BMO Nesbitt Burns | Spring 2019

# Investment Insight

## Equity Investing is Never a Smooth Road

Fear and Greed: the two emotions that are said to drive the equity markets. How quickly, it seems, that the sentiment can oscillate from one extreme to the other. Over recent times, Canadian and U.S. equity markets have experienced periods of remarkable advances in prices, as well as many months which seemed to forecast an Armageddon just around the corner.

It is interesting how quickly the focus of many market commentators can shift with these movements. After a volatile December for both Canadian and U.S. markets, the media was consumed with recessionary talk. Yet this was quickly muted after significant January and February gains. In the U.S., the Federal Reserve took a less aggressive stance in its monetary policy, downplaying its position on the prospect of further interest rate rises. This, combined with a solid U.S. earnings season, and delayed U.S./China trade tariff deadlines, provided much relief to investors.

Here at home, growth has slowed and the struggle continues for various segments of the housing market, as well as the oil and gas sector. Corporate earnings results have been mixed, but the labour market is still solid and cash levels on many corporate balance sheets remain healthy.

As certain voices of the media continue their pessimistic narrative, many investors are wondering where the markets are headed.

**Never a Smooth Road**

This is a good reminder that volatility plays a common role in the equity markets. With the ups and downs, it may be easy to fall into the trap of taking an unbalanced view — looking only to the recent past to guide investment decisions. But this is often counterproductive. When times are difficult, it constrains positive action. How many times have we heard the phrase: "it's not a good time to buy now because…"? Or, when the market progresses, there may be cause for anxiety: "how high can it go?"

We should remember that equity investing is never a smooth road.

Our challenge as investors is to ignore the noise, be it good or bad. For many of us, this involves a longer-term commitment to, and confidence in, the plan that has been constructed to achieve our goals.

The road ahead is a long one filled with many ups and downs. Be guided accordingly. Don't let the inevitable bumps along the way keep you from your drive to the future. Focus on your own goals, keep emotions under control, and keep your assets working hard for you.

**Jan Canning**
Vice President
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**Canning Wealth Management**

**To My Clients:**

Many of us are welcoming the warmer and longer days. Spring is finally here, and perhaps it may be a good time for a "spring clean" of your finances. This may be as simple as updating account beneficiaries (see page 3), or perhaps putting funds that are sitting on the sidelines to work: time can be one of your greatest assets.

Whatever the situation, let me be your resource. Don't procrastinate on taking action to benefit your financial future — and remember that I am here to help!

**Jan**

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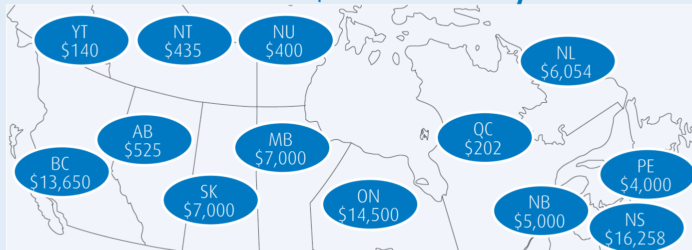
# Estate Planning: Keep Probate Fees in Perspective

In Canada, we don't have a "death tax," where significant taxes must be paid on the transfer of wealth at death. Consider that in some countries like the U.S. or Japan, estate tax can reach rates of up to 40 and 55 percent respectively! Yet, over the years, probate fees have become a de facto estate tax.

**Estimated Probate Fees on a $1M Estate Value by Province[1]**




Probate is the process by which a court confirms the validity of the will of the deceased individual. This declaration allows estate representatives and institutions to proceed on the basis of the instructions detailed in the will, without worry of future disputes. The fees vary by province — in most cases, based on a percentage of the value of the estate.

It may make sense to try and minimize these fees; after all, not many enjoy giving up their hard-earned wealth to the government. In doing so, a basic strategy would be to pass as many assets as possible to heirs outside of the estate: registered plans and insurance with designated beneficiaries, as well as property registered jointly with rights of survivorship ("joint tenancy")[2], may pass outside of the estate.

But keep in mind that there may be dangers involved in trying to minimize probate fees. It can actually lead to greater financial implications or other headaches. Particular care must be taken when a beneficiary or joint tenant is not your spouse. For instance, joint tenancy means permanently giving up full ownership of your asset, which may include its control. If a joint tenant encounters financial difficulty, creditors may force the sale of a jointly-owned asset. There is also risk of a falling-out in any relationship, with spouses or others.

There may also be equalization issues. Suppose you have two grown children as your only heirs and you designate Child 1 as the beneficiary of a Registered Retirement Savings Plan (RRSP) in an attempt to bypass probate, leaving the rest of the estate to Child 2.[2] When you die, taxes due on the fair market value of RRSP assets will be payable by the estate, potentially reducing the amount for Child 2.

Saving a few dollars in probate fees may result in other taxes. For example, putting an asset such as a house in joint ownership with a non-spouse may save future probate fees, but if they already own a principal residence, they may be subject to capital gains tax on the sale of the property.

