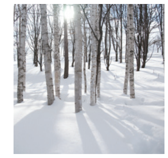
TD Wealth

Wealth Insights

TD Wealth Private Investment Advice

Winter 2021



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In This Issue

To Our Clients:

While we face continued challenges this winter with the resurging virus, we can take comfort in the news of promising vaccines to bring optimism for 2021. Continue looking forward and positioning your wealth for better times to come; we are here to provide this support.

This is likely a different holiday season for many of us. We hope that you and your loved ones stay safe and healthy, and we wish you every happiness for the holidays and the year ahead.

Smith & Associates
Wealth Management

Paving the Road to Recovery

It is a testament to the human spirit: adversity often builds strength. While 2020 was a year that many would rather forget, it has paved the way for the road to recovery.

There are signs that better times may lie ahead. After the spring 2020 shutdowns, many economists were surprised by the speed at which economic activity rebounded once markets reopened. Employment levels grew faster than anticipated, as did consumer spending. Though the cooler months have slowed momentum due to a resurgence of the virus and new shutdowns, we shouldn't overlook the ability of economies to recover in 2021 once things restart.

Unlike previous recessions, the economic effects have been uneven and concentrated to certain sectors. This has resulted in a relatively weak multiplier effect for the overall economy. Canada's housing market has shown resilience. Many companies continue to adapt to the new normal, reassessing business models, leaning operations and innovating within the digital space.

Yet, others continue to struggle. In the service industry, hard hit with its many small businesses, there has been well-needed recognition that some of the most vulnerable citizens work in sectors that help hold our society together. Canadian equity markets have been hindered more than their U.S. counterparts, largely due to pressure on the energy and resources sectors. Sectors that have been able to thrive, such as technology, have helped drive U.S. equity markets.

One must not overlook the significance of stimulus efforts in providing support. Canada has the largest stimulus deficit of any nation globally in 2020.[1] This has helped to fuel an ongoing debate that challenges mainstream economics. Proponents of "Modern Monetary Theory" (MMT) argue that a country with its own currency should not worry about accumulating debt and can print as much money as needed, as long as there is an increase in demand to keep the currency's value stable. Regardless of this heterodox view, the good news is that the current cost of carrying debt remains low due to near-zero interest rates. In the 1990s, more than 35 percent of government revenue went to pay interest costs on federal debt. Today this percentage hovers in the single digits.[2] Many economists remain concerned with the future debt burden: will recovery drive enough economic growth to reduce this burden or will austerity in the form of tax increases or reduced spending be needed?

In the U.S., a reset has begun as a result of the highly contested presidential election, widely watched by Canadians. After an autumn of rampant civil and social unrest, there is hope that new leadership and a much-needed stimulus package will support the U.S. this winter.

Most notably, we have made remarkable progress in the race to find a vaccine in a significantly compressed timeline. This is exceptional, given the typical vaccine time-to-market is 10 to 15 years. The fastest to date has been the mumps vaccine, which took four years.[3]

Progress in combatting a pandemic takes time. However, as we have seen in 2020, equity markets don't wait on the sidelines for recovery to happen. They are, after all, forward looking. Moreover, periods of retrenchment have almost always been followed by new growth, expansion and progressing equity values. There is little reason to expect otherwise in this cycle.

After a difficult 2020, we are all deserving of a better year ahead. Continue to look forward to better times to come.

1. As a % of GDP; 2. "The Bearable Lightness of Canada's Debt Burden", Globe & Mail, 10/30/20, p. B6; 3. http://nationalgeographic.com/science/health-and-human-body/human-diseases/coronavirus-vaccine-tracker-how-they-work-latest-developments-cvd/

Retirement Planning

Don't Need Excess Funds? RIF Minimum Withdrawal Planning

As you think about retirement, maximizing your retirement income is an important part of this exciting transition. Ultimately, it's your after-tax income that counts: paying the least amount of tax on your income can help you keep more of your hard-earned dollars.

