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KPW NEWSLETTER

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Our **"LIFESTYLE WHEEL"** is a unique tool integrated into our extensive financial planning services, designed to empower clients in assessing their current lifestyle satisfaction and pinpointing opportunities for enhancement. This innovative feature examines ten critical lifestyle facets, encompassing physical and emotional well-being, leisure and enjoyment, interpersonal connections, time management, financial health, and personal growth, ensuring a holistic approach to your life's blueprint.

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IMAGINE YOUR FUTURE

"The function of economic forecasting is to make astrology look respectable."- John Kenneth Galbraith

THE WAY I SEE IT

CLIMBING A WALL OF WORRY

One of the most famous Wall Street sayings describes our current market experience. ***"Bull markets climb a wall of worry; bear markets slide down a river of hope."*** Many market "experts" believe we can, at least temporarily, ignore the latter part of this saying and focus on the first part.

What is this **"wall of worry"?** The general consensus is that it refers to the financial markets' tendency to look beyond a deluge of negative occurrences and continue to rise. The conclusion is that investors are so confident in the market's future upward trend that they are willing to overlook impediments along the way.

This attitude generally becomes prevalent towards the end of a bear market trend when investors are more apt to focus on a perceived market lifter. For example, we know that inflation has recently reached multi-decade highs and we know that this caused interest rates to escalate very rapidly. But, we also know that Central Banks have been adamant about fighting these issues and bringing inflation back to more *'normalized'* levels, say around 2%. We also know that once this has been achieved, interest rates will fall back into line. These are extremely positive catalysts for markets.

The only problem is that we don't know the timeline. Sure, we can guestimate this and in fact most analysts are within 9 months of this occurring. Some believe it will begin in Q2 2024 while others believe it will begin in Q4 2024. Twenty years from now we will look back and conclude that 9 months is really a brief period of time in the big picture. Unfortunately, while we are living it, it seems every day is a journey.

Investors are so confident that rates will come down, whether they begin three months from now or nine months from now, that they are willing to overlook the nuisance of negative market issues. While they are willing to overlook these issues, it doesn't mean they are doing it happily. Let's face it, even when the markets are booming, investors can always find a reason to worry. I believe it is human nature. The cause is generally rooted in investors' short-term outlooks. Instead of trusting the market's long-term trend, they will focus on short-term impediments.

When the markets are considered to be healthy like in most bull markets, many investors become tense in anticipation of the end of the good times. They wonder and worry about how long it will last, should they invest more money, should they cash in their gains, what catalyst will finally put an end to the market madness. To make matters agonizingly worse, there seems to be a direct correlation between the rise in the markets and the rise in their worry.

While this worry escalates, a new fear emerges – FOMO – Fear Of Missing Out. Greed envelops us and we finally capitulate and invest our last dollar in the markets. This is when the antacids become part of our daily diet. Of course, the media loves to stimulate this worry as it creates more readership and more clicks. They begin a drip, drip, drip of modestly negative news. Each item lays a brick on the **'Wall of Worry'** and each brick becomes a little more difficult to ignore and overcome.

Look no further than the last year where we have one layer of bricks after another being added to this wall. There was the trade-war brick, the escalating inflation brick that led to the escalating interest rate brick, the tightened credit brick, the wage inflation brick, the political dysfunction brick, the Israeli/Hamas conflict brick, the potential government shutdown brick, and the bricks just kept piling up, one on top of the other.

We ask ourselves, with all this going on, how is it possible that the stock market indices are hitting all-time highs. Fortunately many investors have been stoic enough to ignore the 'media noise' and stay committed to their long-term planning. To have benefited from the market downturns investors had to make at least one of two decisions.

Climbing a Wall of Worry - Continued

One: Hold on, ignore the media and patiently wait for the market to recover or

Two: Invest more money.

Ideally, both events would ultimately have created the best portfolio results.

The investor who benefited most from what happened in 2022 was the one who ***"climbed the wall of worry"*** and showed great patience and discipline. By sticking to their long-term plans, they won the short-term growth lottery.

This leads me to another idiom called the Stockdale Paradox, inspired by Admiral James Stockdale's survival of horrific conditions in a North Vietnamese prisoner of war camp. It is a technique used to navigate challenging and ambiguous times by combining the ability to confront the brutal facts of your current situation, even as you maintain an unwavering faith that you will prevail in the end.

When we look at historical market trends we can be confident that markets rise over a long period of time. It is so much easier to climb the wall of worry if we are committed to the ideal that **"the good days will return".** I challenge anyone to tell me a day earlier than 2020 that they would not have invested compared to today's stock market index levels. Time and patience are the great healers of investment portfolios. Yet, if we look back to 2020, investors had to deal with a landmine littered field of market shocks. How many of you are wishing you had more money to put into the market in early 2020. How many of you wish you had pulled the trigger back then and converted cash to investments?

Let's take a look back at 2022. That was definitely a difficult year for the markets. The bond market crashed, having their worst year over the previous century. Stocks ended the year in a significant decline. The so called market experts where calling for a continuation of this in 2023. There seemed to be no light at the end of this tunnel. The general consensus was that the Fed had been too aggressive with their tight money policy and that we were heading into a recession in 2023. Many investors converted their investments to cash and decided that the best decision was to park their money and wait on the sidelines until the upcoming recession was over.

The patient and disciplined investors took a different approach. They ignored the doomsayers and their negative forecasts and stayed the course. These were the investors who were rewarded with an unexpectedly great year with many investors realizing double digit returns in their portfolios. **The S&P 500 finished the year up 26%!**

The best lesson to be learned in 2023 is that short-term market prognosticators have a very poor track record. The second-best lesson to be learned was to stay patient and committed to your long term plans.

I am often asked what I think will happen with the markets this year. The truth is I don't know though I have some thoughts.

THE WAY I SEE IT

This year will seem like **"death by a thousand cuts"** as one negative bit of news will follow another. Each cut will cause a market reaction. These are not market moves or directional moves, they are reactions. Sometimes the reaction will take the market down and sometimes it will move the market up.

I believe interest rates will begin coming down by either late Q3 or Q4 of this year. I expect there will be signs later this summer that will give us a better idea of timing. Right now it is still up in the air and with employment numbers that were just released coming in much better than expected, I expect the timing will be delayed a little.

Once the signs of interest rate reductions are imminent, investors will buy to stay ahead of the curve in the hopes of taking advantage of the expected uplift when rates begin to fall. This will push the indices up, but I believe the probability is very high that these returns will come with a lot of worry. The smart money will likely prevail, but it will come with a tireless escalation over that **"Wall of Worry".**

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LIFESTYLE FINANCIAL PLANNING BY KPW

LIFESTYLE PLANNING SOLUTIONS BY KPW

HOW YOUR NUMBER IS THE DOLLAR VALUE OF FINANCIAL INDEPENDENCE

How much money do you need to live the rest of your life, without worry? I'm talking complete financial independence. Five hundred thousand? One million? Three million? One billion?

It's a hard question to answer with any kind of seriousness. Most people I ask will say $10 million or $100 million or something like that. But is it that much? Could you be happy and financially independent with less? How would you know if you've already reached a point in your life where financial independence could be a reality? These types of questions are explored in a book by Lee Eisenberg titled **'The Number: What Do You Need for the Rest of Your Life and What Will It Cost'.** If you can, go and find yourself a copy.

As a lifestyle financial planner, I've made it my objective to help people figure out their number. From a planning standpoint, providing a client with their number is crucial because it means we can properly 'advise' our clients on how to get to that number. And, if they are already there, we can give them the confidence to focus less on their return on investments and focus more on achieving a **'return on life'.**

Let's just admit that we all live in chaos – and some more than others. You probably know how your day is going to go because most days go that way. Then suddenly, you find yourself facing a 'one-off' as we call them in the planning world. One-offs are things that happen outside of the norm (and in my world they usually cost money). A one-off can mean nothing, or it can be downright dangerous to a person's number.

The most expensive one-offs tend to happen in relation to the home, vehicles, and health. Needing a new roof on the house is probably the top one-off expense I hear about the most. However, these are easily planned for in a proper cash flow analysis, so this type of one-off should already be built into your number. But the most dangerous one-off's I've come across are health related because they can affect an important source of cash – **your career income.**

"TRUE FINANCIAL INDEPENDENCE LAUGHS IN THE FACE OF HARDSHIP"

No one plans to get sick, or hurt, or worse but when it does happen it can be detrimental to your number, your lifestyle, and your financial independence. Fortunately, insurance can help cover major one-offs relating to home, vehicle, and especially health so it is important that your number reflects and incorporates an insurance need. If this is not done, then your number is not a true reflection of complete financial independence because your lifestyle will depend on whether you experience hardship. True financial independence laughs in the face of hardship.

One-offs, though unpredictable can be planned for and accounted for in the number; however, we must also include certain assumptions in our number. The most common assumptions in planning are how long you plan to live, your investment returns over that lifetime, and inflation. Investing is an excellent way to help people get to their number faster. We save our extra income, and we invest those savings so that they grow in the most tax efficient way possible and at a rate of return that aligns with our own risk tolerance and risk capacity. The problem is what to do after we have reached our number. The 'post-number' investment strategy can't be subject to the whims of the stock market and where we are in the economic cycle. Otherwise, our financially independent lifestyle turns into a stock market dependant lifestyle.

