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Developing a Personal Tax Strategy

Ten families may have identical levels of income, but it is unlikely any of them pay the same amount of income tax. Four factors determine the amount of tax that a family will pay and these are:

- Our country and province of residence
- The types of income we earn
- The tax planning strategies that we have implemented to reduce our family tax liability
- Correctly calculating the tax liability

If we examine the past few federal budgets, it appears the government's strategy is to reduce personal taxes by leaving the tax base relatively stable, i.e., few new deductions or credits have been introduced. Tax savings have been achieved by reducing the rates of tax. This approach results in a lack of new tax-planning opportunities to minimize family taxes. Individuals must determine if their circumstances allow them to take advantage of the various tax planning opportunities, most of which have been available for over a decade. In part one of this series, we shall review two of the ten tax-planning ideas that are the cornerstone of an effective family tax planning strategy.

Prior to reviewing these strategies, we shall summarize the issues related to residence and types of income, as these factors can significantly impact the family's total tax burden.

Residence - Our residence is normally determined by our place of birth or emigration resulting from employment opportunities or lifestyle choices. Most individuals understand that marginal rates vary by provinces and residents of Alberta pay the lowest level of income tax in Canada. However, income taxes could be further reduced by moving to certain areas in the United States, or possibly eliminated by moving to a tax haven country.

Although our province and country of residence determine the amount of taxes paid, most families are reluctant to move exclusively for tax motivated reasons. Any potential tax savings resulting from a change in residence must be weighed against family and lifestyle considerations. However, there is a correlation between low tax rates and regions of economic growth and many individuals discover that by moving to an area with superior employment prospects, lower tax rates may be a side benefit.

Types of income - The most common types of income that individuals receive are employment, investment, pension and self-employment. Unfortunately, employment and interest income are the most common types of income earned, but are the least tax effective. Streams of income that are more tax efficient include:

Type of Income	Tax Benefit
Capital Gains	50% of gain included in income Top marginal rate in Ontario is 23%
Stock options	Only 50% of the gain is taxable
Canadian dividends	Qualifies for the dividend tax credit and top marginal rate is 31% in Ontario
Self-employment Income	Allows for a deduction of certain expenses that may have a personal component, such as entertainment, travel, automobile expenses or a deduction for an office in the home
Commission, rental & farming income	Permits numerous deductions to be claimed

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TOP TEN TAX PLANNING STRATEGIES

The following list of tax planning strategies attempts to minimize tax, while supporting family financial planning objectives such as retirement, funding a child's education, or maximizing disposable income. Many of these strategies are not based upon claiming a deduction that is otherwise available; rather they are based upon achieving certain financial planning objectives in the most tax effective method possible. Our top ten tax planning strategies are:

- Maximizing RRSP's
- Tax effective strategies to fund a child's education
- Avoiding the attribution rules to maximize family investment income
- Planning for interest expense
- Investments that focus on after tax rates of return
- Claiming a deduction for a home office
- Minimizing a company car benefit
- Tax planning for children
- Maximize claim for charitable donations
- Entrepreneurship

STRATEGY #1- MAXIMIZING RRSP's

Most taxpayers are familiar with the benefits of registered retirement savings plans. For those individuals that are members of a generous pension plan that will provide sufficient income to fund their lifestyle throughout retirement, RRSP's are not critical. However, many individuals are not members of employer sponsored pension plans and even those who are currently members of such a plan have no guarantee that their future employment status will ensure they will receive an adequate pension.

The goal of maximizing the size of one's RRSP is achieved by following these four steps:

- Contribute the maximum allowable amount each year
- Start contributing at the earliest age possible
- Make the contribution at the start of the year, rather than in the 60 day period following the close of the calendar year
- Implement an appropriate investment policy for the funds contained in the RRSP

By Maximizing the contributions at an early age, it is possible to achieve financial planning objectives other than retirement. These include:

Home Buyers Plan - Taxpayers can borrow up to \$20,000 from their RRSP to use as a downpayment on a home purchase. The amounts borrowed must be repaid over a fifteen-year period. Although intended for new homebuyers, the rules allow individuals to qualify if they have not owned a home in the previous five years.

