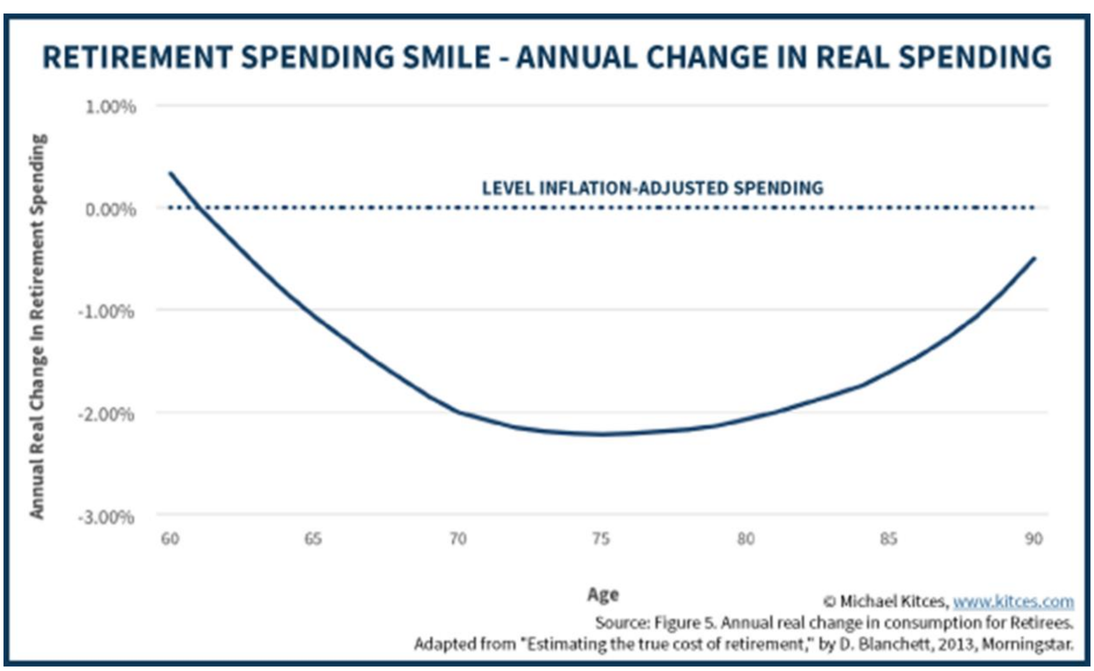
The bucket list has been completed with all those exotic and expensive trips; travelling is much more localized and relatively inexpensive; a couple is down to one car; the renovations have been finished; the balance of the mortgage is paid off. Late in life, some people will experience increased costs of living for assisted living, aging in place with support or long-term care.

A better way of looking at retirement is looking at the various phases of lifestyle that make up retirement.

The first phase is typified by doing all those things people have dreamed about and planned for during their working years. Travel, renovations to their home, experiences and physical activity like sports and hiking in far off lands. Entertainment and dining out with friends are fairly common. That may a decade or so and then peters off. You've see all the places you really want to visit; travel health coverage is getting so expensive; travel is becoming more challenging. Expenses go down on these bigger ticket items. Spending time with the grandkids and aging friends and family takes on more importance. Mobility issues start to crop up.

The reality is that annual real change in consumption for retirees follows what has been referred to as a smile pattern of consumption. This reality, gleaned from much research, should put a smile on people's faces who are saving for retirement and worried about overall increases in spending during retirement. Retirement financial goals are no longer as high, so out of reach and saving for retirement as part of retirement planning is more attainable for more people.

Table 2-3 Retirement Spending Smile – Annual Change in Real Spending



2-4.5 Will The Government Take Care Of Any And All Expenses?

At the risk of sounding nitpicky, governments don’t pay for anything. Working Canadians do. Taxpayers do. Taxes are directed to certain areas of need. Growing needs and rising costs means that there isn’t enough public money to go around. That reality is hitting retirees and will hit them harder as time goes on.

We hear a lot about cutbacks on services, whether it’s in a hospital or government health care. All expenses are not covered. Many caregivers as well as the sick and disabled learn that the hard way. You’re on the hook for those extras, like medications, home care and treatments that can make you well, keep you fit and preserve some dignity, control and independence.

Our rapidly aging society is backing governments into a corner where they are making tough decisions on health care. It seems that there are already too many older people to care for with existing programs and funding. Absolute costs are going up while services are being cut back.

The new national dental plan and pharmacare may provide some relief for elders, focused on lower income individuals and families, and for some but not all expenses.

2-4.6 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.

How much do people need for retirement?

The answer is not as simple as picking a number which in most cases is not related to income needs, but rather to what it will produce, a backwards approach.

The amount an elder needs varies with the following:

- your age when you retire
- Age when your spouse/partner retires
- your hobbies and avocations and spouse’s
- your travel plans and spouse’s
- if you'll continue to work indefinitely or for a certain number of years as part of “retirement”…and again, what about your spouse?
- if you'll have family members to support financially
- whether you’ll have debt to pay, such as a mortgage or a loan
- Where you want to live during your retirement
- Comparing your current spending with expected retirement spending

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

They fail for three reasons:

- ❖ Gaining financial independence requires sacrifice, planning, and commitment.
- ❖ Few investors have the knowledge or understanding to manage their assets effectively.
- ❖ Comparatively few have a comprehensive, documented plan.

2 – 5 THE FINANCIAL PLANNING PROCESS

Basic financial planning involves eight simple steps or stages.

2 - 5.1 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. They also want to age in place. This desire has dramatically increased with people’s knowledge and experience of nursing homes and long term care during the Covid-19 pandemic.

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

Many families have a goal of protecting the financial security of the healthier spouse/common law partner. This means providing enough money to pay for a place to live, daily living expenses, and any assisted living or 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 a legacy 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;…nor should they. And legacies are more than just money. They include assets, treasured items, income streams and values.

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.

2-5.2 Goal setting approach

Keep in mind that different perceptions of goals and their priorities and significance 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 specific, measurable, achievable, realistic and time bound (SMART). Effective strategies do three things:

1. They move the elder toward the goal and provide motivation and incentive.
2. They define the goal as well as establish a period to reach it.
3. They are rooted in the elder's current financial position. If an elder feels that the goal relates to their situation, they are more likely to act on i.t

2-5.3 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, segregated 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 Lines of Credit
- 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 2-4 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		

An important point to make is that advisors should look beyond traditional investments and include all household assets in retirement plans and retirement income plans. The joint objective of the advisor working with the client should be to generate a safe (including guaranteed base), foundation that offers protection against inflation, especially if the client has no company defined benefit pension plan. Then couple that with government pension benefits which are indexed to inflation. This should provide cash flow to cover essential expenses throughout retirement. Investable assets and leveraging others like a home, can then be used to generate cash flow to cover lifestyle, discretionary expenses, and fund other financial goals.

2 - 5.4 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 and doing so prior to considering any tax advantaged investment opportunities depending on the comfort and reliability of doing better, after tax by investing vs. paying down non-deductible debt.

2 - 5.5 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
- ❖ Tax Free Savings Accounts (TFSA)
- ❖ Tax preferred non-registered investments

Here’s something for advisors to think about in their dealings with clients.

46% of investors have not had their financial advisor discuss the impact of taxes on their investment returns. *(Source: Canadian NGAM Survey, April 2017)*

6 out of 10 investors would fire their advisor in favour of one who could do a better job of advising them of the tax impact on their investment portfolio. *(Source: CIBC Annual Financial Priorities Poll, 2022)*

2 - 5.6 Step Five - Retirement Planning

This step focuses on the importance of saving for financial independence.

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

2 - 5.7 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 - 5.8 Step Seven - Implement the Plan

The plan is an exercise in futility if it is not carried out. The planner/advisor guides the client with preferred recommendations that align with the client's goals, risk tolerance, personal situation, and preferences, explaining the benefits and drawbacks of implementing vs. not moving forward. Part of that role is to assemble a package, where the components support each other and the overall objectives and ensuring the plan has alternatives when components don't.

2 - 5.9 Step Eight - Monitor the Plan and Reassess

Periodically review the plans, progress, solutions, and strategies to ensure that they all continue to work together effectively to meet the plan goals. Legislation, tax rules, the economy, markets, family dynamics, relationships and employment income are constantly in a state of flux.

The plan needs monitoring, so timely adjustments can be made to reflect current goals, priorities and situations and keep the plan on track. This is the reason why the plan should be reviewed on a regular basis and stress tested to see how well everything hangs together.

2-5.10 Planning Assumptions

Projections revolve around basic assumptions made regarding such things as rates of return, inflation. A key consideration is the reasonableness of these factors.

Each year FP Standards Council Canada and Institut de planification financière (IQPF) publish the Projection Assumption Guidelines for their members. Non-members are encouraged to follow the same set of guidelines. These organizations are responsible for maintenance and annual updates. Members may be called upon to defend the assumptions they use by clients, other professionals and the organizations. The assumptions are intended to be used for projections of 10 years or more.

As noted by "The use of the Projection Assumption Guidelines is strongly encouraged to promote trust and confidence in the financial planner's projections, given the Guidelines' objectivity and basis in reliable sources. The financial projections are positioned serve as a guide and to be free from the potential biases of financial planners.

Table 2-5 Financial Assumptions (Before Any Administrative And Investment Management Fees) For 2024

Assumption	Rate Percentage
Borrowing rate	4.4
Inflation rate	2.1
YMPE or MPE growth rate	3.1(inflation +1%)
Short-term	2.4
Fixed income	3.4
Canadian equities	6.4
Foreign developed market equities	6.5
Emerging market equities	8.3

Note that the administrative and investment management fees paid by clients both for products and advice must be subtracted to obtain the net return.

2 – 6 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 for some, increase costs for workers and increase benefits, more for some than others. Funding for healthcare and long-term care is being frozen, increased very modestly or slashed. Pricey defined benefit pension plans from the employer's perspective where they assume the risk for lifetime income, are giving way to less costly and less risky (for the employer) defined contribution plans. This has resulted in a shift from the employer taking the risk for generating lifetime income to the employee taking on that risk and responsibility.

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!

A LIMRA survey released findings from a poll targeting retirees and employees ages 40-85 in January 2024. It found that 69% of Canadian worker are confident they are saving enough. For Despite widespread knowledge about the need to save early and often for retirement, Canadians are not taking the necessary action to secure their future or enough action to do so. The same survey found that 91% of Canadian workers are saving for retirement.

Why do they feel this way? BMO Survey results from early 2024 found that on average, Canadians believe they need $1.7 million for retirement. There are gender differences. Men say they need $2 million, and women say they need $1.3 million. Where do the numbers come from? Who knows. There appears to be little science or math to support this and unfortunately, many financial advisors are as ill informed as their clients on how much to save.

A similar survey conducted by MacKenzie Investments in 2021 found that working Canadians said they needed to save $697,000, on average, before they reach retirement, compared to the $327,000, on average, saved by retired Canadians. That is almost a tripling of the target number in three years! And while you might think that the pandemic was a big influencer, the survey also found 69% of all respondents said the coronavirus pandemic had no impact on their retirement. One third said they saved more during the pandemic.

The fact of the matter is that they really don't know. And advisors tend to take the wrong approach, discounting other assets that could generate income and government benefits.

The real issue is that the focus is on the asset side, not the income side. The focus should be on figuring out how much income you need for each phase of retirement to cover the basics and needs and how much more to support the lifestyle you want.

2 – 6.1 Retirement Savings

Canadians reported $54.2 billion in RRSP contributions according to a StatsCan report released in April 2024. The median contribution was $3,910 in 2022, the last year reported. That median number is far below maximum limits and simply adds to the unused contribution room.

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 and are not knowledgeable about options that can provide theme with guaranteed lifetime income like in a defined benefit pension plan. In 2022, 6.7 million Canadians of normal retirement age were members of a registered retirement pension plan, a number that is predicted to fall as retirees pass away and new retirees join the ranks who do not have one.

The good news is that about 6 in ten Canadians ages 18-54 plan on contributing to an RRSP in 2024. This is offset by the finding that only one in five plan on contributing the maximum amount.

Only 12% cannot afford to make an RRSP contribution with 10% planning on investing in something else, with the majority opting for a TFSA (Tax Free Savings Account) or FHSA (First Home Savings Account). *(Edward Jones Survey, Jan. 2024).* Total registered retirement savings plan contributions have fallen across Canada, except in the Yukon. *(Registered retirement savings plan contributions, 2022, Stats Canada)*

Canadians have left more than $600 billion in unused RRSP contribution room on the table. The average amount held in an RRSP is $144,613. When looking only at households age 65+, the amount, including RRIFs, falls to $283,000. *(BMO Retirement Survey, 2022)*

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. The HOOPP and Abacus data Survey, 2023 reported that 44% of non-retired Canadians ages 55-64 have less than $5,000 in savings and 1 in 5 of those haven't set aside anything for retirement.

A growing number of individuals who are nearing traditional retirement age report having more debt than they do savings. It looks as if the scourge of elder poverty is on the verge of a comeback in Canada.

The average age of retirement is 65.1. Self employed Canadians have an average retirement age of 68. Women on average retire about 18 months earlier (64.2), with those that are self employed retiring at 66.9 on average.

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, many 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 – 6.2 Sufficient Retirement Assets – 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). 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 – 6.3 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). The plan is to downsize, perhaps combined with moving to a place where housing is cheaper and spending the difference. Unfortunately, that may mean moving far from family, friends and the familiar. The surplus generated by the move may be insufficient and further eroded by moving costs.

One planning tactic that may work is relying on the principal residence to fund assisted living or long term care or using a reverse mortgage or HELOC to provide funds to support lifestyle needs late in life.

2-6.4 Secondary Suite Lending Program

A more recent opportunity was unveiled in the Federal Budget 2024 for aging homeowners. A secondary suite lending program has been proposed. Up to $40,000 in low interest loans would be available to convert existing "vacant" space into rental units. This would allow elder homeowners to age in place, optimize space they are not using and generate rental income by offering rental units to the many people seeking accommodation. This can be combined with up to $7,500 for new secondary suites for a senior or adult with a disability and the opportunity for homeowners to be able to refinance insured mortgages to access home equity so that they can convert part of their home into a rental suite.

2 – 6.5 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. The challenge with all these figures is that Canadians in general have no documented retirement plan to guide them and have not gone through the exercise of figuring out how much they need for basic expenses and to support the lifestyle they want during the various phases of retirement.

2 – 6.6 CPP and OAS

Although sustainability of the government's public pension system is a concern expressed by surveyed Canadians, most say (68%) they are concerned that federal and provincial retirement benefits will not provide a sufficient 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!

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.

A big benefit of government pension benefits like CPP/QPP, OAS and GIS, is that these programs are indexed to inflation. The income value of these programs goes up with time and can assist with fixed income needs and cashflows. Most employer pensions in the private sector do not offer inflation protection as they are not indexed.

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 – 6.7 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 comparatively conservative definition of an adequate retirement income; they define it as being able to maintain 65% of pre-retirement consumption.

Although McKinsey identified "inadequate savings" as the principal reason for retirement funding shortfalls, there are a variety of underlying causes. Marital breakdowns, 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 setbacks 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.

2-6.8 Focus On The Large, Low-Hanging Fruit

Pinching pennies will not balance the books – it is the big ticket items that matter. Pay off that mortgage, taking a big chunk out of cash flow needs during retirement. Selling a vacation property (even to the kids) 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, first-class holiday trips annually and expensive club memberships if those things simply are not sustainable throughout the bulk of retirement.

Many people are reluctant to cut back even when 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 day, the retirement goal in terms of necessary assets and income sources gets harder to fill.

2-6.9 Deferring Retirement: Six Benefits

Every year that a person continues working and postpones retirement, a handful of things happen. First, the shortened retirement time horizon reduces the funding requirement. Second, one’s investment portfolio grows without the burden of withdrawals. Third, the investment has one more year to recover from any downturns. Fourth, the elder is living off their earnings, not their savings. Fifth, additional monies can be invested for retirement. Sixth, each year you defer taking government pension plans, the amount you begin to get increases and indexing is on that starting point figure. Deferral cannot occur beyond age 70 under current legislation.

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 – 7 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, investment advisors and insurance agents, all 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. One initial barrier is conflicting priorities. While retirement is a leading concern for most Canadians, many cited difficulties balancing such long-term needs with other, often more immediate financial priorities.

2 – 7.1 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. Have things changed over this time?

The 2023 Natixis Global Survey of Individual Investors found that 68% of respondents around the globe are confident with their outlook on their finances. 22% feel they are stressed and only 3% expressed failure. Investors are beginning to realize the true value of professional advice and set specific service expectations for their advisor given the complexities and volatility in the investment space.

Many Canadians believe that OAS and CPP/QPP will not meet their retirement needs. And the majority of 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 – 7.2 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.

Almost nine in ten Canadians polled by LIMRA in a report released in January 2024, who had a formal, written retirement plan are "very" or "somewhat" confident they are saving enough. That figure drops to just under six in ten who have no retirement plan. Planning helps individuals feel more secure about their retirement.

This is supported by other studies on opinions about the value of the advice and service clients have 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. Of course, having a plan does not mean people are saving enough for retirement, but it is a start.

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 – 7.3 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 Canadians, 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. These priorities conflict with each other, as non-deductible debt places a strain on savings and retirement income. The most common reason for not being able to save for retirement is that other financial priorities get in the way.

There are any number of reasons why people don't save money or dip into their long term savings before retirement. Among them are the cost of living and monthly expenses, including rent, mortgages and car loans, lifestyle creep, shopping too much, instant gratification, not thinking ahead and it's simply not a priority. One major factor preventing Canadians from saving is that they are using disposable income to pay down debt. (*14 Reasons Why It's So Hard to Save Money Today; Anna Davies, August 23, 2022)* Many Canadians are finding themselves caught between the struggle to save money and repay their debts, says a survey from TD Bank. Over half of the survey respondents said it was very hard or even impossible to save, due to a 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. The majority of Canadians (57%) say they are more concerned with meeting their current needs instead of saving for their future. They prefer short-term liquidity and stable returns, indicating a focus on the near term over the long-term accumulation of wealth or retirement *(Maru Public Opinion online survey, February 2024)*

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 does beg the questions; how much risk are they taking? How much money are they putting away regularly? How long will they let that money work for them. Rate of return is but one of the three variables needed to grow money.

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 – 7.4 The Communications Barrier

Financial institutions and advisors 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.

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. Recall the 2023 RBC Financial Independence Poll that found on average, 71% of Canadians had not spoken with a financial advisor in the last year. The figure was 63% for elders, those presumably with the greatest need for assistance given their proximity to retirement and their expressed anxieties.

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 segment 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 - 7.5 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. Two thirds of Canadians do not know anything about annuities or segregated funds or understand how they work and where they apply. This knowledge gap is matched by their aversion to these products. The 2021 Retirement Readiness survey found that 1/5 Canadians nearing retirement who have more than $100,000 in investable assets expect to outlive their savings by 10 years. Guaranteed lifetime income products can play a big role in dealing with this, if only financial literacy was improved for clients and advisors.

For comparatively low risk products such as annuities and segregated funds, with their guarantees, 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 product's 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 – 7.6 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. A number then decide to be do-it-yourselfers.

Let's look on the flip side. When asked who they trust when making financial decisions, investors say they place the same level of trust in their financial advisor as they do in themselves, 91%! That ranks ahead of family at 74%, close friends at 62%, banks at 57% and financial media at 48%. Less than 1 in 5 trust social media for financial advice. And that includes Millennials. *(2023 Natixis Global Survey of Individual Investors).* A telling sign is that the particularly high ranking on an investor's advisor is much higher than for planners in general. This emphasizes the importance of establishing trust over the long term.

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 really 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 leverage 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 - 7.7 The" Do-it-yourself" Barrier

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. 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 for advisors and investors alike.

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 - 7.8 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. Convince more advisors to take not just a planning approach, but a holistic planning approach that goes beyond the numbers. 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 and other 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.

A key part of the advisor’s role is to serve as the catalyst for conversation. Strip away the confusion and get all concerned parties to focus on key benefits. They should engage customers in conversations about what is important to them about approaching milestones like retirement, going it alone because of divorce or death, what’s involved, how can they adapt to new lifestyles effectively and efficiently.

Help them redefine who they are and reinvent or reengineer themselves. Ensure funds and plans are in place to support that and protect them. Ensure that clients make informed decisions.

2 – 8 PLANNING FACTORS

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

Rather than fixate on a single number, indexed by inflation, it's very helpful to compartmentalize retirement into its various phases, setting an income or cash flow target for each one. Be sure to identify whether the cash flow figure is spendable dollars or before taxes.

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 - 8.1 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 - 8.2 Interest Rates

Interest rates represent one of the most important factors 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.

The challenge is that most people, including advisors, don't define what definition of interest rate is actually being used. Is it gross, after expenses, after taxes, achievable, sustainable, risk adjusted? Without knowing that, it is impossible and improper to compare rates between products or competitors. Ensure that a rate of return is documented and defined in a retirement plan and then periodically reviewed for sustainability and appropriateness.

2 - 8.3 Inflation

Inflation has become more than a minor irritant. The concern over reduced buying power over time is something that elders worry about as they think about fixed incomes over decades of retirement. 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 - 8.4 Income Tax Laws

Changes in income tax laws have made a number of financial plans and solutions unworkable, inappropriate, invalid or necessitated major changes in strategy. As with the other factors discussed above, they must be closely monitored.

2 - 8.5 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?
- What is the expected future income flow?
- Can the elder save money?
- What, if any, family obligations exist?

