TD Wealth

Wealth Insights

TD Wealth Private Investment Advice

Winter 2019

Keeping Perspective

The turning of a new year is synonymous with optimism and hope. Yet after a rough year for the Canadian equity markets, it may feel as though optimism is in short supply.

But here are some thoughts to help keep perspective. We are living in one of the most prosperous times in history. Income and quality of life have improved; disease, violence and child mortality have fallen. Though the world is far from perfect, necessities and luxuries alike are more affordable. Just 20 years ago, a 50-inch plasma TV would cost around $10,000; today a similar TV costs less than $600.[1] Consider that these technologies didn't exist 50 years ago: smoke detectors, cell phones, pocket calculators, global positioning systems (GPS).

In just 50 years, our standard of living has more than doubled. In 1968, Canada's Gross Domestic Product (GDP) per capita was around $27,600 (in today's terms) when adjusted for inflation. Today, GDP per capita sits at around $60,000.[2] Back in 1968, our life expectancy was 72 years. Over two generations, it has increased by almost a full decade.[3] Throughout this time, investors saw the S&P/TSX Composite Index appreciate over 5.9 percent on an annualized basis.[4]

Yet, even during this period of growth:

- Annual inflation was greater than 5 percent in 13 of those years.[5]
- The stock market fell over 232 of those 600 months.[6]
- The S&P/TSX Composite Index lost a quarter of its value at least seven times.[6]
- There were nine bear markets lasting a total of 75 months.[6]
- We experienced five recessions, cumulatively lasting over five years.[7]

This should remind us that even with significant progress, setbacks are a natural occurrence. There is no doubt that we face many challenges. Trade tensions have been a source of market volatility. Canada's competitiveness remains a concern. GDP growth has slowed, foreign direct investment has fallen and our energy sector, a significant component of the Canadian equity markets, continued to face headwinds. The price differential between Western Canada Select oil produced here at home and the benchmark U.S. West Texas Intermediate oil highlighted the problems of getting our oil to broader markets. While the federal government acknowledged these challenges in its November 2018 fiscal update, it is yet to be seen if the proposed measures will help to improve competitiveness.

Despite the challenges, consider that having a wealth plan in place and participating in the equity markets can offer an advantage over the longer-term. While history has shown that you are likely to experience recessions, pullbacks and perhaps even a market crash, the stock market has also been one of the greatest wealth generators over time. If you can persevere through the ups and downs, it's likely that you will reap the returns.

We are here to support you and wish you much health and happiness for the year ahead.

1. https://nytimes.com/1999/01/14/technology/flat-tv-s-still-for-the-fat-wallet-set-improve-as-prices-fall.html; 2. Statistics Canada, Thomson Reuters, IMF WEO; 3. statcan.gc.ca/eng/help/bb/info/life; 4. S&P/TSX Composite Index, 1/1/68 to 4/30/18; 5. inflation.eu/inflation-rates/canada/historic-inflation/cpi-inflation-canada.aspx; 6. S&P/TSX Composite Index, 4/30/18; 7. cdhowe.org;

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Planning Ahead

Make 2019 Less Taxing

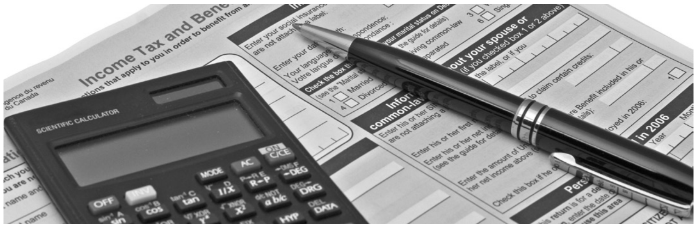
What did you do to reduce your tax bill last year? Perhaps you can do better in 2019 — the time to start is now. Here are a few suggestions to start your thinking:

1. Contribute to your registered Retirement Savings Plan (RSP). Consider whether to make a personal contribution or a spousal contribution. If one spouse has the prospect of having a high level of income in retirement while the other will not, a spousal RSP may provide an income-splitting opportunity.

Reminder: Deadline for 2018 RSP contributions is **Friday March 1, 2019.** Consider an automatic monthly contribution plan to minimize any impact of missing the deadline.

2. Contribute to your Tax-Free Savings Account (TFSA). The annual TFSA contribution limit for 2019 is $6,000. The total TFSA contribution amount is $63,500, for eligible individuals who have not made contributions since its inception in 2009.

3. Split income, save tax. Review your family's potential tax bill to determine if income-splitting opportunities exist. Talk to a tax professional about reducing your family's overall tax bill. This may include paying reasonable salaries to spouses/children for services provided to a self-employed business/private company, splitting eligible pension income with a spouse on a tax return, or setting



up a loan at the prescribed interest rate where proceeds are used for investment purposes by a spouse.

