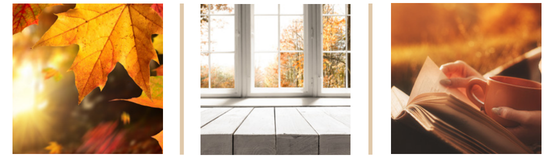

Wealth Insights

TD Wealth Private Investment Advice

Autumn 2021

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In This Issue

Do Good, Feel Good, Benefit Taxes ... 2
Beware: TFSA Overcontributions ... 2
Supporting Wealth Longevity 3
Time to Review Insurance? 4

To My Clients:

Autumn is a season of change. This year, change may be particularly abundant: some of us may have returned to the office and (grand)kids may be back in school. If your personal situation has recently changed, a discussion may be worthwhile to assess changes to your wealth plan.

It is also the Thanksgiving season. As we focus on things to be grateful for, I would like to take this opportunity to thank you for your confidence in my services. Sending my best to you and your loved ones this season.

Cutting Through the Noise

When people are asked to choose between 10 hours of undesirable work on October 1, or 12 hours on October 15, most people will choose 10 hours — the logical choice. Except, on September 30, many change their minds. Indeed, certain tendencies can impact our decision making.[1]

Much of economic and financial theory is based on the notion that individuals act in rational ways. Yet, the impedance of our natural tendencies can sometimes get in the way. What about you? Do you make financial decisions based on your longer-term best interests or do short-term expediencies sometimes get in the way?

In much the same way, modern behavioural scientists have shown that our cognitive biases can sometimes cause investors to make investing decisions that may not be in our best interests. Focusing too much attention on our portfolios may be one way to trigger these biases. Quite worryingly, a recent *Reuters* report suggested that investors using a U.S. discount brokerage platform were checking portfolios at an alarming rate of seven times per day.[2]

One risk is that frequent checking increases the probability of seeing a loss. By checking the S&P/TSX Composite Index daily compared to annually, the likelihood of seeing negative performance grows from 28 percent to 48 percent.[3] A loss aversion bias suggests we feel the pain of a loss about twice as much as the pleasure of a similar-sized gain. As such, we may make investing decisions to try and avoid the pain of a relative or absolute loss. Yet, even seeing positive performance may cause us to want to take action. In bull markets, we may be tempted to sell a well-performing stock too early. The challenge then becomes finding the right time to re-enter the market.

It's not just our biases that can impact investing decision making. Daniel Kahneman, Nobel-prize-winning father of behavioural finance, suggests that the "noise" around us can also be influential.[4] As the markets continue to climb the wall of worry, there has been no shortage of noise.

One of the themes continuing to dominate financial circles is inflation. There has been significant unwanted variability in opinion — or noise — on the path forward: will inflation be transitory or is it more endemic? Bond yields usually rise with increasing inflation expectations, as inflation erodes the purchasing power of a bond's future cash flows so investors demand a higher yield to compensate for this risk. However, despite rising inflation rates, over the summer bond yields remained low and actually fell. Even gold, traditionally considered a hedge against inflation, was down at the halfway point of the year.

This is to suggest that predicting the course of near-term markets and economies is often difficult. Adding to the current challenge? We've never experienced a situation of this magnitude: the unprecedented actions taken to combat the Covid-19 pandemic have helped to distort market and economic cycles. Part of my role is to help cut through the noise to focus on what is important.

Our challenge as investors is to be aware of the influence that human behaviour can have on investing and to not be led astray by the noise. One way? Instead of checking portfolio performance on a frequent basis, consider paying attention to other important things in life and leave the day-to-day focus on your portfolio to those who are here to manage it.

1. www.ncbi.nlm.nih.gov/pmc/articles/PMC5543983/; 2. www.reuters.com/breakingviews/chancellor-robinhood-is-more-sheriff-than-rebel-2021-07-15/; 3. S&P/TSX Composite Index 1985 to 2020; 4. Kahneman, Sibony, Sunstein (2021), *Noise: A Flaw in Human Judgment*, Harper Collins.