2 – 9 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 - 9.1 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. As a result, 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 available capital and time horizon 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 -9.2 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. Equally unfortunate is that upwards of 80% of widows leave their family advisor within 12-18 months following the death of their husbands. Why? The advisor had not worked to involve the woman or actively nurture that relationship while the husband was alive. The same experience holds for adult children inheriting from their parents.

The Financial Comfort Zone Study, 2018, found that women tend to invest less and participate less in company sponsored pension programs. Compared to men, they feel less confident and more risk averse regarding investing. Not surprisingly, they may be more conservative investors. They are generally less prepared for retirement - and must often live on significantly reduced pension and other benefits down the road because of lower paying jobs, time taken out of the workplace to provide care for children and parents or find themselves suddenly single due to divorce or the death of their partner. On the flip side, they are more open to seeking advice and once a plan is put together, more likely to stick with it. Advisors could be doing a better job of helping women, in particular to better understand their financial picture to address uncertainty, discomfort and anxiety about the financial aspects of retirement.

A longer life span means women should be investing more, to meet their needs post-retirement. Working with advisors can help with the emotions around retirement and financial planning.

A big win for advisors is that properly done over time, builds trust and better assures the acquisition and retention of assets as women inherit from their parents and spouses/common law partners. As a closing thought, consider the University of Toronto Journal on the Evolution of Gender Patterns in Retirement Saving in Canada, 2022, which found that women in the top and middle of income distribution are 33% more likely to always contribute to a RRSP in a five-year period relative to men. In addition, continuous participation in a registered pension plan rose for women over a five-year period and has declined for men.

2 – 10 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 - 10.1 Presenting Risk and Realistic Returns

Investors may be missing the importance of and reference to a documented plan when it comes to risk given that only 11% define risk in terms of failing to meet their financial goals. An advisor can play an instrumental role in helping to set up a plan, stress test it periodically and point out the significance of missing out on milestones and objectives. They can add context and perspective to conversations about risk and reward.

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. One risk issue of 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 market meltdowns of 1987, 2000, 2008, 2018 and the roller coaster ride brought on by the COVID-19 pandemic in 2020-2023. Elders who had already retired, or those who planned on retiring during these periods, faced ongoing challenges in replacing lost earnings and assets. This is where products with guarantees and downside protection built into their fund manager’s style and mandate can play a large role, even if fees may be higher, though the spread has shrunk considerably.

However, market risk is in fact, not the only 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)
- ❖ Asset allocation has variable risks. Each asset class has different risks and potential return opportunities with the result that the combination and actual underlying investments will perform differently over time.
- ❖ 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. Market behaviour over the last few years has challenged long held beliefs and experiences around stock performance on its own and on the historic negative correlation between stock performance and bond performance. Investors have seen both drop and experience volatility in recent years.

One thing that came out of the recent global survey of investors is that over a quarter (26%) define risk as asset exposure to volatility, ranking higher than losing money and twice as high (13%) as underperforming the market or missing out on an opportunity (10%).

2 - 10.2 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).

Table 2-6 Real Rates 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 2-7 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 - 10.3 The Correlation between Time and Risk

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

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 - 10.4 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 hazier when it comes to the question "how much will this cost?" Followed by "and how long will it take?" And finally saying; "you've got to be kidding!"

Working with investors to meet their long-term investment objectives is simplified when the advisor and client understand 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 - 10.5 The Cost of Procrastination

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

2 - 10.6 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- 8 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 2-9 Example of Compounding and The Difference Between Interest Earnings Using $100,000 and length of investment period

Initial Investment	Scenario 1	Scenario 2	Scenario 3
$100,000	100,000	100,000	100,000
Starting year	one	one	five
Years of growth	20 years	20	10 years
Rate of return (ROR)	5%	7%	9%
Future value	$265,330	$386,968	$196,715
Difference from scenario 1		+$121,638	-$68,615
Advantage/loss		+45.84%	-26%
observations	A 200 bp or 2% increased ROR increases the result by almost 46% just after 10 years		
	Waiting 10 years and earning 50% higher ROR, still results in a 26% shortfall, while taking on a lot more risk		

Longer periods produce results that are even more dramatic. Starting earlier and keeping the money invested can generate a higher nest egg with arguably less risk and certainly with a lower rate of return.

2 - 10.7 Dollar Cost Averaging

Some people feel that they cannot produce large lump sums to invest and optimize contributions to RRSPs and TFSAs. Others find themselves on a budget and prefer to work this way. Many are concerned about timing the market, trying to figure out the best time to invest. Systematic, monthly deposits into plans can actually prove advantageous.

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 2-10 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 - 10.8 Measuring Investment Results

An elder client states that they are doing well with their blue-chip growth mutual fund. They state that last year they received a total return of 8%. How are they doing? On the surface, an 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 they feel about the investment? It had a good return, but most of the similar funds performed better.

Performance can only be evaluated if there is some context. Comparing results to other similar finds or to market indices or better yet to a target goal that is documented in a retirement plan is the only sure way of distinguishing good performance from bad.

The best way of measuring results should be comparing actual results vs. targeted performance.

In the previous example, if the client's plan called for a 6% return on a regular basis, then earning 8% is doing well in exchange for the amount of risk taken, the elder's risk tolerance and the particular investments chosen. What if some of the people who earned 12.5% had lost 5% the year before and were trying to get back to a 6% overall return? What if they actually were expecting to get 14%? The investment underperformed.

Here are some key considerations when looking at rates of return.

- ❖ What does the plan say in terms of target rate of return over time?
- ❖ Is this gross rate of return (ROR), net ROR, after tax ROR?
- ❖ Each response would be different as each calculation would be different. Was the ROR defined not just in terms of a number, but what that number represented?

Remember, most people don't have a plan. Those that do, often don't include a target rate of return. Fewer still, define what that means.

2 - 10.9 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 2–11 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 by Natixis followed up in 2021 found that almost half of investors reported that their financial advisor had not discussed the tax impact on returns. That makes effective planning and dealing with rates of return and performance problematic.

2 - 10.10 The Importance of Diversification and Asset Allocation

The components of successful investing include the following: 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 can be.
If you have a longer-term time horizon, say 30 years or more until retirement, investing a higher proportion of your monies into equities/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 in the few years preceding and following retirement could put a serious damper on your retirement income streams for the long term. As you get closer to retirement, your risk tolerance usually decreases or should decrease, if only to address sequence of returns risk. 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 or even long term high performance with lots of volatility. 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. 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. Another term for this is product diversification.

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, war or pandemic. 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 and every financial problem that can have a massive impact.

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, segregated 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.

These 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 fund, 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 funds, 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 – 10.11 Asset Allocation Strategies

As noted above, asset allocation is the practice of dividing resources among different categories such as stocks, bonds, 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 – 10.12 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 – 10.13 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 80% 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. or a widow(er) with children receiving a lump-sum settlement from their spouse'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 invested (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 – 10.14 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 – 10.15 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 advisor when selecting a portfolio manager, that they are interested only in defensively selected investments.

2 – 11 INVESTMENT VEHICLES - STOCKS

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

- Over the long term, equities have outperformed other types of investments like bonds, dividends, and high yielding term deposits. Common stock returns should outperform inflation over time and produce a net positive rate-of-return over the long-term. That has proven difficult over the last few years.

- Allocating assets to common stocks and fixed income securities, rather than designing a non diversified portfolio of 100% stocks or 100% bonds, reduces investment risk. Portfolio diversification that includes both stocks and bonds tend to produce a more consistent, less volatile long-term total return. Determining equity (asset) allocation and the investment risk parameters is certainly more complex. Selecting individual stocks is a sophisticated, demanding, precise, and a micro decision-making process. Engaging the services and expertise of trained professionals can make this easier, more reliable and more efficient.

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 – 11.1 Stock Selection Using a Four-Step Decision-Making Procedure

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

From a financial advisor's perspective, when recommending stocks or equities, 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 equity dominant funds are appropriate for the client? Money managers define their specific investment philosophy and management style in their investment policy statements.

2 - 11.2 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 objective 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 – 11.3 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. Generally, the same percentage of allowable losses are deductible against taxable capital gains. Proposed legislation aims to increase the inclusion rate for individuals to 2/3 for capital gains exceeding $250,000.

2 – 11.4 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 who are purchasing funds, using an asset and fund managers is prudent.

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 a 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 – 12 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 - 12.1 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, which 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 – 13 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.

2 - 14 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 - 14.1 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 holding units of the fund on declaration day without taxation at the fund level for mutual fund trust structures. 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 - 14.2 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 2019, IFIC reported that there were approximately 140 fund management companies in Canada sponsoring close to 4,000 mutual funds to individual and corporate investors through their network of dealer firms.
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.

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 investment company receives the order.

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 2-12 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 -13 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 2-14 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 - 14.3 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 outperformed 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 or segregated funds.

2 – 15 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.

2-15.1 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

2-15.2 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 and may not align with investor risk tolerance or comfort with volatility.
- Non-registered funds must generally pass through the estate on the death of the unitholder. Income tax on realized capital gains may be deferred if they are passed to a surviving spouse.

2 – 16 SEGREGATED FUNDS

These funds are sometimes referred to as the Insurance Industry’s version of Mutual Funds. They were launched in 1961 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 when compared to mutual funds. 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.

Investment income retains its character when allocated to unitholders. That is to say, interest, dividends and capital gains generated are allocated as such.

Keeping track of investments in segregated funds is easier than with mutual funds, with tracking and reporting done by the insurance company. The method used is described in the Information folder. Reporting is arguably easier and simpler 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 - 16.1 Guarantees

Segregated funds operate under the Insurance Act and as such offer a basic guarantee of 75% return of deposits paid at death or the maturity date, provided the maturity date chosen is at least 10-15 years after the purchase date, depending on the contract.

A guarantee of 100% is the norm at death; some companies even offer a 100% guarantee at maturity. Many segregated funds also offer resets on those guarantees, periodically locking in market value gains and basing the death benefit guarantees on the new higher market value. That amount will not go down, regardless of market performance so long as money stays in the plan. Reductions in guarantees occur if monies are withdrawn.

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 - 16.2 Creditor Protection and Control

All provinces and jurisdictions provide protection against creditors for money while in a pension plan or when transferred out to a personal locked-in or prescribed plan such as a locked-in retirement account (LIRA) or life income fund (LIF). Please note that assets transferred from a Quebec regulated pension plan to a LIRA or a LIF are generally creditor protected. Creditor protection may not be available if assets are transferred from certain Quebec government pension plans to a LIRA or a LIF. The same applies where assets are transferred from a federally regulated pension plan to a locked-in RRSP, a restricted locked-in RRSP, a LIF, or a restricted LIF.

Assets that are otherwise creditor protected may be seizable if there is a court order to that effect. Consider for example, support payments to a former spouse/common law partner or family maintenance obligations.

Non-registered 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. Dependency relief claims may not be frustrated either.

Investors may have concerns over control or have tax motivated 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 - 16.3 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. In fact, segregated funds may be used to directly fund a life insurance trust, bypassing probate and estate settlement costs and delays. 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 - 16.4 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.

2-16.5 Myths and Realities

Segregated funds have been misunderstood by many Canadians and financial advisors. Unfortunately for many, these misunderstandings have kept some investors and advisors away from exploring what they are, and where they fit. A world with aging Canadians and lots of volatility and turbulence offers a great opportunity to learn more about these funds and show investors how they can protect their investments.

Given the importance of incorporating deeper and more holistic approaches to building a risk conscious investment portfolio, segregated funds can play a key role as a building block in an overall portfolio and retirement plan.

The extra fees if only marginally more than comparable mutual funds in a number of cases is due to the various guarantees these funds offer and estate planning benefits, which for a number of investors, is well worth the difference.

2 – 17 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. Non-registered investments may benefit from tax preferred treatment on dividend income and realized capital gains.

The following material examines registered vehicles designed for saving and investing of particular interest to elders and provides some guidelines and considerations.

2 – 17.1 Registered Retirement Savings Plans (RRSPs)

RRSP is an initialism 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 – 17.2 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 incorrect.

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 – 17.3 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 for individuals
- My CRA mobile app
- Tax information Phone Service (TIPS)
- the "Available contribution room for the current year's 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).

The Canadian government will allow people to contribute 18% of their yearly earned income for the previous year up to a maximum amount set each year. That amount is indexed each year.

The Canada Revenue Agency (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 - 17.4 Types of Accounts

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 spouse or common law partner, called a spousal contributor, to contribute to an RRSP in their spouse's name. In this case, it is the recipient spouse, not the contributor, 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 your spouse withdraws money from spousal RRSP in the year you made a contribution to their plan or in the two preceding tax years, 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 tax deductible 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. An additional benefit is the potential ability to take the plan with you when you leave the employer.

Pooled Registered Pension Plans

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 in the Yukon, NWT or Nunavut or live in a province that has the required provincial standards legislation in place.
It is a retirement savings option for individuals, including self-employed individuals who work in a federally regulated business or industry for an employer who chooses to participate in a PRPP. It allows members to benefit from lower administration costs that result from pooling and hence participating in a large, pooled pension plan. It's also portable, so it moves with its members from job to job. An account holder can cash out an amount from an PRPP at any age. However, any amount withdrawn qualifies as taxable income and is therefore subject to withholding tax.

2 – 17.5 Withdrawals from an RRSP or PRPP

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 – 17.6 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), Registered

Disability Savings Plan (RDSP), 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, 2024, Canadian residents, age 18 and older, can contribute up to $7,000 annually to a TFSA. 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 $95,000 as of 2024.
- 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. (Note that US holdings may be subject to U.S. withholding tax with no offsetting foreign tax credit against Canadian income.)
- 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 without requiring additional contribution room. Re-contributing to 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, segregated funds, securities, 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 – 17.8 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.

- ❖ Registered retirement savings plans (RRSPs), registered retirement income funds (RRIFs), deferred profit sharing plans (DPSPs) and registered disability savings plans (RDSPs) may receive federal creditor protection in the event of bankruptcy only (except for contributions made in the previous 12 months). A TFSA doesn't benefit from federal bankruptcy protection. This means that in the event of bankruptcy, you would have to surrender this account for the general benefit of your creditors. Your trustee in bankruptcy may recommend that you file a consumer proposal, depending on your level of debt and income.
- ❖ A TFSA may be eligible for creditor protection if the underlying investment is with an insurance company and there is a named beneficiary under certain conditions.

All this said, the 2023 RBC Financial Independence Poll found that 58% of Canadians had a TFSA and 46% had an RRSP. This may be partially skewed by seniors who converted their RRSPs to income payout plans and only had TFSAs as an option.

2 – 17.9 Tax Strategies

With the introduction of the TFSA, you now have a choice of three savings vehicles in which to invest – non-registered (taxable with the potential for tax-preferred treatment depending on the income generated by the underlying investments), 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?

Most elders are not optimizing Tax Free Savings Accounts

Canadians' unused TFSA contribution room exceeded the fair market value of their plans at all income levels, except the highest. Even there, TFSA holders earning $250,000+ had an average unused contribution room of almost $24,000 according to the most recent StatsCan figures. Clients with no earned income or who are over age 71, have few alternatives available to them to accumulate cash on a tax-sheltered basis.

There are over 7.6 million people age 65+! *(This is what Canada will look like in 20 years – are we ready for an aging population? Dec. 2023)* That's estimated to grow to 9.5 million people by 2030, according to the 2018 Survey of Experts on Future Demographic Trends.

If we focus on people age 65+, they represent about 4.4 Million of all plan holders or about 27%. Just over ½, 2.27 million made a contribution. Only 651,230 maximized their contributions. That's 15% of all plan holders over age 65 who have few tax shelters available to them. (*Tax-Free Savings Account 2021 Statistics from the CRA, updated Oct.14, 2023)*

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 under current legislation.

With the addition of the TFSA, some financial advisors recommend that the investor 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 serves to shelter interest income from proportionately higher taxes compared to dividends and capital gains.

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% under current legislation.
If this could impact eligibility for these benefits, consider moving dividend earning investments into a TFSA where none of the income is reportable and the investor continues to benefit from this type of income and diversification.

2 – 17.10 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. That may change with Federal Budget 2024 proposals to increase the inclusion rate to 66 2/3% for realized capital gains on individually held appreciable assets for amount exceeding $250,000. (The 50% inclusion rate would continue for realized capital gains under that threshold.) Appreciable assets held in corporations and trusts would have all capital gains taxed with an inclusion rate of 66 2/3% from dollar one. This may impact the tactic of moving investment portfolios to a company.

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 and proposed legislation of 66 2/3 % for capital gains over $250,000. 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 more favourable
- ❖ Reinvest their tax savings into non-registered investments, an RRSP will be more favourable
- ❖ Use their tax savings to pay down non-tax-deductible debt (e.g., their mortgage), an RRSP will likely be more favourable

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, risk tolerance, how and where the money is invested and marginal tax rates — now and upon retirement. Recent tax changes now allow retirees age 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, 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 – 17.11 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 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 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

2-17.12 Individual Pension Plans

An Individual Pension Plan (IPP) is a defined benefit pension plan designed for incorporated business owners. Target clients are typically those ages 45+, earning over $100,000 a year in T4 income.

There specific conditions for a plan including that it must conform to the Income Tax Act (ITA)(Canada) and the Canada Revenue Agency (CRA) requirements. It is usually established for a single person. An IPP generally allows higher tax-deductible contribution amounts compared to what is allowed under an RRSP, substantially more for older individuals. It is even possible to make contributions for past years of employment and top up plan assets at retirement to better ensure that adequate funding is available for generating guaranteed lifetime income.

Like an RRSP, contributions are based on T4 income. Contributions and IPP related expenses are tax-deductible for the sponsoring company. Creditor protection is available for assets within the plan and the plan is set up as a trust, separate from the Company. IPP are protected from creditors

2 – 17.13 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.

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.

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.

2-18 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. Remember that a key part of the advisor's role is to act as the catalyst for conversation. And what a set of engaging conversations they can have.

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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 where you had to set your own agenda for the entire day, every day. Perhaps you had hobbies where you could spend more time, or you had more time 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 federal government 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, like other countries dealing with longer lives and fewer workers contributing to government programs. This has yet to occur.

Increasingly, retirement income will depend on how much a person has saved and how they manage their own money. Unfortunately, just as Canadians are being forced to rely on their own resources in retirement, they are being hit with low, longer term 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 to generate income through the various phases of what collectively is still referred to as retirement.

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 (group and individual)
- Deferred Profit Sharing Plans (DPSPs)
- Other company sponsored and supported savings plans

3 – 2.3 Personal Sources

- Registered investments (RRSPs, RRIFs, personalized pensions)
- Tax free savings accounts (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 through government retirement plans that are fully indexed to inflation have contributed to Canada's consistent ranking as one of the finest places in the world to live. These benefits may be insufficient for many people. That means Canadians need to participate in other plans to generate lifetime retirement income. 9 out of 10 Canadians want income for life. In fact, it's the number one feature they want in a financial product. (Designing retirement schemes Canadians want. caat pension plan. April 2017)

The following provides a brief summary of some of the guaranteed sources of retirement income that Canadians can count on:

3-2.5 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.

Here is a table showing average and maximum payouts for 2024 at traditional starting ages and if benefits are delayed

up to the maximum age 70.

Table 3-1 CPP Average & Maximum Payouts at age 70

CPP pension starting age	Average amount for new recipients	Maximum amount if payments delayed to age 70
Age 65	$831.92	$1,364.60
Age 70	$1,079	$1,937.73

One's individual situation will determine how much they will receive up to the maximum. Many people don't get the maximum payout for various reasons.

3-2.6 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). An eligible person is entitled to a full pension if they have lived in Canada for at least 40 years. If they haven't, they can still get a partial OAS pension, calculated at 1/40th of the full OAS pension for every year they have resided in Canada since age 18.

Table 3-2 Key OAS payment amounts for Q2, 2024

Age when payments begin	Monthly amount for eligible individuals assuming no recovery tax	OAS elimination net income amount
Age 65	$713.34	$142,609.00
Age 70	$970.14	$148,179.00
Age 75 top up (10%) if started at age 65	$784.67	$148,179.00

As you can see, at age 76, a person delaying payments until age 70 could expect to receive $1067.15 per month.

Some provinces provide a top up seniors assistance benefit for people who begin OAS payments at age 65. This is not available for people who decide to delay payments.

This is consistent with the rule that they won't be eligible for other OAS benefits like the Guaranteed Income Supplement and Allowance during the pension deferral period.

If an eligible person is or will be 75 years old or older in June 2022, they will get an automatic 10% increase of their Old Age Security pension starting in July 2022. For those turning age 75 after July 1, 2022, they will receive the increase in the month following their 75th birthday.

3-2.7 Guaranteed Income Supplement (GIS)

The Guaranteed Income Supplement is available to all eligible OAS recipients who have little or no other sources of income.

Table 3-3 Guaranteed Income Supplement Payment Amounts April – June 2024

Situation	Annual income	Maximum monthly payment
I am single, divorced or widowed	Less than $21,624	up to $1,065.47
I have a spouse/common-law partner who receives the **full** OAS pension	Less than $28,560 (combined annual income of couple)	up to $641.35
I have a spouse/common-law partner who **does not** receive an OAS pension or Allowance	Less than $51,840 (combined annual income of couple)	up to $1,065.47

Source - https://www.canada.ca/en/services/benefits/publicpensions/cpp/old-age-security/guaranteed-income-supplement/benefit-amount.html

3-2.8 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.