Carefully consider and plan for all sources of income, including pension income, non-registered assets, and Tax-Free Savings Accounts (TFSA). If you have sufficient funds through pension income and non-registered assets to meet your retirement expenses, it may make sense to only withdraw the mandatory minimum amount from your registered Retirement Income Fund (RIF) or locked-in plans such as Locked-in Fund (LIF), Locked-in Retirement Income Fund (LRIF) or Prescribed Retirement Income Fund (PRIF) each year. This allows for continued tax-deferred growth within the plan. Here are some additional strategies to help keep funds invested for longer:

Basing the withdrawal rate on a younger spouse's age — If you have a younger spouse, consider basing your withdrawal rate on their age in order to lower the amount of the required annual withdrawal, thereby helping to keep more assets to potentially grow within the plan on a tax-deferred basis.[1]

Making your first withdrawal at the end of the year in which you turn 72 — You are required to convert your registered Retirement Savings Plan (RSP) or Locked-in Retirement Account (LIRA) into a RIF/LIF/LRIF/PRIF by the end of the year in which you turn age 71, but don't need to make the first withdrawal until the end of the year in which you turn age 72.

Timing annual withdrawals at the end of each year — The timing of withdrawals can make a difference over time. If you take your withdrawal at the end of each year, instead of the beginning, you allow for greater time and potential compounding of funds within the plan.

RSP Season Reminder

Deadline for 2020 RSP contributions: **March 1, 2021.**

RSP contribution limit: 18 percent of the previous year's earned income, to a maximum of $27,230 (for 2020).

For example, consider a 71-year-old with a marginal tax bracket of 40 percent and an RIF worth $500,000 that has an annual rate of return of five percent. If this individual withdraws the minimum from the RIF at the end of the year in which they turn 72, the after-tax income from age 72 to age 90 will be higher than if payments were made at the start of the year. As well, by the age of 90, $315,970 would be remaining in the RIF, as opposed to $293,177, if payments were made at the start of every year.[2]

Plan Ahead

While these strategies involve minimum withdrawals from your RIF, consider that, in some cases, withdrawing more than the minimum amount can improve an overall lifetime tax bill. Every situation is different. As such, please get in touch if you require support as you think ahead.

1. Provincial locked-in plan legislation for LIF/LRIF/PRIF allows for the use of a younger spouse's age, with the exception of New Brunswick; 2. Based on current prescribed RIF withdrawal factors.

Income-Splitting Strategies

Investment Loans to Spouses Can Make Sense

Consider income-splitting opportunities for the year ahead. With the prescribed rate at its lowest level possible, one strategy may involve splitting income with a spouse by use of a loan.

Making a bona-fide loan to a spouse for investment purposes is one way to put family investments in the hands of a lower-income spouse.

Why is a spousal loan required for this strategy? Generally, you achieve no tax advantage if you were to simply give funds to a lower-income spouse to invest. This is because the Canada Revenue Agency (CRA) attributes any investment income earned on these funds back to the higher-income spouse, as if earned by that spouse, and it is taxable at the spouse's higher marginal tax rate. This is known as the "attribution rules."

A spousal loan must be documented and interest must be paid by the borrowing spouse at the CRA prescribed rate. Any interest for the year must be paid no later than January 30 after the year-end. Failure to do so means the attribution rules will apply, and any returns on the investment will be taxable in the hands of the higher-income spouse. Interest paid will be taxable income to the spouse loaning the money and may be deductible from the investment income earned by the lower-income spouse.

The lower the prescribed rate relative to the return on investments, the greater the opportunity to benefit from such a strategy. The current prescribed interest rate is one percent, the lowest possible rate (see CRA website[1]).

Muddy Waters: The TFSA

An exception to the attribution rules applies to the Tax-Free Savings Account (TFSA). While the Income Tax Act prohibits anyone other than the TFSA holder from making contributions, it does not prevent an individual from gifting assets to a lower-income spouse who then contributes that gift to his/her own TFSA.

However, the attribution rules may apply when money gifted and then contributed to a TFSA is subsequently withdrawn within a short period of time. The CRA has stated that where a higher-income spouse gifts funds to a lower-income spouse to contribute to a TFSA, and these funds are immediately withdrawn from the TFSA and reinvested, future income or capital gains earned would be taxable to the original high-income spouse.[2]

Please seek the advice of a tax specialist for your particular situation.

