



Money Management Retirement Planning Estate Planning Goal Setting

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Trust Yourself!

New ways to protect yourself, your spouse and your family from taxes

When the federal government announces income tax changes, our first instinct is to scurry to clasp our purses or clutch our wallets. However, the changes to the Income Tax Act announced in June 2001 actually provide battered senior taxpayers with a new way to reduce taxes. Don't send your MP a note of thanks just yet though – you have to die to take advantage of the tax break.

The change to the legislation allows Canadians over 65 the use of a special type of trust technique. It is called an Alter Ego Trust if used for yourself or a Joint Partner Trust if used for you and your spouse. You can transfer into this trust any assets you choose without triggering a capital gains tax liability. This includes investments like stocks or mutual funds, as well as cottages and rental or other real estate properties. Assets without capital gains, such as your home, bonds, GICs and bank accounts, can also be placed in the Trust.

HOW IT WORKS

What does "alter ego" mean? It is Latin for "one's other self." And that's what this type of trust really is, just an extension of your own self. You create it. You select which of your assets will go into it. You get all of the income and value. You control it during your lifetime. You can move assets in and out whenever you please. And you decide who gets what's left over after your death.

A Joint Partner Trust works the same way. One or both of the spouses act as the trustee, making all of the

investment and operation decisions. Both are beneficiaries until the first spouse dies. Upon the death of the second spouse, the Joint Partner Trust passes its unused assets on to the chosen beneficiaries.

HOW IT HELPS

Why would anyone want to put valuable assets into such a Trust, even with the government's promises that there will be no punishment for doing so? There are lots of good reasons.

Save Probate Tax

Every province and territory has some form of probate tax. This tax is usually a percentage of the value of an estate that passes by a Will to the beneficiaries after the death of a taxpayer. The calculation formula and the actual amount of the probate taxes vary from province to province, but in most estate situations it will be thousands of dollars, and in larger estates can be tens of thousands. The good news is that no matter where you live in Canada, the value of your assets in one of these Trusts is always exempt from probate tax. In the least case, this automatically reduces the estate expenses. At best, if you choose to put all assets of value in one, there will be no probate tax whatsoever.

Reduce Legal Costs

Usually a lawyer's services are required to some extent after someone passes away. Depending on the size of the estate and the complexity of the hurdles to be overcome, these services can cost from hundreds to thousands of dollars. The use of an Alter Ego Trust

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Registered Retirement Income Funds

The Income Tax Act states that a Registered Retirement Savings Plan (RRSP) matures by December 31 of the year in which the plan holder (annuitant) reaches age 69.

At the time an RRSP matures, planholders must choose what they want to do with the retirement savings they've been deferring from taxes. Three options—or a combination of them—are possible:

- Cashing in the RRSP
- Purchasing an annuity
- Converting the RRSP to a Registered Retirement Income Fund (RRIF)

Here's a look at the options.

Cashing in the RRSP

When an RRSP is cashed in, the entire fair market value of the plan will be included in the planholder's income for the year of withdrawal – and taxed at his or her marginal income tax rate. This could entail a tax bite exceeding 45 per cent for many Canadians. So withdrawing all RRSP savings is probably not the best way to start retirement.

Purchasing an annuity

Annuities pay a predetermined amount of annual income over a specified number of years. The amount paid will be based primarily on interest rates prevailing at the time the annuity is purchased. Unlike cashing in an RRSP, when an annuity is purchased, the value of the RRSP is not included in income all at once. Rather, the amount received annually will be taxed as income each year.

Converting to a RRIF

RRIF payouts are essentially the opposite of annual RRSP deductible contributions. There are maximum annual amounts that may be contributed to an RRSP, and there are minimum RRIF withdrawals each year. The amount withdrawn from a RRIF will be taxable each year.

And, as in an RRSP, growth within a RRIF is tax deferred, and annuitants may continue to manage their own investments if a self-directed plan is used.