Lifelong Learning Plan - Taxpayers are allowed to withdraw up to \$10,000 per year to a maximum of \$20,000 to support a return to school. The student must be in full time attendance and the program must be at least three months in duration. Amounts borrowed from the RRSP must be repaid in equal instalments over a ten-year period. Assuming the individual is a full time student in a qualifying educational program, the repayments will commence in the fifth year following the withdrawal.

Financing a Maternity Leave - An individual on maternity leave will receive employment insurance benefits, plus whatever employer sponsored income and benefits may be available. If this income level is inadequate, the individual may collapse a portion of their RRSP to help fund the maternity leave. Any amount withdrawn will be taxable, but since the individual's income may be significantly reduced during this period, it may be a tax effective strategy. Many women make the maximum RRSP contributions prior to their maternity leave with intention of withdrawing these funds while they are off work.

Funding a Period of Unemployment - If an individual suffers from an extended period of unemployment, an RRSP is a tax effective source of funds during this difficult time.

Miscellaneous RRSP Tips - In order to achieve the maximum advantage from an RRSP, individuals may wish to consider the following tax tips:

- Children should file a tax return for every year they have earned income. Although no tax return may be required, nor any taxes payable, reporting earned income creates RRSP contribution room. These amounts can be carried forward until the child enters the workforce and has a meaningful level of income
- If an individual faces the possibility of bankruptcy, RRSP's offered by insurance companies may offer creditor protection
- Individuals are allowed a lifetime over-contribution of \$2000. Use this deduction as soon as possible
- A spousal RRSP contribution is an effective income splitting strategy if the spouses expect to have the different tax rates at retirement
- Individuals can carryforward unused contribution room to future years. This carryforward should be claimed in years when income levels are high. For example, students who create unused RRSP room from their part time job, should not use the deduction until they have started full time employment and their income level has risen accordingly
- Make your RRSP contributions at the start of the year, rather than in the 60 day period following the end of the calendar year. This effectively allows an additional contribution over an individual's lifetime.

STRATEGY #2- FUNDING A CHILD'S EDUCATION

In the past few years, amendments have been made to the rules related to Registered Educational Savings Plans (RESP's) that eliminated much of the inflexibility and penalties that were problematic if the beneficiary did not attend a post-secondary educational institution. Unlike RRSP's, contributions to RESP's are not deductible for income tax purposes. However, individuals can contribute up to \$4000 per year per beneficiary and receive the following benefits:

- Investment income generated within the RESP will be taxable to the student when the funds are withdrawn, rather than to the parent or grandparent who made the contribution.
- Although the investment income is taxable to the student while attending school, the student may not pay tax on these amounts if either their income level is low or they can eliminate their tax liability by claiming a tuition credit, moving expenses, education credits or their basic personal tax credit.
- Contributions to an RESP qualifies for a Canada Education Savings Grant from the government. This grant is 20% of the first \$2000 contributed to a maximum of \$400 per year.

In the next issue, we will continue our review of the top ten tax planning strategies.

Source: Canadian Tax Planners

Thank You!

We would like to take a moment to thank you for taking the time to refer your friends, family and associates to our firm. Your expression of confidence in our service is sincerely appreciated, as our practice continues to grow as a result of these referrals from thoughtful clients such as yourselves! Thank you!

New!



Starting January 2004, we will be holding a quarterly draw within our office. Each quarter, one lucky client/family will win a great prize! The winner will be announced right here in the monthly newsletters and will be notified upon winning. The prize will change each quarter so good luck!

Harvest Day 2003

Thank you to everyone who attended our first Harvest Day at the Pitt Meadows Rec Hall on October 18th, 2003. Your smiling faces made this event a huge success!

The family event was full of funny moments and lots of laughs. Our entertainers: Michael - Magician at Large, Cassie - face painter, and Mark - Caricaturist were on hand all day offering fun and unique entertainment to the children and adults alike!



Be sure to log onto
www.perlerfinancial.com

to see more great pics from this event
and information on future events.