1. https://canada.ca/en/revenue-agency/services/tax/prescribed-interest-rates.html; 2. See CRA technical interpretation #2010-0354491E5.

Investing Resolutions

Looking Forward: Lessons from the Pandemic

Amidst the many hardships created by the pandemic, there may be prudent lessons that can assist us in finding greater future financial success. As we look to better times to come, here are some reminders:

Don't Overlook the Merits of an Emergency Fund

The pandemic has been a stark reminder that unexpected events can affect everyone, regardless of income level. Economic shutdowns have affected the income streams of many, highlighting the benefits of having an emergency fund in place. For some high-net-worth individuals, a common notion has been that having enough assets negates the need to have funds set aside for an emergency. But one of the strongest arguments for having an emergency fund is to avoid the need to liquidate investments on short notice, especially since larger daily expenses may need to be covered. For retirees, while emergency savings may not be needed to replace a missed paycheque, they may help support other unanticipated costs, such as health care.

Avoid Emotionally-Driven Investment Decisions

The equity market sell-off in March 2020 and the ensuing rebound reminds us that markets can quickly reverse their course, even during the most challenging times. This illustrates the difficulty in attempting to time the market — a testament to the importance of staying the course with your investments. Not everyone is able to keep calm during a crisis, which is understandable. However, this is where our role as advisors comes into play — to help provide objectivity and perspective and offer counsel. While it may be difficult to abandon the worry that comes with fluctuating portfolio values, it is important not to let these worries derail you as you work towards achieving your ultimate goals.

Reassess Your Current Budget

This is not to admonish anyone about their spending habits, however taking time to sit down and map out the family income and expenses each month can be revealing. More notably, the current pandemic has altered many household spending habits, due to working remotely or lifestyle changes — perhaps you have saved more by not going to the office or gym or traveling for vacation. Reevaluating spending on a periodic basis may uncover opportunities to put more towards retirement savings, which has the potential to pay significant benefits down the road.

Don't Make Unnecessary Withdrawals

Making early withdrawals from retirement accounts can result in unintended consequences. While the pandemic may have made this temporarily necessary, it is important to have a thoughtful plan for prioritizing sources of potential income during difficult times. Why? Liquidating investments to generate cash flow could potentially result in unanticipated taxes or, in the case of retirees, the loss of income-tested benefits such as OAS (Old Age Security). Equally important, careful thought should be given to how to make up for the potential loss of retirement income down the road.

Market Perspectives

Equity Market Volatility: The Norm

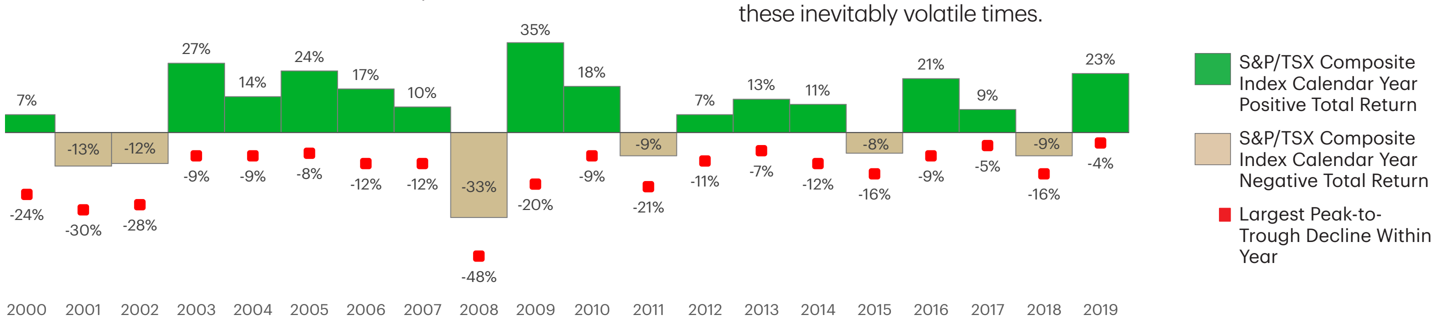
Was 2020 a more volatile year in the equity markets? With heightened noise, it may have felt as though the markets were particularly unsettled.

