

# Return On Investment

TD Wealth Private Investment Advice

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**Jocelyn Willoughby**, BBA  
Investment Advisor  
Certified Retirement Specialist  
33 Collier Street, 3<sup>rd</sup> Floor  
Barrie, ON L4M 1G5  
289 470 1099 705 726 1542  
jocelyn.willoughby@td.com  
www.jocelynwilloughby.ca

## 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 over 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 often 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 is often 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 during these times. The danger is that fear can lead to inaction. Volatility may present buying opportunities, but opportunity does not wait for those who procrastinate.

The perils of procrastination can also extend to other areas of wealth management. In many cases, estate planning activities are 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 and updating power of attorney documents or wills 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 who is entitled to parts of his estate. 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, and possibly your friends or family, 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.

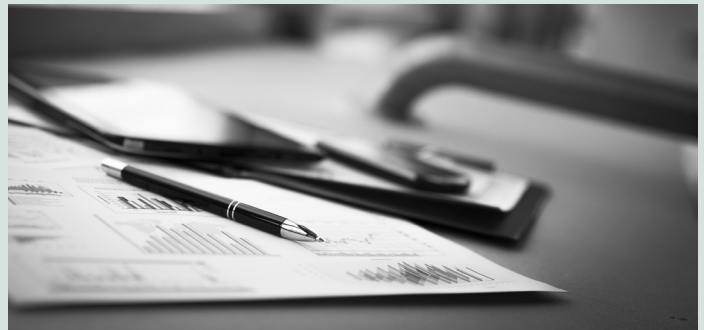
**No changes to the tax rules for donations of private company shares and real estate.** The federal budget reversed the proposed elimination of capital gains tax on the sale of appreciated private company shares and real estate if the proceeds were donated to a qualified charity, which was expected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

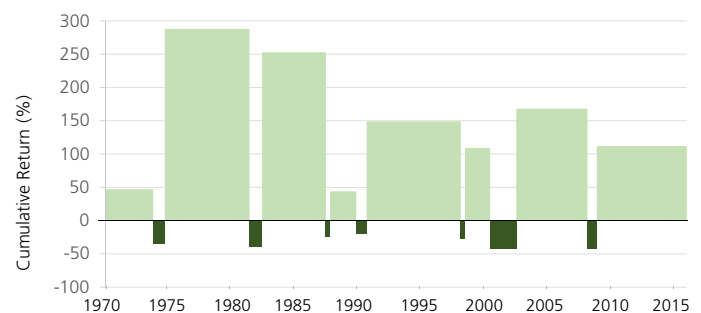
## Perspective: A History of Bulls and Bears

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.

■ Bull Markets ■ Bear Markets

## 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 (TFSA)) 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).

# Understanding the Fees You Pay

Over the past year, TD Wealth has been making changes to the information you receive to give you a better understanding of your investment fees and portfolio performance. Given the focus on costs in our industry, we wanted to give you some background to help provide greater clarity about the fees you pay.

## Types of Accounts

There are two main ways to pay for the advice of a professional advisor: through a fee-based or a commission-based account. With a fee-based account, a fee is paid each year for the account's management, often calculated as a percentage of the account's value. With a commission-based account, fees are based on the purchase and/or sale of the portfolio's investments. In addition, certain fees are associated with the cost of acquiring and owning a mutual fund.

Over the years, the industry has been moving more towards a fee-based model. Some advantages may include:

- Tax-deductible fees
- Less bias in recommendations
- Potentially lower overall costs for significant portfolio activity

## What is an MER?

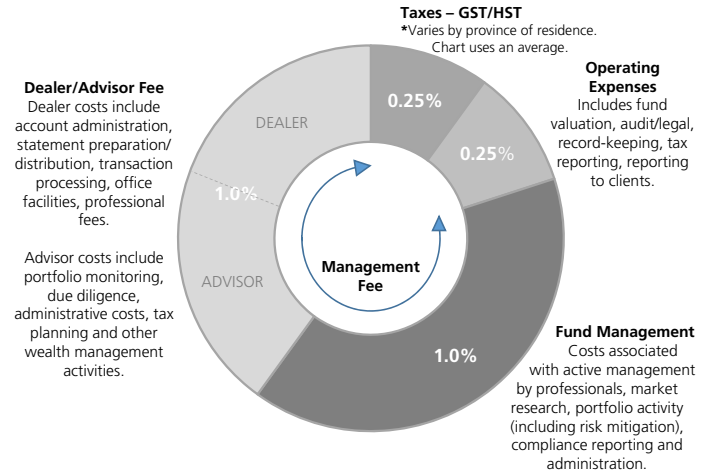
The costs associated with running a mutual fund are included in the management expense ratio (MER) and charged as an annual percentage fee of the asset value of the fund held. There are three main components: i) Management fee — the cost associated with fund management, which includes having a dedicated team of professionals who actively research and monitor the underlying holdings of the fund, and make adjustments when necessary to manage risk. The fee may also include a dealer and advisor component, which helps to pay for the services that we provide to our clients; ii) Operating expenses — various administrative fees, including legal, tax and financial reporting costs; and iii) Sales tax (GST/HST) charged to the fund, which depends on the province of residence of the fund investors.

For Canadian equity mutual funds, the MER generally ranges between 1 percent and 3 percent. Any returns reported by mutual

funds are net returns after fees. Mutual funds that are part of a fee-based account often have discounted MERs.

## What Makes Up the MER?

The following chart illustrates what the fees paid on a mutual fund with a 2.5 percent MER can comprise:



## The Bottom Line

Understanding the costs associated with your investments is important, but it is arguably more important that you feel you are receiving value for what you pay.

Our objective is to keep your money working for you which involves fostering investment discipline, managing your portfolio within your level of risk tolerance and maintaining suitable asset allocation. Wealth management also extends beyond investment advice and we have access to a broader team of specialists at TD Wealth to support retirement planning, estate planning and succession planning, as examples. Don't forget that this is all part of our ongoing service to you. Please reach out to us at any time as we are here to support you.

With the Compliments of:

**Jocelyn Willoughby**, BBA  
Investment Advisor, Certified Retirement Specialist  
289 470 1099 705 726 1542  
jocelyn.willoughby@td.com

**Erica Van Overschelde**  
Client Service Associate  
705 726 8141  
erica.vanoverschelde@td.com

TD Wealth Private Investment Advice  
A Division of TD Waterhouse Canada Inc.  
33 Collier Street, 3<sup>rd</sup> Floor  
Barrie, ON L4M 1G5  
TF: 1 800 669 7896  
www.jocelynwilloughby.ca

**Willoughby**  
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