General RRIF rules

A RRIF can be opened at any age, but new contributions can never be made to a RRIF. The most common way money gets in to a RRIF is through a rollover from an RRSP. When an RRSP is rolled into a RRIF, no taxes are payable on the transferred funds. Just like in an RRSP, tax is only payable on

amounts actually withdrawn from a RRIF, allowing the remaining assets to continue to grow on a tax-deferred basis. Many planholders find the tax rate on RRIF withdrawals much lower than the tax rate they faced on employment income because their income in retirement is not as high. This is one of the benefits of the whole RRSP/RRIF system: RRSP contributions are often included in income and taxed at much lower rates.

Minimum annual withdrawals

Once a RRIF is established, the annuitant is required under the Income Tax Act to withdraw a minimum amount each year. That amount is based on the age of the annuitant (or the annuitant's spouse or common-law partner – see "Calculation using spouse or common-law partner's age" below) as outlined in the accompanying "minimum payment schedule." The minimum annual withdrawals are calculated by multiplying the fair market value of the RRIF at

the beginning of the year by the corresponding age factor table. In the year a RRIF is established, no minimum withdrawal is required. In each subsequent year, only the minimum withdrawal amount is required. To maximize tax-deferred growth (beyond electing not to receive a first year payment), some annuitants subsequently choose to withdraw only their minimum amount and to have it withdrawn at the end of each year.

Example One

John converted his RRSP to a RRIF in September 2001 when he turned 69. His minimum withdrawal for 2001 is zero. Assuming that the value of the RRIF at the beginning of 2002 was \$200,000 John must withdraw \$9,524 ($(1/(90 - 69)) \times \$200,000$) in 2002.

MINIMUM PAYMENT SCHEDULE					
Age	General	Qualifying RRIF*	Age	General	Qualifying RRIF*
71**	0.0738	0.0526	82	0.0927	0.0927
72	0.0748	0.0556	83	0.0958	0.0958
73	0.0759	0.0588	84	0.0993	0.0993
74	0.0771	0.0625	85	0.1033	0.1033
75	0.0785	0.0667	86	0.1079	0.1079
76	0.0799	0.0714	87	0.1133	0.1133
77	0.0815	0.0769	88	0.1196	0.1196
78	0.0833	0.0833	89	0.1271	0.1271
79	0.0853	0.0853	90	0.1362	0.1362
80	0.0875	0.0875	91	0.1473	0.1473
81	0.0899	0.0899	92	0.1612	0.1612
82	0.0927	0.0927	93	0.1792	0.1792
			94+	0.2000	0.2000

* A qualifying RRIF is generally a Registered Retirement Income Fund entered into before 1993.
** For ages below 71, the formula is $1/(90 - \text{age})$

Calculation using spouse or common-law partner's age

When setting up a RRIF, an annuitant can base the annual minimum withdrawal calculations on either his or her own age, or on the age of his or her spouse or common-law partner. To maximize the amount that can continue to grow tax deferred in the RRIF, many annuitants choose to base the calculations on the younger spouse's or common-law partner's age as the minimum payment factors increase with age. The election to use a spouse's or common-law partner's age must be made before the first RRIF withdrawal.

Attribution on spousal or common-law partner RRIFs

The RRIF rules outlined above also apply to spousal or common-law partner RRSPs, which must be terminated by the end of the year the annuitant spouse or

Amount of RRIF withdrawal in excess of minimum amount	Quebec	All Other Provinces
Up to \$5,000	21%	10%
\$5,001 - \$15,000	30%	20%
Over \$15,000	35%	30%

common-law partner reaches the age of 69. If the funds in the spousal or common-law partner RRSP are used to buy a RRIF, the normal RRSP spouse or common-law partner attribution rule will not apply on the minimum amounts received from the RRIF.

However, if spousal or common-law partner RRSP contributions have been made in the current or previous two years before the conversion to a RRIF, then the attribution rule will apply to any amounts in excess of the minimum amounts. This causes these withdrawals to be taxed in the contributing spouse's or common-law partner's hands.

