TD Wealth

Return On Investment

TD Wealth Private Investment Advice

Summer 2016

Time: A Most Valuable Asset

With the arrival of spring came welcomed strength to the equity markets. Oil prices continued to stabilize, despite the devastating Fort McMurray fires that brought many Canadians together to support Albertans in their time of need. The Canadian dollar continued to strengthen. Even the concerns about the earnings recession south of the border subsided. Despite many positives, many uncertainties remain that could affect the geopolitical landscape in the coming months: the "Brexit" referendum (which will have taken place by the time of this newsletter's printing) in which the U.K. will vote on an exit from the European Union, the upcoming U.S. election in November and continued slowing growth in the Chinese economy.

Summer brings warmer weather and, for many of us, some well-deserved down time. While relaxing in the sun, don't forget that time can be a strong ally. Also keep in mind that one of the greatest enemies in wealth creation can be procrastination.

It's no wonder that those close to retirement may wish that they could turn back time. After all, the combination of time and compounded growth can be beneficial for an investment. An investor starting at age 25 who invests $500 a month will have yielded over $1 million by the age of 70 (at an annual compounded rate of 5 percent, assuming no taxes). Starting later, at the age of 45, to achieve a similar amount by age 70 requires much more — around $1,670 per month. Of course, most of us weren't thinking about retirement at age 25, as saving for retirement was overshadowed by many other competing demands. Yet, the significant difference in the amount needed just 20 years later, to achieve the same outcome, shows the positive impact of time and the potential cost associated with procrastination.

Even during times of market volatility, procrastination can lead to missed opportunity. It is natural to fear what the short term may bring to the financial markets, especially when the prevailing news may be predominantly negative. The danger is that fear can lead to inaction. Volatility may present buying opportunities, but opportunity does not wait for those who procrastinate.

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The perils of procrastination can also extend to other areas of wealth management, such as estate planning. Activities can easily be put off until "tomorrow" because people may feel uncomfortable addressing the topic of death. But, with the passage of time, tomorrow quickly becomes yesterday, and tasks such as creating or updating a will can easily be forgotten. Take the recent death of pop icon Prince, who is believed to have died without a will. There may be conflict over his estate and, even worse, surviving loved ones have been left to deal with this burden, during an already difficult time.

Often, the hardest part is getting started. We are here to support you with the tasks that might need a jump-start. Whether it is retirement planning, investing, estate planning or other wealth planning activities, we are here to help. Do your best to avoid procrastination and ensure that time is on your side.

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Tax Changes Are Imminent

Federal Budget 2016: A Recap

The 2016 federal budget was released at the start of spring. Here are some of the tax changes* that individuals should be aware of:

What Investors Need to Know

Tax-free switches of classes of shares of a mutual fund corporation will be eliminated. Under proposed rules, as of Oct. 1, 2016, the exchange of shares of classes of a mutual fund corporation will be considered to be a disposition at fair market value for tax purposes. Currently, a tax-deferral benefit is available to investors in these switch funds. If rebalancing is needed, investors may benefit from doing so before October.

Taxation of linked notes is changing. As of October 1, 2016, any gain realized on the sale of a linked note, such as a principal-protected note, will be treated as ordinary income. Currently, if notes are sold on the secondary market prior to maturity, the gain is generally taxed at favourable capital gains rates.

No changes to the tax rules for donations of private company shares and real estate. The federal budget reversed the proposed elimination of capital gains tax on the sale of appreciated private company shares and real estate if the proceeds were donated to a qualified charity, which was expected to begin in 2017.

What Businesses Should Know

Small business tax rates remain flat. The federal small business tax rate for Canadian-controlled private corporations (CCPCs) will remain at 10.5 percent after 2016. It was previously set to decrease to 9 percent by 2019.

Small business deduction limit rules are changing. Certain corporate and partnership structures had previously been able to multiply the number of small business deductions within a group. New rules will limit the ability to claim more than a single annual small business deduction on active business income up to $500,000 federally.

Eligible capital property (ECP) rules are changing. Starting in 2017, the ECP regime will be replaced with a new capital cost allowance class. This may eliminate a potential tax-deferral opportunity that resulted from the treatment of gains on the sale of ECP as active business income.

Rules for the transfer of life insurance policies have changed. The tax benefits associated with certain transfers of life insurance policies to a corporation have been limited.

Personal Measures That May Affect You

Federal tax rates have changed. For the 2016 tax year, the federal tax rate for taxable income between $45,282 and $90,563 is 20.5 percent (reduced from 22 percent). A federal tax rate of 33 percent will apply for taxable income in excess of $200,000.

Various tax credits and benefits have changed. As previously announced, the Family Tax Cut (an income-splitting tax credit) has been eliminated. The Universal Child Care Benefit (UCCB) has been replaced by an income-tested Canada Child Benefit (CCB). The Child Fitness and Arts tax credits are reduced for the 2016 tax year and eliminated thereafter. The Education and Textbook tax credits will be eliminated as of the 2017 tax year.

