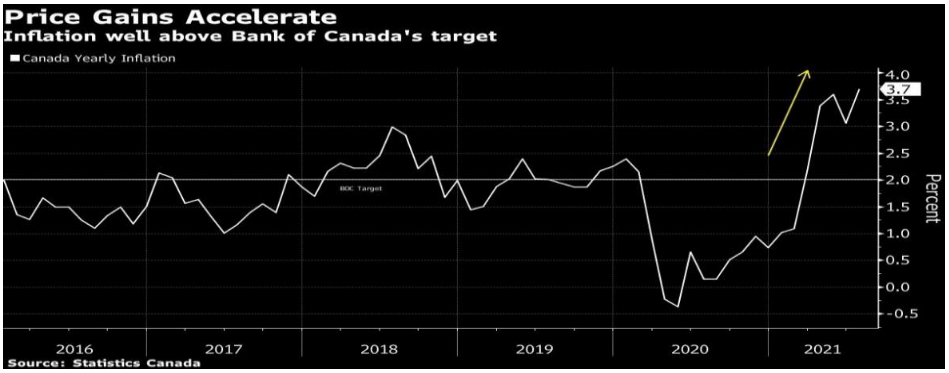
# Newsletter VOL XXXVIII – to vote '*for*' or '*against*' …. July 2021

Retirement and financial planning require time, effort, and specialized knowledge. This newsletter provides information about various aspects of retirement and, general tax issues. It is intended to help you plan your retirement and to assist working folks to prepare for the future*. **It may include general comments on investing but does not provide investment advice.***

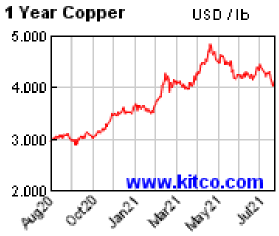
## Overview

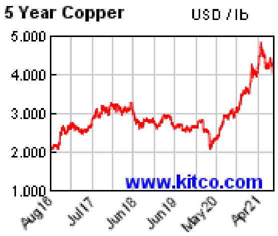
Tensions in Afghanistan, the South China Sea, Covid 'D', and inflation were the main issues in July. July CPI was 3.7%, up from a year earlier and at the highest level since 2011. Economists expect CPI to be 3.9 % in the 3rd Q. Canada hasn't recorded inflation above 3.7 % since 2003. Inflation continues to be a global concern driven by supply bottlenecks and disruptions and, higher food and energy prices. Car prices continued to climb, due in part to a shortage of semiconductor chips. Most policymakers however feel these inflationary trends are transitory. With stronger economies, inflation increases, and expected earnings recoveries it is unlikely central banks will lower interest rates. While economic recovery is likely to continue, due to pent-up demand, returns will likely be modest in the short term according to 'experts'.

Low industrial and agricultural capital investment in the past and current low inventory levels plus the current focus on infrastructure, industrials, and basic materials could result in continuing growth (according to the 'experts'). Increasing future interest rates will likely result in improved profits for banks and other financial institutions and perhaps dividend increases. Uncertainty vs. certainty, however, is the watchword when investing.




Copper is a traditional indicator of global economic activity. Copper prices have retreated a bit, peaking in May.




Dilemma: ***vote for the party likely to ensure that the least harm is done or, one promising the most handouts?***

# Tax Information

## OAS – $500 supplementary ‘adjustment’

The government has sent a one-time OAS ‘adjustment’ payment of $500 to people born before July 1, 1947. This payment is taxable but is exempt when calculating the Guaranteed Income Supplement (GIS) income nor will it impact GIS in the future.

In addition, the normal OAS payment adjustment made on June 30 was 1.3% bringing the maximum monthly OAS payment to $629.49. GIS. The Allowance amount will also be increased.

The recent 2021 Liberal government budget included a permanent increase in OAS of 10%, the first increase since 1973 (other than the normal quarterly inflation adjustments). This increase comes into effect on July 1, 2022.

Election Largesse - or perhaps the fact has finally sunk in that the CPI inflation adjustment to CPP, OAS, GIS, etc. have not adequately compensated for the actual impact of inflation.

## **2.** Renting out your principal residence – tax implications

If you rent out all or part of your principal residence e.g., Airbus, you are deemed to earn rental income that must be reported for tax purposes on Form T2091 and Schedule 3. This also results in a deemed disposition, that must be reported at the time of the change, of the percentage of the property converted to rent usage, based on square footage (Paragraph 45(1)(c) - Income Tax Act). A special exemption to this rule, subsection 45(2), is not applicable when only a partial change of use applies.

The rental portion of a principal residence is not exempt from tax if the property is sold.

There is an exception to the 45(1)(c) rules if 1) the income producing use is **“ancillary”** to the use of the property as a residence, 2) there is no structural change required to the property and 3) no CCA is claimed on the rental portion.

The meaning of **‘ancillary’** is not defined for tax purposes but generally means ‘subordinate’ or ‘secondary’ to the primary use. But it is up to CRA to determine if the exemption applies. (Hmmm!)

If the residence is rented out the property tax grant may not apply and, you may not be able to differ property taxes. To qualify for these programs, you must reside in the home.

## **3.** Foreign Equity - Tax Treatment of Dividends

If you invest in foreign equities, you should be aware of CRA’s treatment of dividends and interest income. Foreign interest income and dividends are reported as ‘OTHER INCOME’ on your tax return. The USA withholds 10% tax on interest payments 15% on dividends. However, both can be claimed as non -refundable tax credits. Information slips (T-5s or T-3s) will be shown in Canadian dollars: foreign exchange capital gains or losses will automatically be included.