■ The Season of Giving

Do Good, Feel Good & Benefit Your Taxes

Many Canadians make charitable donations of one sort or another. We are good at giving: according to the latest Statistics Canada data, more than 40 percent of taxpayers with income over $80,000 donated to charity.[1]

There are a variety of ways to make contributions, some of which may benefit you at the same time as the recipient organization. Here are just a handful of options:

Cash Donations — Any donation to a registered charity in good standing results in a tax receipt which will entitle the donor to a tax credit. The federal credit is 15 percent of the first $200 donated per year and 29 percent (or 33 percent*) beyond this threshold. After taking provincial tax into account, the total benefit may exceed 40 to 50 percent, depending on province of residence.

This credit can be pooled with your spouse to be claimed by whichever spouse can use it to their best advantage. Moreover, donations can be carried forward for up to five years. Charitable donations are limited to 75 percent of net income in any year except upon death. Donations of up to 100 percent of net income are allowed for tax purposes in the year of death and the year preceding.

Donating Appreciated Securities — If you donate stocks or mutual fund units that have appreciated in value, there is potentially a further benefit. Gifting publicly-traded securities with accrued capital gains to a registered charity not only entitles you to a tax receipt for the fair market value, but also eliminates the associated capital gains tax. If you wish to do this for the 2021 tax year, please let us know well in advance of the year end as charitable donations must be made before December 31 and settlement times may vary.

In-Kind Gifts — You may consider donating personal property which a charity can then convert to cash. For example, by donating a used car to charity, you may be eligible to receive a tax receipt for its appraised value. Similarly, you may be able to donate a legitimate work of art to a public gallery. Special tax rules may apply to in-kind gifts so check with a professional tax advisor on how to best handle the situation.

Private Foundations — Individuals with more substantial assets may consider establishing a private foundation as a vehicle for charitable activities. Money paid into the foundation may result in an immediate tax benefit while the foundation can direct future gifts as it sees fit. However, the ongoing cost of the foundation may be a disadvantage.

Donor-Advised Funds or Community Foundations — Giving through a donor-advised fund or a community foundation may be a cost-efficient alternative to establishing a private foundation; they can eliminate certain legal and administrative costs, while still allowing you to direct donations and achieve tax benefits. The benefit of a donor-advised fund is that the contribution will be deductible in the year it is made, but funds can be distributed in future years. The donor may also be able to direct how funds are invested by the charity until their distribution.

Get More Information

Charitable giving can be a wonderful way to leave a legacy, but the options and their outcomes in estate or tax planning can be complex. Where major gifts are concerned, seek independent professional advice. We would be happy to assist where possible.

*The federal donation tax credit rate for donations over $200 increases to 33 percent to the extent that an individual has taxable income that is taxed at 33 percent.

1. Based on 2019 tax return data: www150.statcan.gc.ca/n1/daily-quotidien/210308/t004c-eng.htm

■ Keep Good Records

Beware of Tax-Free Savings Account (TFSA) Overcontributions

In recent years, the Canada Revenue Agency (CRA) has provided some leniency as it relates to the penalties for TFSA overcontributions. However, a recent article in the popular press highlighted the potential consequences of not paying attention to CRA electronic communications.[1]

If you contribute beyond your TFSA limit, the penalty can be significant — equal to one percent per month on the excess amount for each month that you are over the limit. In certain cases, you may request a waiver of the penalty tax, due to "reasonable error" and if the overcontribution is withdrawn "without delay."

The article details a taxpayer who was sent a warning letter to his CRA "*My Account*" due to excess TFSA contributions. The taxpayer claimed he never saw the letter. Two years later, when his *Notice of Assessment* (NOA) detailed the penalties and interest owed, he took action to remove the excess amount and wrote the CRA to request relief. However, this was denied as the CRA asserted that he had not withdrawn the excess amount within a "reasonable time" — when the warning letter was first sent. The taxpayer then took the issue to a federal court, yet the judge sided with the CRA upholding the decision not to waive the penalty.

In addition to being aware of your TFSA limit, this is a good reminder to check for CRA notifications if you have signed up for electronic communications.

The Increasing Move to Digital

This may be especially important to remember as the world continues to go digital. The 2021 federal budget proposed changes to improve the CRA's "ability to operate digitally," to allow the CRA to send NOAs electronically, without the taxpayer having to explicitly authorize them. This may apply to those who file income tax returns electronically, either by themselves or via a tax preparer. Those who file tax returns by paper will continue to receive a paper NOA.