Yet, a look back over the last 20 years shows that volatility has always been a common feature of the equity markets. The chart below shows the biggest peak-to-trough drawdowns during the year for the S&P/TSX Composite Total Return Index and the resulting annual returns. In 12 of the last 20 years, there has been a double-digit, intra-year correction. Significant volatility is no stranger to the markets.

Today, many factors have helped to drive volatility. Interest rates continue to be at historical lows and many traditional lower-risk, fixed income investments no longer provide meaningful returns, which has pushed many investors into equity markets in search of higher returns. There was no shortage of negative news in 2020, which may also have helped to support volatility. As well, there continues to be significant money sitting on the sidelines, which has driven volatility as investors enter and exit the markets.

However, keep in mind that short-term volatility often has little bearing on what happens over the longer term. In fact, in half of the years where the market experienced a double-digit, intra-year correction, the market ended up finishing in positive territory. Extending the time horizon out across many years may further reduce the effects of volatility.

These perspectives may be good food for thought as we weather these inevitably volatile times.



Source: S&P/TSX Total Return Index, Jan. 1, 2000 to Dec. 31, 2019.

Estate Planning

TFSAs: Different Beneficiaries May Have Different Implications

With the lifetime contribution amount now totaling $75,500 in 2021 (for those eligible since 2009), the Tax-Free Savings Account (TFSA) has become a significant investment vehicle. If it will play a substantial role in your estate plan, understanding the impact of naming different beneficiaries is important.

While any income or capital gains earned in the TFSA to the date of death are exempt from tax, keep in mind that the way that beneficiaries are named and structured may have differing financial implications. As such, it is important to carefully plan ahead.

If you haven't revisited your TFSA beneficiary designations since opening the account, perhaps now is a good time to review them. Here are some things to consider:

Deciding "Where" to Designate a Beneficiary — In all provinces except Quebec, you may designate a beneficiary of your TFSA by naming them in the plan documentation or in your Will.[1] If a beneficiary is designated within the TFSA plan documentation, the main benefit is that you'll be able to minimize probate taxes as the value of the TFSA will generally not pass through the estate.

Naming a Spouse — If you intend for a spouse (or common-law partner) to be the plan's beneficiary, they can be designated as a "successor holder," which is a designation only available to spouses. This allows the spouse to automatically become the holder of the TFSA at your death, simply through a name change on the account. If the spouse already has their own TFSA, they will now have two accounts. If they wish to consolidate accounts, they can directly transfer part or all of the value from one account to the other. This transfer doesn't affect their own TFSA contribution room.[2] If the spouse is designated only as a beneficiary, as with any designated beneficiary, any increase in the value of the TFSA after the deceased's date of death will be subject to taxes.

Planning for a Minor as Beneficiary — Careful planning should be done when designating a minor as the TFSA beneficiary. Depending on the applicable provincial laws, proceeds will generally need to be paid to a parent on behalf of the minor child, a court-appointed guardian of property, or an appointed trustee (i.e., such as through a testamentary trust created under a Will

for the benefit of the minor). In some cases, a parent may not automatically be considered the guardian of a child's property and as such may need to apply to the courts. In other cases, if no trustee is named, TFSA proceeds may be paid into the courts. Keep in mind that the involvement of the courts can be a time-consuming and costly process. As such, it is advised to consult with a legal advisor to plan for naming a minor beneficiary.

Designating a Charity — If you wish to make a gift to charity as part of your estate plan and are seeking opportunities to minimize the taxes paid by your estate, consider designating a charity as a beneficiary of a registered plan. With the TFSA, any value on the date of passing would not be considered as taxable income. However, the full value of a registered Retirement Savings Plan (RSP) or registered Retirement Income Fund (RIF) is considered to be taxable income in the year of passing (unless there is a successor or spouse beneficiary who can roll the amount into their own registered plan). A charitable donation tax credit can be used to reduce taxes payable in the year of death.

Please seek the advice of tax or legal professionals as it relates to your particular situation.

1. In Quebec, beneficiaries cannot be named within plan documentation; they must be named within the Will; 2. Unless there is an excess amount in the deceased's TFSA at the time of death.

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