Your number must be resistant to higher-than-expected inflation and resistant to market fluctuations. This is why, at KPW Financial, we establish your lifetime assurance number or your baseline lifestyle number. We haven't come to a consensus on the best title, but we've narrowed it to these two. Essentially, this is the number that supports the lowest amount of lifestyle you are willing to accept. This could mean for example, that you absolutely must be able to travel once a year for two weeks. Anything less than that would be considered a gross infringement upon your bare minimum way of life.

Disclaimer

HOW YOUR NUMBER IS THE DOLLAR VALUE OF FINANCIAL INDEPENDENCE—Continued

Think about your own bare minimum lifestyle. Don't think about the costs; rather, I challenge you to think about the actual things that you are not willing to give up. Personally, I don't need to drive a Ferrari, but I want to always have access to at least one vehicle, so my current baseline lifestyle must include one. I need to make sure that my son is properly fed and has access to a good education, so my baseline lifestyle must include those things – no matter what happens.

To make sure your baseline lifestyle is not worsened by inflation and poor investment cycles, the assumptions tied to this number will be conservative. For example, if you need $1 million to ensure a baseline lifestyle for the rest of your life, then the assumptions on that $1 million will be that it can keep up with a high inflation rate without taking on unnecessary investment risk. If you need $1 million but you have $1.5 million, then you can assume a more aggressive investment for $500,000. This way, you can ensure your minimum lifestyle is maintained via the $1 million, and anything above that minimum lifestyle will come from your additional $500,000. An extra cherry on the cake so-to-speak. This means during a good market cycle, you can take an extra trip, upgrade your car to include heated leather seats, sit a few rows closer at the Blue Jay's game, and just generally increase your lifestyle knowing that if bad times hit, your bare minimum lifestyle will still be okay.

INSURANCE SOLUTIONS FOR INCOME SPLITTING

In the spirit of income tax season, I can't think of a better time to review and discuss some of the exciting income splitting strategies available to those looking to strike while the iron is hot. While it's true there is no avoiding tax altogether as a Canadian, our tax system does allow for strategies to help ease the burden. As an example, the CRA rules encourage individuals to attempt to shift investment assets to lower-income family members. With the highest provincial marginal tax rate well above 50% now, the potential benefits of doing this are greater than ever. In an effort to mitigate the potential loss of tax revenue, the Government introduced income attribution rules which prevent taxpayers from income splitting with lower-taxed family members by attributing the income back to the taxpayer. The purpose of today's article is to brush up on the topic of income attribution rules, discuss exceptions, and consider how life insurance plays a supplementary role.

Income attribution rules that generally apply when a taxpayer transfers (or loans) property to another family member, are "family" income attribution rules and are aimed at preventing income splitting between spouses and minor children. The rules provide that any income/loss or capital gain/loss from the transferred or loaned property will be taxed by the transferor when property is transferred to a spouse, common-law spouse, niece or nephew. Remember that for minor children, capital gains/losses specifically are not subject to attribution; and attribution ceases to apply to children once they turn eighteen.

As is the case with any good rule, there are always exceptions to the income attribution rules. Some of these include: contributions to a spousal RRSP, gifts to a family member to contribute to a TFSA or FHSA, contributions to an RESP, and capital gains realized on transfers of property or loans to minor children, as previously noted. With respect to contributions to spousal RRSPs, TFSAs and FHSAs, there are contribution limits, age requirements and other criteria to be mindful of.

In light of increasing barriers and limitations, we are encouraged to look beyond the traditional income splitting arrangements, to other planning opportunities. As I have recently discovered, life insurance has various benefits that warrant its consideration as a valid alternative.

Provided it remains in the policy, growth in the cash value of a permanent life insurance policy is not subject to annual taxation, although contributions are not tax deductible. While the policy is in force, there are numerous ways to access the cash value of the insurance policy, and the beneficiary can receive the death benefit on a tax-free basis. There are also estate planning benefits whereby creditor protection is ensured when naming a family beneficiary of the life insurance policy, ensuring the death benefit transitions outside of the estate.

Another great strategy, and one that we are seeing utilized more, is when a parent establishes and funds a life insurance policy on their child's life and eventually transfers the policy to their spouse or child on a rollover basis. Theoretically, high income parents may acquire a permanent insurance policy on the life of a child, making additional deposits that grow over time. Once the child turns 18, the policy can be transferred to that child without any immediate tax implications. The child is then free to access and utilize the funds in the policy without the transferring parent being subject to attribution on any policy gains.

Parents can also maintain control with an irrevocable beneficiary designation. Even if the policy values are not required immediately, they can continue to grow on a tax-deferred basis and utilized down the road. This policy can lay the groundwork for long-term insurance protection for that child's family, and work towards achieving intergenerational transfer of wealth.

As we can see, life insurance is a significant alternative option for supplementing and enhancing other income splitting strategies. Overall, it is important to be aware of the income attribution rules that must be considered when property is transferred between family members. Luckily, there are a few important exceptions to these rules to be considered, and when implemented properly can go a long way in enhancing the overall financial well-being of individuals, couples, and families.

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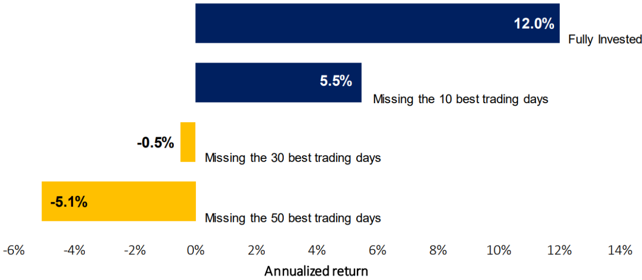
PROTECTING YOUR LIFESTYLE BY KPW

Timing the market can be costly

Missing just 10 days in the market over the past 10 years would have reduced returns



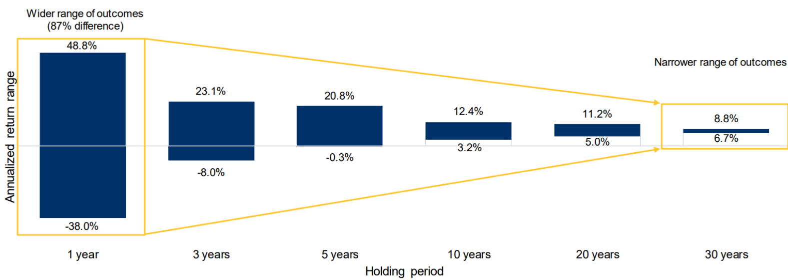
Source: Morningstar, RBC Global Asset Management. Based on the annualized returns in U.S. dollars of the S&P 500 Total Return Index for 10 years, ending December 31, 2023. An investment cannot be made directly into an index. The above does not reflect transaction costs, investment management fees or taxes. If such costs and fees were reflected, returns would be lower. Past performance is not a guarantee of future results.

RBC Global Asset Management

Time narrows your range of returns

Portfolio volatility decreases and consistency increases over time

A diversified portfolio tends to have lower volatility over time



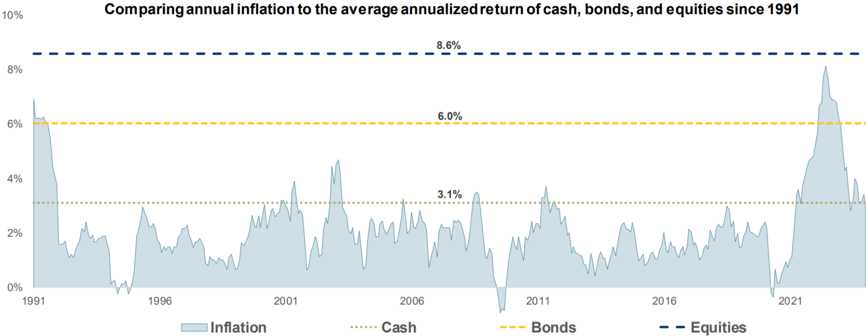
Source: Morningstar. Rolling 1-, 3-, 5-, 10-,20- and 30-year average annual returns from January 1988 to December 2023. All returns are total returns in US dollars. Diversified Portfolio represented by 2% Cash, 38% Canadian Fixed Income, 25% US Equities, 15% Canadian Equities, 15% International Equities and 5% Emerging Markets Equities. Cash represented by FTSE Canada Treasury Bill 30 Day; Fixed Income represented by FTSE Canada Universe Bond; US Equities represented by S&P 500 TR USD, Canadian Equities represented by S&P/TSX Composite TR, International Equities Represented by MSCI EAFE GR USD, Emerging Markets Equities represented by MSCI EM GR USD.
Source: Morningstar, RBC Global Asset Management. An investment cannot be made directly into an index. The above does not reflect transaction costs, investment management fees or taxes. If such costs and fees were reflected, returns would be lower. Past performance is not a guarantee of future results.