Be Aware: *My Account* Updates May Be Lagging

Taxpayers should also be wary when checking *My Account* for TFSA contribution room information. There may be delays in updating TFSA contribution amounts, especially early in the calendar year when the previous year's data may not be fully updated. As such, keep good records. Some taxpayers have also noted that historical information may not always be correct. In this case, you will need to contact the CRA to ensure that records are properly updated.

1. financialpost.com/personal-finance/taxes/missing-a-message-from-cra-doesnt-let-taxpayer-off-the-hook-in-tfsa-overcontribution-case

Planning Ahead

Supporting Wealth Longevity: Generational Wealth Planning

As a likely outcome of the pandemic, we're seeing more of our clients reviewing will and estate plans. Some have voiced concerns that their beneficiaries may not be capable of managing future bequests in a responsible way.

After a lifetime of building wealth, many of us have a desire to leave a lasting legacy for our families. As such, some are now focusing on generational wealth planning to support this longevity. This goes beyond just designating bequests for (grand)kids through an estate plan. A generational plan considers future generations, including those you may never meet, with the objective of supporting your wealth's longevity in complement to traditional estate planning documents — these legal documents can help to distribute, dispose of or deal with assets, but the generational plan keeps assets working into the future.

Start with a Plan and Document It — A generational plan should set out goals and provisions for how money will be used by future generations, as well as how it will be accessed and replenished. For instance, you may wish for family members to invest in themselves, stipulating that funds should be used for higher education, or a business start-up or expansion. By offering heirs the means to obtain an education or run a business for themselves, they can gain the experience needed to create wealth and grow it. Once you determine your desired goals and provisions, it is important to formally document the plan so that it can be passed along to future generations. You may also need to implement tools (such as a trust) to support your plan.

Communicate Your Plan; Be the Family Resource — It is important to communicate your plan to family members. Often, parents keep their finances and related values secretive, missing the opportunity to pass along their ideals to children. A generational plan puts you in the position of leadership and guidance by allowing heirs to understand your vision for your wealth after you pass away. While particular financial details need not be shared, the vision can act as a catalyst for meaningful family discussions. The plan can also form the basis of a family constitution, enabling future generations to carry forward the intentions set forth in the plan.

Even if a generational wealth plan isn't your desired path forward, there may be actions that can help protect and preserve assets for the future:

Consider Protection Tools, Such as a Trust — Certain tools may help to protect future wealth in situations in which estate beneficiaries may not be financially responsible or where you wish certain goals to be attained. A testamentary trust can provide protection by putting estate assets under the control of a responsible trustee. The terms of the trust can specify the timing and the quantum of distributions to be made to heirs. Other tools may be considered, such as life insurance, to help protect and grow assets, while also providing access to cash.

Create a Professional Support System — Having a support system of trusted professionals may be a valuable part of ensuring a successful generational wealth transfer, especially when heirs may not have the skillset to independently manage funds.

Creating a generational legacy can be one of the greatest gifts you leave behind. If you would like support as you plan ahead, please get in touch.

Back-to-School Time

In Brief: Registered Education Savings Plan (RESP) Withdrawals

It is back-to-school time and if you have a (grand)child who has left home to attend college or university — congratulations! In brief, here are four considerations as you look to withdraw from the RESP. For more details, please call.

1. Understand the three components. Track RESP balances according to their source: i) grants, ii) contributions and iii) accumulated income (AI) — income or gains made on contributions and grants. Grants and AI may be paid out to the beneficiary as an Education Assistance Payment (EAP), taxable in the student's hands.[1] Original contributions can be withdrawn, tax free, at any time.[2] When withdrawals are made, you will need to specify how much comes from each bucket.

2. Time withdrawals with care. Consider drawing EAPs early when a child's income is low (factoring in potential summer jobs and co-op programs). Depending on circumstances, it may be beneficial to spread EAPs over several years to make use of tax credits, such as the basic personal amount and tuition tax credit.

3. Plan to deplete the account while the beneficiary is enrolled in an accredited program. While you can only withdraw $5,000 of EAPs in the first 13 weeks of schooling, there is generally little restriction after that period while enrolled. On the other hand, for payments received after a beneficiary is no longer enrolled, unused grants may need to be repaid and AI payments may be subject to a 20 percent penalty tax. There is a six-month grace period after enrolment has ceased that allows for RESP withdrawals to qualify as EAPs.

