

Your questions answered

Our featured planners' responses to your money questions

Financial Post

Monday, February 05, 2007

Two top advisers featured in *Financial Post Business* magazine's February Family Finance issue answered selected questions from our readers.

William Bell is the founder of Aurora, Ont.'s Bell Financial Inc. and the author of the personal finance books *One Step to Wealth* and *Simple Money*. He is also a representative of Manulife Securities International Ltd. Karin Mizgala is a Vancouver-based financial adviser who specializes in planning for couples, widows and divorced women.

Two lucky participants won an hour of free financial advice from our planners. Here are selected questions submitted by readers and our financial planners' responses.

Q: Concerning income splitting for seniors: Is it splitting of all income for seniors or only "pension" income? What qualifies as "pension" income? For example, a deregistration of an RRSP? Does the income splitting only apply as of January 1, 2007 or was it backdated to January 1, 2006?

—**Jake Buhr, Kitchener, Ont.**

Financial planner William Bell responds:

A: Proposed legislation would allow any income that currently qualifies for the pension income tax credit to be split with a spouse or common-law partner. If you are over 65, this would include lifetime annuity payments from a registered pension plan, a registered retirement savings plan (RRSP) or a deferred profit sharing plan (DPSP), as well as payments out of a registered retirement income fund (RRIF). For those under age 65, eligible pension income includes lifetime annuity payments under a registered pension plan as well as certain payments received on the death of the individual's spouse or common law partner. This is to take effect on January 1, 2007 and is not retroactive.

Q: I am recently retired with a pension and investments. I have invested mostly in foreign ETF's or stock in both RRSP and non-RRSP. From a tax perspective, should I now start to take money out of the RRSP if I continue investing in foreign ETF's?

My reasoning is that if I continue inside an RRSP, any capital gain or foreign dividend will not be taxed, but when I withdraw all this in say 10 years, it will all be taxed at a higher rate as income. Now, if it was in a non-RRSP over the next 10 years, any capital gains would take advantage of the lower tax rate, plus could apply any capital loss. The foreign dividend would still be taxed at the higher income rate, but could take advantage of deducting any 15% withholding tax. If I was to implement this idea, I would withdraw only enough to stay below my existing tax bracket.

— **Dennis, Kingston, Ont.**

Financial planner Karin Mizgala responds:

A: RSP withdrawals are taxed as income in the year of withdrawal and it is true that the tax advantage of capital gain/capital losses is lost within your RSP. However, if you withdraw the funds, you will be paying tax that you could instead defer to sometime in the future. The only way to truly know if you would be better off withdrawing RSP funds now and investing in non-RSPs is to compare your overall net worth position in 10 to 20 years under the two scenarios.

To help with this type of analysis, I use RRIFmetric, a retirement planning software program that calculates the impact of tax on various investment and income streams. There is a version of this software available for personal use. Check out www.fimetrics.com or ask a tax professional to help you with the calculations. I suspect that you will be better off keeping your RSPs intact, but the only way you will know for sure is to do the math.

Q: I have a wife, three children and six grandchildren. I am 70 but I am not retired. In my will, I plan to establish a testamentary trust for my children and grandchildren. Is there a trust vehicle I can establish now that will provide the same tax benefits and opportunities for splitting income and capital gains with the nine offspring?

— **Gerald, Toronto, Ont.**

Financial planner William Bell responds:

A: Setting up an *inter vivos* (during one's life) trust today does have one distinct advantage. It would allow you



to potentially distribute the income from the trust to your children and grandchildren, thus splitting income, and perhaps reducing taxes, today. The most significant advantage here may be the fact that you get to see the fruits of your labour enjoyed by your family while you are still alive.

There are some potential disadvantages. Income left in an *inter vivos* trust is taxed at the highest marginal level, and moving funds into the trust would trigger any capital gains now. And, you will have to incur the costs of setting up the trust and filing income tax returns annually.

A testamentary trust pays taxes using the same graduated scale as any other tax payer, which may be an advantage if all income isn't expected to be paid out to beneficiaries on an annual basis. And the use of the testamentary trust would defer any capital gains until the time of your death.

Both trust arrangements should be able to help you reduce or avoid the costs of probate.

So, I think you need to assess the value to you of seeing money get into the hands of your children and grandchildren while you're alive, and then get some help from a qualified adviser to assess your particular situation and evaluate the costs and benefits of each scenario. Based on that info, you will likely see more clearly which is the best course of action. Be sure to get good help in setting up any trust to ensure that it does the intended job.

Q: Should I borrow money to top up my RRSP's? I would like to dip into my RRSPs to use as a down payment on a house in the near future. I am trying to save a down payment of about \$10,000.