RBC Global Asset Management 3

Over time, equities can keep you above the inflation waterline

Since the Bank of Canada inflation mandate in 1991, annual inflation has not reached the 33-year equity average.

Comparing annual inflation to the average annualized return of cash, bonds, and equities since 1991



ource: Morningstar, Stats Canada. Asset data from January 1,1991 to February 29, 2024. Inflation data from January 1, 1991 to January 31, 2024. Cash, bonds, and stocks alculated as average annualized total return over period. Inflation calculated as monthly year-over-year Candian CPI, not seasonally adjusted. Cash represented by FTSE Canada 91-ay T-bill. Bonds represented by FTSE Canada Universe Bonds. Stocks represented by S&P/TSX composite index. Asset returns based on average total returns and rolling returns ay vary during different time periods. An investment cannot be made directly into an index. The above does not reflect transaction costs, investment management fees or taxes. If uch costs and fees were reflected, returns would be lower. Past performance is not a guarantee of future results.

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FEATURED ARTICLE

FEDERAL BUDGET 2024—AND YOU THUGHT THERE WOULD BE NOTHING?!

News & Views

Finance Minister Chrystia Freeland tabled the 2024 Federal Budget on April 16, 2024. After years of speculation, this was finally the budget in which the capital gains inclusion rate was increased. The budget included some relief to higher capital gains taxes through an increased lifetime capital gains exemption (LCGE), sales of business to employee ownership trusts (EOT), and the introduction of the Canadian Entrepreneurs' Incentive (CEI). Additional measures around noncompliance with information requests, avoidance of tax debts, and penalties for reportable and notifiable transactions were also introduced. There are many other points of interest to insurance and investment advisors concerning first-time homebuyers and much more.

Capital Gains Inclusion Rate

Budget 2024 proposes to increase the capital gains inclusion rate from ½ to ⅔ for corporations and trusts. For individuals, the inclusion rate will remain at ½ on the first $250,000 of capital gains realized and ⅔ on the portion of capital gains realized in the year that exceed $250,000 on or after June 25, 2024.

The $250,000 threshold would effectively apply to capital gains realized by an individual either directly or indirectly through a partnership or trust, net of any capital losses (current or applied from other years) and capital gains where the LCGE, the proposed EOT exemption, or the proposed CEI is claimed.

The rules will allow net capital losses realized prior to the rate change to fully offset an equivalent capital gain realized after the rate change.

In addition, for tax years that begin before and end on or after June 25, 2024, two different inclusion rates would apply—½ before June 25, 2024, and ⅔ on or after June 25, 2024. The annual $250,000 threshold for individuals will be fully available with no proration.

Capital gains related to the sale of real estate in which the principal residence exemption was used won't be affected by these changes and will continue to be exempt from tax regardless of the dollar value of the capital gain.

Where an individual claims the employee stock option deduction, the budget provides a ⅓ deduction of the taxable benefit to reflect the new capital gains inclusion rate, but that individual would be entitled to a deduction of ½ the taxable benefit up to a combined limit of $250,000 for both employee stock options and capital gains.

These changes will have a material impact on a variety of different issues relating to tax and estate planning as follows:

- Terminal tax obligations may be greater for taxpayers overall.
- The calculation of capital dividend account (CDA) amounts to corporations. Where the capital gains inclusion rate is ⅔ (meaning only ⅓ of the gain is nontaxable), only ⅓ of the gain will get credited to the CDA.
- It will also affect postmortem planning to minimize double taxation on the death of a private corporation shareholder.
- The 50% solution for the redemption and loss carryback to avoid stop-loss would change to the ⅓ solution where the capital gain exceeds $250,000.
- Life interest trusts won't be eligible for the $250,000 exemption. This can create greater terminal tax liabilities in these trusts relative to owning the assets directly.

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FEDERAL BUDGET 2024—AND YOU THUGHT THERE WOULD BE NOTHING?! - Continued

- It will reduce the tax rate gap between dividends and capital gains, which may lead to a reduction in the use of capital gains stripping transactions that involve generating personal income from a corporation at capital gains rates versus dividend rates.
- Capital losses will reduce capital gains at the same inclusion rate of the capital gain. Tax-loss selling to realize capital losses when capital gains are over $250,000 will fully offset such gains. Capital losses from other years may be more valuable when used to reduce capital gains included at the higher ⅔ rate.
- For corporations, capital gains will increase their Adjusted Aggregate Investment Income (AAII) more quickly. For example, a total capital gain of $74,627 will create $50,000 of AAII at a ⅔ inclusion rate; previously, a $100,000 total capital gain was needed. The small business deduction (SBD) is reduced by $5 for every $1 of AAII starting at $50,000. Conversely, current year capital losses, which reduce AAII, are more valuable at a ⅔ inclusion rate.
- It may create an incentive to trigger capital gains before June 25, 2024.
- It may result in revisiting the investment mix between personal and corporate portfolios to take advantage of the ½ capital gains inclusion rate on the first $250,000 for individuals.
- There may be more incentive to have corporations gift publicly traded securities and segregated fund contracts to charity thereby increasing the CDA credit and avoiding the ⅔ capital gains inclusion rate.
- There may be more incentive to move corporate dollars into the tax-free environment of an exempt life insurance policy.

Finance has indicated additional details are coming.

Lifetime Capital Gains Exemption Increases

The LCGE is a tax exemption for capital gains realized on the disposition of qualified small business corporation shares and qualified farm or fishing property. The LCGE is currently $1,016,836 in 2024, indexed to inflation. Budget 2024 proposes to increase the LCGE to apply up to $1.25 million of eligible capital gains. This measure would apply to dispositions that occur on or after June 25, 2024. Indexation of the LCGE would resume in 2026.

Canadian Entrepreneurs Incentive

Budget 2024 proposes to introduce the CEI to dispositions of shares that occur on or after January 1, 2025.

This is an incentive that would result in a reduced tax rate on capital gains on the disposition of qualifying shares by an eligible individual by reducing the capital gains inclusion rate to ½ of the prevailing inclusion rate, on up to $2 million in capital gains per individual over their lifetime. This measure would apply in addition to the LCGE.

The lifetime limit is scheduled to be phased in by increments of $200,000 per year, beginning on January 1, 2025, before ultimately reaching a value of $2 million by January 1, 2034.

Under the ⅔ capital gains inclusion rate proposed in Budget 2024, this measure would result in an inclusion rate of ⅓ for qualifying dispositions.

Parts of the tests to qualify are similar to those for the LCGE, including the small business corporation requirement at the time of sale (i.e., the 90% rule), the 24-month holding period requirement as a Canadian-Controlled Private Corporation (CCPC), and that more than 50% of the fair market value (FMV) of the assets of the corporation were used principally in an active business carried on primarily in Canada by the CCPC or by a related corporation.

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FEDERAL BUDGET 2024—AND YOU THUGHT THERE WOULD BE NOTHING?! - Continued

In order to qualify, there are additional requirements, including that the claimant be a founding investor who held the share for a minimum of five years prior to disposition and held more than 10% of the FMV of the issued and outstanding capital stock of the corporation and at least 10% of the votes. The claimant must also be actively engaged on a regular, continuous, and substantial basis.

Finally, there's a restriction that the corporation can't be a professional corporation or a corporation that carries on certain types of businesses, including operating in the financial, insurance, real estate, food and accommodation, arts, recreation, or entertainment sector or providing consulting or personal care services.

Employee Ownership Trusts

EOT's were first introduced in Budget 2023, and the 2023 Fall Economic Statement proposed to exempt the first $10 million in capital gains realized on the sale of a business to an EOT from taxation, subject to certain conditions. Budget 2024 articulates the qualifying conditions, including those around who the seller can be, what a qualifying transaction is, conditions that are applicable 24 months prior to the sale, a requirement to be actively engaged in the business, and a requirement that the EOT have at least 90% of the beneficiaries be resident of Canada. The budget also indicated that where there are multiple individuals disposing of shares to an EOT, the $10 million exemption must be shared among them.

The budget also identifies the idea of a disqualifying event. A disqualifying event would occur if the EOT loses its status as an EOT or less than 50% of the FMV of the assets are being used principally in an active business at the beginning of 2 consecutive taxation years of the corporation. Where a disqualifying event occurs within 36 months of the qualifying business transfer, the exemption wouldn't be available. Where the individual has already claimed the exemption, it would be retroactively denied. If the disqualifying event occurs more than 36 months after a qualifying business transfer, the EOT would be deemed to realize a capital gain equal to the total amount of exempt capital gains.

Additionally, in order for an individual to claim the exemption on a sale to the EOT, the EOT, individual, and the corporation owned by the EOT would need to be jointly and severally liable for any tax owing by the individual in the event of a disqualifying event.

Capital gains exempted through this measure would be subject to an inclusion rate of 30% for the purposes of alternative minimum tax (AMT), similar to the treatment for gains eligible for the LCGE.

These measures would come into force for qualifying dispositions between January 1, 2024, and December 31, 2026.