3-2.9 Words of Caution

OAS, CPP, GIS and Defined Benefit Pension programs are unique insofar as they guarantee a specified retirement payment for life. What’s more, these benefits are indexed, so they increase with time, providing some measure of inflation protection. Most other potential sources of retirement income do not offer guarantees of this nature. The money set aside may 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. This is considered a much more prudent and appropriate approach compared to the many rules of thumb that focus on how much income can be generated for a given amount of money or beginning a retirement income plan using one of the many withdrawal rates formulae.

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 monthly Old Age Security and receive at least the average monthly payment from the Canada/Quebec Pension Plan Retirement Benefits.

For those receiving the maximum CPP retirement payout at age 65 and OAS at the same time, they could have guaranteed, indexed income of almost $25,000 in 2024.

Even low income elders in Canada who have never worked, can rely on a reasonable amount of guaranteed retirement income thanks to the Guaranteed Income Supplement, when added to Old Age Security benefits. Most single retirees will receive a minimum of about $1778.81 monthly in guaranteed retirement income or $21,345.72 as of Q2, 2024, going up each quarter.

Some Canadians will be able to rely on other sources of guaranteed income, The most common source will be a government or company pension plan. Canadians who have participated in a work retirement savings plan or set up their own registered retirement plan, in addition to other savings, including tax free savings accounts and non-registered savings and investments will have the means to set up personalized, guaranteed lifetime income using some select products.

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 age 65, determines that they will need $68,500 annually in retirement in 2024, but their only guaranteed sources of retirement income are OAS at the maximum ($8560.08 annually) and ***the average*** current CPP retirement benefit ($9983.04) annually. That would come to $18,543.12

$68,500 – $18,543.12 = $49,956.88

The retirement income "gap" for this individual is almost $50,000 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, payable at the beginning of each year?

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 they will still have $1 million in principal.

If the retiree determines that it is okay to spend principal down to zero by the time they die at age 90, then they would need about $755,000 earning 5% a year to last for 25 years. At the end of 25 years there would be about $1077 left over.

In this simplified calculation used to determine how much is needed to retire, the answer ranges from about $755,000 to $1 million. And that is assuming that the expense gap remains at $50,000, so there would be no indexing of the $50,000; only the government benefits.

Keep in mind to simplify things, we have ignored three additional factors that are used to determine how much an individual requires to retire. They are:

1. Inflation
2. Life Expectancy
3. The taxability of the cash flow from each source

Unless a person knows exactly how long they will live, what they will spend each year, how much of an impact inflation will have and how much of the cashflow they get will be reduced by taxes, they cannot know *exactly* how much money will be needed to retire. You see, an important consideration is not how much dollars you need to generate before taxes; rather how many spendable dollars you have at your disposal.

Since no one knows exactly how much will be needed to retire, the next best thing is to develop both a best case and negative 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. Each individual will have their own best and worst case scenarios. Let's consider the following example.

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, our retiree will need almost $762,000 to provide this $50,000 per year of inflation adjusted income for 25 years. This makes a big assumption that the same amount of money needed at age 65 is needed, adjusted for inflation, throughout the balance of one's life. This assumption does not stand up to scrutiny or well supported studies.

Worst Case

In a worst case scenario, we might make the following assumptions:

- 4% inflation rate
- 35 year life expectancy
- 4% return on investments

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 $762k and $1.8 million. And if real life throws a few additional wrenches into the works, even more money may be required. Neither scenario anticipates leaving money to anyone. It bears repeating that there is a big assumption that the same amount of money needed at age 65 is needed, adjusted for inflation, throughout the balance of one's life. This assumption does not stand up to scrutiny or well supported studies. Income requirements may indeed be largest in the first phase of retirement, which is the most active period in retirement. That same level of income is not required for life as will be noted elsewhere and in fact drops in real dollars until quite late in life when some will require assisted living and care.

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 produce an *exact* answer. The next best thing is to produce a reasonable set of assumptions, and make sure that the plan is re-evaluated every few years. The income determination should be made annually.

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 who is trained and well versed in retirement income planning. This is distinct from retirement planning, which focuses on saving for financial independence.

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.

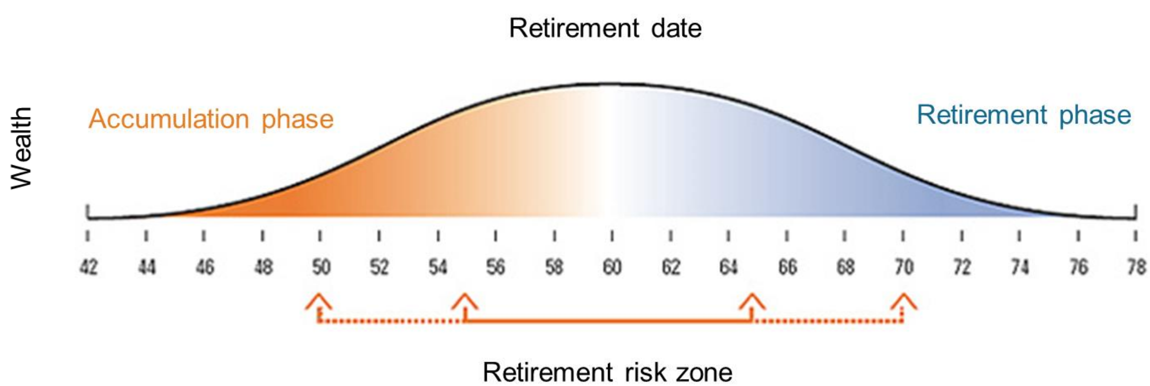
It gets more complicated as retirement looms. When you are 10 or 15 years out, you need to start thinking about preservation of capital, volatility risk, and how you will keep generating cash after you retire and how you will live on the money you have saved.

3- 4.1 Retirement Risk Zone

One of the less commonly discussed risks of retirement is the risk of having too much market risk in your portfolio around the time when you need income. Here is an opportunity to create and build awareness for something called the retirement risk zone.

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.

Table 3-4 Retirement Risk Zones



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.”

<u>Accumulation phase vs. Retirement Risk Zone</u>

An investor in the Accumulation Phase, that period of time when their primary focus is on building their long term investment nest egg, has a longer time-period to recoup losses, earn income and invest additional monies. Someone in the Retirement Risk Zone may not have the luxury of time to sit on an investment and wait for positive rates of return to make up for investment losses. Any new monies invested just before retirement may not be left to grow long enough and potentially reap the benefits of longer term positive investment returns. Furthermore, an investor in the Retirement Risk Zone may be withdrawing income and thus depleting assets faster. A negative sequence of returns has a greater and long term effect during the Retirement Risk Zone.

What is one safeguarding measure? Low volatility of an investment that does have respectable rates of return in line with the particular investor's overall plans, is quite an attractive alternative for helping to make retirement income plans work. This is in addition to having some cash on hand or very conservatively invested savings that can be used for cash flow and to support lifestyle when markets are underperforming.

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 and strategies retirees should consider to generate cash flow:

- Annuities
- Registered Retirement Income Funds (RRIFs)
- Laddered Guaranteed Investment Certificates (GICs)
- Laddered bonds and Bond Portfolios
- Dividend paying stocks/equities
- Systematic withdrawals from investments
- Guaranteed Withdrawal Benefit Plans

3 – 5 ANNUITIES: BETTER REFERRED TO AS PERSONALIZED PENSIONS

Annuities can be described as a personalized pension. They can be funded with registered or non-registered monies.

With an annuity - in exchange for a single lump sum investment - an insurer makes guaranteed regular income payments to an investor that contain an interest component, a return of principal and a transfer of capital from annuity holders who die earlier than statistically expected to those who live longer than expected. 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 contractually 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 fixed income investments.
- ❖ Value security and peace of mind while reducing the need for ongoing investment decisions by anyone; themselves, a family member, or a person acting under a Power of Attorney for Property.
- ❖ 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 or if there are concerns over mental capacity and the income stream they provide is very safe and guaranteed.

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. They may also feel more comfortable with whatever stock market exposure they have in the rest of their 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 contractually 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. It's important to note that life expectancy measures the point where half of the group will die; the other half will live longer.

Table 3 - 5 Longevity for 65 year olds

Woman	86	50%	92	25%
Male	83	50%	89	25%
Couple	90	50%		
Source: Canadian Institute of Actuaries, 2007				

3 - 5.2 Types of Annuities

A **deferred annuity** pays you after a set period or date.

An **immediate annuity** starts to pay out income immediately. Some deferred annuities can be turned into immediate annuities after a given period. You receive guaranteed, set income payments in exchange for a one-time deposit. The amount of income you receive depends on a variety of factors including the amount you deposit, current interest rates, your age and the type of annuity you choose.

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 last 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. You can generally choose a term from 10 years up to age 90.

Prescribed Annuities offer preferential tax treatment for individuals who are investing 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. It makes cash flow and tax planning simple for that stream of income.

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 may 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 a single sum of money, 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 for up to a year in most cases,,.

A deferred annuity may be purchased with either a single sum or with premiums over a specified period. This type of annuity behaves like a GIC. The interest rates offered are guaranteed for a specific 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.

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, generally up to a year.

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 sooner 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 guaranteed payout period

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 guaranteed income stream during the lifetime of two annuitants. On the death of the first annuitant, the income continues in whole or part to the survivor and ceases on the second death. The annuitant can choose how much continues to the survivor as would be the case with a pension plan.

No death benefits are payable to the estate after the second death occurs if it occurs after any chosen guaranteed period. This is the common arrangement for spouses, 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.

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 serve as 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 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. the guarantee period may exceed the life expectancy, and the income will be related more to the guarantee period than to the life expectancy.

Variable annuity

Another name for this type of annuity is an individual variable insurance contract, a guaranteed investment fund or a segregated fund. Segregated funds are discussed elsewhere in this module.

3- 5.5 Income Determinants

The amount of the regular income you get depends on multiple things, as noted by the Financial Consumer Agency of Canada:

- your gender
- your age and health status when you buy the annuity
- the amount of money you invest in the annuity
- the type of annuity you buy
- whether you have the option to continue payments to a beneficiary or your estate after you die
- the length of time you want to receive payments
- the rate of interest when you buy your annuity, and the annuity provider

The type of annuity that is chosen by the elder should depend on the following four factors:

1. <u>Time Horizon</u>

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 may have the potential to outstrip inflation, cost of living, and other investments. Time horizon also refers to how long the elder wants the income to last.

2. <u>Other Investments</u>

Other Investments should be considered when looking at incorporating annuities into an overall investment portfolio. One thing to keep in mind is that things can change in the marketplace and do so quite suddenly. Diversification has always been a fundamental in successful investing.

If the elders' investments are tied up in debt instruments because of safety of principal concerns, they should at least look at equity options within a variable annuity, known as guaranteed investment funds or segregated funds if guarantees, safety of capital and estate planning features are important. This provides an overall balance in the portfolio, aligned with the aging investor's risk tolerance and investment policy statement.

3. <u>Goals and Objectives</u>

Goals and Objectives would include how much income elders want for retirement to support the lifestyle they value as well as goals of helping or even sending their grandchildren or their own children through college, paying off school loans, getting a start in life with a car, downpayment on a home, wedding, or buying or renovating a retirement home or vacation property. Whatever the elders' goal may be it is important to turn these into dollar objectives—something that can be quantified.

Everyone can dream, but once a goal is set, it is important to plan to meet that goal and implement and monitor the plan and solutions they include.

4. <u>Risk Level</u>

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 they choose. 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. Annuities are structured with the intention to provide a firm foundation for a retirement income plan. Any retirement plan is susceptible to instability if it does not have a base of guarantees and income that a personalized pension can provide, issued by an insurance company in the form of an annuity.

3 – 5.6 Annuity Drawbacks

Annuities are not sexy. You hand over your money to an insurance company who then provides an income for a period of time or for the rest of your life. There are no more investment decisions to make and once purchased, they cannot be cashed in. Even though annuities offer a variety of unique benefits and what they do is something most Canadians want, i.e. guaranteed income, comparatively few buy them. They are also under promoted and under explained to people by the same advisors providing advice on generating retirement income. Economists have come to refer to this phenomenon as the "under-annuitization puzzle."

Part of the problem is a low interest rate environment. Low interest rates depress the amount of annuity income one can buy. That said, annuities were not in vogue even when interest rates were much higher years and decades ago.

The economics of annuities have improved greatly, especially when presented to older people who have a certain amount of their money in fixed income vehicles like term deposits and bonds, particularly if they are concerned about the income being generated and the worry about dipping into capital to generate more income. 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, particularly with estate planning and tax efficient strategies offered by insurance companies.

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.

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. On the other hand, this may be a big benefit as people get older and they value putting some of their financial plans and income flows on auto pilot. This makes it easier for spouses and people acting under a Power of Attorney for Property to take over the management of someone's finances when competency becomes a concern or hard reality.

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 if stock markets do well. That is why an allocation of funds to these personalized pensions should not be 100%, leaving money available for other things that arise.

3 – 5.7 Annuity Strategies

To mitigate the concern about committing a large percentage of money into an annuity all at once, 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. This strategy is much like laddering GICs or bonds.

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. Additionally, for non-registered annuities bought by individuals, the taxable amount, represented by the interest portion of each payment, decreases as the purchaser gets older when buying the annuity.

An additional benefit of buying annuities in separate batches is that you will be able to benefit if interest rates rise from initial levels.

When it comes to addressing the perceived loss of income associated with annuities on death, retirees could opt for a joint annuity, where you can arrange for an annuity to pay your spouse in full or in part after you die and have payments continue to a beneficiary for a set period of time or their life as in the case of a surviving spouse or common law partner.

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 with a much higher proportion of 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.

Annuity payout rates are affected by interest rates. That does not mean you should shun these investments altogether—it just means it may pay to wait if there are signs that interest rates will increase. 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 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 particular age.

At advanced ages, annuities also become relatively more attractive compared to other payout alternatives.

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 2023 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 February 2024) annual income of about $8,400, despite low interest rates. And this would come with a 10 year guaranteed payout if the person died early. Not only is this about $2,200 more than the minimum RRIF income, but the annuity is also 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.

3 – 5.9 Insured Annuity

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 from the annuity payments, 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. It operates like a personalized lifetime pension with preservation of capital for heirs and favourite causes.

3-6 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.

Some RRIF points:

- 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 – 6.1 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 – 6.2 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 – 6.3 RRIF Withdrawal Rules

The table below outlines the regular minimum RRIF withdrawals as of 2024, as set by the government. Before age 71, the minimum percentage payout is worked out in the following way: 1÷ (90 – your current age as of Dec 31st of the prior calendar year). So, if you are 65, your minimum withdrawal would be 1÷ (90-65) =4%. With a $100,000 RRIF, that amounts to $4,000. If the annuitant has elected to use the spouse/common law partner's age to calculate the RRIF factor, then the spouse's age should be used as the age in these tables, instead of the age of the annuitant.

Table 3-6 RRIF Withdrawal Rates

Age at Start of Year	RRIF Factor Minimum Withdrawal		Age at Start of Year	Minimum Withdrawal
60	3.33		78	6.36%
61	3.45		78	6.36%
62	3.57		79	6.58%
63	3.70		80	6.82%
64	3.85		81	7.08%
65	4.00%		82	7.38%
66	4.17%		83	7.71%
67	4.35%		84	8.08%
68	4.55%		85	8.51%
69	4.76%		86	8.99%
70	5.00%		87	9.55%
71	5.28%		88	10.21%
72	5.40%		89	10.99%
73	5.53%		90	11.92%
74	5.67%		91	13.06%
75	5.82%		93	16.34%
76	5.98%		94	18.79%
77	6.17%		95+	20.00%
Source - Income Tax Act s. 146.3(1), Regulations s. 7308(3), (4)				

3-6.4 Investment Decisions

Financial institutions offer plans that can hold Guaranteed Investment Certificates (GICs), fund portfolios, 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.

3-6.5 Who Should Consider RRIFs?

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%).

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 all of 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 the potential for some investment growth. Most institutions provide a wide variety of options.

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 transfer to a spouse or common law partner or deregistration.

3-6.6 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 or common law partner, 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.

3-6.7 RRIF Flexibility

One of the benefits of the RRIF is the flexibility you have in setting the level of income you receive over and above legislated minimums. 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.

3-6.8 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.

3-6.9 Withholding Tax

RRIF income may be 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 in all provinces outside of Quebec.

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.

3-6.10 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 $100,000 to invest in a GIC, you could put it all $20,000 away for 5 years. Alternatively, you could ladder them, $20,000 for 1 year, $20,000 for 2 years, and so on. If on maturity, the money isn’t needed, you may reinvest that amount for a period generating the highest rate of return. The following year, another GIC will mature and so on. The benefit to laddering is two-fold:

1. You do not have to tie up all your money in one GIC. Different terms allow you to plan to have some money maturing and hence available for spending or reinvestment each year.

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.

3-6.11 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.

3-6.12 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, which 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.

At 65, this leaves an aggressive investor with 40% in bonds and a conservative investor with 50%.

Alternative Two: 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 Three: 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.

Consider each of these approaches and their appropriateness and fit with each investor and for each investor over time as situations, priorities, the markets and tax regulations change. They are all imperfect, but each is much better than leaving this choice to whim or emotion or the urgings of sales reps not providing integrated, comprehensive financial and retirement income planning services.

3 - 7 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, retirees should consider maintaining a portion of their portfolio in equities and focusing on dividend-paying stocks which may generate income along the way.

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.

Eligible dividends are payments of profits to shareholders that have not benefited from the small business deduction or any other special tax rate. Since the corporation paid more tax on the profits before paying the dividends, the income tax system is set up so that individuals pay less tax on eligible dividends compared to non-eligible dividends.

Non-eligible dividends are payments of profits to shareholders that have benefited from the small business deductions or other special tax rates. Since the Canadian controlled private corporation pays less tax on the profit, the income tax system is set up in such a way that individuals pay more tax on non-eligible dividends compared to 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. There is no gross up and tax credit process for foreign dividends.

More important notes about dividends:

- Non-eligible dividends such as those paid out to shareholders of incorporated businesses, are not considered earned income. This means that dividend income does not contribute to your RRSP limit.
- They are not subject to CPP contribution requirements, meaning you do not have to make CPP contributions on dividend income.
- They are not deductible to the Corporation that pays them, meaning they are paid out of after-tax tax dollars. Salary is deductible.
- 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 offering the potential of increasing the value of those equities. 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 stocks may lag during booms, but often outperform in bad years when looking at income generating vehicles.

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

3 – 7.1 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 – 7.2 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 exchange traded funds (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 – 7.3 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 – 8 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 throughout 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.

3-8.1 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 contractually guaranteed to receive a predictable monthly income that is guaranteed for as long as you live. It is 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. The Lifetime withdrawal amount may be reset higher periodically if market values are higher on reset dates which lock in market gains. Automatic Income Base Resets every three years to lock in any market gains which help increase an investor's income, even if they've started receiving income from the plan.

Guaranteed Minimum Withdrawal Benefit plans may provide for long time wealth accumulation and capital preservation for investors. They are a combination of investment and income solutions built into one package. When used for non-registered investable assets, contract holders may start and stop payments, optimizing flexibility, income and tax planning. They are also cashable.

Essentially, an investor who retires is being guaranteed a base percentage of income life (at age 65 = 4%), with the potential for increases if the underlying funds perform well and for each year they defer taking that income. The older they are, the higher the percentage payout. Investors may withdraw fixed amounts.

This type of plan is available on a registered (RRSP, RRIF) or non-registered basis. It may also be used inside a TFSA.

A key benefit is the ability to name a beneficiary so that proceeds on the death of the owner/annuitant can be paid out directly without the need for probate.

3 – 8.2 Systematic Withdrawal Plans (SWPs)

This tactic is a scheduled investment withdrawal plan typically used in retirement when turning non-registered assets into an income stream. They allow for pre-planned, automatic cash flows generated by investments, usually mutual funds or segregated funds as an income source for retirees. Investors can set up regular payments expressed as a dollar amount or percentage of assets and paid out an monthly, quarterly, semi-annually, or annually. Most are set up on a monthly basis.

The withdrawal rate chosen is driven by considerations like:

- How much cash flow is needed
- How long that cash flow is needed
- The underlying investments
- Whether the investor wishes to leave a legacy for spouses/common law partners and heirs.

Payouts are generally a combination of return of capital and capital gains generated by the redemption of units from funds. There may also be dividend income and interest income generated from the fund each year.

A systematic withdrawal plan allows an investor to convert part of their investment portfolio into a tax efficient income stream. At the same time, there is the potential for the portfolio to continue to grow through investment returns. The underlying investment is cashable.

This strategy's survival hinges on what the rate of return is each year that withdrawals are made. Success depends on whether there are significant ups and downs in investment performance during the withdrawal period, particularly in the early years of retirement when withdrawals begin and what those rates of return are compared to how much is being withdrawn.

3 – 9 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 – 9.1 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 55% 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. Another term for this strategy is equity release.

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 aims to ensure equity in the home over the long term.

Regardless of market fluctuations, in Canada, 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 and wants to age in place.

The maximum amount you may borrow depends on your age and the age of other individuals registered on the title of your home; your home's condition, type and appraised value; and your lender.

3 – 9.2 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. A portion of the interest charged on the loan is then tax deductible, depending on the type of investment and how much of the cash taken out is used to purchase qualified investments.