—**Brent Larson, Kamloops, B.C.**

Financial planner Karin Mizgala responds:

With the Home Buyers' Plan (HBP), you can take up to \$20,000 out of your RSP to put towards the down payment on your first home and you won't be taxed on it. However, you do have to pay it back into your RSP within 15 years. If you are withdrawing \$10,000 from your RSP for your down payment, your minimum annual payment is \$667. If you repay less than the minimum in any particular year, the balance is added to your taxable income. Keep in mind that RSP contributions must be made at least 90 days before your HBP withdrawal.

While there may be a tax benefit to borrowing money for your RSP and then withdrawing the money under the HBP plan, this means yet another debt payment on top of your mortgage payments and HBP repayments. Will you really be able to manage all the debt and the additional costs of home ownership? Before making a decision, estimate your monthly expenses, including debt payments, and make sure your income is sufficient to meet all your obligations. While home ownership can be a desirable financial goal, it only makes sense if you can have a life too.

Q: I have two investment accounts — one RRSP and one margin account. What is the best way to rebalance them for my age and income? I'm 58 and I work part-time. My income from my pension, investments and work is about \$50,000 a year. My risk tolerance is moderately high.

—**Allan Gear, Comox, BC**

Financial planner William Bell responds:

A: Investing should always be done with two things in mind: Your time horizon and your personality. In the case of retirement funds – money that will be spent gradually over a number of years – you need to make an assumption about how long you are going to live and how much you want or need to draw from the funds each year. With that information, you can determine (with the help of a calculator or computer) the minimum return you need to earn on the funds in order not to run out of money too soon.

The return you need to get on your investments will give you some guidance regarding how to invest. For example, if your minimum return is 3%, GICs may be all you need. If the minimum return is 6%, a balanced portfolio will be required.

Your money personality then assists you in making the final choices. If you are conservative and risk-averse, you need to steer as much as possible to guaranteed investments. If you are a more aggressive investor, then you will probably steer towards the more volatile investments with higher potential returns. In a sense, what you are doing is deciding how much risk you "need" to take, how much risk you "want" to take, and finding the optimal point at which these two overlap.

Q: I'm a single mom with three brats (really they can be sweet at times). I moved from Toronto to Barrie to buy a house and provide them with a better life. I still work in downtown Toronto and do the big commute. Will not reveal my true age but my dream is retire real early, circa age 55. I will be getting a large sum of cash soon and have plans to pay debts and invest.

My question is, how much money should go where (RESP, RRSP, mortgage, credit card debt, vehicle, etc.) I am good with budgeting but would like some fun for a change. My last trip was in 1996 and I like fast cars, and I'm hoping to get some fun out of this lump sum.

—**Name withheld, Barrie, Ont.**

Financial planner Karin Mizgala responds:

A: Your first step is to get really clear about what you want in your life and what your priorities are. Then try to estimate the costs of your goals: What will your expenses be now and in retirement? How much do you want to have for your children's education? How much does the "fast car" cost? Figure out if you have enough money to realize all your goals. Chances are that even with this large lump sum you may have to make some trade-offs. But this doesn't mean you can't have fun or that you'll have to work until 95.

In my experience, "lump sums" disappear all too quickly. Start by paying off your credit card debt and put a plan

in place to pay off the rest of your debts by retirement. Talk to your financial advisor about an income and investment strategy that allows you to enjoy today and to retire early. And avoid making any quick decisions. There's nothing wrong with splurging on yourself (sounds like you deserve it), just make sure you are considering all of your life goals and priorities before you start spending the cash.

Q: My wife and I had our RRSPs topped up to the maximum with no additional contribution room for either person for years. About six years ago, we invested in mutual funds outside our RRSPs. We have not been reporting the losses or gains in our tax returns on these mutual funds because I thought that we would pay tax when we finally cashed them in. I now believe that we are supposed to report the gains or losses yearly. Is this true, and if so, do I have to go back and try to figure out what gains and losses we have had and then re-file our tax returns for all those years? Do I use the year-end statements that the various mutual fund companies sent me, because we haven't received any T5s or similar forms?

—Name withheld, Campbell River, B.C.

Financial planner William Bell responds:

A: Mutual funds are taxable in two ways. First, a mutual fund that has earned interest, dividend or realized capital gains income during a year, will usually distribute that income to investors at year end. When that is the case, the mutual fund company will issue a T3 or T5. If you have not received any of these tax slips from your mutual fund companies, that is likely because no income has been distributed, and thus no tax payable by you. Second, if you sell a mutual fund in whole or in part (or are deemed to have sold it, such as when you move it from a non-registered account into a registered account) and it has increased in value more than the sum of previously distributed income, you will realize a capital gain, which must be reported in the year you sell the fund. As with any tax question, the best advice I can give is to take your question to a tax specialist, such as a chartered accountant.

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