Alternative Minimum Tax

AMT is a parallel tax calculation that allows for fewer tax credits, deductions, and exemptions than under the ordinary personal income tax rules. Taxpayers pay either regular tax or AMT, whichever is highest. There was an iteration of the draft rules created in the summer of 2023 which were published for consultation. Budget 2024 proposes that the tax treatment of charitable donations be revised to allow individuals to claim 80% (instead of the previously proposed 50%) of the charitable donation tax credit when calculating AMT. Except for EOTs which are fully exempt, the budget didn't provide any further relief to trusts, which continue to not have a basic exemption.

These amendments would apply to taxation years that begin on or after January 1, 2024.

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FEDERAL BUDGET 2024—AND YOU THUGHT THERE WOULD BE NOTHING?! - Continued

Noncompliance With Information Requests

Budget 2024 proposes several amendments to the information gathering provisions in the Income Tax Act. These proposed amendments are intended to improve Canada Revenue Agency's (CRA's) ability to collect information over the course of an audit.

Some of the proposed tools include the introduction of the "notice of non-compliance" that will impose a penalty on a person who's been issued this document, amending the Act to allow the CRA to include a requirement that any required information (oral or written) or documents be provided under oath or affirmation, compliance orders with significant penalties, and preventing the stopping of the reassessment limitation clock.

These measures will create more issues and considerations for taxpayers going forward and will be in force upon royal assent.

Avoidance of Tax Debts

The Income Tax Act includes an anti-avoidance rule that's intended to prevent taxpayers from avoiding paying their tax liabilities by transferring assets to non-arm's length persons. The effect of this rule is to make the transferee jointly and severally or solidarily liable with the transferor for the related tax debts to the extent that the value of the property transferred exceeds the amount of consideration given by the transferee for the property.

Budget 2024 proposes to introduce a supplementary rule to strengthen the tax debt anti-avoidance rule. It would apply where there's been a transfer of property from a tax debtor to another person at arm's length to the tax debtor as a single transaction or as part of a series of transactions before being transferred to a person who isn't at arm's length with the tax debtor. All parties would be joint and several or solidary liability. The current penalty for tax debt avoidance is the lesser of 50% of the tax avoided or $100,000 plus the fee charged by the arm's length party. This penalty will now apply to situations captured by the expansion of this rule and will now include the fee charged by the arm's length party.

Reportable and Notifiable Transactions Penalty

The Act includes a general provision that provides that a person who fails to file or make a return or comply with certain specified rules is guilty of an offence and liable to penalties up to $25,000 and imprisonment up to a year. The mandatory disclosure rules in the Income Tax Act also include specific penalties. The government intends to remove the general penalty provision for the failure to file an information return in respect of a reportable or notifiable transaction under the mandatory disclosure rules. This amendment would be deemed to have come into force on June 22, 2023.

Homebuyers

Budget 2024 proposes to increase the Home Buyers' Plan (HBP) withdrawal limit from $35,000 to $60,000. This measure would apply to the 2024 and subsequent calendar years for withdrawals made after Budget Day. In addition, Canadians who make an HBP withdrawal between January 1, 2022, and December 31, 2025, will see their repayment grace period extended by 3 years. These first-time homebuyers will now have up to 5 years before they need to start repayments. The enhanced HBP will work in tandem with the Tax-Free First Home Savings Account (FHSA), which allows Canadians to contribute up to $8,000 per year and up to a lifetime limit of $40,000 toward their first down payment.

Budget 2024 announces that the government will allow 30-year mortgage amortizations for first-time homebuyers purchasing newly constructed homes. This new insured mortgage product will be available to first-time buyers starting August 1, 2024.

Disclaimer

FEDERAL BUDGET 2024—AND YOU THUGHT THERE WOULD BE NOTHING?! - Continued

Planning point: With its tax-deductible contribution and tax-free qualifying withdrawals and no repayment requirement, the FHSA should still remain your first home purchase savings choice. The expansion of the HBP withdrawal limit may put the Registered Retirement Savings Plan (RRSP) ahead of the Tax-Free Savings Account (TFSA) for higher income earners saving for a home. These contributions are also tax deductible, and the HBP repayment will now begin 5 years after the home purchase. A TFSA can still be a good choice for lower income earners or those who want to avoid the repayment schedule of the HBP.

Secondary Suite Loan Program

To unlock new housing supply, Budget 2024 proposes a new Secondary Suite Loan Program to enable homeowners to access up to $40,000 in low-interest loans to add secondary suites to their homes starting in 2025-26. Whether the loan's used to bring in a new tenant or to build a space for family members to live close by, this program will help increase density to make the most of available space in communities across the country.

Mutual fund corporations

Mutual fund corporations are generally public corporations with shares that are listed on a designated stock exchange in Canada that are generally widely held. However, a corporation controlled by a corporate group may qualify as a mutual fund corporation even though it isn't widely held. This could allow a corporate group to use a mutual fund corporation to benefit from the special rules available to these corporations in an unintended manner. Budget 2024 proposes to no longer allow a corporation to qualify as a mutual fund corporation where it's controlled by or for the benefit of a corporate group (including a corporate group that consists of any combination of corporations, individuals, trusts, and partnerships that don't deal with each other at arm's length). Exceptions would be provided to ensure that the measure doesn't adversely affect mutual fund corporations that are widely held pooled investment vehicles. This measure would apply to taxation years that begin after 2024.

Other measures

Volunteer Firefighters and the Search and Rescue Volunteers Tax Credits —Budget 2024 proposes to double the Volunteer Firefighters tax credit and the Search and Rescue Volunteers tax credit. As a result, for those individuals who performed at least 200 hours of combined volunteer service during the year, the tax credit will increase from $3,000 to $6,000 for 2024 and subsequent tax years, saving volunteer firefighters up to $900 a year.

Mineral Exploration Tax Credit —Worth 15% of the specified mineral exploration, expenses incurred in Canada and renounced to flow-through share investors will be extended for one year to flow-through share agreements entered into on or before March 31, 2025.

Canada Child Benefit (CCB) —An income-tested benefit that's paid monthly and provides support for eligible families with children under the age of 18. Budget 2024 proposes to extend eligibility for the CCB in respect of a child for 6 months after their death if the individual would have otherwise been eligible for the CCB in respect of that particular child.

Qualified investment rules for registered plans —Consultations will begin after Budget 2024 to review how the qualified investment rules could be modernized to improve the clarity and cohesion between registered plans. This will include reviewing whether annuities should continue to be qualified and whether cryptoassets should be included, among others.

Canada Pension Plan (CPP) —The government proposes to amend the Canada Pension Plan to provide a top-up to the death benefit for certain individuals, improve children's benefits, and end entitlement to a survivor's benefit following a CPP credit split.

Disclaimer

FEDERAL BUDGET 2024—AND YOU THUGHT THERE WOULD BE NOTH-ING?! - Continued

What wasn’t included in the budget?

Budget 2024 didn’t include any further measures around:

Changes to the dividend received deduction affecting financial institutions

Increases to marginal tax rates (only capital gains inclusion rates)

An introduction of a wealth tax

Conclusion

More details and analysis will have to follow, especially regarding changes to the capital gains inclusion rate and other related changes that didn’t have draft legisla-tion.

EQUITON®

2023 RENTAL MARKET COMMENTARY AND 2024 OUTLOOK

Equiton Residential Income Fund Trust—Proven Resilience in an Evolving Rental Market

It was an undeniably challenging year in Canadian real estate. High interest rates in particular impacted transaction volume, borrowing costs, and housing starts through the introduction of rate uncertainty. By the time the Bank of Canada paused — and potentially ended — its protracted interest-rate hiking cycle mid-year, it had become clear which real estate companies had built resilient portfolios capable of navigating macroeconomic challenges such as lingering inflation costs. Though not isolated from those same economic forces, firms exercising conservative operation entered the period from a position of strength, ultimately rewarding their investors. With a disciplined debt portfolio consisting of fixed-rate mortgages and a conservative investment approach, the Equiton Residential Income Fund Trust (the Apartment Fund) navigated this high-interest environment to yield an annual net return of 11.9% (Class F DRIP) in 2023.

The fourth quarter of 2023 concluded what was a banner year for Canadian rental growth. Looking forward to 2024, underlying market fundamentals are strong. Rental demand outpaced the construction of new supply, despite the latter achieving noteworthy gains throughout the year. Buoyed by tailwinds such as surging population growth, the rental market will continue to present investors with considerable opportunities.

Finding Opportunity in a High-Interest Environment

Canada avoided a significant recession amid high interest rates, but economic growth remains languid. A strong foundation will be necessary to capitalize on acquisition and development opportunities that arise in the initial months of 2024. Within this window, a lower transaction volume offers well-positioned companies the chance to make acquisitions with less competition. In such an economic environment, private equity firms have historically exhibited an ability to leverage a deep pool of capital to satisfy the creation of value over the long term. Indeed, while only 64 multi-residential transactions took place in the Greater Toronto Area last year, private equity real estate firms constituted 70% of total dollar volume.

With that in mind, Equiton made two acquisitions in Q4'23. Located in London and Brantford, Ontario, the properties totalling 170 rental units were an exceptional fit for the portfolio. Both were purchased at below-market values, and one is adjacent to an existing Equiton-owned building, unlocking operational efficiencies.