You may be able to get a reverse mortgage from:

- Federally Regulated Financial Institutions, Including HomeEquity Bank And Equitable Bank
- Provincially Regulated Financial Institutions
- Mortgage Brokers

3 – 9.3 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 or cover healthcare expenses. 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 – 9.4 Reverse Mortgage Disadvantages

- Reverse mortgages are subject to higher interest rates than most mortgage types including a Home Equity Line of Credit (HELOC).
- The equity held in your home may 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.
- If you pay off your reverse mortgage early, you may need to pay a fee.
- The time needed to settle an estate may be longer than the time allowed to repay a reverse mortgage
- Taking out a reverse mortgage means that generally, there will be less money in your estate to leave to your children or other beneficiaries.

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 – 10 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 benefits:

- You needn't have any "earned income," to contribute to a TFSA.
- 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 to a TFSA.
- 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 when they are required to convert their registered retirement savings into a retirement income vehicle.

It is also interesting to note that the Income Tax Act makes it possible to split income using TFSAs. This is due to the fact that the Income Tax Act (para. 74.5(12)c) ITA) specifically provides that attribution rules don't apply if money is paid by an individual to his/her spouse/common-law partner and that the transferred money is held under a TFSA of which the spouse or common-law partner is the holder.

However, CRA has mentioned that when the individual's spouse immediately withdraws the transferred money from the TFSA, it is CRA's view that the withdrawn amount may not be exempted from attribution rules.

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 – 10.1 RRSP vs TFSA

TFSAs are catching up to the RRSP as the tax-sheltered investment of choice.

Canadian families' participation rates in the TFSA exceeded their participation rates in the RPP and the RRSP by 2013. By 2020, the most recent year recorded, TFSA share in total contributions of RRSP, RPP (pensions) and TFSA was over half (52%). (Table 1, Average contribution and share of each registered savings account in total contribution, Oct. 2023).

An RRSP gives a person an up-front tax deduction that they do not get with a TFSA. But the government gets its share in income tax assessed on the back-end cash withdrawals, typically after the taxpayer retires and on any unspent savings on death of the annuitant in one lump sum. This taxable event may well drive the final tax return into the top tax bracket.

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. This can be particularly attractive when trying to optimize eligibility for government benefits, most of which are net income tested. Cash flow from a TFSA is not reported as income for tax purposes in Canada. If you expect your marginal tax rate to be lower when you retire then an RRSP generally makes more sense. The deduction is worth more and accumulated savings will be exposed to lower rates of tax during the spending phase, traditionally called retirement.

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, unlike an RRSP, to which you can only contribute up to, and including, the year in which you turn 71. If you have a younger spouse or partner, you can claim a deduction for contributions to their RRSP until the end of the year that they turn 71. This makes the TFSA an ideal vehicle for seniors over the age of 71 to continue to shelter their investment income or even to contribute the after-tax value of their mandatory annual RRIF withdrawals if they don’t need the money.

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 – 10.2 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 – 11 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.

Seniors, or Elders as we prefer to call them, have fewer places to tax shelter deposits and they underuse TFSAs. Educating and promoting the use of tax free savings account should be a natural part of a conversation early in the year with all of the focus on tax sheltered growth on invested monies.

They are either concerned about the taxes they pay, becoming ineligible for government benefits, most of which are net income tested, or having to pay a higher rate of tax if income and cash flow needs go up. What's a good strategy for advisors?

When discussing tax optimization with clients, the tax-free savings account should be included in the conversation. Indeed, not only will the amounts deposited in the TFSA generate tax-free returns but withdrawals from a TFSA are not included in net income calculations. Since amounts are not included in net income calculations, they do not impact the government benefits/credits that we saw earlier. This also means that clients need less funds to generate one after-tax dollar especially it the funds would otherwise be taxed at a high marginal tax rate. Since we are talking tax, the type of income being generated doesn't matter. Dividend generating investments inside a TFSA work well for retirees interested in minimizing the negative effect of dividends on net income and who are interested in diversification of investments.

This could be the case if an elder has a need for a higher amount of after tax dollars during a particular tax year, to pay for medical expenses or to make renovations on his/her home for instance.

3-11.1 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 – 11.2 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 – 11.3 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 into 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 - benefits.

The Gross up in reportable dividend income could also adversely impact an elder's guaranteed income supplement (GIS) and Spousal Allowance income eligibility.

3 – 11.4 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 inefficient from a tax and spendable cash flow perspective. 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. When you reach age 71, you must convert your RRSP to an annuity or RRIF (or a combination of the two) and start taking minimum withdrawals from your RRIF. You may likely require more than the minimum had you been following the strategy of drawing down your non-registered monies first. This can drive up your reportable 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.

Consider drawing on your registered accounts first if 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 each optimize access to the $2000 Pension Income Credit. That could amount to up to $28,000 in pension credits ages 65-71 for a couple. Withdrawals aren't eligible for the pension income amount.

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.

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. When your income from other sources is below the personal exemption amount, you can withdraw money from your RRSP and RRIF money and still stay within the tax-free zone. If you do not make that withdrawal now, you may have to pay a substantial amount of tax down the road. Withdrawals from non-registered accounts, aside from interest, receive better tax treatment than withdrawals from RRSPs and RRIFs.

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 – 11.5 TFSAs and Tax

As noted above, if you are saving for retirement with limited funds, whether you invest money 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 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 on those accumulated monies, 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. 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% (StatsCan Household Income Report, 2022). 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 withdrawals 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 – 11.6 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. This tactic may be valuable when dividend income is desired, which is tax and tax credit unfriendly for people age 65+. Dividend income inside a TFSA attracts no tax and all payouts from a TFSA are tax free, so do not impact net income tested benefits.

3 – 12 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 – 12.1 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 – 12.2 Calculating a Safe Withdrawal Rate

One commonly used formula is the 4% withdrawal rate. Here is how it works.

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.

As noted in research, fluctuating market valuations and rising inflation serve to threaten the security of retirement plans. The latest research (described below), however, provides a different answer, and a set of guidelines to follow that will give you the greatest probability for optimizing your retirement income.

What happens if you follow these new rules? You may be able to have a withdrawal rate of 3% or as high as 6 – 7% of your initial portfolio value. That is a spread ranging from $3000 to $6,000 - $7,000 per year, for every $100,000 you have invested. That's quite a difference.

The percentage of spending from an investment portfolio assumes a 90% probability of having funds remaining at the end of an assumed 30-year retirement period. The safe withdrawal rate used by some researchers like Morningstar, is modeled on portfolios that hold between 20% and 40% in equities. The balance is held in bonds and cash, quite a reversal from historic assumptions of 60% equities and 40% bonds with a 30-year horizon and aiming for a 90% probability of success.

According to The State of Retirement Income: 2023 report, portfolios with equity weights between 20- 40% had the highest starting safe withdrawal percentage but they had a lower median balance at year 30 than did portfolios with more equity exposure. The latter approach risked losing more in the early years, exposing investors to sequence of returns risk.

Of note is that retirees often decrease their inflation-adjusted spending over time, a pattern that can also lead to considerably higher safe withdrawal rates, according to studies of actual spending during retirement including StatsCan.

Other significant issues with these safe withdrawal rates like Bill Bengen's 4% rule, include the following.

One challenge is the assumption that there are no investment expenses. Funds and ETFs have expenses on top of fees that advisors charge. And don't forget about taxes and the way that different sources of income are taxed. There is also ample evidence that investors frequently underperform and don't get market returns. This is due to emotion and market timing.

In the end, the appropriate withdrawal rate for an elder depends on the following. It depends on the market environment during a retiree's drawdown, the length of the period of the drawdown, the portfolio's asset allocation and how different sources of income are taxed or income allocation.

A significant issue with safe withdrawal rate approaches is that they focus on the income side of retirement income planning and not the expense side. In other words, they focus on what you get, not what you need. A better use would be to apply these rules of thumb as a stress test against how much money you need and see if this is sustainable on a long- term basis.

In the previous example, the 4% withdrawal rate shows that you can withdraw $4,000 from a $100,000 investment adjusting it upwards by inflation each year. If you only need $3,000, then you would be building a cushion for future years when your investments underperform, or you need more income.

Conversely, if you think you need $4,500 per year in retirement and you want to only withdraw 4% of your retirement balance, you would need to have saved more money or take on more risk that may generate a higher rate of return.

Another issue is that this rule doesn't account for or adequately account for taxes. Remember, it's all about spendable dollars. It takes far less capital to generate cash flow when that cash flow attracts little or no tax. The rule assumes that all income is taxed the same way.

3 – 12.3 Six Withdrawal Rate Rules

What are these rules that allow you to maximize your withdrawal rate while providing sustainable income for your lifetime?

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 unless you have a very large amount of money where modest interest earnings can generate income that can be paid out along with capital.

If you avoid all equity exposure, you run the risk of running out of money or you need to have accumulated a lot more money. Having too much in equities and being exposed to volatile markets, may scare you away at the worst time or you may suffer dramatic losses in the value of your investments.

It may also be out of step with your risk tolerance and ability to sleep comfortably at night. Conversely, if you have too much in fixed income, your retirement income may 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 or GIC 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 bonds and equities, typically held in mutual funds, segregated funds and/or exchange traded funds. It's important to allocate investments to your profile and to meet plan objectives. You may only take money from the equity bucket when it overflows. An overflow year is any year when equities have above average returns, that is to say, annual returns that exceed the long term average returns documented in your retirement income plan For some investors this may roughly work out to 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 or funds, taking advantage of buying opportunities.

There will be 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. Remember and remind the investor that they should expect some positions to be flat or negative in a given year.

Another term used to describe this concept is the cash wedge strategy. It can be a very effective strategy to employ for taking income when the markets are down. It should be managed through an investment policy statement arranged and reviewed with an advisor well versed in retirement income planning.

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 In this example, your withdrawal would go from $7,000 to $5,740 for the year. Put another way, you withdraw 7% of the now smaller portfolio value.

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. That said, it can be tough to reduce your income, particularly if you require it for fixed expenses.

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. Here, you may take surplus earnings and reinvest them conservatively for that time when markets underperform.

Withdrawal Rate Rules 5 and 6 are referred to as variable withdrawal rates.

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 – 13 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? Enough to do what exactly? And for how long? 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.

Make sure to review and stress test the plan and its components to ensure that they continue to do the job intended.

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 support your lifestyle, inflation, unexpected future expenses or the "nice to haves" later in retirement on a sustainable basis. 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) 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 deposits, depending on your personal preferences. This money need not be invested to generate a generous return, since that is not its primary purpose—it is there to help meet your expenses throughout the year.

Fundamental 3: Consolidate income into 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 funds or periodic RRIF or annuity 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 setting up a systematic withdrawal plan. That is okay too—some investors prefer that approach. Building more predictable portfolio income sources to support your cash-flow needs can be a good first line of support to your long term income plan.

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 balanced mix stocks, bonds and cash investments, aligned with their risk tolerance and both short and long-term objectives.

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 historically have provided 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. Market conditions and performance at a given time may drive a different mix of bonds and equities.

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 a combination of capital gains, interest and dividends, capital 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 equity funds or individual blue-chip stocks, to add fluctuating income sources of income that can grow. This will be part of your allocation to equities, 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 like guaranteed withdrawal benefit plans) to help create reliable cash flow.

Guaranteed Withdrawal Benefit 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. Some refer to this overall approach as the cash wedge strategy.

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 – 14 RETIREMENT INCOME SURVIVAL RISKS

Retirement income survival risks are the things that can destroy your plans for a comfortable, stress-free retirement. There are things you can do before and during retirement to defend yourself against scenarios that can reduce or eliminate retirement income. 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 the money today, think how much you will need it in retirement when your income has stopped.

Prepare for 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. Will today's 25-year-olds live even longer? StatsCan released its latest report in Nov. 2023, indicating life expectancy from birth has declined for 3rd consecutive year. This opens the door to another consideration for retirement income planning. The proper mortality tables you should be referring to are annuity tables. Why? Typical mortality tables measure longevity from birth. Retirement income planning and risk assessment needs to measure longevity for people who have reached a certain age like 65 Keep in mind that life expectancy measures the point in time that ½ of the group at a certain age will die. The other half will live longer!

If you base your plans on life expectancy, you have a 50% chance of being wrong. That's a coin toss. Are you prepared to take that kind of risk with setting up a retirement income program? With Canadians living longer these days, it's even more important to be financially prepared.

When do you move from long term savings to long term spending?

Your first consideration is targeting that 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, turning a hobby or avocation into a money making enterprise, 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 may lessen if you live both a long and healthy life. Do what you can now to reduce your retirement healthcare costs by committing to a healthy(ier) lifestyle . 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. Ask yourself this question posed by Peter Wouters over the years; If I can't pay off my debts when I am working, how can I pay them off when I'm not working? What will that do to long term spendable cashflow and the emotional pressures that brings?

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 lower interest rates. Aim to pay more than the minimum balance each month.

Ignoring Investments

You can do just fine 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 and to address sequence of returns risk. A good move is to make a date to check in with your portfolio periodically, with the help of an advisor 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 or cash flow plan. Income and lump sum cash needs do not follow an upward curve during the various phases of retirement. What would it look like if you spent a big portion of your savings today and had to live on the rest for the rest of your life? If you eat away at your savings early on, it can quickly put your long-term plan out of whack. Practice living a sustainable lifestyle. Make financial common sense a part of your personality,

Sequence of Returns Risk

One of the less commonly discussed risks of retirement is the risk of having too much market risk in your portfolio around the time when you need income. Here is an opportunity to create and build awareness for something called the retirement risk zone.

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.

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 each year that make up the average can have a marked influence on how long income lasts during retirement.

It is vital that investors are aware that the sequence of returns can have a dramatic effect on the longevity of an investor’s portfolio when the emphasis switches from accumulation to spending. Put another way, investors and advisors should be mindful that the order of the rates of return that an investment earns over a period of time may not matter when saving for retirement. It’s simple multiplication. For example, 2x3x4 yields the same total as 4x3x2 or 3x2x4. All equal 24. And generally speaking, no withdrawals are being made when saving for retirement.

The order of the rates of return matters a great deal when the investor is spending their accumulated money during retirement and it’s a much bigger surprise to investors and advisors alike.

A pattern of lower than expected or negative returns during these 5 to 10 years before and after retirement generally 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 fund lifestyle. 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.

An investor in the Accumulation Phase, that period of time when their primary focus is on building their long term investment nest egg, has a longer time-period to recoup losses, earn income and invest additional monies. Someone in the Retirement Risk Zone may not have the luxury of time to sit on an investment and wait for positive rates of return to make up for investment losses. Any new monies invested just before retirement may not be left to grow long enough and potentially reap the benefits of longer term positive investment returns. Furthermore, an investor in the Retirement Risk Zone may be withdrawing income and thus depleting assets faster.

It's not just that the comparatively simple math works. This is very much research supported. Fan, Murray, and Pittman (2013) developed an adaptive model which considers a client's spending needs and uses equity exposure as a lever to manage shortfall risk. They find for example that beginning retirement with a lower allocation in equities can help to reduce the sequence of returns risk. The equity allocation may become higher later in retirement when the client enjoys at least satisfactory market performance. (Source: Fan, Yuan-An, Steve Murray, and Sam Pittman. 2013. "Optimizing Retirement Income: An Adaptive Approach based on Assets and Liabilities." Journal of Retirement 1, 1 (Summer): 124-135). This tactic is called the rising equity glidepath approach to investment mix.

The important point to consider is that portfolios are set up to match the profile, not the other way around.

If investors avoid exposure to the sequence of returns risk by putting all monies into short term fixed-income products that do not fluctuate, the portfolio will show comparatively little growth over time. It will not likely keep up with inflation and the cost of living. And the cash flow may run out before death. If the retirement portfolio is comprised of equities, it's very likely that early negative returns will decimate the portfolio and force the retired investor to reduce planned spending levels or put off retirement. We cannot predict the sequence of returns in the future.

As noted earlier, you should consider various income generating tactics to deal with sequence of returns risk.

You may pensionize some of your non-registered assets by purchasing a prescribed annuity.

You may ladder your purchases as well, taking the guesswork over when you will get the best return and matching them up with fixed expenses. Instead of buying one larger plan, you can stagger them over time, say 5 year increments. This gives retirees the chance to buy blocks as they get older, where the monthly payout may be higher and the taxable portion drops.

When doing retirement income planning, there are three factors that may help to create a more predictable and stable cash flow:

- All Equity funds: select a Portfolio Manager that displays competent downside protection
- Portfolios: select a Portfolio Manager that displays competent Tactical Asset Allocation decisions
- Distributions: take them in cash to create a "cash wedge" to fund future income needs and to shore up lagging positions, that is, take excess profits from one investment pool and invest them into another pool that is underperforming, buying low. Unless this third option comes from a product that provides guaranteed lifetime income, distributions should be reinvested in down markets and moved over to the three-step cash wedge strategy to provide stable, predictable and reliable cash flow on a three year revolving cycle.

One final point. You don't have to choose amongst the various tactics. In fact, combination programs may work best. It's more a matter of how much of each and how that ratio may evolve over time.

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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 what Peter Wouters has termed 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.

4 – 1.1 How Will This Objective Be Achieved?

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.

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, let alone coordinating this with those of a spouse or common law partner may be more complex. Today, we also have the all-too-common complex family situations; multiple marriages, children from different relationships and family members with financial, emotional or addiction issues. 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 have been shared, including specific instructions and arrangements.
- 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 values and wishes. Your legacy plan should also contemplate inter vivos transfers (passing along assets while you are still alive), potential future incapacity and explore structures such as substitute decision makers and trusts, complete with documented direction, powers and limitations.

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 and corral 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 during and after one's lifetime, while allowing the surviving family or designates to deal with the deceased's wealth.

4 – 2.2 What is an Estate?

In estate planning it is important to understand what this means and entails.. 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, vacation homes 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 and important aspects preserved. 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 both representative of one's wishes and is correctly structured.

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 since applies when you die.

Deemed disposition tax is so named because your investments are deemed to be sold at death regardless of whether they are actually sold. Any capital gains and recapture of write-downs 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, including vacation properties 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 or common law partner. 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. When taxation, estate settlement costs 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 or estate administrator (usually the spouse or children) will be the only participants.

The Estate Planning process starts well before it is needed. Due to potentially substantial taxes at death, estate value conservation is an issue that must be dealt with before death, and transfer or disposition must be planned for in order to facilitate an orderly passing of the estate assets, while minimizing taxes and other settlement costs.

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.

4 – 2.5 The Law of Intestacy

If the deceased did not file a Will, the courts will arrange the passing of the assets under the law of intestacy. 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.

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 split between the spouse and children.

Where there is no surviving spouse or children, the estate devolves according to the rules of consanguinity.

A summary of the various laws of intestate is provided in the following chart.

Table 4-1 Provincial and Territorial Laws of Intestate Succession – 2024

PR or Terr	**Spousal Only And Preferential Share***	**Spouse And One Child****	**Spouse And Children****	**Can Common Law Spouses Inherit?**	**No Spouse Or Children**
BC	Spouse only: all to spouse preferential share $300,000 if 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 of balance in either case	½ of balance each to spouse and children	Yes (min. 2 year cohabitation)	Surviving parent(s), then siblings; if sibling dead, then their children
AB	no preferential share all to spouse	All to spouse, where all of the children are also children of the surviving spouse. Otherwise, 1/2 to spouse, and ½ to child	All to spouse, where all of the children are also children of the surviving spouse. Otherwise, 1/2 to spouse, and remainder to child.	no	Surviving parent(s), then siblings; if sibling dead, then their children
SK	All to spouse even if Child is also child of spouse Otherwise: first $200,000	½ of balance each to child of different relationship	1/3 of balance to spouse 2/3 to children of different relationship	Yes (min. 2 year cohabitation)	To parents; then siblings; if sibling dead, then their children

MB	All to spouse	All to spouse where all of the children are also children of the surviving spouse. Otherwise, greater of $50,000 or 1/2 to spouse, 1/2 to child.	All to spouse where all of the children are also children of the surviving spouse. Otherwise, greater of $50,000 or 1/2 to spouse, 1/2 to children	Yes (min. 3 years cohabitation, or 1 year together with child)	To parents; then siblings; if sibling dead, then their children
ON	Only spouse: all to spouse Preferential share $350,000	½ of balance each	1/3 of balance to spouse 2/3 to children	Extends only to legally married spouses	To parents; then siblings; if sibling dead, then their children
QC	Spouse only: all to spouse. If marriage or civil union contract has testamentary clause, then all to spouse; otherwise If no children: 2/3 to spouse, 1/3 to parent(s), If no parents, but have siblings: 2/3 to spouse, 1/3 to siblings	1/3 to spouse 2/3 to child	1/3 to spouse 2/3 to 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	½ to Parent(s) ½ Siblings and thei children must be whole blood relatives Different rules for half-siblings
NB	Spouse only: all to spouse	½ each "Child" does not include a stepchild	1/3 of balance to spouse 2/3 children or to their surviving children "Child" does not include a stepchild	Extends only to legally married spouses	Equally to parent(s), then siblings; if sibling dies, then their children

NS	Spouse only: all to spouse Preferential share: $50,000 or the home	½ of balance each	1/3 of balance to spouse 2/3 to children	Extends only to legally married spouses; Excludes spouses "living in adultery", i.e. in another conjugal relationship whether registered or not	To parent(s), then siblings; if sibling dies, then their children
PEI	Spouse only: all to spouse	½ each "Child" does not include a stepchild	1/3 to spouse 2/3 to children "Child" does not include a stepchild	Extends only to legally married spouses	To parent(s) then siblings; if sibling dies, then their children
NL	Spouse only: all to spouse	½ each "Child" does not include a stepchild	1/3 to spouse 2/3 to children "Child" does not include a stepchild	Extends only to legally married spouses	To parent(s), then siblings; if sibling dies, then their children
YK	Spouse only: all to spouse Preferential share: $75,000	½ of balance each	1/3 of balance to spouse 2/3 to children "Child" does not include a stepchild	no	To parents; then siblings; if any sibling dead, then their children
NWT	Spouse only: all to spouse Preferential share $50,000 or matrimonial home	½ of balance each	1/3 of balance to spouse ,2/3 to 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,	To parent(s), then siblings, then their children

NU	Spouse only: all to spouse. Preferential share $50,000 or the home	½ of balance each	1/3 to spouse 2/3 to children "Child" does not include a stepchild	no	To parent(s), then siblings, if any siblings dead, then their children

*A spouse receives the first portion of the estate in many provinces. 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 depending on the province. 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 laws of intestacy. If a person wishes to leave any of their estate to stepchildren, they must indicate this in a will.