For more information, please see: budget.gc.ca. *At the time of writing, the federal budget had yet to receive Royal Assent but this is not expected to be an issue.

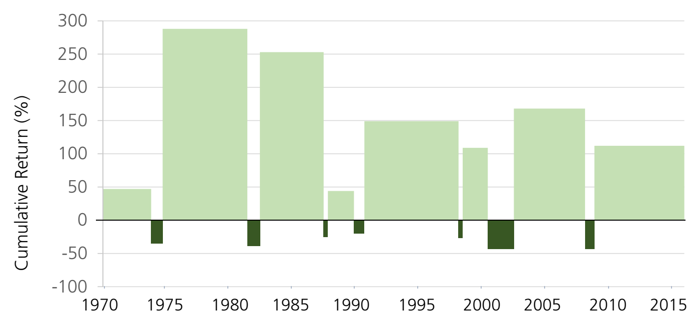
Perspective: A History of Bulls and Bears

When the market climbs the proverbial "wall of worry", an underlying feeling of uncertainty is often present. Keep in mind that uncertainty is a constant part of the financial markets. While not to be ignored, uncertainty should be kept in perspective.

It may be helpful to look back at the history of the Canadian equity market to provide some balance. History has shown us that bull markets have been longer and stronger than bear markets. Focusing on longer-term objectives can play an important role in most portfolios.

As well, don't forget that in order to take advantage of the wealth-building opportunities of the equity markets, remaining invested is important. Along the way, there may be volatility, but history has shown us that brighter days have generally dominated the markets.

S&P/TSX Composite Total Return Index
Bull and Bear Markets: Jan. 1970 to Apr. 2016



Source: TSX Composite Total Return Index, 1/1/1970 to 29/04/2016. Bull/Bear Markets defined as +/-20% change in monthly closing figures.

Planning Ahead

The Big Picture: Beneficiary Designations

As you think about your estate plan, one important consideration is naming and updating your beneficiaries. Beyond thinking about who will be named, consider the significance of how assets are treated depending upon the named beneficiary. *Note: In Quebec, beneficiary designations on registered accounts (such as registered Retirement Savings Plans (RSPs), registered Retirement Income Funds (RIFs) and Tax-Free Savings Accounts (TFSAs)) are generally not allowed to be made directly in the plan documentation and must be made within the will.*

Certain Tax Considerations May Be Important…

Naming a spouse/common-law partner (CLP) as beneficiary (or successor holder/annuitant) can often lead to favourable tax treatment upon the transfer of assets. For an RSP or RIF, upon the death of the holder, the surviving spouse/CLP can defer paying taxes on the account's holdings by arranging a tax-deferred rollover to their own RSP or RIF. For other beneficiaries (not including financially dependent (grand)children), the value of the RSP/RIF is taxed. With the TFSA, a spouse/CLP can continue to operate the TFSA and benefit from future tax-free growth as the successor holder. Other named beneficiaries are required to collapse the plan and any gains made after the date of the holder's death are considered taxable income to the beneficiary.

Naming beneficiaries may also be important to help to reduce probate tax, in provinces where applicable. If no beneficiary is named, assets that otherwise would have passed outside of an estate may be included in the estate and subject to probate.

…But There May Be Other Considerations

Although these tax considerations may be important, when looking at the big picture, naming an estate as the beneficiary may be beneficial:

Estate Equalization — Naming the estate as a beneficiary may simplify the task of equalizing an estate amongst beneficiaries. For example, if the estate is not named as the beneficiary of an RSP/RIF and taxes are due on the value of the RSP/RIF, the estate (and its beneficiaries) will be responsible for the taxes, while the full value of the RSP/RIF will pass along to the RSP/RIF beneficiary. This may complicate a situation in which the intent is to equalize the after-tax amounts received by all beneficiaries.

Covering Costs of the Estate — Naming the estate as a beneficiary for certain assets, such as life insurance policies, can provide funds to help cover the costs of the estate, such as the capital gains tax liability of an appreciated family vacation property.

Control — If a beneficiary is not currently financially responsible, establishing a trust, with the terms established within the will, may help to protect assets until certain requirements are met.

As you review your beneficiary designations, remember to take some time to consider the implications of your selections. As always, please seek legal advice as it relates to your particular situation.

Understanding Taxation

How Are My Dividends Taxed?

With interest rates at historic lows, you may be relying on dividends to generate income within an investment portfolio. Here are some types of dividend income and their tax treatment:

Eligible Dividends — Dividends received from Canadian companies are subject to the gross-up and tax credit system. When the company paying the dividend has paid tax on its income at the general corporate rate, the dividend is considered "eligible". When including it in taxable income, the recipient must gross up the amount received by 38 percent, but is entitled to a dividend tax credit equal to 15.02 percent of the grossed-up amount. *(Note: Percentages shown may be rounded. All figures used are federal only; each province has its own gross-up and credit percentages).* As a result, eligible dividends are subject to tax at a lower marginal rate than ordinary income (i.e. salary/pension/interest).