For the year ahead, Equiton is maintaining a selective, proactive posture to ensure all opportunities are captured effectively. Equiton will look to reinforce its market position in Ontario's high-growth regions, including Toronto and the GTA, where transaction activity is expected to pick up, as well as expand its presence into Vancouver and secondary markets such as New Westminster, Coquitlam, and Victoria. In the growing Edmonton market, Equiton will seek to bolster the scale of its portfolio.

Optimism in Purpose-Built Rental Construction

Other opportunities may arise out of the entrenched supply-demand gap in Canadian rentals, which is expected to widen amid high population growth and robust employment. Federal immigration targets will continue to drive population growth in larger markets, particularly in the Ontario and Vancouver areas where immigrants have a higher tendency to rent. Canada expects to welcome up to 485,000 permanent residents in 2024, and up to another million by the end of 2026. In parallel, housing starts dropped off sharply in 2023. Though purpose-built rental construction slowed as well, quarterly completions in the GTA hit a 30-year high in Q4'23. Ultimately, rentals comprised 35% of total housing completions in major Canadian markets last year.

Disclaimer

2023 Rental Market Commentary and 2024 Outlook —Continued

While challenges to creating new supply remain, Equiton is encouraged by accelerating policy trends aimed at easing the construction of purpose-built rentals. Various levels of government have taken measures to shorten development timeframes and reduce costs in key markets. Industry groups suggest that the recent removal of HST and PST on purpose-built rental construction positively impacted starts in Q4'23.

As one example, the tax rebate on purpose-built rentals has added a level of cost certainty to new and some in-progress projects, including the three-tower Maison Riverain development in Ottawa where Equiton partnered with local-market experts Main and Main. While the first tower is on track to welcome residents in early 2025, investors will benefit from lower costs in future phases of the project. Riverain will contribute approximately 1,100 sorely needed residential units to the local supply when it is completed.

In addition, Q4'23 saw several more major metros engage with federal and provincial incentives by committing to end exclusionary zoning practices and allow purpose-built rentals in residential areas by default; opening greater density along transit corridors; and slating municipal lands for high-density development. In Equiton's view, these policy tailwinds must evolve into more incentives to increase the viability of building rental supply at scale. Other opportunities include reducing multi-residential property taxes, a key component of post-construction costs and rent prices, to the level of condos and low-rise homes. Ongoing work by organizations such as the Canadian Chamber of Commerce's Housing and Development Strategy Council*, in addition to demonstrations of political will, are causes for optimism in the realm of construction.

*Equiton is a member of the Housing and Development Strategy Council

Demand for High-Quality, Accessible Rental Options

The costs of buying and owning a home, pushed up by high lending rates and the lingering costs of inflation, supported the retention of potential homeowners within the rental market. Though rent prices increased as well, purpose-built rentals continued to offer a more affordable alternative to homeownership's escalating costs, as indicated by record low vacancy rates and a cooler market for private homes. In this regard, Equiton places great importance on providing residents with high-quality and accessible housing options.

In addition, stability has become a primary renter concern. Renters living in purpose-built units benefit from regulated rent prices that can offer a measure of predictability in periods of high rent growth. By contrast, renters in newer condo units can be subject to sudden rent hikes in line with tax, strata fee, and market rent increases. They may also face eviction for a unit owner's personal use — in Toronto, personal-use applications surged 77% in the first nine months of 2023.

Responding to Renters' Evolving Expectations

The population of potential renters aged 24 and under accelerated in most provinces, with more forming households owing in part to employment gains. Among this group, Equiton observes an acceptance of (and preference for) the rental lifestyle, which offers greater flexibility and mobility than ownership. Although these and other renters gravitate toward creating households in lower-cost accommodations and smaller unit sizes due to economic constraints, many have also signalled a desire for single-occupant accommodations. Equiton explores opportunities to meet this demand within its existing portfolio through units that offer an attractive combination of accessibility and privacy.

Equiton's demonstrated ability to identify and respond to the changing needs of residents is foundational to its mission of building a resilient, stable portfolio that continues to create value for investors through many different market conditions.

ESG: Adding Value in Challenging Times

In alignment with Environmental, Social, and Governance (ESG) practices, Equiton concluded its first full year of participation in the Global Real Estate Sustainability Benchmark (GRESB). The independent environmental assessment provided insights into Equiton's strengths and areas for improvement, informing our approach to the year.

When faced with a challenging environment for acquisition and development, Equiton turned to implementing a number of green upgrades to existing properties to strengthen the quality of its portfolio.

2023 Rental Market Commentary and 2024 Outlook — Continued

For example, Equiton recently completed the modernization of windows at five of its largest properties, with the aim of improving heat retention and reducing energy consumption. Measures of resident satisfaction experienced an immediate boost. Over the long term, the retrofits are expected to achieve significant cost savings as well. By harnessing a variety of approaches to create value, Equiton aims to achieve sustainable growth within its portfolio and stay on pace to achieve the goal of net-zero carbon emissions by 2050.

Equiton's commitment to creating spaces where residents thrive was recently recognized by SatisFacts. The independent multi-residential housing evaluator awarded three Equiton properties with the 2023 SatisFacts Resident Satisfaction Award, which recognizes superior resident satisfaction and retention rates. Notably, two of these award-winning communities were the site of Equiton's new emergency awareness and community social pilot programs, which were designed to engage residents and foster a sense of belonging. Equiton regularly connects with residents through satisfaction surveys at multiple touchpoints throughout their tenancy and acts on the findings.

A Portfolio Built to Navigate Uncertainty

The past year was an ultimately positive period for firms demonstrating a commitment to conservative decision-making and growing value. 2024 is widely predicted to be another year of exceptionally tight rental markets amid ongoing population growth. Rental demand continues to be well-supported by robust employment numbers, and rental growth — expected to moderate toward its five-year average of approximately 5% in 2024 — establishes room for further gains. Equiton will continue to respond to the dynamics of immigration, interest rates, and new rental trends as they arise to continue to provide solid returns for investors.

Forward-Looking Information
Certain information in this communication contains "forward-looking information" within the meaning of applicable securities legislation. Forward-looking information may relate to future events or the Trust's performance. Forward-looking information includes, but is not limited to, information regarding the Trust's distributions, growth potential and volatility, investor returns, ability to achieve operational efficiencies, objectives, strategies to achieve those objectives, beliefs, plans, estimates, projections and intentions; and similar statements concerning anticipated future events, results, circumstances, performance or expectations and other statements that are not historical facts. These statements are based upon assumptions that the management of the Trust believes are reasonable, but there can be no assurance that actual results will be consistent with these forward-looking statements. Forward-looking information involves numerous assumptions, known and unknown risks, and uncertainties that contribute to the possibility that the forward-looking statements will not occur and may cause actual results to differ materially from those anticipated in such forward-looking statements. Some of these risks are discussed in the section "Risk Factors" in the Offering Memorandum. These forward-looking statements are made as of the date of this communication and the Trust is not under any duty to update any of the forward-looking statements after the date of this communication other than as otherwise required by applicable legislation.

PRIVATE WEALTH

INFORMATION AND SOLUTIONS FOR HIGH NET WORTH INVESTORS

IE INVESTMENT EXECUTIVE

START EARLY ON CANADIAN DEPARTURE TAX PLANNING

By Michael McKiernan

Clients leaving Canada must put departure tax planning at the top of their travel checklist.

While there are easy fixes to the negative effects from last-minute packing, the same can't be said of a rushed approach to the departure tax — a colloquial term to describe the deemed disposition under the Income Tax Act that generally requires emigrants to pay capital gains tax as if they had sold all their assets at fair market value immediately before becoming a non-resident.

Debra Moses, expatriate tax practice leader for BDO Canada in Montreal, finds nothing more frustrating than a client who asks for help with their travel already booked and a tight timeline for departure — except for one who has already left the country.

"Once you're gone, you can't do any planning, because you've already triggered the tax," Moses said.

Emigrants whose total property exceeds $25,000 in value have until April 30 in the year following their move to file forms T1243 and T1161 detailing their assets' fair market value and adjusted cost base, as well as to arrange with the Canada Revenue Agency to post collateral to cover any deferred tax owing without incurring late filing penalties, which accrue at $25 per day up to a maximum of $2,500.

Half of any capital gains are taxed at the emigrant's marginal tax rate for their year of departure.

Moses likes to build in plenty of lead time to talk clients through their options and then execute on strategies to minimize their tax liability. Doing so could take months or even years, depending on the complexity of their finances and the need to post collateral, known as security.

"Depending on the country you're going to, you want to make sure that your holdings are structured properly so that your departure tax can be done in an efficient manner and you're not double-taxing yourself," Moses added.

Kim Moody, founder of Moodys Tax Law in Calgary, has noticed a spike in interest in departure tax matters in recent years, which he traces back to the feds enacting a new top personal income tax rate of 33% in 2016.

"That spooked a lot of high-income earners," said Moody, who estimates his firm has helped 600 clients prepare to expatriate while Prime Minister Justin Trudeau has been in power. That's many times greater than the number of departure files he'd handled in the two-plus decades he'd practised pre-Trudeau.