3 Dynamic Tips For Paying Your Mortgage Off Faster!

One of the highest financial priorities of Canadian homeowners should be to pay off their mortgage as quickly as possible," says Karen Hall, Mortgage Broker, with Dynamic Mortgages. However, it's quite shocking as to how many Canadians these days, actually are retiring with mortgages still on their homes and only meager pension income to make payments. Somewhere along the way they missed out on opportunities to take advantage of a few simple strategies that would have had them mortgage-free, years ago. Any consumer taking out a mortgage today without an easy-to-implement mortgage reduction plan is missing the opportunity of a lifetime. Let's say you took out a \$100,000 mortgage today, at 6.00%, amortized over 25 years. Your monthly payment will be \$639.81. In 25 years, you would have to repay over \$190,000 for the mortgage including principal and interest before you can invite your friends and family to the mortgage burning party. That's almost double the amount of the original loan. More importantly, it's the additional time – time spent having to work, time not spent relaxing, traveling and doing those things that you enjoy the most. Well, here are three, easy-to-use tactics on paying your mortgage down faster. They won't hurt your pocket book in the short term but will help you retire mortgage-free in the long run.

Tip #1:

Using the example mortgage scenario above, tip #1 is to increase your monthly payments by just \$60.19 per month, effectively rounding up the mortgage payment to an even \$700.00 over the lifetime of the mortgage. The immediate result will be that you will pay off your mortgage in 20 years and 8 months. You would realize a total interest saving of over \$18,000 over the life of the mortgage. Most of us spend \$60.00 a month, a toonie-a-day, without even knowing about it. Skip the large-double-double on your way into work. Not only will you escape the dreaded, donut shop drive-thru and get to work faster; you'll also be well on your way to being mortgage-free, faster.

Tip #2:

After you've put tip #1 in to play, you can start working on tip #2. Now that your amortization is down to 20 years and 8 months, let's take the same situation and put a principal prepayment plan in to motion. Simply put, a pre-payment is making an additional lump-sum payment to lower your outstanding principal. If you're like many Canadians and take out an RRSP loan to get the maximum tax refund due to you, tip#2 is a simple exercise to implement. When applied to the mortgage principal, the tax refund is a "gift that keeps on giving". Combining the refund with the tax-free interest earned on the RRSP over the subsequent years will quickly outpace the short-term interest costs of the RRSP loan, which is usually at prime rate. In our example, a tax refund of just \$1200 applied to the mortgage principal once a year, will reduce your amortization down to 16.5 year; an interest savings of over \$35,000. Not only are you paying your mortgage down faster but you're also topping up your RRSP at the same time. A double benefit! Imagine the savings if you could pay more than \$1200, a year against the principal!

Tip #3:

Most people get paid on a weekly or biweekly basis. Nowadays, very few individuals get paid monthly. Therefore, it makes good sense to make your mortgage payments as often as you are paid. Making weekly or biweekly payments also has a dramatic effect on how fast you pay off your mortgage. In our example, so far, we have taken the original mortgage from a 25 year amortization down to 16.5 years.

Now let's take the same monthly mortgage payments of \$700 per month and divide by two, for a biweekly payment of \$350. By paying your mortgage biweekly, you will effectively reduce the amortization even further and pay off this mortgage in 14 years and 8 months with a total interest savings from all three tips of over \$41,000 over the life of the mortgage. A bonus, simply

because you were smart and coordinated your mortgage payment with your pay day!

There you have it! Three, easy to implement tips that will reduce your mortgage by over 10 years, save you thousands of dollars in interest costs and disposable income, and top up your RRSP at the same time. You've effectively given yourself an opportunity to enjoy a greater life style for a longer period and peace of mind at retirement. After all, isn't that what we're all working for, today? Doesn't it make sense then, that when you take out a mortgage that you also have an easy-to-implement, mortgage reduction plan, in place? I highly recommend that you set 20 minutes aside, confer with your spouse and figure out what you can afford, to implement Tip#1. Once you put that in motion, Tips 2 and 3 will come easily. Good Luck!

For all your mortgage questions please contact Karen Hall at (604) 936-7740 or visit website at www.karenhall.ca

Mortgage Rate Update (as of December 3, 2003)



Lender/Broker fee may apply to non-traditional applications

*Mortgage rates quoted for first mortgage as of
Decemer 3, 2003*

Term	Posted Bank Rates	Our Best Rates
6 MONTHS	5.45%	4.45%
1 YEAR	4.55%	3.75%
2 YEARS	5.00%	4.30%
3 YEARS	5.65%	4.65%
4 YEARS	5.90%	4.90%
5 YEARS	6.40%	5.19%
7 YEARS	7.25%	5.75%
10 YEARS	8.00%	6.09%

Mortgage rates provided by
Karen Hall, Dynamic Mortgages