Taxes on RRIF withdrawals

Though all RRIF withdrawals are fully taxable, only amounts withdrawn from a RRIF in excess of each year's minimum amount are subject to withholding taxes at source. The withholding taxes are the same as for RRSP withdrawals: The table above represents only the withholding tax on the excess RRIF withdrawals. This withholding tax is essentially an estimated prepayment of the taxes that may actually be owing. All RRIF withdrawals must be reported on the annuitant's income tax return for the year of withdrawal, and tax will be payable at the annuitant's marginal rate on these withdrawals. The annuitant's will then claim the amounts withheld, if any, as a credit against the taxes owing.

Note: Because there's no required minimum withdrawal in a RRIF's first year, withholding taxes will be applied to all withdrawals during the first year. In subsequent years, only withdrawals in excess of the minimum amount will be subject to withholding taxes at source.

Systematic withdrawal plans

Systematic withdrawal plans (SWPs) are often used in conjunction with RRIFs. SWPs enable mutual fund investors to automatically receive payments from their RRIF accounts on the dates they desire. Investors can choose to receive only the minimum amount for each year so that no withholding taxes will be applied. SWP payments can be sent to planholders by cheque or as a direct deposit to a bank account.

Installment tax payments

Depending on the RRIF annuitant's overall tax situation, the Canada Customs and Revenue Agency or CCRA (formerly Revenue Canada) may require quarterly income tax installments. This circumstance is generally triggered if the difference between an annuitant's income tax payable and amounts withheld at source exceeds \$2,000 in the current year and either of the two preceding years. A RRIF annuitant who withdraws only the minimum amount without any withholding tax may be required to remit income tax quarterly. The CCRA will send out Installment Notices that set out the amounts due quarterly, if installments are required.

Pension credit

Recipients who are age 65 or older are entitled to a pension credit on up to \$1,000 of pension income. RRIF payments are taxed as pension income. Recipients who are under 65 may also be entitled to the pension credit, provided certain criteria are met. For more information, consult your tax advisor.

Death of a RRIF annuitant

When a RRIF is established, careful consideration should be given to naming a beneficiary of the plan's assets. The annuitant may also wish to name a successor annuitant.

A beneficiary is a person who, on the annuitant's death, will receive the assets in the RRIF. A successor annuitant is a spouse or common-law partner who, if named on the account, will continue to receive the annual minimum payments from the RRIF following the annuitant's death.

On the annuitant's death, if the surviving spouse or common-law partner is the beneficiary of the RRIF, the RRIF assets may be transferred on a tax-deferred basis to the spouse's or common-law partner's RRIF. If the surviving spouse or common-law partner is age 69 or under, the RRIF assets may also be transferred to an RRSP.

If a child or grandchild was financially dependent on the deceased annuitant and was the beneficiary of a RRIF, the funds in the RRIF may be used to purchase an annuity that must end by the time the child or grandchild reaches the age of 18. However, if a financially dependent child or grandchild of any age was also dependent on the deceased annuitant by reason of mental or physical infirmity, the child or grandchild may transfer the value of the deceased annuitant's RRIF into his or her own RRIF or RRSP.

Note: It is assumed, unless proven otherwise, that a child is not financially dependent on the deceased annuitant if his or her income for the year before the annuitant's death was greater than the basic personal amount (approximately \$7,400).


If anyone else is named as the RRIF beneficiary, the entire value of the RRIF will be included in income and taxed in the deceased's terminal return.

The last word

As usual in tax matters, the rules covering RRIFs are complex and specific cases need to be addressed individually. Professional legal and tax advice should be sought when necessary.

Source: AIM Funds

Don't
Forget!



Your RRSP contribution
deadline for 2002 is
March 3rd, 2003.

If you have yet to make
your 2002 contribution,
be sure to call us today!