"Not all of them have actually pulled the trigger and left," he added.

Once a client considers giving up their Canadian tax residency, much of Moody's focus turns to which of their assets could fall into one of the five major categories of exceptions to the deemed disposition rule:

Canadian real estate

Property of a business carried on through a permanent establishment located in Canada

Start Early on Canadian Departure Tax Planning - Continued

An “excluded right or interest” as defined under the Income Tax Act, which includes RRSPs, RRIFs, TFSAs, life insurance policies, pension plans and interests in certain Canadian-resident trusts

Unexercised employee stock options

For short-term Canadian tax residents, certain assets owned before or inherited during a stay in the country of five years or less

Typically, the major assets left subject to the deemed disposition include investments held in non-registered accounts, shares in private corporations and real estate outside Canada — including vacation properties for personal use.

Kris Rossignoli, a cross-border tax and private wealth manager partner with Cardinal Point Wealth Management in Toronto, frequently handles departure tax issues for U.S.-bound clients.

“Every family and every person is unique,” he said, explaining that the firm creates a personal net-worth statement for anyone looking to depart Canada that allows them to study the implications of the tax.

Rossignoli said clients with business interests may wish to pay out from their corporations’ capital dividend accounts before ending their Canadian tax residency, in order to avoid withholding taxes that become due when the company makes distributions to non-residents under the Canada/U.S. Tax Treaty.

Eligible individuals approaching their Canadian departure date may also wish to fund retirement compensation arrangements, individual pension plans or other vehicles that meet the definition of an “excluded right or interest” exempt from the deemed disposition under the Income Tax Act, Rossignoli added.

Moody said the deferred payment election available in Form T1244 is an important tool for emigrants faced with particularly large departure-tax bills, since the election allows them to pay the owed amount, without interest, when the asset is actually disposed of. (If the emigrant owes $16,500 or less in federal tax due to their deemed disposition of property, they don’t have to post security. The threshold is slightly lower for Quebec residents.)

“What we’re trying to do in many cases is to time the tax with the actual monetization of the assets, as opposed to having a fictional disposition, because that’s where you can get into cash flow issues,” Moody said. “Putting up security with the CRA used to be worse than pulling teeth, but it’s gotten better.”

Moses said clients posting security using a letter of credit from a financial institution can expect the smoothest ride from the CRA, but added that borrowing can be expensive if clients run into higher-than-expected interest rates.

Otherwise, clients may have to arrange a lien or mortgage in favour of the government on assets subject to the departure tax or put up investment instruments like publicly traded securities. In either case, Moses said the security may be held at a discount from its full value against the deferred tax owing.

“They want to have a buffer in there in case anything drops in value,” she explained.

CORPORATE CULTURE

Employee Ownership Trusts: Business Succession Alternative For Private Businesses in Canada

Over the next decade, 76 per cent of Canadian business owners plan to exit their business which represents a potential transition of more than $2 trillion worth of business assets. However, only 9 per cent of business owners have a business succession plan.

If the business will not be transitioned to the next generation of the family, finding a suitable buyer may be difficult. Many business owners consider factors that go beyond maximizing the purchase price to protecting their employees and ensuring the business remains in the community. Canada's Employee Ownership Trust (EOT) regime may provide another exit option for business owners that may address these concerns.

The initial EOT proposals, announced in the 2023 Federal Budget, generated little interest; however, additional tax incentives have been introduced to encourage business owners to consider an EOT as a viable business succession option. EOTs are to be available as of Jan. 1, 2024.[1]

Overview

The goal of an EOT is to encourage the purchase of a business by its employees (through a trust arrangement) without requiring the employees to provide up-front funding. The underlying business provides the funding to the EOT, which then acquires a controlling interest in the qualifying business. Similar arrangements can be found in both the United States and the United Kingdom.

Tax incentives

There are a number of tax measures aimed at facilitating the use of EOTs.

Incentives for the business owner and family

First, in recognition that the businesses earnings will be used to fund the purchase price, the normal 5-year capital gains reserve is increased to 10 years. This will be available to all selling individuals.

Second, the government announced a temporary capital gains exemption on the first $10 million of capital gains realized on the sale of a business to an EOT.[2] This incentive would be in effect for the 2024, 2025 and 2026 tax years. The legislation relating to this temporary capital gains exemption has not yet been introduced, so its conditions of application and its interaction with the existing $1 million capital gains exemption available for qualifying small business corporation shares (if the requirements of that exemption are also met) is not yet clear.

Incentives for the EOT and the employees

The EOT will benefit from an exemption from the shareholder loan repayment period and deemed interest benefit rules, which will extend the repayment period from 1 year to 15 years on funds borrowed from the qualifying business to purchase shares in a qualifying business transfer. The deemed interest benefit rule will also not apply to the shareholder loan for this 15-year period.

The EOT will also be exempt from the deemed disposition rules which require certain trusts to pay tax on a deemed disposition of their capital property every 21 years. This will enable EOTs to hold qualifying businesses indefinitely.

Disclaimer

Although EOTs, like other personal trusts, will pay tax at the highest personal marginal tax rate on income retained in the trust, trust income that is distributed from the EOT to its employee beneficiaries will be subject to tax in the hands of the beneficiaries. In addition, dividends will retain their character permitting employees to access the dividend tax credit. Unlike earlier proposals, there is no prohibition on an EOT from distributing shares of a qualifying business to its beneficiaries.

An EOT will not be considered to be an employee benefit plan or an employee trust for income tax purposes.

Requirements

1. EOT residency: An EOT must be a Canadian resident trust for tax purposes. This requires that the central management and control be in Canada. See "EOT Trustees" below for further information on the requirements imposed on the trustees of an EOT.

2. EOT beneficiaries: The EOT must benefit all active employees of the business (and, if desired, may also benefit former employees) other than:

   a. Employees who own (outside of their interest in the EOT) directly or indirectly shares in the qualifying business having a value which is equal to or greater than 10 per cent of the fair market value of all of the shares of that class (i.e. employees with significant ownership outside the EOT).

   b. Employees who, alone or together with related or affiliated persons or part nerships, own directly or indirectly shares in the qualifying business having a value which is equal to or greater than 50 per cent of the fair market value of all of the shares of that class (i.e. employees related to or affiliated with significant owners).

   c. Employees who, immediately before the acquisition of the qualifying busi ness by the EOT, alone or together with related or affiliated persons or partnerships, did not own directly or indirectly shares in or indebtedness of the qualifying business having a value which is equal to or greater than 50 per cent of the fair market value of all of the shares of the capital stock and indebtedness of the qualifying business (i.e. employees who were part of, or are related to or affiliated with, the vendor ownership group).

   d. Employees who have not completed a reasonable probationary period (not exceeding 12 months), who may be (but are not required to be) excluded.

3. **Limits on EOT distributions:** In making distributions, the EOT must treat all employee beneficiaries in the same manner utilizing a formula based solely on any combination of an employee's length of service, renumeration (which for this purpose is capped at twice the highest marginal income tax bracket), and hours worked. Although there is some flexibility to apply different combinations of the criteria in different circumstances (i.e. applying a different formula for active employees and former employees, or for income distributions and capital distributions) the trustees have no discretion to favour the interests of one beneficiary over another.

4. **EOT trustees:** Each trustee of an EOT must be a Canadian licensed trust company or an individual (natural person) and are to be elected at least every 5 years by the active employee beneficiaries of the EOT. At least one-third of the trustees must be active employee beneficiaries. Unless elected by the EOT active employee beneficiaries, at least 60 per cent of the trustees must deal at arm's length with each member of a vendor ownership group. Each trustee has an equal vote.

5. **Employee beneficiary special approvals:** More than 50 per cent of the active employee beneficiaries must approve the following:

   a. Any transaction or event or series of transactions or events that causes at least 25 per cent of the active employee beneficiaries to lose their employment and cease to be active employee beneficiaries (unless in connection with a termination for cause) and

b. Any winding up, amalgamation or merger of a qualifying business (other than with affiliates)

6. **EOT property**: all or substantially all (i.e. 90 per cent or more) of the fair market value of the EOT's property is attributable to shares in qualifying businesses controlled by the EOT. A qualifying business is a Canadian-controlled private corporation ("CCPC") that meets certain board representation and control requirements, aimed at ensuring the EOT will operate with a level of independence from the prior controlling shareholder(s), related persons, or affiliates.

7. **Requirements of business acquisition by EOT:** Shares of the qualifying business can be acquired by the EOT or by a CCPC which is wholly-owned and controlled by the EOT. Immediately before the sale, all or substantially all of the fair market value of the assets of the target corporation must be attributable to assets (other than partnership interests) that are used principally in an active business carried on by the target corporation or a subsidiary that is controlled by the target corporation. At the time of the sale, the vendor must deal at arm's length with the EOT and any purchaser CCPC. At all times after the sale, the vendor must deal at arm's length with the target corporation, the EOT and any purchaser CCPC and must not retain any right or influence that would permit the vendor (alone or together with related parties or affiliates) to control, directly or indirectly in any manner whatever, the corporation, the EOT or any purchaser CCPC. These requirements are to ensure that only genuine business transfers qualify for the preferential tax treatments discussed above.