4. Get organized for tax season. While personal income tax returns will not be top of mind for a few months, why not organize your records before the crunch season approaches? This may prevent medical expenses, donations, business charges and other receipts from being missed or overlooked. Consider starting a 2019 tax folder and begin the new tax year on good footing.

5. Plan for your business. If you are a small business owner, speak to a qualified professional to review the options for your business for the year ahead, now that new passive income rules for Canadian-controlled private corporations are in effect for taxation years commencing after 2018.

Tax planning continues to be an important part of investing. If you need assistance with any of these ideas, please call or seek advice from a tax professional.

Investing for the Future

Debunking the RSP Myths

Participation rates for the registered Retirement Savings Plan (RSP) have been declining over recent years. In fact, many Canadians may believe there is "no point" in investing in them because taxes eventually have to be paid in retirement. But the RSP can provide a substantial tax advantage. Let's debunk some of the myths:

Myth: There is no point in investing in an RSP as you pay all the savings back in taxes when you retire.
While you do pay tax on RSP withdrawals, don't forget that you received a tax deduction when funds were contributed. This is often overlooked; people confuse pre-tax with after-tax dollars. A $4,000 RSP contribution is equivalent to a $2,800 after-tax contribution to a non-registered account at a 30 percent marginal tax rate.

Myth: The RSP is disadvantaged because investment earnings are subject to higher taxes, since withdrawals incur tax at regular rates, whereas capital gains realized in a non-registered account are taxed at lower rates.
If you assume a constant marginal tax rate and adjust for pre-tax and after-tax amounts, the RSP will potentially outperform a non-registered account holding identical investments. The following chart shows a scenario with this outcome, in which a pre-tax contribution of $4,000 has been made for 20 years. The example assumes a 30 percent marginal tax rate and growth of capital at 5 percent.

Scenario: After-tax Difference of RSP vs. Non-Registered Account

	RSP Account	Non-Registered Account
Pre-tax annual contribution	$4,000	$4,000
After-tax contribution: 30% tax rate	n/a	$2,800
Total contribution over 20 years	$80,000	$56,000
Growth over 20 years at 5%	**$138,877**	**$97,214**
Tax at withdrawal at 30%	*$41,663*	*$6,182*[1]
Net after-tax amount	**$97,214**	**$91,032**
Difference	***+6.8%***	

1. Realized capital gain of $97,214 - $56,000 = $41,214, taxed at 50% inclusion rate.

This net after-tax amount will vary depending on circumstances such as your time horizon, actual rates of return and applicable tax rates. In addition, the tax liability may be less if you are in a lower marginal tax bracket at the time funds are withdrawn, which is often the case for retirees.

As such, don't overlook the potential tax-deferral benefits of compounding over time through the use of the RSP.

Our Aging Population

Preventing Elder Abuse

Nobody wants to believe that elder abuse could happen to someone they love. But with estimates indicating that about 10 percent of elderly individuals may suffer from abuse,[1] there is reason to be concerned. Financial abuse is one of the most common types of elder abuse and it can take many forms, from bullying, manipulating or theft to financial scams. Sadly, it may be relatives or friends who are responsible for the abuse.[2]

Here are some signs that may indicate financial abuse:

- **Unusual financial activity** — Unexplained account activity, including withdrawals or credit card charges, may indicate that an elderly individual is being coerced. Sometimes funds are "borrowed" but never repaid; cheques may be cashed without authorization, or by forging a signature.
- **Missing valuables** — Lost items may indicate abuse, but this can easily be dismissed if a person suffers from cognition problems. Helping to locate missing valuables can determine if the issue is simply confusion, or if it signals a larger problem like abuse.
- **Appearance of a new friend** — A new companion may be cause for concern if warning signs are present, such as unusual financial activity or missing personal effects.
- **Changes to important legal documents** — Unexplained changes to important documents, such as a will or power of attorney documents, may indicate potential abuse. Sometimes seniors are coerced or deceived into signing documents.

While there are often signs, elder abuse may be difficult to uncover and can continue for long periods of time. Victims may become secretive because they feel ashamed or embarrassed, or fear punishment or retaliation from their abuser.

One way to help prevent elder abuse is to take steps in advance to protect those who may be vulnerable:

Prevent isolation — Form a wide support network of family, friends and professional advisors. These individuals can help identify problems and intervene where necessary. Widening an elderly person's network can help to provide support from trustworthy sources.

Check in — Call and visit as often as possible or find a trusted confidante to check in. This can help to identify warning signs that may indicate abuse. Listen closely to the elderly individual when they share information. Ask questions, and never dismiss potential red flags.

Offer support — Offer simple support with finances, such as conducting a quick scan of bank or credit card statements to make sure things are in order. Or, provide support for larger projects, such as helping to update financial documents or conduct a credit check. These reviews may uncover abuse.