Keep in mind that interest and dividends earned in tax-sheltered accounts e.g., DC, RRSP, LIF, etc. are 100% taxed **when withdrawn from the account**. The US withholding tax credit is therefore lost. It is better not to hold these types of securities in registered accounts.

If you own foreign equity in non-registered accounts during the year and the cost-base is more tha$100,000 you are required to file Form T1135 with your tax return.

### **4.** Employee stock option plans

New rules apply to the taxation of employee stock option plans.

- There is now a $200,000 annual vesting limit (based on the options value on the date granted) on stocks qualifying for the 50% deduction.
- There is an employer deduction for employee stock options that exceed the new vesting limit.

# B. Other Issues and Information

### **5**. Fees – Transparency and the federal election

The Conservative election platform includes a requirement for more transparency regarding investment management fees. Banks would have to show investment returns net of fees. This doesn't appear to include other financial institutions.

Given the high cost of Canadian management fees, this would be a welcome change. It may improve investors' evaluation of investment performance vs. the value-added (cost) by a fund manager and/or advisor etc.

### 6. Recreational Properties – Tax Issues

Taxpayers are required to report the sale of a principal residence on their annual tax return (Form 2091). Some try to claim recreational properties i.e., cottages, cabins, and the land, as their principal residence. This allows them to try to avoid paying tax on capital gains on the sale of a personal property when it is sold.

Recreational properties are considered to be properties used for a limited period during the year. Renting out the property during the year reinforces the argument it is not a principal residence. Couples can only designate one property a principal even if they own more than one property.

Gifting or transferring a recreational property is a deemed disposal. It is subject to capital gains tax on the sale of personal property. However recreational properties can be transferred (rolled over) to a spouse at the adjusted cost base without creating a capital gains tax event.

BC levies other taxes such as a foreign buyer's tax, a vacant house tax, and a property transfer tax which are applicable to disposals. Ontario has a Non-resident Speculation tax that may apply.

The take-away from this is to make sure you understand the rules about recreational properties or, second homes.

### 7. Cryptocurrencies – a tax bookkeeping nightmare

Bitcoins and other cryptocurrencies have been around for a few years; however the tax treatment is complex, confusing and, still evolving. Given the large sums involved, it is a given that government tax agencies, like CRA, will focus on their interpretation of what is taxable and ensure all such income is reported**.**

An article is attached which briefly outlines some of the basics regarding the taxation of cryptocurrencies in Canada. See - "Taxation of Cryptocurrencies" below.

## **8.** Sponsors of 'Money purchase" Pension plans – Be Aware!

Many organizations offer employees 'money purchase' pension programs such as Defined Contribution plans, RRSPs, RRIFs, LIFs etc., without being fully aware of their responsibilities or the fiduciary risks they are assuming. The decumulation phase, when the retirement savings are being drawn down, is particularly challenging and poses considerable potential fiduciary risk for plan sponsors.

For more details browse – "Why decumulation is a challenge for CAPS' - Benefits Canada Magazine - https://www.benefitscanada.com/news/cir-news-news/expert-panel-why-decumulation-is-a-challenge-for-caps/

## 9. 'Risk Free' Interest Rates - Government Bonds

| August 25 , 2021 | Current Rate | Previous Month |
|---|---|---|
| 3-Month Treasury Bill | 0.18% | 0.17 |
| 1-Year Treasury Bill | 0.28% | 0.36% |
| 2-Year Treasury Bond | 0.46% | 0.45% |
| 5-Year Government Bond | 0.88% | 0.88% |
| 10-Year Government Bond | 1.25% | 1.24% |
| 30-Year Government Bond | 1.81% | 1.77% |
| | | |
| Prime Rate | 2.45% | 2.45% |

There is a significant disconnect between what people are experiencing with respect to higher spending on food, gasoline, and other goods vs. CPI. An adjustment for higher inflation for OAS is on the way.

The Prime Rate which is set by the major Canadian banks, is unchanged at 2.45%. An increase in prime rate will have an immediate impact on many people with variable-rate mortgages etc.

**Commented [gw1]:**

The BoC increased its inflation forecast for the rest of 2021 to 3%. Projected inflation for 2022 has also been increased from 1.6% to 2+%. Both appear to be optimistically low at this point.

The 'real rate of return" is defined as the current risk-free rate less inflation. Real rates of return have been negative in many parts of the world for some time.

Negative real returns mean that investors experience declines in the purchasing power of their investments. Negative real yields have occurred in the past e.g., in the 1930s, 1940s, 1970s, and early 2000: overall, about a third of the time since 1927. They pose significant challenges for government and personal spending and investment policies.

The issue for investors is that offsetting the loss of purchasing power to achieving positive real returns can only be achieved by taking on additional investment risk.

***Tax is a critical aspect of retirement and financial planning.***

The investment industry continually churns out new investment products (with little performance history). The government also provides many different types of benefit programs. Your advisor, if you have one assisting you with retirement planning, will know about new investment offerings and, if you qualify and the details about government programs. The advisor should also be aware of the tax rules and requirements regarding all types of investments to assist you in filing your tax return.

Having a formal financial plan in place minimizes retirement problems and stress. It leads to better financial and estate planning decisions. For example –"Should you invest in insurance company segregated mutual funds?" or "how much can I spend without damaging my retirement savings?" An 'informal' plan is not effective - things often change with unexpected consequences. Most importantly, to be effective a financial plan must have a comprehensive tax component. Most don't!

Consider using an experienced person with a comprehensive financial model to develop your financial plan. Avoid paying advisor fees based on the value of your investments. Use an advisor who provides good service and charges a flat annual fee (generally $500- $1500 per year).

If you would like to see information on specific topic in a future Newsletter or, to be removed from the mailing list, please let me know.

Previous Newsletters and additional pension information is available at https://www.thepensionadvisor.info/

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