4. Explore alternatives if a child does not go to school. The RESP can remain open until the end of the calendar year that includes the 35th anniversary of its opening. If plans have changed, consider the option to transfer the RESP to a sibling or transfer AI to the parent's registered Retirement Savings Plan (RSP), both subject to various conditions.

For more information, see: canada.ca/en/revenue-agency/services/tax/individuals/topics/registered-education-savings-plans-resps.html

1. Unused grants will be clawed back; unused AI may be subject to penalty tax; 2. Or paid tax free to a qualifying beneficiary.

Business Owners & Family Succession — Changes as a Result of Bill C-208

Keeping a business in the family has become easier and less costly. Over the summer, Bill C-208 was passed. Before this, the Income Tax Act treated the proceeds of intergenerational sales as deemed dividends to the vendor, whereas sales to third parties were treated as lower-taxed capital gains that could be used against the LCGE.* Bill C-208 eliminates this treatment and also enables corporate reorganizations among siblings to take place without being subject to anti-avoidance rules in certain circumstances.

*Lifetime Capital Gains Exemption. However, Bill C-208 reduces access to the LCGE if taxable capital involved exceeds $10 million; at $15 million or more, there is no access at all.

■ Insurance Planning

Have You Reviewed Your Life Insurance Needs?

One of the lessons that the pandemic has taught us is the importance of preparing for unexpected events before they happen. As part of that planning, have you considered whether your life insurance meets your needs?

As part of the retirement planning process, we often suggest that our clients consider the use of life insurance for its many benefits. As life insurance is often more difficult and costly to obtain in the later years, it's worth considering at a younger age and while an individual is in good health.

Yet, even if you haven't planned in advance for insurance as part of your wealth plan, it may not be too late. We most often see individuals in their 60s and 70s purchase life insurance as a planning tool and certain insurance companies will even issue life insurance to individuals up to age 85.

Here are four areas where it may prove valuable in your planning:

Complement Investment Returns — Many insurance products blend certain aspects of insurance with investing. Depending on the type of insurance and the policy, there may even be choice in how the investment portion is invested, and the potential for a certain amount of growth to be on a tax-sheltered basis. This may be one way to complement investment returns, especially in situations in which the cost of managing the policy is reasonable. Upon death, the proceeds will pass to beneficiaries on a tax-free basis. While older individuals will be subject to higher premiums, there may still be a benefit gained from the tax-sheltering opportunity and the eventual tax-free benefit payout. It can be easy to project the internal rate of return on a life insurance payment and might complement a conservative part of one's investment portfolio.

Support Philanthropic Efforts — Insurance may be a way to create a legacy and, in some cases, provide benefits even while you are alive. For example, you could have a charitable organization purchase an insurance policy on your life while you donate the cash annually to pay the premiums. This way, you would receive a tax credit for the annual cash donated. You could own a life insurance policy and name the charity as the beneficiary or donate appreciated shares to fund an insurance policy. There may be a variety of tax-efficient ways to use

insurance to support your charitable endeavours.

Help to Cover Taxes on Death — Many estates incur a considerable amount of taxes on death and this situation may be complicated by the presence of illiquid assets such as real estate or a family corporation. A life insurance policy may help to effectively cover those taxes, so that your estate isn't left with a shortage of cash when these taxes come due. For example, there may be a significant capital gains tax liability upon the transfer of a cottage or cabin and the proceeds from an insurance policy can help to cover these taxes to keep the property within the family.

Equalize an Estate — In cases where you wish to leave your estate to multiple beneficiaries and it is important to provide assets of approximately the same value, life insurance may potentially help to provide that equalization. You may have assets that are better left to certain beneficiaries, rather than being shared, such as a family business. In these instances, the insurance death benefit can be used to help equalize the inheritance for those heirs who may not be the beneficiary of these assets.

We Can Assist

In many cases, it is never too late to explore the opportunities for insurance to play a role in retirement and beyond. There are many products available to support a variety of investment, tax, retirement and succession planning solutions. For a broader discussion, please call the office.

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