8. **Control over business:** An EOT must hold a controlling interest in one or more qualifying businesses. Further, 60 per cent or more of the directors must not be individuals who (together with related persons of affiliates) controlled the business prior to the trust acquiring the shares. Directors must deal at arm's length with the prior controlling shareholder(s), related persons or affiliates.

Takeaways

The temporary exemption of the first $10 million of capital gains may make EOTs an attractive succession alternative for business owners. Although the original EOT proposals imposed significant restraints on the operation of the business after control was acquired by an EOT, including a requirement that all or substantially all of the fair market value of the corporation's assets is attributable to assets used in an active business carried on primarily in Canada, these have largely been removed, significantly increasing the flexibility of operating a business controlled by an EOT.

However, it is not clear if these incentives will be sufficient to counter the fact, unless third party financing is available, that the selling business owners will likely receive the proceeds over a period of many years. Given the limitations on the ability to control, or regain control of, the business after sale, business owners may be reluctant to place their trust in the EOT and its trustees to operate the business so as not to jeopardize its ability to fund the purchase price. Given that the funding the purchase price (or repaying third party purchase financing) will require sustainable and predictable cash flow, not all businesses may be suitable candidates for an EOT.

For additional questions about employee ownership trusts, please reach out to any of the authors or key contacts listed below.

BLG's tax team

By: Pamela L. Cross, Grace Pereira

[1] The EOT proposals are contained in Bill C-59 - Fall Economic Statement Implementation Act, 2023, which at the time of writing is in Second Reading. If enacted, EOTs will be available on or after January 1, 2024.

[2] Announced in the Fall Economic Statement 2023

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THE GROWING APPETITE FOR A BLOCKBUSTER CATEGORY OF DRUGS

AGF Investments

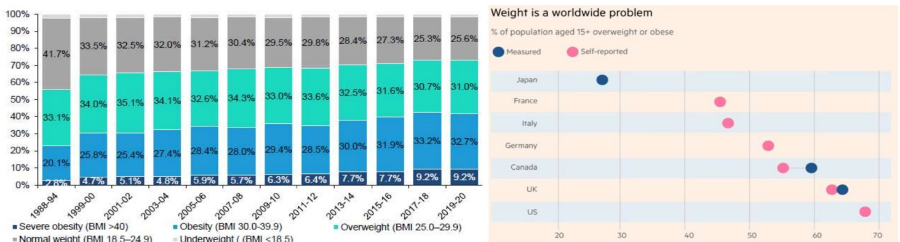
By: Tony Genua, SVP & Portfolio Manager, Jonathan Lo, VP, Growth Equities, Auritro Kundu, Co-Portfolio Manager, Ling Han, Senior Equity Analyst

Why Obesity is a Big Deal

The global obesity problem has been increasing in recent decades and is now considered a major public health issue. More than 1 billion people worldwide are obese globally – 650 million adults, 340 million adolescents and 39 million children, according to the World Health Organization (WHO). This number is still increasing. By 2025, approximately 167 million people – adults and children – will become less healthy because they are overweight or obese, according to the WHO estimate.

This matters because obesity is associated with more than 200 possible health complications, as it affects the heart, liver, kidneys, joints, reproductive system and other bodily functions. It leads to a range of noncommunicable diseases (NCDs), such as type 2 diabetes, cardiovascular disease, hypertension and stroke, various forms of cancer, as well as mental health issues. In the U.S., obesity affects 20% of children and 42% of adults, and the U.S. Center for Disease Control (CDC) estimates that obesity costs the U.S. healthcare system approximately $173 billion per year. In fact, an economic analysis by McKinsey described obesity as one of the top three global social burdens generated by humans, after smoking and war.

Figure 1 –U.S. Population by Weight Over Time (LHS), Global Obesity Rates (RHS)



Source: CDC, Bernstein, as of January 11, 2024 (LHS), Bloomberg Intelligence via Financial Times (RHS), as of January 9, 2024.

GLP-1's – A Long Runway of Growth Ahead

Over the past year, the health care sector has been dominated by excitement around weight-loss drugs. These drugs were originally designed in the treatment of type 2 diabetes, by controlling blood sugar levels through the stimulation of insulin secretion. The first GLP-1 (Glucogen-like peptide 1) drug was approved in 2005 for Type-2 Diabetes, but it was not until 2021 when the U.S. FDA approved Wegovy as a treatment for obesity that consumer interest in GLP-1 drugs took off. Since then, GLP-1s have gained mainstream and social media attention, which has been driving a demand surge.

The leading brands of GLP-1's are Eli Lilly's Mounjaro (diabetes) and Zepbound (obesity), and Novo Nordisk's Ozempic (diabetes) and Wegovy (obesity) – both are two versions of semaglutide. Semaglutide is a drug which mimics a key gut hormone, known as GLP-1 that is activated after people eat, boosting the release of insulin and slowing the release of sugar from the liver. They lower blood sugar and slow down digestion so people feel full longer, changing their hunger cycle.

In the US, GLP-1 penetration for Type-2 diabetes patients is currently at ~15%, but the penetration rate for obese adults is much lower at just ~1%, due to a combination of supply constraints, insurance access, and lack of patient education. It is commonly believed the market could potentially be significantly bigger over time – consensus estimates are forecasting a ~20% penetration of obese adults in the US by mid-2030, using a benchmark of historical data of patient uptake for chronic cardio-metabolic diseases.

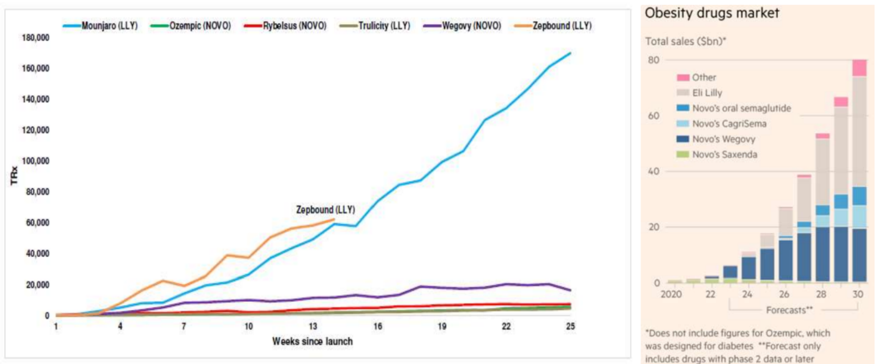
Disclaimer

The Growing Appetite for a Blockbuster Category of Drugs—Continued

Due to supply constraints, the enormous demand for GLP-1's not being met - this is expected to persist through this year and next. Both Eli Lilly and Novo Nordisk are ramping up capacity as quickly as they can, both in-house and externally. Eli Lilly is expecting to increase their capacity by ~50% in 2nd half of 2024, while Novo Nordisk is looking to double its low dose capacity this year.

The future market size will hinge on factors including insurance coverage, drug prices, convenience, adherence rates, further innovations and the lack of significant side effects. Current consensus is forecasting GLP-1s to possibly have a total global market size of $100B+ in 2030, while more bullish analysts believe the whole GLP-1 class could achieve $150B sales globally, with the two current leaders dominating the market in early 2030s.

Figure 2 - GLP-1 Scripts Ramp Since Launch (LHS), Obesity Drugs Market Growth (RHS)



Source: IQVIA, Morgan Stanley, as of February 23, 2024 (LHS), Bloomberg Intelligence via Financial Times, as of January 9, 2024 (RHS). TRx represents total prescriptions.

New Catalysts – Access & Coverage, Oral Versions, and New Therapeutic Opportunities

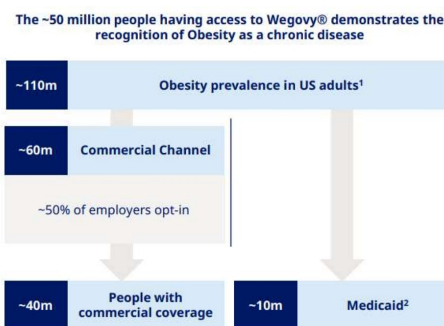
Both Eli Lilly and Novo Nordisk have seen their shares surge over the past year. Eli Lilly has seen its shares more than double over the past year, while Novo Nordisk has seen a similar sized run. In doing so, Eli Lilly is now the 9th largest weight on the S&P 500 (after 6 of the Magnificent 7 and Berkshire Hathaway), while Novo Nordisk has become Europe's most valuable company surpassing LVMH. Yet despite these remarkable runs, we believe that there is still more upside ahead, given multiple catalysts. These include:

GLP-1 Insurance Coverage is Rapidly Improving - Obesity insurance coverage is different across the commercial, Medicare and Medicaid channels in the US. Currently, it is primarily covered in the commercial market and in Medicaid to some level.

