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NetWorth

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Financial guidance providing peace of mind for a well-deserved retirement

Know someone who could benefit from the kind of relationship we have? Client referrals are welcome. Thank you.

Communication, communication, communication.

Dear client,

Most of you are no doubt familiar with the creed used in the world of real estate, namely: "location, location, location."

If I had to think of one for investment advisors, it would be: "communication, communication, communication."

Why? Well, for several reasons, actually. In today's world, it has become increasingly critical to:

- Demystify the investment world
- Understand the various mechanisms involved
- Continuously track its rapid and sometimes complex changes.

With this increased knowledge, each one of you will be better equipped to:

~ Better rationalize your emotions when confronted with risks or unforeseen events

~ Fully grasp the goals and intricacies of your investment plan: knowing your financial framework will greatly enhance your peace of mind both while preparing and throughout your retirement

If there is one single thing that I am constantly striving to improve within my practice, it is communication!

For instance, my current quarterly financial newsletter - "Net Worth" - is one way for me to reach my goal of better communication. In fact, I would like to take this opportunity to thank you for the positive feedback many of you have given me on the subject. Naturally, this newsletter doesn't take the place of our regular meetings, phone calls, e-mails and mailings on various topics of interest, but is intended rather to complete them.

As I am always looking for ways to better communicate with you, as this year draws to a close, I have decided to introduce two new initiatives which, I believe, will enable me to keep you better informed and, thus, to better meet your needs.

The **first initiative** will take the form of a **survey**. This yearly questionnaire will help you express your level of satisfaction regarding various issues. The answers you provide to these questions will help me tailor my approach to your needs. When you read this, you will probably already have received the survey, or will be receiving it shortly. My goal is to implement any changes required as soon as possible in 2008. Needless to say, I hope many of you will complete the survey.

A **second initiative** will have been announced to you on a separate cover, namely **the hiring of a marketing assistant** who will be joining my team and who, in addition to my administrative assistant, will help me increase my contacts with you and the information I can provide you.

It is said that perfection lies in the details. By caring about the small things - the details - one can aspire to perfection.

This is my promise to you for 2008, this ongoing search for perfection in my communications with you.

I will end this by quoting Aristotle: "Excellence is an art won by training and habituation. We do not act rightly because we have virtue or excellence, but we rather have those because we have acted rightly. We are what we repeatedly do. Excellence, then, is not an act but a habit." Excellence is what I strive for in my daily work.

To each one of you I wish a Happy Holiday Season. May your wishes, aspirations and dreams come true in the New Year.

I thank you once again for your ongoing confidence!

M. Vaillancourt

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Pension Income Splitting Provides Tax Planning Opportunities for Couples

Pension income-splitting, originally announced in the 'Tax Fairness Plan' on October 31, 2006, will take effect for the 2007 taxation year. Being able to split pension income provides an opportunity for couples to reduce their overall family tax bill by taking advantage of a spouse's or common law partner's (hereinafter referred to as "spouse") lower marginal tax rate where retirement incomes of spouses are disproportionate.

The rules allow a Canadian-resident individual receiving eligible pension income to allocate up to 50% of this income to his/her spouse. To make an allocation of income, each spouse must make an election on their income tax return each year. For income tax purposes, the amount allocated will be deducted from the income of the spouse who actually received the eligible pension income and added to the income of the other spouse.

The definition of eligible pension income is the same definition used for determining eligibility for the pension income tax credit (increased to $2,000 effective 2006), such that individuals currently eligible for this credit will also be eligible to split pension income with their spouse. It is important to remember that it is the age of the spouse entitled to the pension income that is relevant in determining the eligibility for pension income-splitting, such that it is possible to allocate eligible pension income to a spouse who is under age 65.

Ineligible income includes Old Age Security (OAS), Guaranteed Income Supplement (GIS), Canada/Quebec Pension Plan (CPP/QPP)(1), RRSP withdrawals and income from retirement compensation arrangements (RCAs).

Let's take a look at an example of how pension income splitting works. Assume that both you and your spouse are age 65 and reside in Ontario. Further assume that you earn interest and other income of $100,000 and $50,000 of (eligible) pension income, whereas your spouse earns only a total of $30,000 of interest and other income.

In preparing your 2007 tax returns, you and your spouse agree to split your pension income to allocate 50% (ie.$25,000) of this income to your spouse which will reduce your taxable income by an equivalent $25,000.

Your overall family tax savings in 2007 will be approximately $3,800 (ie. $11,600 - $7,800) as a result of taking advantage of pension income-splitting. You would save approximately $11,600 in combined federal and provincial tax by avoiding tax on this $25,000 amount at the top marginal tax rate. Your spouse's combined federal and provincial tax owing would increase by approximately $7,800 at the lower marginal tax rates (with the additional $2,000 pension tax credit offsetting much of the reduction in the age credit).

Eligible Pension Income

If you receive the following type of income, it will qualify for pension income splitting purposes.

You Are 65 or Over and Receive:

1. Registered pension plan payments;
2. RRIF payments (includes LIF and LRIF payments);
3. Lifetime annuities from registered plans; or
4. Prescribed and non-prescribed annuities (interest component only)

You Are Under 65 and Receive:

1. Registered pension plan payments; or
2. Amounts (2) to (4) above only if received as a result of the death of a spouse.

In other scenarios, the amount of Old Age Security payments clawed back may be reduced as a result of pension income-splitting allocations, creating additional tax savings. The actual results will vary by province.