Where no heir can be determined, the estate is declared bona vacantia and escheats to the Crown.

Sources: Dying Without A Will In Canada, Willful, accessed Jan.19, 2024 and Provincial and Territorial Government sites

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 the courts formally accept a Will. In the absence of a Will, the court appoints someone to act on behalf of the deceased.

The probate process is also intended to officially authorize the Will's executor or estate administrator to administer the estate. Once completed, the executor or estate administrator is given a legal document called a "grant of probate," or a "grant of administration" that confirms the validity of the Will, so that its instructions can be administered.

The settlement process includes complete documentation of assets and their valuation, payment of debts, taxes, professional fees 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 or estate administrator. Trusts may be used to avoid probate and maintain privacy, and to utilize other tax and estate planning techniques.

4-2.7 Must All Assets Go Through A Probate Process?

The value of the probatable estate and the existence of any debts or claims against the deceased are important points that are considered when deciding whether or not a Will must go through probate. The vast majority of Wills in Canada are probated. Debts must be paid off before assets are distributed to heirs and named beneficiaries of the Will.

Depending on how the assets are titled also impacts whether they need to go through probate. Jointly held property including bank accounts and investments with rights of survivorship may not form part of the estate under certain circumstances. These assets may well pass to the other surviving person/joint owner without going through probate.

The same holds true for named beneficiaries, such as on a life insurance policy, life insurance-based investments and registered plans where permissible. These assets will pass to the named beneficiary(s) without going through probate.

As such, probate or the estate settlement process, is a major estate planning consideration.

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.

4-2.8 Where to Start?

Estate planning to ensure your wishes are met after you pass away, remains an area that most people neglect. It’s estimated that 70% of Canadians have no comprehensive estate plan. (National Institute on Ageing and RBC Royal Trust report, cited Aug. 29, 2023). Misconceptions and myths of its importance serve to add time and expense, worry and frustration, confusion and conflict to settling an estate. Legacy planning is arguably given even less thought and consideration. Being forgotten, not having mattered, having charities and favourite causes negatively impacted by your absence all tend to prey on people’s minds as they age. Yet this planning goes to the heart of what people, especially elders, worry and wonder about as they get older.

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?
- If I have business partners, are they interested in working with my heirs?
- Which family members will share in my estate (spouse, children and possibly grandchildren)? Is there any 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 for which I would be interested in leaving a legacy?

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

Exploring Strategies For Preserving And Transferring The Elder's Estate

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 a financial advisor, lawyer, trust officer and tax planner. Get clarification on who is assuming the role of the quarterback. 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:

1. Implementing the plan based on appropriate strategies and solutions
2. Monitoring the plan

- ❖ 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/preserve the size of the estate
- ❖ Provide direction on various strategies and their implementation
- ❖ Confirm the timely planning and implementation of the plan including helping the 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 for property and health care, 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 tactics

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:

- ❖ Identifying 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 discussions and decisions such as:

- What property is in the estate, but outside the Will (probatable 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.

4 – 3.4 Step Four - Exploring Strategies for Transferring the Elder's Estate

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.

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 for $100 which is worth $50,000 may still be classified as a gift.

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 value of the interest in the asset to have been disposed of at fair market value in assessing capital gains to the donor, or 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 if the asset appreciates in value and is subsequently sold by the recipient, being first taxed on the increase from the adjusted cost base to the fair market value for the donor when they transferred it and again on the increase in value from the consideration paid to the fair market value when sold by the donee.

3. By Trusts

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 two classifications of trusts are living or inter vivos trusts and testamentary trusts. Living trusts avoid probate; testamentary trusts are generally 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.

4-3.6 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.

The most common types of trusts used by elders/seniors are alter ego and joint partner trusts.

1. Alter ego trust

This is a trust created by a settlor who was 65 years of age or older at the time the trust was created, where the settlor is entitled to receive all the income that may arise during their lifetime. That individual is the only person who can receive, or get the use of, any income or capital of the trust during their lifetime.

2. Joint partner (spousal) trust

This is a trust created by a settlor who was 65 years of age or older at the time the trust was created. The settlor and the settlor's spouse or common-law partner are entitled to receive all the income that may arise from the trust before the later of their deaths. They are the only persons who can receive, or get the use of, any income or capital of the trust so long as either one is alive.

Assets in these trusts do not form part of the settlor's estate.

4 – 3.7 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. There is no right of survivorship. On the death of one of the tenants in common, their share passes to their own respective estate and is dealt with according to their estate plans or provincial or territorial rules of intestacy.

This type of ownership triggers questions regarding rights of possession, who covers carrying costs and mortgages, what happens in the event of default or creditor claims and rights to sell an interest in the jointly owned property.

2. Joint tenancy with rights of survivorship

Joint tenants have full ownership of the property and have an equal and undivided right to keep or dispose of the property. At the death of one tenant, the full title to the property passes to the surviving tenant(s). For example, if three individuals own a property as joint tenants, and one owner dies, the two surviving owners become the sole owners of the property.

Joint Ownership applies when property is owned with a spouse or child in joint tenancy with right of survivorship. It is possible to sever the joint tenancy and create a tenancy in common if the co-owners decide that joint tenancy no longer suits their needs or situation. At death, the deceased's interest in the property ceases and is totally owned equally by the surviving joint owner(s). No part of the property is included in the deceased's estate thus potentially avoiding probate.

Care must be taken when setting up this arrangement. Joint tenants cannot leave their portion of the property to a third party in their Will.

A taxable disposition may occur when transferring partial ownership to another person during lifetime of both people. Generally, adding a spouse as joint tenant of capital property can be done at the adjusted cost base of the property. That means no taxable capital gain/loss will result. 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 is a trust that arises upon the death of the testator, usually under his or her Will or using a separate document. The settlor of the trust can direct and outline trust management via duties and limitations Generally, the transfer (including adding a spouse as joint tenant) of capital property between spouses can be done at the adjusted cost base of the property, so no taxable capital gain/loss will result that are spelled out in the trust document. It is common to leave a letter of wishes for the trustees. Like inter vivos trusts, existing and future testamentary trusts are generally taxed at the top marginal tax rate applicable to individuals on any income or capital gains not paid or payable to beneficiaries.

Graduated Rate Estates

These trusts may "benefit" from graduated tax rates like individuals for a period of time. The Department of Finance announced revised rules on an estate or testamentary trust, which now subjects them to the highest marginal tax rate for individuals after 36 months from the date of death (and then are considered a "flat top-rate estate"). Graduated rate estates will have a deemed taxation year-end on the day on which the estate ceases to be a graduated rate estate. These measures have been passed into law and apply to existing and new arrangements for the 2016 and later taxation years.

Under the regulations now, A graduated rate estate of an individual at any time, is the estate that arose on and because of the individual's death. Among the conditions that must be met are the following:

- that time is no more than 36 months after the death of the individual
- the estate is at that time a testamentary trust
- the individual's social insurance number is provided in the estate's T3 return of income for the tax year that includes that time and for each of its earlier tax years that ended after 2015 (36 month period after the death of the individual)
- the estate designates itself as the graduated rate estate of the individual in its T3 return
- no other estate designates itself as the graduated rate of estate of that individual in a T3 return of income for a tax year that ends after 2015
- An estate can only be a "graduated rate estate" for up to 36 months following the death of an individual. The estate will cease to be a graduated rate estate if it is still in existence at the end of the 36 months period.

(Government of Canada Trust types and codes; https://www.canada.ca/en/revenue-agency/services/tax/trust-administrators/types-trusts.html)

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, accounting and executor 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. The same holds true for named beneficiaries under an RRSP and RRIF regardless of the issuer outside of Quebec. You cannot name a beneficiary, successor holder or annuitant on a registered account if you are a resident of Quebec. The proceeds of your plan will be part of your estate. If you wish to designate a person to receive those registered assets, then under Quebec legislation, you must make that designation in a Will.

- **Save more money:** probate, filing fees and estate administration taxes, payable to the provincial or territorial 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 life insurance-based investment 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.

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.

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 outside of Quebec. 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.

4 -3.8 Step Five - Implementing the Plan

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.

To carry out the plan requires the naming of those people who will act on the elder’s behalf.

Executor, estate administrator or estate trustee

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 member 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

Consider the 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 – 3.9 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, tend to be asset based, not cash based, and so liquidity will be the first and largest problem the executor/executrix must deal with. Cash is easy to use to pay off debts and obligation and distribute to heirs, 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. One of the top three reasons Canadians have not completed these important documents is that they say they don’t know where or how to start.

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 and reflects their current wishes and circumstances.

It is estimated that over ½ of adult Canadians do not have will and upwards of 65% have not appointed agents under Powers of Attorney documents. This is despite the finding that 91% of Canadians think Wills are an important component of an estate plan.

An Advance care planning in Canada 2021 national poll found that while almost 8/10 Canadians (77%) think it is important to have discussions with their health-care provider about their future care wishes, only 7% have done so.

Reference Where There’s a Will, There’s a Way: Exploring Canadian Perspectives on Estate Planning, May 2023, National Institute on Ageing

Completing a Will and Power of Attorney documents and reviewing them periodically makes good sense. Not only does it give the personal representative the power to make decisions that will impact heirs and minimize income taxes, they also can provide specific instructions as to how the estate and affairs should be administered. Being an executor or agent under a Power of Attorney 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.

Note: Quebec has notarial Wills. These are drawn up by a notary and are made in the presence of a witness generally provided by the notary. Quebec is the only province that has a mandatory registry for notarial Wills. They do not need to be probated.

4 - 4.2 The Executor

An Executor / Executrix is 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. The executor may have few or broad powers of investment and the right to continue the business, or to wind it up at their discretion, depending on the powers granted in the Will and any restrictions in a Shareholders Agreement. They cannot actively withhold estate assets from beneficiaries or use those assets for their own benefit.

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.

For example, 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 in most jurisdictions. Exceptions exist in BC, Alberta, Saskatchewan, Quebec and most recently in Ontario. In fact, marriage does not automatically revoke a prior will in Ontario for marriage occurring on or after January 1, 2022. A will is not automatically revoked by a divorce. Instead, a Will made before a divorce is read as if the ex-spouse died immediately prior to the testator's death. This also means that the ex-spouse will not be an executor or beneficiary, unless the divorce is specifically addressed in the Will, a comparatively rare scenario. If spouses have been 'separated' under the definition found in the Succession Law Reform Act, referred to as a formal or long-term separation, then a Will made before the separation will be dealt with as if the separated spouse pre-deceased the testator, similar to a divorced spouse. Specifically, a couple that have been separated, but not divorced for at least 3 years before a death that occurs after December 31, 2021, or have a separation agreement, are now treated the same as divorced spouses in Ontario.

   It's important to emphasize that this change in the law is not retroactive. Couples who were married before January 1, 2022, are still subject to the previous rules. That means they do not have a Will, unless they made a new one in contemplation of marriage, and this is in the document, or they made a new one after marriage.

   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?

   Divorce does not revoke beneficiary designations made in favour of the former spouse on plan documents filed with financial institutions. Needs and scenarios change so be sure to check all beneficiary designations with financial institutions to make sure they reflect current wishes and circumstances.

   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?

2. **Situations change**

   Does the elder have business partners now? Do they have substantially larger (or even different) assets? Are there assets which have been sold or given away during the settlor's lifetime? Is their spouse in a care facility?

   Someone who is named as an executor is not obligated to accept the role. Has an alternate been named in the Will? Once that person formally accepts the position of executor, or even assumes it by beginning to administer the estate, they must continue.

3. **Times change**

   Is the elder's current Will still tax-effective? Was it ever? Tax regulations change from time to time, and some may be substantive, impacting how much estate shrinkage will occur.

4. **People die**

   If the elder decides to leave part of their estate to someone who dies before them, complications arise. Who gets that share? Is it dealt with in the residue of the estate? In addition, what happens if the chosen executor dies before the elder? Has an alternate executor been named who can step into the role of executor? Could the elder's estate end up with their executor's executor and if so, is there 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.

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. Stepchildren 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 handwritten, 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.

4 - 7.1 Costs

If there is no Will, the courts name an administrator, and the document issued is called "letters of Administration."

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 (2024)

PROVINCE	FEES
ALBERTA - Flat Rate For Estate Values At Each Level, Not Cumulative. No Rounding	Under $10,000 – $35 fee $10,001 to $25,000 - $135 $25,001 to $125,000 - $275 $125,001 to $250,000 - $400 Over $250,000 and over - $525
BRITISH COLUMBIA - Calculate For Each Level, Then Add Together. No Rounding Plus, Court Application Fee Of $200 Plus $40 For Each Copy Of Grant Of Probate And Assets And Liabilities	First $25,000 - no fees $25,001 to $50,000 - $200 + 0.6% Over $50,000 - $200 + 1.4%
MANITOBA	Eliminated probate fees
NEW BRUNSWICK - Flat Rate For Estate Value At Each Level Range. No Rounding Not Cumulative	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 -Add Flat Rate To Balance	First $1,000 - $60 Over $1,000 - $60 +0.6%
NORTHWEST TERRITORIES Flat Rate Between Each Level Noncumulative, I.E. Goes Back To Dollar One For Each Level	first $10,000 – $30 fee + $15 filing 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

NOVA SCOTIA - Non-Cumulative: Flat Rate For Each Band Back To Dollar One. No Rounding	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 + 1.695% on excess over $100,000
NUNAVUT	$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
ONTARIO - No Round Up	First $50,000 - 0 Over $50,000 - 1.5% on excess over $50,000
PRINCE EDWARD ISLAND - Round Up To Nearest $1000. Amounts Not Cumulative So Flat Rate Applies For Each Level	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 + 0.4% on amount over $100,000
QUEBEC	Notarial Will $0 not necessary to probate Natural Person (non notarial Will) * Legal Person (non notarial Will) * (*court filing charges for verification of wills - $230)
SASKATCHEWAN - No Rounding	All Estates - $7 per $1000 (0.7%) To file probate application, pay D34 court fee + $25 if request Certificate of No Infants.
YUKON	$25,000 or under - $0 Over $25,000 - $140 filing fee

4 – 7.2 Ontario Probate Rules as an Example

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 timelines 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 substantiating 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 using such devices and structures as Joint Spousal Trusts, Alter Ego Trusts, direct designation of beneficiaries, secondary Wills for non-probable assets in Ontario and BC, and perhaps joint tenancies where appropriate.

Here is a list of assets which do not require probate and that may be included under a secondary Will:

- Shares of privately held corporations, related shareholder’s loans and receivables
- Partnership interests and related loans and receivables
- Household goods and personal effects (excluding any items that may need to have ownership verified)
- Assets over which the testator has a power of appointment
- Unsecured debts

4 - 8 ESTATE LIQUIDITY

All the above information begs some questions, “Have you made a Will and is it current?” When the Will’s content is examined, the first thing that may be quite evident is the need for liquidity—CASH! Debts and taxes must be paid 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 it comes with the sacrifice of earning little if any interest and must be easily accessed.
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 frequently attracts taxation. Life insurance proceeds are generally 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.

Select life insurance policies may have increasing sums insured to deal with inflation at death, increased taxes, and keeping up the real value of bequests long after the policy was acquired. Life Insurance policies when combined with equity products, may provide a double-barrelled approach to offsetting inflation.

Inflation results in a diminished future value. Life Insurance and equity products may increase over time, without taxation, in the case of life insurance, or in the case of equity products, receive tax-favoured treatment.

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% of net income in a year to offset taxes owing. However, an estate can use charitable receipts for up to 100% of net income in the year of death and the preceding year. An estate will continue to be able to claim a charitable donation tax credit in respect of other donations in the year in which the donation is made or in any of the 5 following years. This may be extended to 10 years for gifts of certified ecologically sensitive land made after February 10, 2014. Another tax planning point is that the donation tax credit for donations made in the year of death can be claimed by either the deceased or their surviving spouse/common law partner.

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. For the 2016 and subsequent taxation years, donations by will and designation donations will be deemed to have been made by the estate, and where certain conditions are met, by the individual's graduated rate estate.

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, 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 Gifts of Property and Life Interests

An elder can make a gift of property (for example, real estate, investments 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, they can continue to use that property during their lifetime. The life estate holder, referred to as the income beneficiary, benefits from the use of the property or the income earned from the financial investments for the duration of their life. Upon their death, the ownership and use of the real property or assets passes to someone else so designated by the Will like a charity or adult children, who is considered the capital beneficiary.

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. Consider who pays carrying costs and maintenance, the income beneficiary or the capital beneficiary? Where is this documented and are there funds to pay for this?

The strategy of setting up a life interest is often suitable for a second marriage where the testator wants to provide for their second spouse without compromising the inheritance of children from a previous relationship.

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 may occur following a serious illness, or accident or at the end of your life and is specific as to how you want to be treated, including what may be your final days.

There are two kinds of advance directives. In the first one, the focus is on the who, i.e. the individual chooses who they wish to make these decisions for them. In the second one, the focus is on what i.e. the individual provides instructions about what decisions they want another to make or describe their beliefs and values and beliefs. This serves to guide a decision maker about what the donor would have wanted in a given scenario. The donor must be competent and only they can make an advance directive. In some parts of Canada, you can only do the first kind. In some, you can do both.

The living will is not unlike a “power of attorney” that one appoints to manage their finances once they become incapacitated. A living will is not the same as a Power of Attorney for Personal Care. It does document one’s wishes for end-of-life medical care. It does not need to name anyone to serve as the voice or be drafted in a specific way. A Power of Attorney for Personal Care names an individual(s) who has the legal right to act on the donor’s if they are unable to make decisions for themself.

The living will may appoint another person of their choosing to make the decisions that the donor cannot. This is commonly referred to as a "proxy directive" or a "durable medical power of attorney." A substitute decision maker can be appointed by the court if there is no living will or someone has not been named in a document.

There may be some confusion about living wills since the legal name for this document differs depending on the law of the province under which the document is created. *It may be referred to as an:*

- Advanced Health Care Directive
- Advanced Medical Directive
- Personal Directive
- Health Care Directive
- Representation Agreement

Whatever the case, courts in Canada have ruled that doctors and other health care providers must respect valid advance directives.

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 physical medical treatment they will receive as well as lifestyle decisions (think hairdressers, going to certain events, giving or withholding treatment. 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 4-3 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, other than to make me comfortable.

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:

I hereby appoint the following person 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 (POA)

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 and ends immediately if the grantor becomes mentally incapable or dies.

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. They may start immediately or be springing.

For each power 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.

One idea is for spouses to appoint each other as agent under a 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. The same person need not serve in both capacities. It may make sense to name different people for each of a Power of Attorney for Property and one for Personal Care, depending on perhaps business or medical acumen and a solid understanding of the donor's wishes, values and priorities.

While there are do-it-yourself forms available to allow individuals to appoint someone under a Power of Attorney for both property and personal care, there are special rules involved, which dictate whether a power of attorney document is validly signed and witnessed, 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 and/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 POA and or Living Will expire when the person dies. Thereafter, instructions are taken from the last Will and testament.
- POAs and Living Wills do not have to be registered with the government in most jurisdictions.
- A lawyer is not required to make a POA or Living Will - however if the elder's affairs or family dynamics are complicated; they should consider that option
- If an elder does not have a POA or Living Will, the government will not generally step in and manage their affairs. Family members have the right to apply to become "guardian" in the absence of a POA or Living Will. Close friends can also make application. In both cases, conditions are that they are at least 16 years old and are not being paid to provide the elder with health care, residential, social, training, or support services (other than spouse or partner). The guardian must stay connected with the elder and explain the kinds of decisions that are being made. The guardian has a responsibility to make decisions that are consistent with how the elder would have made them themself.
- The Office of the Public Trustee only acts in situations where no other suitable person is available, able and willing.

4 – 11 MEDICAL PROXIES

4 - 11.1 Proxy Advance Directives

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.

These directives name alternative persons, called surrogate decision makers, if someone is found to be incompetent to make their own decisions.

The proxy Advance Directive should be someone close to the elder, a person who is aware of the elder's wishes which may be a friend instead of a family member. 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.

Like not having a Will, an elder doesn't have to have a living will or Power of Attorney. The challenge is that decisions about their personal care or their property would likely be made without anyone knowing the elder's values, wishes or preferences.

4 - 11.2 Guardianship for Minors or adult infirm dependents

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.

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.

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 their family.

However, the value of most closely held businesses is reduced at the death of the owner, as they are usually the driving force behind the success. Thus, the primary estate planning objective of most business owners is to preserve the business for an orderly sale 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.

Get answers to the following questions. What are the five most important things that would need to be done on the death or incapacity of the business owner. Where is that written down? Who would do them? How well would they be done?

Selling a business at the death or retirement of the owner requires an organized and preferably, documented 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? Keep in mind that the value of a business does not necessarily equal the value of the assets held by the business. Furthermore, assets owned by the business, specifically a corporation, are not assets of the estate, even in a situation where the deceased was the sole owner of that business.