Novo Nordisk recently estimated that approximately 50 million patients have access to Wegovy through insurance coverage. This drug is priced at ~$1350/month in the US, but ~80% of the 50 million patients with access pay only $25 or less. Insurance plans pay a net price of ~$700/month as of late 2023. It is expected that obesity drugs' net price will continue to decline to ~$600/month on average in 2024, ~$500/month in 2025, and progressively to ~$400/month in 2030, when more payors step in to cover it.

Medicare plans are not covering Obesity drugs due to provisions in the 2003 Medicare Modernization Act (only covers diabetes labels). In response, the "Treat and Reduce Obesity Act" (TROA) has been re-introduced in Congress in July 2023, looking to enable Medicare coverage.

Figure 3 - Current Access to Obesity Drugs

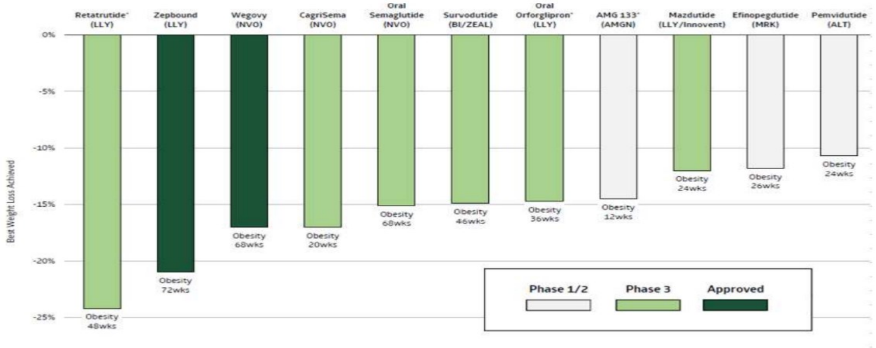


Source: Novo Nordisk Q4 2023 Investor Presentation, as of January 31, 2024

Oral Pills Are to Expand the Market Materially Starting from 2025 – Another catalyst on the horizon is the drug in pill form. Orals will open the door to patients who are hesitant to use injectables, which are estimated to be ~20% of the total addressable patient population. We believe this is meaningful in resolving the current supply chain bottleneck which is mainly on the injection device side; and may also help bring costs down and help with equity issues experienced with drugs.

The Growing Appetite for a Blockbuster Category of Drugs—Continued

Figure 4 – Weight Loss Achieved by Approved Drugs and Clinical Candidates

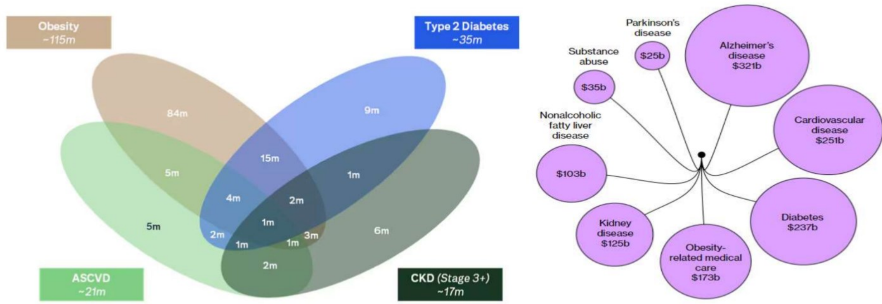


Source: TD Cowen Research, as of November 15, 2023

In early March 2024, Novo Nordisk saw its shares spike yet again after showing Phase 1 data for the oral version of its drug (amycretin) that demonstrated 13.1% weight loss after 12 weeks. The drug will undergo Phase 2 trial in the 2ndhalf of this year, with results due in early 2026.

Other Therapeutic Opportunities - Based on GLP-1's mechanism of action, it works concurrently on the stomach, pancreas, liver and brain. This leads to the potential that GLP-1s could be used on other therapeutic areas, including heart failure, obstructive sleep apnea (OSA), Non-Alcoholic Steatohepatitis/ Metabolic dysfunction-associated steatohepatitis (NASH/MASH), chronic kidney disease (CKD), and, interestingly, Alzheimer's disease. We believe these studies may broaden the usage of the obesity drugs and further the uptake by supporting payer coverage and demand.

Figure 5 – U.S. Patient Overlap for GLP-1 Key Focus Areas (LHS), Annual US Spending on Conditions Potentially Treatable with GLP-1's (RHS)



Source: Novo Nordisk company reports, as of March 7, 2024 (LHS), Bloomberg as of October 18, 2023 (RHS)

The Road Ahead – Continued Innovation

GLP-1's have been an innovation in achieving weight loss that previously required surgical intervention. The next generation of GLP-1's is rapidly approaching, and while this includes the oral pill versions which could bring down costs and improve accessibility to these drugs, the drug companies are also pushing other boundaries on improving these drugs. This includes:

 Pushing for more weight loss - The next generation of GLP-1 drugs are aimed to achieve a weight loss level that is comparable to bariatric surgeries at 25%-30% in a year, without triggering potential safety concerns. This compares to the 15%-20% the drugs currently on the market can achieve.

 More convenience to possibly increase adherence – Currently the average duration of a patient staying on an obesity drug is less than 12 months, due to a combination of reasons. But the inconvenience of having to inject on a weekly basis was part of the reason. There are several ongoing late-stage clinical trials on less-frequent injections (monthly instead of weekly), aiming to increase patient convenience and, therefore, adherence.

 Preserving muscle could potentially be the next target of innovation – One of the key debates of GLP-1 usage is patients losing a good portion of muscle mass while losing weight, which could increase risk of injury, especially for elderly patients. In last several months, several companies, including Eli Lilly, have disclosed studies on helping patients achieving better balance of muscles and fat loss while using GLP-1s. Eli Lilly acquired Versanis Bio last year in order to gain access to class of drug called anti-myostatin which has the potential to slow muscle mass loss.

A Potential Market Leader

In conclusion, the addressable market for obesity drugs is large and growing, and the companies that are racing to meet this need, led by Eli Lilly and Novo Nordisk, are demonstrating innovation that has now led to an inflection point with growth accelerating higher. These are the types of companies that we seek to identify and participate in within our growth mandates - Eli Lilly has been a holding in AGF Global Select Fund and AGF American Growth Class since the first quarter of 2023. And while there has been a tremendous run over the past year with Eli Lilly being among the top contributors for both funds over the past year, we believe there remains more potential upside over the longer-term given the long runway for growth in the usage of these drugs.

Overall, in our view the prospects for the Health Care sector remains promising – we are overweight the sector in both AGF Global Select Fund and AGF American Growth Class. While so far year-to-date, the performance of the Health Care sector has been approximately in-line with the S&P 500 Index and election years historically have sometimes presented sentiment headwinds for Health Care, we believe the sector's prospects remain promising, as it has demonstrated favourable revenue and earnings upside surprise compared to consensus estimates in the most recent quarter, is trading at a very reasonable valuation relative to its own history, and has above-average earnings growth (based on consensus estimates) in 2024.

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TECHNOLOGY UPDATE

MONTHLY COMMENTARY

DYNAMIC FUNDS

By Noah Blackstein, Vice-President & Senior Portfolio Manager

Historically, the biggest risk to the technology sector has always been periods of stagnation with relatively little innovation to stimulate market demand. Then, along comes a tectonic shift in computing platforms that stimulate waves of innovation for decades to come. Platform shifts are inherently disruptive and present risks to industry leaders, but it is this shifting of the platform that fuels innovation and opportunity for growth.

AI is a bigger opportunity than anything I've witnessed in my career that spans from the PC era to GenAI. We've never been more optimistic or more excited about the size of the opportunity we're seeing today and how open-ended it is. The internet, mobility, and the cloud are now coalescing into this moment. This culmination of everything I've witnessed over the last 30 years is putting us on the cusp of the next Industrial Revolution.

We are still in the very early stages of this opportunity. Investors have gone on a binge, buying everything in semiconductors and hardware as AI datacenter buildouts are right in their faces. We were surprised to find that despite the moves over the last year, investors are still shunning newer companies' and other areas of technology poised to benefit even more from data in the cloud.

Hardware and semis always eventually commoditize. Recent research reports show investor positioning in technology outside the MAG7 is at some of the lowest levels in modern history, with software the absolute lowest that it's ever been. There is a hype cycle in semis and hardware that is non-existent in software today.

AI will define the economy and investing for the next decade or more, but stock selection has never been more critical. The structural threats AI presents to certain companies and industries are real. This market is also beginning to broaden out and opportunities we find other sectors are starting to get noticed as the macro influence continues to wane. Thank you for your continued support. – N

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THE S&P 500 CLINCHES BEST START TO YEAR SINCE 2019

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FEDS COMMIT TO EXPLORING CRA INCOME VERIFICATION IN BUDGET 2024 TO ADDRESS MORTGAGE FRAUD

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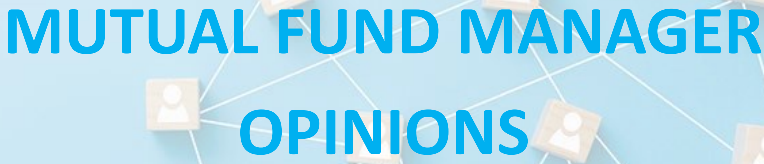

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