At the end of the day, keep perspective: probate fees may be little more than a nuisance in the broader objective of effectively settling your estate. Should you require estate planning assistance, we would be happy to connect you to someone to provide support.

1. At 1/9/2019. Based on provincial website estate administration schedules (see: taxtips.ca/willsandestates/probatefees.htm for links); 2. Not applicable in Quebec.

# Tax Time: Consider the Benefits of Pension Income Splitting

It's tax time again! If you have eligible pension income, there may be an opportunity to income split with a spouse/common-law partner to reduce family taxes and minimize the loss of income-tested tax credits and benefits. But just how much of an impact can this make?

For tax purposes, up to 50 percent of eligible pension income can be split with a spouse. Eligible pension income is determined by the recipient's age and the nature of the income. In general, for those under age 65, it includes amounts received from a registered pension plan (except Quebec). For those over age 65, it also includes amounts received from a RRIF, LRIF or other annuity payments. While the obvious benefit of pension income splitting is the tax benefit achieved by allocating income from a spouse in a high-income tax bracket to one in a lower tax bracket, there are other potential advantages:

**Age Amount Tax Credit** — The 2018 federal age amount is $7,333, available to those 65 years or older. It is reduced for income over $36,976 and eliminated at $85,863. A benefit may be achieved if a spouse can reduce income to access the credit.

**Pension Income Amount** — Allocating pension income to a spouse who wouldn't otherwise have eligible pension income could entitle the spouse to claim up to a $2,000 tax credit.

**Old Age Security** — Splitting eligible pension income may enhance the family unit's ability to receive OAS payments.

The chart below shows two scenarios for two spouses over age 65, where Spouse A earns $86,000 of eligible pension income and Spouse B earns none. When they income split, they use lower tax brackets, enhance tax credits and avoid an OAS clawback for Spouse A. As always, consult with a tax advisor for your particular situation.

| | No Splitting | | Income Splitting | |
|---|---|---|---|---|
| | Spouse A | Spouse B | Spouse A | Spouse B |
| Eligible Pension Income | 86,000 | | 43,000 | 43,000 |
| Interest Income | | 12,000 | | 12,000 |
| CPP | 13,610 | | 13,610 | |
| OAS | 7,040 | 7,040 | 7,040 | 7,040 |
| Taxes Payable | -25,834 | 0 | -11,923 | -11,397 |
| OAS Clawback | -4,611 | | | |
| After Tax Income | 76,205 | 19,040 | 51,727 | 50,643 |
| **Difference** | | | **7,125** | |

For illustrative purposes only. Note: The chart uses estimated 2018 Federal and Ontario tax rates. Assumes the maximum amount payable for CPP benefits and Jan. 2018 annualized figures for OAS.

# Spring Cleaning: Is it Time to Revisit Beneficiary Designations?

Naming a beneficiary is a big decision that is sometimes overlooked. At some point in your life, you may buy a life insurance policy or start a new job with a retirement plan and receive a form that includes a section for the names of your beneficiaries. Many people, unprepared, leave it blank or complete the section without much thought. If many years have gone by since completing account paperwork, perhaps a review is in order. Here are four questions to start the thinking process:

**1. Have you named a child or dependent adult as a beneficiary?** In certain provinces, if the proceeds are not directed to a trust set up for the minor, the courts may decide who will manage them. Similarly, if a trust has not been named for the benefit of a dependent adult, the court may potentially appoint someone to make decisions on their behalf. This could lead to delays or additional costs. Directly naming the dependent beneficiary may also unintentionally disqualify them from receiving government benefits.

**2. Have you coordinated designations with the rest of the estate?** If you intend to equalize your estate between multiple beneficiaries, do not forget the impact of taxes. When certain assets do not pass through an estate, it may be difficult to accurately equalize amounts for different beneficiaries (see the example in the article "Keep Probate Fees in Perspective" on page 2).

**3. Have you revisited your beneficiary designations?** It is possible that a named beneficiary is no longer alive, or perhaps a major life event, like divorce, has changed the status of an existing beneficiary. Be sure to keep beneficiaries updated following life changes. It isn't unheard of to have a former spouse erroneously named as a beneficiary because the designation was not revisited. If an intended beneficiary has passed away, proceeds will likely pass through the estate. To avoid this situation, naming a contingent or secondary beneficiary may be useful.

**4. Have you been specific in the way you have named your designations?** If you have used non-specific designations, such as "my children", there may be uncertainty regarding intent. For example, in a blended family, the children of a new spouse may be unintentionally included. Or, if a child predeceases you, that child's share may go to your other children and not to that child's family, which may not be what was intended.

## Seven Investing "Sins"

It has been documented that certain behaviors can prevent investors from maximizing their returns. Meant as a light-hearted take on the original "seven deadly sins", here are seven behaviours that can paralyze an investor's path to success.