Non-Eligible Dividends — If the company paying the dividend has been subject to tax at less than the general corporate rate (e.g., it is eligible for the small business deduction), the dividend gross-up factor is reduced to 17 percent and the dividend tax credit is 10.52 percent of the grossed-up dividend. While these dividends are also taxed at a lower marginal rate than ordinary income, they are subject to a higher marginal tax rate relative to eligible dividends (reflecting the fact that less corporate tax was paid on the distributed income).

Foreign Dividends — For dividends received from non-Canadian corporations, the dividend gross-up and tax credit system does not apply. These dividends are subject to Canadian tax at the marginal rate that applies for ordinary income. If non-resident tax was withheld from these dividends at source, a foreign tax credit may be claimed on a Canadian tax return to account for the taxes already paid. However, this tax credit is limited to a maximum of 15 percent of the income, so, depending on the withholding tax rate applied, there may be double tax on a portion of this income.

Things to Remember

Business Owners — There are different tax consequences that apply if the dividend income is earned within a corporation. Also, there may be inefficiencies with non-resident withholding taxes if foreign dividends are earned within a corporation.

Location Can Make a Difference — Any non-resident withholding taxes paid by registered accounts (i.e., RSP, RIF, TFSA, Registered Education Savings Plan (RESP), etc.) are not recoverable. However, the Canadian tax treaty with the U.S. provides that taxes are not to be withheld from dividends paid to a retirement account, making RSPs or RIFs (but not TFSAs) ideal places to hold U.S.-listed equities with high dividend yields.

Impact on Taxable Income — The dividend gross-up artificially increases taxable income, which may impact the ability to claim certain income-based tax credits or benefits (i.e., Old Age Security, Age Credit).

Buffettology: The Making of a Successful Investor

Warren Buffett — known as the Oracle of Omaha — is one of the most legendary investors of our time, and, arguably, the most successful investor alive today. He is the third richest person in the world, with an estimated net worth of over $60 billion.* At 85 years old, Warren Buffett is said to be winding down his career and making succession plans for Berkshire Hathaway, a company that he has made such a strong success. In fact, a $1,000 investment in Berkshire Hathaway stock in 1964, when Buffett initially took over the company, would be worth about $11.6 million today.**

Many investors continue to be fascinated by Buffett and value his advice. Recently, someone paid over $2 million at a charity event auction to have dinner with Buffett.

What has made the Oracle of Omaha such a success over the years?

He started early. Many successful investors say that time has been one of their greatest allies and Warren Buffett is no exception. Buffett started early, buying his first stock at the age of 11. From this very young age, he continued to invest money and build small returns.

He worked hard and saved. By the time Buffett was 16 years old, he had amassed the equivalent of $53,000. He worked hard to save money, by delivering the Washington Post, selling used golf balls and stamps and even polishing cars. At the same time, he was constantly thinking about investing and producing returns on his savings.

He experienced rejection and failure, but persevered. In his younger years, Buffett applied for business school, but was rejected by Harvard despite being confident that he would be accepted. He has also had his fair share of failed investments. Ironically, Buffett claims that his worst investment was Berkshire Hathaway, which at the time of purchase was a textile mill. It was only after he shut down operations to focus on other ventures that he started to make money.***

Like many successful entrepreneurs, he does a lot of reading. Buffett estimates that both he and his business partner, Charlie Munger, spend 80 percent of the working day reading, thinking and continuously building up their knowledge base.

He is an example of how success can take time. It took almost 20 years for Buffett to restructure Berkshire Hathaway, and for the share price to begin to significantly appreciate in value. In 1980, when Buffett turned 50 years old, one share of Berkshire Hathaway was worth only $380. Today, it is worth around $217,000 which equates to a 19.4 percent compound annual return over almost 36 years.**

Despite his tremendous success as an investor, Warren Buffett continues to live modestly. He still lives in the same home that he purchased in 1956. In 2006, together with Bill Gates, he pledged to donate 99 percent of his wealth, establishing a movement that has been embraced by various other high-profile billionaires.****

"I measure success by how many people love me," says Buffett. "And the best way to be loved is to be lovable"— fine words of wisdom from a great investor.

Sources: *"The World's Billionaires", Forbes, March 2016. ** Yahoo Finance, BRK-A Historical Data. Prices at Aug. 1980 and May 2016. 1964 share price estimated at $19. ***http://www.bloomberg.com/news/articles/2010-10-18/berkshire-the-textile-mill-was-buffett-s-worst-investment-he-tells-cnbc; ****The Giving Pledge. www.thegivingpledge.com. All other information sourced from: "22 Fascinating Facts About Warren Buffett's Success", Time Magazine. 11/03/15.

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