Put safeguards in place — Plan ahead and grant a power of attorney to a trusted individual. Consider appointing a professional (such as a trust company) to work alongside a family member to help provide a safeguard.

Many resources are available to provide support. A starting point is the Government of Canada website: canada.ca/en/employment-social-development/campaigns/elder-abuse/financial-reality.html

1. http://www.carp.ca/2016/10/14/elder-abuse-widespread-problem/; 2. https://cnpea.ca/images/canada-report-june-7-2016-pre-study-lynnmcdonald.pdf

New Year Resolutions: Keep Time on Your Side

"You may delay, but time will not."
- Benjamin Franklin

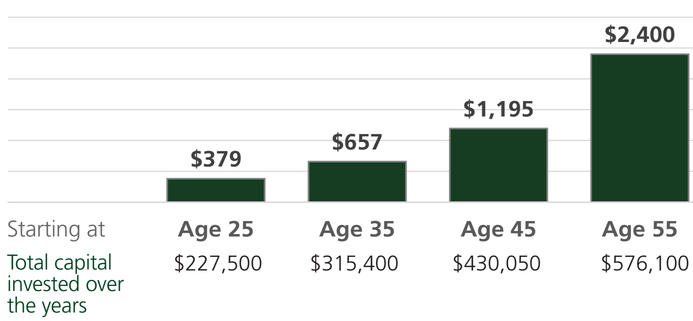
It is often said that procrastination is the thief of time. As we begin another year, don't let procrastination preclude you from using time wisely to generate wealth.

Perhaps there is an opportunity to put funds to work that are currently sitting on the sidelines. Or how about passing along some financial wisdom to younger generations, teaching them the value of time and compounded growth?

The chart to the right shows the impact that time can have on generating retirement savings. It illustrates how an investor would need much less capital the earlier they start investing in order to accumulate a $1 million nest egg by the age of 75.

Remember that time can be one of an investor's greatest allies.

Estimate Monthly Amount Needed to Accumulate $1M by Age 75
(Assuming a 5 Percent Compounded Annual Rate of Return)



Note: Assumes a return of 5 percent compounded annually on the annual amount invested, with taxes and expenses ignored. The estimate monthly amount equals the annual investment amount divided by 12. For illustrative purposes only.

Rental Properties: Don't Let Taxes Surprise You!

With interest rates on the rise and price cooling measures introduced in some markets, some landlords may be reassessing their real estate rental holdings. As part of this exercise, it is important to understand the impact of income taxes so that there aren't any surprises upon the sale of the property.

Annual Taxation

In your personal tax return, you report the rental income received and any expenses incurred to earn that income, such as insurance, property taxes and other related expenses. Mortgage payments cannot be fully deducted; only the interest component of the mortgage payment is tax deductible. However, it may be possible to annually amortize the cost of the rental property (other than the land value) for tax purposes to further reduce the amount of net rental income reported each year. The maximum amount of amortization that can be claimed in a year is limited to the net income of the rental property (so you cannot create or increase a loss from the property to use against other income)*. While claiming amortization provides a tax benefit in the current tax year, it can create a future tax liability when you sell the property.

Sale of the Property

When the rental property is eventually sold, there are at least two major tax issues to be aware of. First, if the property is not your principal residence, you may be subject to capital gains tax. This is equal to the difference between the proceeds received and the adjusted cost of the property (the original purchase price plus any capital improvement costs). One half of any gain is subject to tax.

Second, and often overlooked, is a tax "recapture" that applies when a property is sold for an amount that is above its depreciated tax base. If you have benefitted from claiming amortization in previous tax years, you may need to bring all (or a portion of) this amount back into income for tax purposes. The amount included in income is the lesser of i) proceeds received and ii) the adjusted cost basis ***minus*** the undepreciated capital cost of the property.

For example, assume Mary bought a rental property for $380,000 a few years ago. She claimed a cumulative amount of amortization over the years of $90,000. If Mary sold the property for $600,000 in the current year, she would report a taxable capital gain of $110,000 (= 50% X ($600,000 - $380,000)). In addition, since both the proceeds received ($600,000) and the cost basis of the property ($380,000) exceed the unamortized cost of the property of $270,000 (= $380,000 - $90,000), her recapture amount would be $90,000 (the lesser of $600,000 and $380,000 minus $270,000). In Mary's case, her modest employment income normally puts her in the lowest tax bracket; but including the taxable capital gain of $110,000 and recapture of income of $90,000 now puts her in a higher tax bracket. As a result, she could be taxed on the recapture at a higher tax rate than the deduction she received previously on the amortization at the low tax rate.

Seek Assistance

Income tax should be considered when evaluating real estate as an investment as it can significantly impact the effective rate of return. Consult a professional tax advisor to review your situation.

*As prescribed under the Income Tax Act (Canada).

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