**1. Sloth** — A lazy approach to investing, which can prevent individuals from achieving long-term gains or better after-tax returns. Examples: Keeping substantial funds unnecessarily in liquid form or not fully contributing to tax-advantaged accounts like RRSPs or TFSAs. **Solution:** *Take stock of your resources and keep all of your assets working hard for you.*

**2. Pride** — Refusing to adapt, despite markets being dynamic and ever changing. The prospects for certain companies, industries and even asset classes can be attractive today but not tomorrow. **Solution:** *There are times when portfolio adjustments benefit an investor, such as rebalancing when necessary. Don't become so connected to a particular security that changes can't be made.*

**3. Avarice** — Speculating on the day's market darling or "hot" tip in the hope of quick profit. **Solution:** *Invest in securities that meet your needs and objectives. Resist the temptation to follow the herd or speculate on short-term quick wins. High potential returns are often associated with high risks.*

**4. Fear** — Reacting to downturns in the equity markets, which can paralyze sound investment decision making. **Solution:** *Accept that fluctuations are a regular occurrence in the equity markets. While drops in portfolio values may be difficult to stomach, this is part of the process of longer-term investing. One way to reduce short-term pain may be to leave the day-to-day scrutiny to those who manage investments. Others turn fear into an opportunity, using lower prices to build portfolios.*

**5. Forgetting Taxes** — Neglecting the impact of taxes, which can needlessly reduce investment returns. A dollar earned in one way is not always worth the same as a dollar earned another way. **Solution:** *There may be ways to structure finances to minimize taxes, such as using tax-advantaged accounts or splitting income with a spouse.*

**6. Indecision** — Putting off an investment program until tomorrow with the hope that the outlook will improve or a better opportunity will come along. Financial markets will always be filled with uncertainty and, in doing so, you lose one of your greatest assets: time. **Solution:** *Commit yourself to your investment program and continue to invest steadily. Using tactics such as dollar-cost averaging or systematic withdrawal programs can help to encourage regular investing.*

**7. Self Loathing** —"I'm never going to reach my retirement goals", say those who are often defeated before they begin. Many Canadians don't even have a financial or retirement plan. **Solution:** *Planning, perseverance, long-term thinking and the power of compounding can work wonders. By having a plan in place, you're at an advantage — keep it working for you.*

## It Can Be Taxing to Be a Snowbird

With the days growing longer and warmer, it may be easy to forget the polar vortex that froze much of Canada this winter. For some, this prompted an escape to warmer climates. If you are a "snowbird" spending considerable amounts of time in the U.S., you may face U.S. income tax implications of which you may not be aware. Even if you have no U.S. tax to pay, you may be subject to U.S. tax filing requirements. Here are some considerations:

**Overstaying** — While you may consider yourself to be a resident of Canada, the U.S. may think otherwise. The "substantial presence test" is one of the tests used by the U.S. Internal Revenue Service (IRS) to determine whether an individual is considered a U.S. resident for tax purposes. It is a weighted formula that takes into account the days spent in the U.S. in the current and two preceding years. Qualifying as a U.S. resident for tax purposes can have consequences, such as increased compliance costs and potential U.S. filing requirements.

**Owning a U.S. property** — Canadians who own and then sell a U.S. property are liable for U.S. taxes on the capital gain on its disposition and may be required to make certain U.S. filings. Canadians are generally subject to a U.S. withholding tax on real property on the gross proceeds if the sales price exceeds US$300,000 or the property is not acquired for use as a residence. As a Canadian resident, you are generally subject to Canadian income tax on worldwide income, which may include any capital gains realized on a U.S. property. However, Canada would provide some relief for U.S. taxes paid in the form of a foreign tax credit.

**Renting out your U.S. residence** — Generally, Canadians who earn rental income from their U.S. property are subject to a 30 percent withholding tax which tenants are required to deduct from the gross rent paid and remit to the IRS. If you have expenses associated with the property (e.g., mortgage interest, property taxes, utilities), you may have much lower net rental income. As such, you may wish to speak with a cross-border tax advisor about filing a U.S. non-resident tax return to make an election allowing you to pay tax on the net rental income.

**Dying while owning U.S. property** — Canadians who pass away and own U.S. real property could be subject to U.S. estate tax based on the value of their U.S. situs assets, including assets such as U.S. real estate or U.S. marketable securities. The U.S. estate tax laws continue to change; currently the maximum estate tax is 40 percent.

### Be Aware

It is important to remain in good standing with the U.S. authorities if you travel or own assets across the border. Over recent years, more information is being shared by U.S. and Canadian governments. Canadian and U.S. border services now track the movement of citizens as they enter and exit border crossings. The Canada Revenue Agency (CRA) and IRS also require financial institutions to share certain financial information in an attempt to reduce tax evasion.

As a snowbird, there may be significant tax, financial or estate planning implications to consider. There may also be ways to minimize the implications. Plan ahead and seek cross-border tax and legal advice for your particular situation.

With the compliments of...

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