Some Planning Opportunities

$2,000 Pension Income Credit

Since the spouse receiving the transferred income (transferee) is treated for tax purposes as having received the portion of the pension income allocated to them, the transferee spouse may be eligible for the pension income tax credit, thereby possibly doubling the use of this credit for a couple. The age of the transferee spouse is relevant in determining the eligibility for this credit, again based on the criteria described earlier. Therefore it may not always be possible to double-up the use of the pension income credit. For example, consider a spouse, age 67, who receives RRIF income and allocates this income (which is eligible pension income) to his/her spouse who is only 63. While the transferee spouse would be able to claim the RRIF income on his/ her tax return, the allocated income would not be eligible for the pension income tax credit since it does not represent eligible pension income to the transferee spouse due to his/her age.

Reduce or Avoid the OAS Clawback

The reduction of the higher-income spouse's net income may reduce or avoid the clawback of OAS benefits and may increase the amount of other tax credits, since the amount of eligible pension income allocated is deducted from the individual's income.

Spousal RRSPs Still Useful

The use of Spousal RRSPs as an income-splitting tool may still be recommended despite the opportunities created by pension income-splitting, since Spousal RRSPs will allow for additional income-splitting prior to age 65. In addition, a Spousal RRSP provides a further opportunity to increase the amount of income-splitting beyond the 50% limitation provided by the new rules.

Impact on Quarterly Tax Installment Payments

Pension income-splitting may provide additional cash flow to the extent that an individual's quarterly income tax installments can be reduced as a result of allocating a portion of the eligible pension income to a lower-income spouse. However, care should be taken in estimating current year income tax installments to avoid potential installment interest charges if estimates differ from actual results.

As always, it is important to work with your tax advisor to fully understand the tax implications to your situation in determining the potential benefits of the above strategies.

The Lofty Loonie's Legacy

Michael Gregory, CFA, Senior Economist

Although the loonie might not fly above parity indefinitely, this autumn's cross-over could leave a lasting impression on the behaviour of consumers and businesses. On the consumer side, parity sparked cross-border price comparisons and cries of outrage over Canada-U.S. price discrepancies; the latter reflected in longer vehicle lines at the border and increased northbound parcel traffic. Under pressure, domestic retailers have started to cut prices. More generally, for import-competing businesses and exporters used to operating with the loonie always at a discount, a premium currency is a rude awakening. Just as consumer behaviour seems to have shifted in non-linear fashion to parity, we judge that a sea change in business behaviour is about to unfold, one in which firms opting to swim with the loonie's surge will likely expedite requisite restructurings.

The Canadian economy has already been adjusting to the loonie's multi-year appreciation. Real exports have been dampened as imports have been boosted, narrowing real net exports from a record high surplus during early 2002 to a record

low deficit last year (which could be surpassed in 2007Q3). This shift amounts to a massive 9.6% of GDP—equivalent to about three years of respectable economic growth. However, this GDP growth headwind has been masked by the fact that Canada's terms of trade soared to record high levels because of commodity prices, keeping the nominal trade balance hardly changed over the same period and, more importantly, providing an effective income lift for domestic spending.

The Lofty Loonie's Legacy (continued)

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More adjustments are coming. Since 2002Q1, Canadian unit labour costs have grown faster than their U.S. counterparts, a cumulative 16.0% compared to 10.5%, through 2007Q2, mostly reflecting slower productivity growth. However, in U.S. dollar terms, Canadian costs are up a whopping 68% in the past five years because of the loonie. This more than erased the 28% cost advantage built up during the prior decade as the loonie depreciated from its early 1990s' highs. This emphasizes the need for Canadian firms to raise productivity, particularly by increasing the capital-labour ratio.

Canadian companies have lagged their U.S. counterparts in machinery and equipment spending (as a share of GDP) for most of the past three decades, as the steady decline in the Canadian dollar provided little incentive to invest to become more competitive. Note that Canadian firms sharply increased capex during the second half of the 1980s to close the investment gap with U.S. companies, adjusting to multi-year C$ appreciation and, of course, the Canada-U.S. Free Trade Agreement. Interestingly, the last time Canadian firms spent relatively more on M&E was around 1976, the last time the loonie was at parity.

In aggregate, Canadian businesses appear up for the challenge, as balance sheets are in the best shape in generations. "Financial balance" is defined as cash flow less investment spending, a measure of firms' financial capacity to spend. Although energy and commodity company profits could account for a large part of this largesse, Canadian businesses, generally, still appear to have the resources to pay for restructuring. (Interestingly, U.S. firms' financial balance has been eroding, in part due to stock buybacks).

Higher capital-labour ratios will also be achieved by reducing labour, adding to the losses coming from outright plant and firm closures. Since peaking at 2.3 million in late 2002, 300,000 factory jobs have disappeared in the Canadian economy. Currently, total U.S. employment is about 8.1 times larger than Canada's, but Canada has a relatively larger number of factory jobs (the ratio of U.S.-to-Canada manufacturing employment is a much smaller 6.9). Assuming that forthcoming adjustments will push up the U.S-Canada factory jobs ratio to at least 8.1, and that U.S. factory jobs will be flat over the period, we could easily see at least another 300,000 jobs lost in the Canadian manufacturing sector.

The Bottom Line: The strong Canadian dollar is going to cause economic pain. The only uncertainty is whether this will be fully or only partly offset by still solid domestic demand and the buoyant Western Canadian economies. But, the lofty loonie could also be the catalyst for a productivity boom, with positive longer-term benefits. Recall that it was the record-high trade-weighted U.S. dollar in the mid-1980s that helped sow the seeds of the U.S. productivity boom during the 1990s; Canada could be in store for the same.

(1)Income splitting already exists for CPP/QPP recipients. Spouses who are both at least 60 years old can elect to share their CPP/ QPP pension benefits. You must apply to the government requesting an equal share of the retirement benefits you both earned during the years you were together. The amount of CPP/QPP that is split depends on how long you and your spouse have lived together and your contributions made to CPP/QPP during that time. If only one spouse is a CPP/QPP contributor, you may share that one pension.