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will reduce legal costs. The larger the portion of your estate that you arrange to have flow through the Trust to your beneficiaries, the smaller the chance that probate process will be required. If probate is not needed, the lawyer's fees will reflect this.

Speed Estate Administration

By avoiding the probate process, weeks and months of delay in estate administration can be saved. There are also some simplicities built into the Trust that make the job of the trustee easier and quicker than the corresponding job of the executor. A speedy administration is not only a blessing for the trustee, it reduces tension and stress on the beneficiaries who are awaiting their inheritances. The sooner the beneficiaries receive their shares, the quicker mortgages can be paid off, investments for retirement can be made, and grandchildren's educational needs can be met.

Protect Your Beneficiaries

It is clever to arrange our estate affairs to ensure that the maximum amount of money goes to our families in the minimum amount of time, but there are other considerations. Another fundamental function of estate planning is to protect the inheritances of our beneficiaries. These Trusts provide the same important protections of a Will. Consider the following examples: If you choose, you can creditor-proof the inheritance of your son so that it survives even his bankruptcy. You can exempt your daughter's inheritance from claims by a son-in-law who divorces her years after your death. Or you can ensure that a disabled child will continue to receive vital government support without losing the benefit of the inheritance nest egg.

Protect Yourself

You can also obtain a measure of personal protection by moving your assets into an Alter Ego Trust. If you ever have a period of mental incapacity following a stroke or because of advanced age, the Trust ensures that your trustee will automatically take over management of the Trust assets. Then you can be confident that your investments will be renewed, the bills paid, and even your house sold if necessary, all by your chosen people and without government interference or court involvement. You could also decide to have a child or other dependable person step in as trustee at any time because of your health problems or emotional difficulties. He or she would then manage the Trust until you were well enough. You always retain the right to resume control or appoint a different trustee.

Keep Your Privacy

After you die, if your Will is probated, much of your personal financial life becomes a matter of public record. Detailed information about the value of your house, how much money you have, which children play roles in the estate administration, and who benefits under your Will is available for any curious friend, neighbor, creditor or newspaper reporter to comb through. The Trust and the particulars of all of its assets remain private, seen only by those people directly involved.

Leave Your Options Open

This type of Trust is flexible. You can amend your choice of trustees, the number of beneficiaries or the structure of the inheritances whenever you feel like it or take all of your assets out of the Trust. The Trust works for individuals, married couples, common-law spouses, and same-sex partners.

A Word About Wills

Alter Ego and Joint Partner Trusts don't completely remove the need for a Will. Such a Trust can, but often does not, involve all assets. It is the Will that operates to pass any items not in the Trust on to the family. With a Trust, the risk of being forced to probate the Will is lessened because much or most of the estate value will be in the Trust. If the Will must be probated, the probate tax is substantially reduced by the value of assets in the Trust. A lawyer can help to predict what assets are likely to trigger the probate process, thereby providing valuable guidance as to what should go into the Trust.

A Will may have advantages over a Trust in some estate planning situations. If each child beneficiary were to receive a large inheritance, for example, a special Testamentary Trust Will could save tens of thousands of dollars of tax on the income produced by the inheritance compared with a direct inheritance. The novelty and sophistication of the Trust approach mean that the legal costs for preparing the Trust will probably be more than for a Will. On the other hand, one Joint Partner Trust can effectively provide for both spouses, while each would require an individual Will.

Source: Peter Lillico

Mortgage Rate Update

(as of February 7th, 2003)



Lender/Broker fee may apply to non-traditional applications

*Mortgage rates quoted for first mortgage as of
February 7th, 2003*

Term	Posted Bank Rates	Our Best Rates
6 MONTHS	5.55%	4.55%
1 YEAR	4.90%	3.90%
2 YEARS	5.60%	4.50%
3 YEARS	6.00%	4.65%
4 YEARS	6.25%	4.85%
5 YEARS	6.60%	5.15%
7 YEARS	7.35%	5.90%
10 YEARS	7.90%	6.15%

Mortgage rates provided by
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