A discussion on valuation 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 or that its value is preserved on sale or wind down. 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 or sell to a competitor, supplier or distributor.

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.

4-12.1 Steps to take on the death of a business owner

Identify executor powers, obligations and limitations.

Is probate of the Will required? (perhaps covered under a secondary Will in Ontario and BC).

What is the scope of the executor's powers and obligations under the Will? If there are no instructions in the Will, the executor is obliged to sell the business in a timely manner at the best price and terms.

Is the executor both able and willing to act in that role when dealing with the business?

Does the executor have a conflict of interest? The executor has a responsibility to put the interests of beneficiaries as determined under the Will ahead of any personal interest, serving as a fiduciary to beneficiaries. These beneficiaries, if under a secondary Will may be different, as may be the executor.

What is the scope of the executor's contractual and statutory obligations under corporate law including shareholder agreements, articles of incorporation, or partnership agreements?

Can the business continue with the loss of the business owner? What was their role and expertise?

Did the business owner have a controlling interest? Did they own preferred shares, common shares, voting shares? Where an estate owns a controlling interest in a corporation, the executor may need to exercise their voting rights to appoint themselves or another person as a director of the corporation. Keep in mind that a director is held to a higher standard of care than an executor.

As a director, they are expected to be knowledgeable of and experienced in running the business. Here, the executor's first obligation is to the corporation, not the estate. As you can see, this may cause a conflict of interest.

The executor's main duty is to maximize the value of the shares for the estate. You see, the value of the shares in the business represents the value they bring to the deceased's estate.

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, when retirement is likely to occur, 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

Many Canadians are now doing more investing in the United States than ever before, including buying recreational properties. 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. These include 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.

4 – 14.2 Interests in U.S Real Estate

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.

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?

4 – 14.3 Personal Property & Investment Securities Located in the US

Such interests may be subject to U.S. income and estate tax.

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 worldwide 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.

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)?

4 – 14.6 Liabilities

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.

Income Tax at death is somewhat more complicated than while alive. Income taxes arising on death can be a significant drain on estate assets. Tax & estate planning will help to conserve the estate and ensure that estate assets are distributed in an orderly manner. 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.

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.

4 – 15.1 Filing of Tax Returns

The executor or estate administrator is accountable for filing income tax returns and paying taxes due from the estate. They may retain the services of an accountant to complete the necessary forms. 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.

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. There may not be a clearance certificate at the provincial level for such things as probate.

Income tax legislation, as it relates to deceased persons and their estates, can be very complex. Although there are opportunities for tax planning after death occurs, much more can be done beforehand to optimize one’s situation and minimize estate shrinkage due to taxes.

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 as well as 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.

The following form provides a convenient way of reviewing and recording the essential details of an elder’s personal financial plans.

Table 4-4 Estate Planning & Administration Professional Contact List

	Contact Information	
Advisor	**Phone Number**	**Email**
Financial Advisor(s) and Consultants -		
Lawyer -		
Accountant -		
Banker -		
Trust Officer -		
Investment Counselor(s) -		
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 – 15.2 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
- ❖ Choose an executor
- ❖ Choose agents under Power of Attorney for Property
- ❖ Choose agents under Power of Attorney for Health Care
- ❖ Choose 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
- ❖ Speak to agents under POAs and family about wishes and location of important papers
- ❖ Make list of assets and liabilities
- ❖ Speak to family about who will receive personal effects
- ❖ Make plans for your digital assets including access
- ❖ 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.

Separate surveys of older Canadians, including those done by the National Institute on Ageing in May 2023, identified a number of concerning issues. *Among them:*

- Among Canadians aged 55 years and over, ¼ (27%) 73% don't believe or don't know that a consequence of not having a will is that their wishes will not be known or followed.
- 59% of Canadians surveyed most frequently said that a consequence of not having a Will was that their wishes will not be known or followed.
- 73% of Canadians ages 55 and older felt the same way.
- 56% of Canadians say not having a Will can lead families to argue over the deceased's assets.
- 16% of Canadians believe there are no consequences or don't know the consequences of not having a Will
- 73% of Canadian age 55+ say that a consequence of not having a POA for property is that their wishes will not be known or followed, and 46% saying a consequence is that there will be no one to handle their finances.
- 23% of Canadians believe there are no consequences or don't know the consequences of not appointing a POA for property.
- 34% say they do not know the difference between a POA for healthcare and a POA for property.
- Most Canadians surveyed had named a friend or family member as their executor or multiple family members. Risks include actual or perceived conflict of interest, decisions based on emotions and family rifts
- Two thirds of respondents thought an estate could be wrapped up in a year or less, while 38% 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.
- 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.
- More than one in four Canadians age 55+ had no Will.
- 53% of Canadians age 55+ have appointed someone under a POA for themselves.
- Only 25% are working with a financial advisor on a plan; 29% on an investment plan and 28% on a retirement plan.
- 30% of Canadians say they have no financial plan at all.

Most people tasked with the role of estate administrator; trustee of executor had no prior experience in administering a Will. When conducting client seminars over many years, Peter Wouters has frequently commented that something you don't do often you are not likely to do well or quickly. The irony is that most of the mistakes and omissions are easily avoided and can be rectified. With a little forethought and impetus, people can construct estate and legacy plans to reflect their wishes, values and objectives.

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.

The challenge today is that less than a third (30%) of Canadians say they have an estate plan. Only 44% of Canadians age 55+ said they have an estate plan.

4 – 16.2 Mirror image Will or The "I Love You" Will

Most people have very simple Wills. They say that when one spouse dies, all their property goes to the surviving spouse and, when they are both gone, all the property goes to their children. It sounds very straightforward, and for people with modest estates and traditional family units, these Wills may be fine. For elders with large estates and/or more “modern” or complex family situations and dynamics, these Wills can create thousands of dollars of probate and other taxes plus litigation amongst heirs and those feeling cut out of the estate.

A mirror image Will attempts to ensure that the estate distribution wishes stay the same regardless of the order of death of the spouses. That is not a guarantee, and the deceased's wishes may not be followed. The surviving spouse can change their own Will, leaving their own and inherited estate to a new spouse or to beneficiaries other than the couple's surviving children.

Remember that if the surviving spouse remarries, in most provinces, the existing Will is automatically revoked, and intestacy laws would apply unless a new Will had been made. Then there is the possibility that the surviving spouse gives away inherited assets during their lifetime to other individuals and not to the people originally intended to receive them.

A prudent step is to periodically stress the terms and conditions and consider provisions in Wills or living trust agreements, which will become effective at the death of the first spouse. Spousal trusts and arrangements made to pass assets on to children on the first death are strategies to explore to guard against all of this.

Another alternative is to consider Mutual Wills which involve an explicit, agreement between the spouses/common law partners in a binding contract that following the death of one of them, they will not change or revoke their Will to defeat their current joint intention. That may not prevent the survivor from depleting the assets while alive, leaving little or nothing for intended heirs.

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.

4 – 16.4 Property Transfers Based on Non-Will Provisions

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. 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 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 taxes every year on the death of a taxpayer, from the estates of people who never quit being "accumulators" which could have been legally avoided or reduced,

4 – 16.6 Lack of Liquidity

Many affluent people create estates of great value, which, at death, are very illiquid. Holdings of real estate represent almost 80% of household assets (77%; Ipsos Poll 2022) and 41% of high net worth individuals state that their main source of investable assets come from income from owning or selling a business. (PWC Survey 2022, As the high-net-worth seek out new wealth managers, how do you retain clients and capture money-in-motion?) But, if those estates are subject to any taxes, those assets often must be sold at fire-sale prices to pay them. Taxes triggered on death are generally due within certain time limits without incurring penalties and interest charges. Forcing your family to choose between sacrificing a treasured asset and / or taking on an enormous burden of debt to pay capital gains and income taxes is inefficient. In many cases, it is 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" or fair. Most people will not argue about fairness; they often argue about equal treatment.

While dozens of examples exist, a common problem, often mishandled, is when a person owns a business in which only one or 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; consider not carving 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, misunderstanding and procrastination.

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, a lot of money could potentially be saved, and much heartache can be avoided.

4 – 17 SUMMARY OF LEGACY PLANNING

Estate or legacy planning is necessary for an individual to convey their assets to beneficiaries, both during their 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. Prudent individuals seek legal counsel and tax advice from qualified advisors before making estate planning insurance decisions.

Sometimes, those professionals reach out to insurance specialists to assist with the review, recommendation and implementation processes.

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 for some people.

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 Power of Attorney for Property, Power of Attorney for Personal Care, a 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, they invariably feel a well-deserved sense of satisfaction and peace of mind.

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. Effective planning may also increase the assets an elder leaves to the people and causes that are nearest and dearest to them.

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. They may well have had multiple marriages and be in common law relationships with children from different relationships. 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 where your assets go and how much heirs get.
- Keep all your valuable papers together - insurance policies, Wills, bonds, investment records, birth certificates, marriage certificates and social insurance numbers, tax files – and make sure your family knows where they are. Include digital assets and accessibility.
- 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.
- Be sure to check on those beneficiary designations when there is a change in one's personal situation to make sure they still reflect where those assets go on death of the owner.
- 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 to get your estate in order. Planning makes everything easier for your family and friends, not to mention yourself.

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Chapter 5

Travelling or Moving Abroad

5 – 1 KEY OBJECTIVE OF THIS CHAPTER

A number of Canadian elders decide, for a variety of reasons, to move to the USA. Many more travel there and to other countries - often for extended periods of time. The big drawing card is that it's warm and cheap. This chapter looks at some of the implications of spending a lot of time outside Canada, including purchasing property. This chapter will focus on the USA, covering some 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 affluent ones. Elder Canadians who travel to the USA expose themselves to a number of potential pitfalls that should be taken into account, planned for and managed on an ongoing basis.

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 USA. for extended periods of time and establish ties there.

5 – 2 INTRODUCTION

In many ways Canada and the USA are not all that different. Residents in both countries share much of the same entertainment, food, interests in sports, television, other media. There are many similarities and areas of common interest and concern with respect to lifestyle, tax, retirement and estate planning. There seems to be common issues regarding health and healthcare as well as housing, nutrition and caregiving.

Though the issues may be similar, the options, strategies and solutions available to deal with the various issues can be quite different and ineffective or conflict when applied across borders and jurisdictions. This is certainly the case when it comes to moving - or even travelling - from one jurisdiction to another. Tax, retirement and estate planning issues can become quite complex when straddling borders and there are different treatments for some of the same things when comparing Canada to the US. It's important then, to deal with specialists who understand the rules and applicability of strategies across borders and who can apply integrated solutions and alternatives.

The dynamics of working, living, or moving between countries, demands that, to quote, Peter Wouters, "the plans, components, solutions and strategies be reviewed periodically 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 reporting obligations and 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 USA for income taxes, estate taxes, or both while remaining liable for taxes in Canada. That brings up the issue of potential double taxation.

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 Canada Revenue Agency (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 USA. Elders, and the advisors working with them, owe it to themselves to be cognizant of the ramifications of becoming or being deemed to be an American resident.

5 - 2.1 Establishing Residency

"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 USA. Tax authorities reserve the option of assessing everyone's situation, and the facts provided, on a case by case 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 very important in terms of family, economics and property.

5-2.2 Deemed Residency

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.

There continues to be confusion, lack of understanding and appreciation for how Canadian residents or citizens can be deemed to be U.S. residents for income and estate tax purposes. There is an oft' quoted "183-day rule" or "physical presence" test which is not understood and is confused by the physical presence or sojourner rules for Canadian residency. *To see if an elder is affected by this, the individual must be physically present in the US for at least:*

- ❖ 31 days in the current calendar year and
- ❖ Add up the total number of days spent in the U.S. in the current year, plus
- ❖ 1/3 of the days spent in the U.S. in the previous year, plus
- ❖ 1/6 of the days spent in the U.S. the year before that (i.e., the second previous year)

If the elder's substantial presence in the U.S - based on the above formula - totals 183 days or more, that person will be considered a U.S. resident for tax purposes. Part days, even for a very brief time count as full days. Time spent includes that spent while in the territorial waters of the United States. That grabs boaters and their guests. The days do not have to be consecutive. The only part days that do not count are those spent travelling between two locations outside of the US and time spent in the US is less than 24 hours. There are some other exceptions noted below. As you can see, the calculation covers a rolling three-year period. The elder's travels may not be exactly the same each year.

Let's look at an example: Marcel and his wife Joanne purchased a condo in Florida a few years ago after vacationing in the area for a number of years.

They were in the US for:

- ❖ 126 days in 2024
- ❖ 120 days in 2023
- ❖ 120 days in 2022

The few extra days were for an hour of quick shopping and gas one day, a golf game on another and taking in a sporting event and dinner with friends on another day.

To see if they meet the substantial presence test for 2024, add up all the days from 2024 (123), one third of the days from 2023 (120/3 =40) and one sixth of the days from 2022 (120/6 =20). Since the total number of days over that three-year period is 183, they are considered U.S. residents under the substantial presence test for 2024.

Exclusions

Day commuters for work for those living in Canada don't count. It's likely they will be caught by other rules, like holding a Green Card whose holders are deemed residents of the USA regardless of the amount of time they spend there. Excluded days also include:

- Days that someone spends in the US as a crew member of a foreign vessel.
- Days someone is the U.S. for less than 24 hours, when in transit between two places outside the USA.
- Days that someone is an exempt individual. This is beyond the scope of this chapter.
- Days that keep someone in the U.S. due to a medical condition that develops while in the USA.

If someone was unable to leave the U.S. because of a medical condition or medical problem, they must include Form 8843, Statement for Exempt Individuals and Individuals With a Medical Condition. If they do not otherwise have to file a U.S. income tax return, they need to send Form 8843 to the address indicated in the instructions for that form by the due date for filing an income tax return.

If Form 8843 is not filed on time, then the individual cannot exclude the days they were present in the U.S. due to a medical condition that arose while they were there.

There are steps an elder can take to avoid being deemed a U.S. resident after meeting this substantial 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), whether they are covered by Canadian provincial health insurance. The form must be filed by June 15 of the following year.

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 U.S. residents for U.S. 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 U.S. There are other steps a green card holder can take to minimize tax and reporting that are beyond the scope of this chapter.

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 U.S. 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.

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 and border officials wary and inquisitive.

But that limit could change in the immediate future.

5-2.3 Proposed Changes

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 USD penalty. It is not the taxes that hurt you, it is the penalties for failing to file that are painful.

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 in Canada. Each province has specific rules about what type of resident qualifies and associated time spent in that province.

5 – 2.4 Opportunities for Wealthy Canadian Elders

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 began tracking not only when you enter each country by land, air or sea, but also when you leave.

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, California, Nevada, etc.), a lower cost of living, and lower taxes.

Unfortunately, moves of this nature are far from easy. Establishing non-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.

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. The CRA’s position is that there must be some permanence to someone’s stay outside of Canada. Spend less than 183 days in Canada each year, beginning with the date of your departure. Residential ties with Canada must be severed. That includes your home and family, including dependents in Canada, which are collectively referred to as primary residential ties.

Access at any time to a year round vacation property in Canada is considered a significant tie to Canada. The CRA also looks to see if primary residential ties have been established in the new country, which for purposes of this chapter, means the USA. Failing that, the CRA may presume you remain a Canadian resident.

Take care not to assume that establishing a permanent residence outside of Canada means that you have become a non-resident of Canada.

Secondary ties include such things as personal property and social ties. (think about service organizations, church/synagogue/temple membership, union and professional organizations, recreational organizations. Get a driver's license in your new place of residence and make that your main mailing address, having cancelled your Canadian ones.

The list is quite extensive and the more there on your list, the fewer that should be retained.

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 as tactics to address 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 - 3.1 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. That triggers capital gains tax if the value has gone up, and recapture of depreciated assets, which will have to be reported in the tax year of departure.

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. Assets not included in the total include:

Cash, bank accounts/deposits, personal use items like household effects, clothing and vehicles where the fair market value is less than $10,000. The value of registered plans are also excluded. Affected individuals need to file an Information form T1161 which lists all of their significant assets and send it along with their Canadian tax return for the year they emigrate.

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 (except of the first $100,000 of capital gains) but they do not incur any interest charges as a result of this deferral. Tax is still do on the entire capital gain.

Note, that if you post security, no interest is charged for the time up to earlier of the actual disposition of the property, including gifting it away 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 date of the assets).

Taxable Canadian property includes assets like:

- Shares of private Canadian companies and those not listed on a designated stock exchange other than mutual fund corporations
- Share interests in companies or units of a mutual fund trust where you and other non-arm’s length owners’ control 25% or more of any class of shares and more than half of the value of the shares or units were derived from Canadian or timber resource, property, real or immovable property situated in Canada or options in any of these.

- Shares of a corporation that are listed on a designated stock exchange where more than 50% of the value of those interests were derived by investments in the previous bullet
- 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 60 months
- Real or immovable property situated in Canada
- Goodwill, inventory used in a business you carried on in Canada

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 and capital losses cannot be claimed against these assets while a non-resident of 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. A Tax Treaty may make provisions for the now resident of the USA to apply any tax paid in the new country against any tax paid or payable in Canada.

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 - 3.2 Safeguarding RRSPs and RRIFs

There are some things that Canadian residents can do to safeguard 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. The same applies to tax free savings accounts (TFSAs), deferred profit sharing plans (DPSPs), private company pension plans (RPPs), retirement compensation agreements (RCAs).

An elder who wishes to leave Canada for the U.S. should leave their 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 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 if done while resident in Canada for income tax purposes.

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. This is not so for a TFSA when it comes to U.S. tax reporting. All TFSA growth is to be reported and taxed each year for U.S. tax purposes as ordinary income. That’s problematic considering that Canadian financial institutions do not track the type of income or report it.

Any withdrawals made from an RRSP or RRIF are subject to tax in the U.S. and Canada. Withdrawals from a TFSA are presumably tax free since all growth is taxed as earned. The Treaty ensures that tax on RRSPs and RRIFs is triggered in both countries on a federal basis at the same time. Canada taxes all withdrawals and income 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 their RSP/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 they intentionally or accidentally are 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.

Filing a special relief election form with the IRS each year will ensure that the growth within the RRSP or RRIF is not taxed by the US federal government. US persons are allowed an automatic election to defer income from an RRSP or RRIF under the Treaty,

The relief is offered to the beneficiaries of Canadian RRSP and RRIF plans. Information Reporting requirements were simplified Oct. 2014 with retroactive relief. Plan holders may qualify automatically for tax deferral.

To qualify automatically:

1. They must be either a resident alien or a US citizen and
2. They must have filed US tax returns for all and any years in which they held an interest in an RRSP. They must also have included distributions as income on these returns.

Income tax in the U.S. is deferred until withdrawals are made or income begins, with tax applied to those withdrawals, matching the timing that Canada taxes the same monies. Again, this election to defer income is now automatic.

This tax relief applies to contributions, transactions, and any "income and gains," protecting all from U.S. federal income tax.

Plan holders are not required to file Form 3520-A with respect to a U.S. citizen or resident alien who holds an interest in a RRSP, RRIF or RESP under Section 3 of Rev. Proc. 2014-55. This excludes TFSAs.

They still need to file Form 8938 (Statement of Specified Foreign Financial Assets) and FinCEN Form 114 (commonly referred to as FBAR, or Report of Foreign Bank and Financial Accounts).

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 – 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. Be sure to check that Wills made in one jurisdiction not only cover all assets regardless of location. Also check that revocation clauses in multiple Wills do not invalidate or replace each other and are specific to the assets and people intended. Check that assignees like executors and attorneys are recognized in any jurisdiction where needed to effect the wishes of the elder. Consider other documents and structures like trusts and corporations to protect and direct asset legacy plans.

5 - 4.1 U.S. Domicile

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 their 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."

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 Gift and Estate Taxes

Given the increases in federal estate tax exemptions and the fact that many states do not even have estate taxes or gift taxes, you might wonder why an elder Canadian who is resident in the U.S. should be concerned about gift and 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 Estate and Gift Taxes

The U.S. has a tax system that includes estate tax, gift and inheritance tax, and generation skipping transfer tax. For Canadian residents who are not factual or deemed U.S. residents or domiciliary residents, these transfer tax systems only apply to the value of U.S. situs assets. It's important to emphasize that the tax is on the value, not the increase in value.

Congress passed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 on Dec. 17th of that year. 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% 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, adjusted for inflation, per person for U.S. citizens and residents, with a maximum tax rate of 40% for the year 2013 and beyond. Estate tax rates begin at 18% and increase rapidly as the excess rises on average by $20,000 increments to 40% maximum tax once the excess exceeds $1 million.

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. Effective January 1, 2024, the federal estate and gift tax exemption amount increased to $13.61 million USD per individual.

This comes to a combined $27.22 million USD for a married couple. There is still a sunset clause that takes effect in 2026.

It then reverts to the pre 2018 rules of $5M USD indexed through to 2026, unless additional legislation is enacted to extend or change the legislation.

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 U.S. 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.

Exclusions from U.S. estate tax calculations

The following assets are not included as U.S. situs assets for Canadian residents.

- Canadian mutual funds and segregated funds and exchange traded funds (ETFs) with U.S. even if they are in USD denomination.
- U.S. Bank deposits and American depository receipts
- U.S. Treasuries or certificates of deposit
- U.S. corporate and government bonds subject to portfolio interest exemption
- Canadian issued notes linked to a U.S. index
- Assets not typically left in the U.S. (e.g. Driving a car back and forth vs. leaving one there

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. Benefits on death are still paid tax-free.

The sum insured is added to the denominator of the equation to help set the level of the estate for combined U.S. Gift and Estate taxes.

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. Twelve states, including popular destination states like Florida, California and Nevada have no estate or inheritance tax.

As of July 2024, 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. The exemption limits tend to be much lower than the federal limit. State inheritance and estate taxes range from 10% to 20% depending on the state.

Estate taxes are applied against a decedent’s assets and include the entire worldwide estate. Inheritance taxes are paid by beneficiaries and only on the amounts that each one receives. Non resident aliens, like Canadian residents with U.S. assets don’t get an exemption. They may avoid federal tax and remain liable for state tax due to the lower exempt thresholds.

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. Items like the full amount of a nonrecourse debt and a number of deductions reduce the value of the taxable estate.

Non-recourse debt is typically a mortgage obligation but may be another debt that can only be collected by the lender against the U.S. situs property itself and not against any other property of the individual or estate.

Allowable deductions include the value of U.S. situs property that is bequeathed to qualified U.S. charities, a prorated portion of expenses like funeral costs, administrative expenses and regular debts including part of a regular mortgage and estate tax paid to a U.S. state where that state has an estate tax regime. The prorated portion of the aforementioned expenses is the ratio of one’s U.S. situs estate to the value of their worldwide estate. A similar calculation determines how much of the combined lifetime estate and gift tax exemption, a Canadian resident may claim.

The calculation of U.S. estate tax can be quite complex so retaining the services of an accredited cross border tax specialist is considered quite prudent.

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.

5 - 4.5 Exemptions for Non-Residents

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.

The general exemption for non-residents remains unchanged at U.S. $60,000 (i.e., a U.S. federal 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 $13.61 million U.S D. (2024). If worldwide assets exceed that figure, estate taxes will be payable.

Under the Canada-U.S. Tax Treaty, an applicable credit amount applies. For 2024, it is the greater of:

- $13,000 USD or
- $5,389,800 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, they would be entitled to an enhanced applicable credit amount of $538,980 (IRS Rev. Proc. 2023-34)

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 the same lifetime estate and gift tax exemption, the same applicable credit amount, an unlimited marital deduction (to a U.S. citizen spouse) or a marital credit of $13,000 (for a non-U.S. citizen spouse).

No gift tax applies to transfers between spouses if both are U.S. citizens.

5 - 4.7 Marital Credits

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. That may prove to be a huge risk. They may be faced with unexpected and onerous demands for liquid assets and cash to meet death tax obligations plus assorted filings and reporting.

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 $5,389,800 million USD. The marital credit is available when U.S. situs property is transferred to a surviving Canadian or U.S. resident spouse. It's important to note that a spouse for this purpose is considered to be someone you are legally married to, so common-law partners may not qualify for this credit.

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 applicable credit amount. 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 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 $18,000 (2024) per year can be made to any number of individuals. Gifts of this amount do not impact the 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 that amount each 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 2024, 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 $13.61 million per individual (a combined $27.22 million for a married couple), representing an increase of $690,000 from 2023. It is in addition to the $13.61 million exemption for estate and gift tax.

For 2024, elders interested in passing on assets to their children, can give each one up to $18,000 USD 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 to a non-U.S. citizen spouse in 2024 is $185,000 USD.

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.

At death, capital gains are taxed as income in Canada and under estate tax legislation in the US.

Depreciation on U.S. rental property is deemed to be taken by the IRS whether the taxpayer uses it or not and increases the gain for sale and estate taxes.

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 resident 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, they should seek enough tax advice to be vested under the U.S. system.

Similarly, a Canadian resident 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 their rights to vest in Canadian social security and elder (senior) 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.

When a Canadian resident sells or is deemed to have sold appreciable assets on death, capital gains are triggered. U.S. situs assets are subject to estate tax. Under the Treaty, a foreign tax credit for U.S. estate tax may be claimed on their Canadian return to reduce federal tax attributable to income or gains on their U.S. situs property. There is a limitation on amount. The maximum foreign tax credit they can claim is limited to their Canadian tax liability. Frequently that may be much smaller than their U.S. estate tax liability. A further limitation is that Canadian provinces don't allow foreign tax credits for U.S. estate tax paid.

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.

The 2023 Employer Health Benefits Survey published in October 2023, found that the average premium for single coverage in 2023 was $8,435 per year. The average premium for family coverage was $23,968 per year. These average premiums each increased 7% in 2023. The average family premium has increased 22% since 2018 and 47% since 2013.

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 was a product of the health care reform agenda of the Democratic 111th Congress and the Obama administration. The law provides consumers with subsidies in the form of “premium tax credits,” which reduce costs for households with incomes between 100% and 400% of the federal poverty level. The Act also expanded the Medicaid program to cover all adults with income below 138% of the federal poverty level. Note that some states have not expanded their Medicaid programs.

The law included a large number of health-related provisions to take effect over the ensuing including 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. The Act has been under attack since then, not supported by Republicans and under supported financially.

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. Canadians moving to the U.S. should take note.

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 if residency and location for coverage are taken into account.

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. The U.S. national median cost for assisted living is $4,807 per month. For those that wish to age in place, the cost of a 40 hour per week in-home caregiver amounts to $5,280 per month, according to 2023 data collected from A Place for Mom's partner communities.

According to Genworth's 2021 Cost of Care Survey, the monthly median cost of nursing home care is $7,908 USD for a shared room, rising to $9,034 for a private room.

There is, however, a wide range of costs from state to state, as noted by the National Council on Aging, ranging from around $5,171/mo. in Illinois to over $31,512/mo. 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. Full benefits are available to those that have been in Canada for 40 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 (Wills, 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.

Tax and estate planning are never just about taxes. Think legacies and legacy planning. Simple and short may not capture unique situations, include adequate protection for later in life and associated aging issues, protecting surviving spouses/partners and children from creditors and predators.

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? Who will advocate for me when I can no longer do this for myself?

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.

5 - 8.1 Health Care Power of Attorney

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.

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 due to illness or injury 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.

5 - 8.2 Powers of Attorney

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.

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 U.S. 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 dismay 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 they are 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. Take care to check that documents made in one jurisdiction are considered validly completed in another.

5 - 8.3 Irrevocable Trusts

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 their parent's monies.

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 live 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 The 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 may permit these advisors to provide limited 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. One issue is that Canadian regulators may not approve the giving of advice or engaging in transactions with Canadian advisors not licenced to practice in the particular U.S. state.

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. 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 of 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.

5 - 10 REFERENCES

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- Form NR73, Determination of Residency Status
- Substantial Presence Test, IRS; https://www.irs.gov/individuals/international-taxpayers/substantial-presence-test
- Publication 519, U.S. Tax Guide for Aliens; IRS https://www.irs.gov/forms-pubs/about-publication-519
- Income Tax Folio S5-F1-C1: Determining an Individual's Residence Status
- Information Circular 76-17R4, Procedures concerning the disposition of taxable Canadian property by non-residents of Canada – section 116
- Form NR73, Determination of Residency Status (leaving Canada)
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Chapter 6

Income Tax Planning

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 touch on some effective tax planning strategies of interest to elders, 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 optimizing after tax cash flow to cover lifestyles, stretching their retirement dollars and optimizing legacies. Although, these goals may be important for all Canadians, the issues and opportunities are more numerous and complex for seniors, people age 65+. As will be noted later, a number of government benefits these people value or need are net income tested.

Tax planning then, is not just for the rich. In fact, most targeted income tax credit programs and government income support programs are designed for lower and middle income seniors, or elders as we prefer to call them. Few people, then, can afford not to engage in proper planning which can qualify them for these benefits.

Income and sales taxes, whether direct or indirect, are here to stay despite the introduction of temporary income tax back in 1917 to help finance WWl, followed by manufacturers' sales tax and other taxes in 1920. They are required to pay for generous social programs, servicing government debt, and cover the expenses associated with maintaining infrastructure and government initiatives. Laws and regulations are changing on an ongoing basis and getting more complicated in the process. It is necessary to keep abreast of these changes, to minimize the tax you pay.

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 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 included 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.

6 – 3.1 General Tax Provisions

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. Powers under GAAR have been broadened over recent years.

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, Estate Planning or Retirement Income Planning, includes components that look at how to minimize taxes for people by working within the boundaries and guidelines set out in the Income Tax Act (Canada) and the CRA.

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 for income tax purposes for the entire year.

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 at the time of attaining residency. Individuals ceasing to be resident are regarded as having disposed of their property, other than taxable Canadian property, at its current fair market value at the point of giving up their Canadian residency.

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 covered in Chapter 5, Travelling or Moving Abroad. Essentially, it is any property that can create a capital gain or capital loss when sold or transferred to another person or entity with certain exceptions. This includes depreciable property used to earn income. It is of particular interest to non-residents of Canada and to those who purchase this type of property.

When a non-resident of Canada sells taxable Canadian property, the buyer or purchaser must withhold and remit 25% of the net proceeds to the Canada Revenue Agency (CRA). The seller and buyer are jointly liable for taxes withheld. Capital gains realized by a non-resident on other forms of property are not taxable in Canada.

Taxable Canadian property is defined as including:

- ❖ Shares of private Canadian companies and those not listed on a designated stock exchange other than mutual fund corporations
- ❖ Share interests in companies or units of a mutual fund trust where you and other non-arm's length owners' control 25% or more of any class of shares and more than half of the value of the shares or units were derived from Canadian or timber resource property, real or immovable property situated in Canada or options in any of these.
- ❖ Shares of a corporation that are listed on a designated stock exchange where more than 50% of the value of those interests were derived by investments in the previous bullet
- ❖ 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 60 months
- ❖ Goodwill, inventory used in a business you carried on in Canada
- ❖ Real or immovable property situated in Canada
- ❖ Property deemed to be capital 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 chart shows the top combined Federal and Provincial Tax rates for 2024.

Table 6 - 1 Individual Top Combined Federal-Provincial Tax Rates for 2024 (%)

Province	Interest & Ordinary Income	Capital Gains [1]	Eligible Dividends	Non-Eligible Dividends
Federal	33.00	16.50	24.81	27.57
Alberta	48.00	24.00	34.31	42.31
British Columbia	53.50	26.75	36.54	48.89
Manitoba	50.40	25.20	47.78	46.67
New Brunswick	52.30	26.25	32.40	46.83
Newfoundland & Labrador	54.80	27.40	46.20	48.96
Northwest Territories	47.05	23.53	28.33	36.82
Nova Scotia	54.00	27.00	41.58	48.28
Nunavut	44.50	22.25	33.08	37.79
Ontario *	53.53	26.76	39.94	47.74
Prince Edward Island	51.75	25.88	36.20	47.63
Quebec	53.31	26.65	40.11	48.70
Saskatchewan	47.50	23.75	29.64	40.86
Yukon	48.00	24.00	28.93	44.04

Note: Top marginal income thresholds vary by province

[1] Changes made to alternative minimum (AMT) tax effective, Jan.1, 2024 which impact effective tax rates on capital gains for individuals at top tax rates. Considering federal income tax rate only, individuals subject to the top federal income tax rate of 33% will have an effective federal income tax rate on capital gains of 16.5%. Proposed federal AMT rate is 20.5%. This means someone with large capital gains after 2023 may be subject to a higher tax rate on that income.

***Provincial Surtax Rates for 2024**

Only Ontario has a provincial surtax system as of 2024 with PEI having replace theirs with a 5-bracket system. Ontario's surtax system is comprised of:

- 20% of basic provincial tax payable over $5,554-7,108
- plus 36% of basic provincial tax payable over $7,108

6 – 3.4 Tax on Tax System

The 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 a 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 TD1s is different.

6 – 3.5 Indexing

There is indexing to the personal income tax system. Amounts subject to indexing include the various personal credits, the tax brackets for individuals and the thresholds for eligibility for benefits and losing them or repaying government allowances, such as the Old Age Security.

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, address affordability for that first home, provide support for family members as caregivers. 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

Income is comprised of earned income, investment income and other income on a worldwide basis, totaled each year and reported on an annual tax return.

Earned Income

- Employment earnings, net of union dues and employment expenses
- Research grants (net of deductible, related expenses)
- Net income from self-employment and active partnership income
- Disability pensions under the CPP/QPP
- Royalties from works or inventions
- Net rental income from real estate
- Alimony or separation allowances received, and child support received (if taxable)
- Employee profit sharing plan allocations
- Supplementary unemployment benefits plan payments (not EI)

Unlike the income described above, the following income is not factored in when calculating RRSP contribution limits.

Investment - Interest income

The interest income on compound-interest obligations 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 under current legislation and only up to net capital gains up to $250,000 as noted in Federal Budget 2024.

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, again under current legislation.

Any unused allowable amount may be carried back up to three years or forward indefinitely to reduce taxable capital gains of other years.

Budget 2024 proposed an increase to the capital gains inclusion rate from one half to two thirds for corporations and trusts, and from one half to two thirds on the portion of capital gains realized in the year that exceed $250,000 for individuals, for capital gains realized on or after June 25, 2024.

The $250,000 threshold would effectively apply to capital gains realized by an individual, either directly or indirectly via a partnership or trust, net of any:

- current-year capital losses;
- capital losses of other years applied to reduce current-year capital gains; and
- capital gains in respect of which the Lifetime Capital Gains Exemption, the proposed Employee Ownership Trust Exemption or the proposed Canadian Entrepreneurs' Incentive is claimed.

Net capital losses of prior years would continue to be deductible against taxable capital gains in the current year by adjusting their value to reflect the inclusion rate of the capital gains being offset. This means that a capital loss realized prior to the rate change would fully offset an equivalent capital gain realized after the rate change.

Two different inclusion rates would apply for tax years that begin before and end on or after June 25, 2024. That means taxpayers need to identify capital gains and losses realized before the effective date (Period 1) and those realized on or after the effective date (Period 2). The annual $250,000 threshold for individuals would be fully available in 2024. It would not be prorated. The higher inclusion rate would apply only in respect of net capital gains realized in Period 2 and would be applied on that portion of net capital gains arising in Period 2 that exceed the $250,000 threshold and only for those net gains that had not been offset by a net loss incurred in Period 1 or any other taxation years.

Lifetime Capital Gains Exemption

The income tax system in Canada provides an individual with a lifetime tax exemption for capital gains realized on the disposition of qualified small business corporation shares and qualified farm or fishing property. The amount of the Lifetime Capital Gains Exemption is $1,016,836 in 2024 and is indexed to inflation.

The Federal Budget 2024 proposed an increase to this exemption to $1.25 million of eligible capital gains. This measure would apply to dispositions that occur on or after June 25, 2024. The exemption would be indexed beginning in 2026.

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? One issue is that the dividend gross-up for tax reporting increases net income. That in turn impacts eligibility for most government benefits.

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 non-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 applied. Both are reported on a tax slip.
- Non-eligible dividends are grossed-up by 15% and a federal dividend tax credit is applied, to be reported on a tax slip. These are paid out by Canadian controlled private corporations (small businesses) that pay corporate tax at a lesser rate.

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. Foreign dividends are not subject to the gross up and tax credit system. There may be withholding tax from the source country which may be credited in part, federally against Canadian taxes owed.

The improved tax position of dividend income may well be overshadowed by losses or reductions in a number of government benefits due to the reported gross up of Canadian dividends.

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), an annuity
- 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

If someone is required to use their own vehicle for business purposes and does not receive a reasonable, non-taxable allowance a portion of automobile expenses are deductible for income tax purposes.

6 – 5.2 Other Deductions

The following deductions do not impact RRSP contribution room **:**

- ❖ Contributions to registered deferred income plans (pension funds, RRSP)
- ❖ Childcare 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 than their old home
- ❖ The moving expenses have not been refunded to the taxpayer. Those expenses may be taxable depending on whether they are reimbursements for documented expenses. Certain moving expenses may be reimbursed without triggering a taxable benefit.

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

These include capital gains deductions 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 (except unused allowable business investment losses (ABIL), which can only be carried forward 10 years). If they haven't been used by that time, they are lost. Any unused ABIL after the carry-forward period becomes a net capital loss. This may be carried forward indefinitely and offset against capital gains.

- ❖ Farm losses that exceed income can be deducted as a non-capital loss against net income for the year and can be carried back 3 years and forward 20 years. If the farmer's chief source of income is farming/fishing or a combination of this and a subordinate source of income then farm losses may be deducted as ordinary business losses. If farming is not the chief source of income nor a combination thereof and subordinate sources of income, then the loss claimed is limited to the first $2,500, plus ½ of the next $30,000 (i.e. up to $15,000). The balance can be carried back or forward according to the time limits above.

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 indexed each year. It was set at $31,560 for 2024.

An individual's contribution limit for any given year is calculated based on their previous year's earned income, less the previous year's pension adjustment up to 18% of the previous year's income and subject to the maximum dollar amounts 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/common law partner 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 their own contribution to their plan, using their 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. You can contribute to your spouse/ common-law partner's RRSP until the December of the year that they turn 71, despite the fact that you may be well over that age.

Interest paid on funds borrowed for the purpose of funding a contribution to a Registered Retirement Savings Plan is not deductible for tax purposes.

Contributions made after death

No contributions can be made to a deceased individual’s RRSP after their date of death. That said, the deceased individual’s legal representative can make contributions to the surviving spouse/ common-law partner’s RRSP in the year of death or during the first 60 days after the end of that year. Contributions made to a spousal/ common-law partner’s RRSP can be claimed on the deceased individual’s income tax and benefit return. The limit is up to the deceased’s RRSP deduction limit for the year of death.

6 – 5.5 NET INCOME

One strong focus for retirees age 65+, is to pay attention to net income. *For retirees, the net income calculation determines:*

- the level of most government benefits and tax credits
- “income” upon which tax is payable and
- the amount of the OAS clawback or recovery tax.
- And it is used in assessment of long-term care per diems.
- It can also factor into provincial pharmacare and dental benefits.

From a tax investment perspective, let’s consider the impact on net income of various income sources.

Table 6-2 Let’s Consider The Impact On Net Income Of Various Income Sources.

$10,000 Investment Income Source	Net Income Inclusion for Income Tax
Eligible dividend	$13,800
Non-eligible dividend	$11,500
Foreign Dividend	$10,000
Interest	$10,000
Registered Retirement Income	$10,000
Realized Capital Gain	$ 5,000
Tax Free Savings Account	0
Effective 2024 Government of Canada information	

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

Personal tax credits of special interest to elders include:

1. Basic personal amount
2. Age amount available to those over 65. The amount of this nonrefundable tax credit is dependent on the elder’s net income level and is phased out by 15% over a certain threshold until reduced to zero. Spousal net income is not included.
3. Spouse/ common law partner amount if a spouse or partner has income under a specified amount.
4. Dependent amount.

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. It is a nonrefundable tax credit

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

6 – 6.2 Other Credits

Other tax credits of interest to elders include the following:

1. Pension income amount
2. Dependent amount
3. Disability amount
4. Caregiver expenses
5. Medical expenses
6. Charitable donations and gifts
7. GST/HST credit

Visit the Government of Canada website and search for topics that apply to you to find tax credits. Each province has information on their particular tax credits, generally contained in a tax credit directory. Remember that some tax credits are offered automatically. You may need to apply for others and see it you are eligible. A few of those appear when you are completing your annual tax return.

Transferring Unused Tax Credits (between spouses)

With couples, whenever possible, ensure that tax credits are being claimed by the spouse/common law partner who will benefit the most from them when looking at thresholds to claim them and reducing income tax owed.

A refundable tax credit may be claimed regardless of how little income tax you owe. You can still claim a credit for its established amount even if you owe no income tax at all.

A non-refundable tax credit can only be used to reduce federal or provincial/territorial taxes payable to zero. They cannot be carried over to future years.

Some tax credits, if not used fully by the taxpayer, are lost. This is generally due to the fact that the taxpayer has insufficient taxable income to fully use them. Others may be transferred. *The following personal credits may be transferred between spouses:*

- Age credit
- Pension income amount credit
- Disability tax credit
- Caregiver amount (for infirm child)

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 – 6.3 Disability Credit

If the taxpayer has a severe and prolonged physical or mental impairment or 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.

A nonrefundable tax credit is available when the impairment is certified on Form T2201. The certification is provided by an appropriate professional depending on the nature of the impairment. It could be a medical doctor, nurse practitioner, optometrist, audiologist, speech language pathologist, occupational therapist, physiotherapist or psychologist.

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 Expanded support for Persons with disabilities

Federal Budget 2024 proposed to enact the Canada Disability Benefit Act in June 2024 and provide $200/mo. to low income Canadians, ages 18-64 with a valid Disability Tax Credit certificate, effective July 2025. The federal government called on provinces and territories to exempt Canada Disability Benefit payments from counting as income in relation to provincial or territorial supports.

Budget 2024 announced the government's intention to amend the Income Tax Act to make additional expenses eligible for the Disability Supports Deduction, subject to certain conditions, such as:

- ❖ service animals trained to perform specific tasks for people with certain severe impairments;
- ❖ alternative computer input devices, such as assistive keyboards, braille display, digital pens, and speech recognition devices; and,
- ❖ ergonomic work chairs and bed positioning devices, including related assessment
- ❖ Impairment in physical or mental function:

- ❖ Vision impairment: navigation device
- ❖ Mention impairment: memory or organizational aids.

6 – 6.5 Canada Caregiver Amount Credit

A tax credit is available for caregivers who provide in-home care for elderly or infirm relatives with a physical or mental impairment. The amount of the credit available to be claimed is dependent on the elderly or infirm relative's income. It is not available for non-infirm parents age 65+ who live with the taxpayer. Aside from spouses/common law partners, eligible infirm dependents include spouse/common law partner's child or grandchild, their parent, grandparent, siblings, uncle, aunt, niece or nephew resident in Canada.

There are two maximum amounts, depending on the age and relationship of the infirm dependent.

1. Spouse/common law partner; $2,499, whose net income must be less than your basic personal amount (or your basic personal amount plus $2,499) plus
2. Spouse/common law partner or eligible dependant 18 years of age or older with net income within certain range declared annually; up to $7,999 which is reduced dollar for dollar by the dependant's income within that range, down to zero.

6 – 6.6 Pension Income Amount

A 15% federal tax credit for up to $2,000 of eligible pension income is available to qualified individuals and is applied to the first $2,000 of eligible income. You need to trigger income to get this credit.

Eligible pension income when less age 65+ (i.e. any age) includes:

- ❖ Formal pension income at any age including deferred profit sharing plans (DPSP)
- ❖ Foreign source pensions reported on Line 115 of individual's tax return for the portion of pension income that is taxable, (e.g. U.S. social security minus 15% deduction on Canadian tax return)
- ❖ Survivorship income of previously eligible pensioner (i.e. life annuity receipts from a superannuation or pension fund Including interest income from insurance company issued GIC

Eligible pension income at age 65+ includes the above plus:

- ❖ Registered Annuity payments under an RRSP or DPSP
- ❖ Periodic receipts from a RRIF, LIF or LRIF
- ❖ Interest component of taxable portion of non-registered annuities (term certain and life annuities), 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 at any age

- ❖ Amounts distributed from retirement compensation arrangement (RCA) (T4A-RCA slips) in certain circumstances and subject to certain limits

Non-qualifying pension income includes:

- ❖ CPP/QPP
- ❖ Old Age Security
- ❖ Death benefits
- ❖ Retiring allowances
- ❖ Excess amounts from RRIF transferred to RRSP, another RRIF or annuity
- ❖ Amounts shown in (boxes 18,20,22,26,28,34 of) T4RSP slips
- ❖ Amounts distributed from retirement compensation arrangement (RCA) (T4A-RCA slips)
- ❖ Salary deferral benefits
- ❖ Income from a US Individual Retirement Account (IRA)
- ❖ Any foreign source pension income that is tax-free in Canada due to tax treaty entitling deduction (on line 256)

6 - 6.7 Housing Support

A series of incentives has been announced by the federal government as part of Federal Budgets 2023 and 2024. *These include the following:*

<u>The Secondary suite lending program providing</u>

- ❖ Up to $40,000 in interest free loans to convert existing space in homes. This will offer senior homeowners the opportunity to age in place, optimize "vacant space" and generate income for them while providing housing for others. The program can also be used to construct space to have family members to live close by in a new renovated unit.

- ❖ Up to $7,500 for a new unit secondary suite for a senior age 65+ or adult with a disability, ages 18-64 and eligible for the Disability Tax Credit at any time in the renovation period tax year.

Called the **Multigeneration Home Renovation Tax Credit**, it is a refundable tax credit. Individuals can claim up to $50,000 in qualifying expenditures for each qualifying renovation that is completed. The tax credit is 15% of the costs, up to a maximum of $7,500, for each claim an individual is eligible to make. The claim must be made in the same year that the renovation is completed, not started. Only one renovation can be claimed for a qualifying individual during their lifetime.

A qualifying relation may be a parent, grandparent, child, grandchild, brother, sister, aunt, uncle, niece or nephew of the qualifying individual (or the qualifying individual's cohabiting spouse or common-law partner) at any time in the renovation period tax year.

An eligible individual is a resident of Canada from January 1 to December 31 of the year they are making the claim who either:

1. Ordinarily resides, or intends to ordinarily reside, in the eligible dwelling within 12 months of the end of the renovation period of a qualifying renovation and is one of the following:

    - ❖ A qualifying individual
    - ❖ The cohabitating spouse or common-law partner of a qualifying individual (at any time in the tax year for whom you are making the claim)
    - ❖ A qualifying relation of a qualifying individual

2. Owns the eligible dwelling (or is the beneficiary of a trust that owns the eligible dwelling) and is a qualifying relation of a qualifying individual

Details are available under the Government of Canada's publication; Multigenerational home renovation tax credit (MHRTC)

- ❖ Canada Builds" a $15-billion top-up to the Apartment Construction Loan Program
- ❖ Launching of a Canadian Renters' Bill of Rights and $1.5B Canada Rental Protection Fund supporting renters; $1 billion in loans and $470 million in contributions to the fund to combat evictions and dramatic price increases. These initiatives would be well received by all renters and in particular elders.

6 – 6.8 Canadian Dental Care Plan

The Canadian Dental Care Plan will help ease financial barriers to accessing oral health care for eligible Canadian residents. The program first targets seniors starting with the oldest age 87+ and moving down in age blocks so that applications opened up for all elders age 65+ starting in June 2024.

Applications will open in phases starting with seniors.

The Canadian Dental Care Plan will help cover a broad range of oral health care services that keep a person's teeth and gums healthy, prevents and treats oral health care issues and diseases.

Here are some examples of services that could be covered when recommended by an oral health provider:

- ❖ preventive services, including scaling (cleaning), sealants and fluoride
- ❖ diagnostic services, including examinations and x-rays
- ❖ restorative services, including fillings
- ❖ endodontic services, including root canal treatments
- ❖ prosthodontic services, including:
- ❖ complete dentures, and

- ❖ partial removable dentures
- ❖ periodontal services, including deep scaling
- ❖ oral surgery services, including extractions

The plan will reimburse a percentage of the cost, based on established plan fees and the individual’s adjusted family net income. Individuals may have to pay additional charges directly to the oral health provider, if their adjusted family net income is between $70,000 and $89,999. Additional out of pocket charges also include the excess cost of oral health over established plan fees. The individual will pay the full cost of services received where they and their oral health care provider agree to services that the plan doesn’t cover.

6-6.9 Pharmacare Act

Bill C-64 was introduced in February 2024 to propose foundational principles for phase one of national universal pharmacare in Canada. The federal government is working with provinces and territories to provide universal, single-payer coverage for a number of contraception and diabetes medications. This was further announced in the April Federal Budget. The government has planned to set up a fund to support Canadians’ access to supplies that diabetics require to manage and monitor their condition, including syringes and glucose test strips

6 – 6.10 GST/HST Credit

Eligible Canadians who file an income tax return will automatically receive the goods and services tax/harmonized sales tax credit, referred to as the GST/HST credit. It is paid out four times per year. This tax credit is available to Canadians with low to moderate incomes. It is intended to help reduce taxes paid on products and services throughout the year.

6 – 6.11 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 exceeding the lesser of $2,759 or 3% of the individual’s net income for the year (2024 tax year). The expenses must have been paid by the taxpayer or the taxpayer's legal representative. This includes the individual's spouse/common law partner. This is a non-refundable tax credit.

All provinces and territories except Quebec use the federal medical expense total to calculate their respective provincial medical expense tax credit. Note that the provincial base amount threshold is different from the Federal one for most provinces and territories. In Quebec, if the individual was a resident of Quebec age 18+ on December 31 of the year and was a resident of Canada throughout the year when the claim was incurred by the claim, then a refundable tax credit may be claimed for certain medical expenses.

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. Generally, all eligible medical expenses can be claimed, even if they were incurred and paid outside of Canada. Remember that when medical expenses are reimbursed by an insurance plan, only non reimbursed portion can be claimed. Medical expenses are deductible based on when they were actually paid, not when the services were performed. A taxpayer can either delay or prepay expenses to optimize the use of expenses near year end.

The list of expenses eligible for the medical expense tax credit includes:

- ❖ Premiums for medical, hospital and dental coverage excluding provincial and territorial health care plans
- ❖ Attendant care for disabled workers, up to 2/3 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, disease or disorder to a maximum of $1,000; prescription needed
- ❖ Air filter, cleaner, purifier for severe chronic respiratory ailment or severe chronic immune system disorder, prescription needed
- ❖ Assisted breathing devices that give air to the lungs under pressure, like a continuous positive airway pressure (CPAP) machine; prescription needed or a mechanical ventilator
- ❖ Acoustic coupler, prescription needed
- ❖ Hearing aids including batteries and repairs
- ❖ Altered auditory feedback devices for treating a speech disorder; prescription needed
- ❖ 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
- ❖ Artificial limb or eye; no prescription or certification
- ❖ Expenses incurred for moving to accessible housing, to a maximum of $2,000 (Ontario provincial limit $3,282)
- ❖ Sign language interpreter fees
- ❖ Laser eye surgery
- ❖ 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
- Ambulance service to/from hospital
- 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
- Audible signal devices including large or loud ringing bells, single stroke bells, vibrating bells, horns, and visible signals; prescription needed
- Bathroom aids to help a person get in/out of bathtub or shower or to get on/off a toilet; prescription needed
- Service animals; cost of specially trained animal to assist in coping with an impairment for a person with certain severe conditions; plus, care and maintenance, including food and veterinarian care

As you can see, the list of expenses eligible for the medical expense credit is lengthy and this one is not exhaustive. For a review of eligible medical expenses, refer to, Government of Canada publication, Details of medical expenses, IT-519R2 or other CRA publications.

When claiming medical expenses, the taxpayer can choose any 12-month period ending in the calendar year for which the tax return is being filed, to optimize inclusions for tax purposes.

This credit may be transferred to a spouse/common law partner. In fact, it can be of greater benefit when claimed by the lower income spouse/common law partner. As one of those net income tested benefits, only medical expenses exceeding 3% of the taxpayer’s income or a set threshold announced by the government annually may be claimed. Remember, medical expenses can be combined and claimed on one return. The lower the net income, the more that can be claimed.

Medical expenses can be claimed for a deceased person who is a (eligible) dependent. In this case, they may be claimed provided they were paid within any 24 month period including the date of the person's death, so long as they were not claimed in a previous year.

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) federally and provincially. Ontario has a cap periodically adjusted ($17,147 per year and $34,293 in year of death (2024)).

6 – 6.12 Attendant Care Amount

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.

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 as soon as possible after January 1 of the following year.

Canada assesses income taxes on the basis 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 significant residential ties with Canada while they are 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 for the entire year if that individual sojourns in Canada for a total of 183 days (or more) in a calendar year. Their worldwide income would need to be included on their Canadian tax return.

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.

6 – 8.1 Income Splitting Opportunities

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.

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 CRA prescribed 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, provided the interest is paid on time each year. Otherwise, the rate moves to the current rate and income is attributed to the lender.

Spousal loans may 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 to optimize tax on that income during accumulation and withdrawal as lump sums or an income/cash flow stream.

The higher income spouse could 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 (grand)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.

Graduated Rate Estates

During the first 36 months following the death of a taxpayer, the estate trustee/executor can choose to have the estate treated as a Graduated Rate Estate. Income is taxed on a graduated basis, the same as for an individual. Thereafter, income is taxed at the top marginal tax rate. An estate could have two year ends in the year where the 36 month limit is reached. The first is from Jan.1st to the third anniversary of the individual's death. The second is from there to the end of the year. A trust remaining in effect after that time has a calendar year end. Testamentary trusts are considered a separate taxpayer for income tax purposes.

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 their federal income tax reduced by $300.
- Reinstate Old Age Security benefits by reducing or eliminating OAS repayment (claw back) via the OAS recovery tax.
- 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)

Income Tax Rules and Death

Paying more attention on tax planning as part of estate planning for elders is a prudent and more holistic approach. In estate planning as in life, two things are certain: death and taxes. At death, the decedent's property is transferred to their heirs. How much they get 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 both the decedent and their beneficiaries.

Income tax at death may be more complicated and certainly much higher than while alive. Income taxes arising on death can be a significant drain on estate assets. Tax and Estate planning will help to conserve the value of the estate and ensure that estate assets are distributed in an orderly manner.

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.

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 involves identifying and declaring all income to the date of death. 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 as well as dividend income and other investment income. 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. Appreciable property is generally deemed to have been sold immediately before death, triggering capital gains or losses (except for personal use property) and recapture of depreciation if the market value is higher than the depreciated value reported. Investment portfolios and shares of a business may be rolled over to a surviving spouse without triggering tax. The surviving spouse assumes the adjusted cost base of the investment or shareholding. They would pay tax on subsequent sale or deemed sale.

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.

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.

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!

6 – 9 WEALTH TRANSFERS & DEEMED DISPOSITION TAXES

6 – 9.1 Capital Properties

As mentioned earlier, 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 for individuals on the first $250,000 of net capital gain and 66.67% on the balance.

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 plus the cost of documented additions and improvements is the capital gain on the property for the owner. "Additions" include such things as: renovations, additional rooms, building a new deck or replacing an old one with a larger one, upgrading fixtures, new windows, doors, perhaps even a new roof that is better quality or changes the pitch.

Also keep track of money spent on new septic systems or wells, water systems, driveways, pathways, correcting drainage issues, fencing, permanent docks, storage buildings, garages and the like.

Save those invoices and payments for materials and outside labour (not your own).

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 and maintain the property, pay property taxes and so on.

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.

An issue that arises is that simply adding a adult child as a co-owner may not avoid inclusion for probate. This tactic may be viewed as a presumption of resulting trust. It's presumed that the transferor intended to retain the beneficial ownership of the transferred property. The burden of proving that a gift was intended falls on the transferee/recipient of the property transferred. Clear documentation and communication helps clarify intent and whether a gift of ownership was intended

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 generally be subject to the attribution rules. (exceptions covered elsewhere).

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. The additional problem that arises is that the non arms length buyer assumes an adjusted cost based equal to what they paid, inviting double taxation on a subsequent disposition for the difference between what they paid and the fair market value of the parent when the sale was made.

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

6 – 10.1 Income and Losses from Property Transferred or Loaned to A Spouse or Minor

These schemes include:

- Loan guarantees
- Interest-free or low interest loans
- Indirect payments and transfers of rights to income
- Split income tax

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 of the transferor.

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.

6 – 11.1 Taxation of Withdrawals and Loans

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.

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 may 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 ITA (Canada) 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) ITA (Canada) 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 insureds are children of the policyholder, do not qualify for the tax-free transfer of ownership.

A transfer by way of the Will would not satisfy the tax free rollover rules. It can be done via successor designation (s. 199, Insurance Act) as confirmed by CRA technical interpretation letter 9618075 September 3, 1996.

No consideration is permitted under the rollover rules for tax exemption.

Attribution rules will apply for transfers (and subsequent dispositions) while the child is under age 18. For this reason, generally the transfers will be delayed until at least that time. A spouse or parent of the child can be named as interim successor owner should the original owner die before the transfer to the child who is still a minor at that time.

6 – 12 CHARITABLE GIVING

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 and CAGP Environics Analytics Study published in 2020:*

- ❖ Only 48% of Canadians have made a Will
- ❖ Nearly 90% of Canadians will have a will by age 75
- ❖ 86% of Canadians know they can make a charitable gift in their Will

- ❖ Only 1/3 of Canadians are interested in leaving a gift to charity in their will. The number one fear of most is that doing so will leave less for their loved one. In fact, most don't even consider the option because they do not believe it possible to support both charity and family in their Will!

Canadian seniors ages 65-74 are the most interested portion of elder want to help charities and their favourite causes. They make an important contribution to charitable giving and volunteering. They are more likely to make in-kind donations such as clothing, and food, than their older counterparts. That said 7% of older seniors left a bequest to a charitable, religious or spiritual organization, compared to 4% of younger seniors.

Almost nine out of ten (87.2%) Canadians age 65 and older donated to charities for a combined total of over $2.56 Billion.

There are three conditions that must be met as per Bulletin IT–11OR2 for a gift to qualify as a charitable donation:

- ❖ Property and cash are transferred by a donor to a registered charity
- ❖ The transfer is voluntary; any legal obligation on the payor would cause the transfer to lose its status as a gift
- ❖ The 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 Charitable Donation Tax Credit

Donations by individuals made to a registered charity, receive a federal tax credit of:

- ❖ 15% on amounts up to $200
- ❖ 29% on amounts over $200 for a combined federal and provincial tax credit of up to 54% depending on income level and province/territory
- ❖ 33% on amounts exceeding $200, on the lesser of:
  - the amount of the donation or
  - the individual's net income over the top income tax bracket threshold ($246,752 for 2024)

Provinces and territories also provide additional tax credits. All or part of eligible amounts of donations may be claimed up to 75% of a taxpayer's net income for the year. Unused amounts may be carried forward and claimed for any of the next 5 years (10 years for gifts of ecologically sensitive land).

Spouses/common law partners may combine donations on one tax return to optimize tax credits and get higher tax credits. Donations made by one may also be split between the two, particularly if very large donations relative to income are being made.

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.

Donations made by corporations get a deduction within the same specified limits. When appreciable assets are donated, the corporation's notional capital dividend account is credited with the non-taxable portion of triggered capital gains. Credited amounts can be paid out tax-free to Canadian resident shareholders.

6- 12.2 Charitable Giving Using Life Insurance

Permanent life insurance offering lifetime coverage may be used as donations to registered charities. The policy may be owned by the donor with a charity(s) named as beneficiary of some or all of the benefit paid on death of the life insured. Alternatively, the policy may be owned by the charity with itself being named as beneficiary. In the latter case, the policy may be set up initially with the charity as owner or an existing inforce policy may have its ownership transferred to the charity as the new owner for fair market value minus any policy loans. In this situation, if the value exceeds the policy's adjusted cost basis, the excess is taxable to the owner. If premiums are still required to keep the policy in force, they are treated as further donations by the donor.

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 as the owner. Alternatively, a credit can be claimed for the proceeds of the life insurance policy paid to a charity when it is owned by the donor. This credit is available in the year of death of the life insured.

A life insurance policy is taken out on the life of the donor personally with either the donor's estate or the charity named as the beneficiary of the policy. The donor is the owner of the policy. Alternatively, the individual as a shareholder of a private company may set this up with their company as the owner with the charity as the beneficiary. The door maintains control over the policy. They can direct the funds to another charity if objectives or priorities change or if the values of the donor and charity no longer align.

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. Also keep in mind that should the charity lose it registration status as a qualifying charity by the CRA or it stops operating, the terms of the Will need to be changed or the Will should include instructions to address what should happen, like naming another charity more in keeping with the values of the donor as contingent beneficiary.

A tax 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 is often 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.

This preserves more of the estate for family and other heirs by reducing taxes owed on death via the donation tax credit.

The tax benefit of having the insurance proceeds pass through the estate or paid directly to the charity is the same. A donation tax credit is given to the individual 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. It is easier and more certain from a charity's perspective to receive a donation as the beneficiary of a life insurance policy rather than from an estate. In the latter case, the charity may get caught up with potential liquidity issues, creditors' claims, litigation and protracted time delays experienced by the estate. The donation may fail if there are insufficient funds remaining and the donation is no longer private.

6- 12.3 Naming Charity as Irrevocable Beneficiary

Note that if the charity is designated as an irrevocable beneficiary, the donor no longer retains full control over the policy. Policy changes, including beneficiary changes, cannot be made without the consent of the irrevocable beneficiary. That could be quite problematic if the charity lost its registered and qualified status, meaning that there would be no donation tax receipt eligible for the tax credit.

The Income Tax Act (Canada) has a provision stating that if you donate by beneficiary designation, then immediately before death you must have a level of control over your policy so that changing the policy's beneficiary would require your consent. (ref. ss. 118.1(5.2). This rule is typically satisfied by virtue of your ownership of the policy. That said, there was some uncertainty and discomfort about whether the donation tax credit would be available in a scenario where the charity was named irrevocable beneficiary. The CRA confirmed that a taxpayer donor who is the owner of a life insurance policy, may receive a tax credit if the charity is set up as irrevocable beneficiary. (see CRA Technical Interpretation 2004-0065451C6, May 4, 2004.)

6-12.4 More on 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 life 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. Additionally, the donor must demonstrate a history of supporting the charity commensurate with the size of the donation in terms of past donations, pledges and volunteering.

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. This is the preferred approach by insurance companies. The donor and charity get proof of payment, and the charity issues a tax receipt.

Alternatively, 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 an annual 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 life insurance 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 generally, the tax credit more than offsets the taxes due.

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. This strategy also permits donors to make substantial donations with comparatively modest commitments.

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 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
- ❖ 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. Receipts required

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
- ❖ Recognizing that the capital portion of non-registered annuity payments is not taxable; they are a return of capital.

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.

Federal Budget 2024 announced an expansion of simplified services (SimpleFile by Phone) for tax filing so that non-filers have the opportunity to collect benefits only available to tax filers. Simplefile Digital and SimpleFile by Paper will be piloted in the summer of 2024.

6 – 15 CONCLUSIONS

An elder’s tax situation after leaving the workforce and embarking on that series of phases, collectively called 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. And of course, cash flows from TFSAs are also non-taxable and not reportable as income.

They may also begin receiving income that has no or insufficient 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 own a Registered Retirement Savings Plan (RRSP), it must mature by the end of the year that they turn 71. Decisions must be made about what to do next. 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.

A very good guide for elders age 65+ is to focus on net income and reduce it as much as possible to optimize the many government benefits and tax credits available where possible. This is even more important for low and modest income levels where a number of benefits phase out or are restricted to individuals and families below certain income levels.

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 valued by aging Canadians and their families.

6 – 16 REFERENCES

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We hope that the EPC Designation program is just the beginning of your aging education, as you continue to interact with Canada’s aging society.

Congratulations on wanting to becoming an Elder Planning Counselor!

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