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THE NEWSLETTER OF MONEY MANAGEMENT AND FINANCIAL PLANNING IDEAS

Planning Ahead

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FOCUS ON INSURANCE

You share a life together, so why not share life insurance?

Couples looking to reduce life insurance costs may want to explore the possibilities of a joint term life policy.

The main attraction. A joint policy is a great way to make sure your family is covered should either partner pass away prematurely and will cost less in premiums than two individual policies. A joint first-to-die policy, for example, might be 10% to 20% lower in premiums than two individual term life insurance policies.

Who they're for. Because the insurance benefits are paid when the first spouse dies, joint first-to-die policies are best for those who will be financially comfortable after the death of the first spouse, without needing continued life insurance coverage. Joint policies are attractive for couples who have shared financial obligations, such as a mortgage or the expenses of child-rearing.

It's all about coverage. Because the surviving spouse will be left uninsured, it's essential that your joint life policy provide a sufficient payout to meet that spouse's financial needs well into the future and protect any dependent children in case that spouse also dies prematurely.

They're not for everyone. You should also be aware of the disadvantages of joint policies. For example, in the event of divorce, a joint policy can't be split; two individual policies are easier to deal with.

We'd be happy to explore whether a joint term life policy is a good choice for meeting your family's life insurance needs. ■

Asset location: Sometimes it's personal

It's common to hear about asset allocation, but asset location, not so much. Yet asset location is very important — it's all about determining the most suitable investment vehicle for each mutual fund you hold.

To start, you're generally best off taking full advantage of the tax breaks the government gives you by contributing your maximum allowable amounts to your Registered Retirement Savings Plan (RRSP) and Tax-Free Savings Account (TFSA). But when you have both registered and non-registered accounts, a number of factors come into play that can influence which types of investments go where.

Usually we base asset location on what's most favourable from the tax perspective, in order to maximize after-tax returns. But it's also important to take into account your personal investment objective and time horizon, which can change things.

Here are three scenarios using the exact same investment, but with three different asset location outcomes.

SCENARIO 1

Thomas and his RRSP

Thomas, 40, is building his retirement nest egg and invests $5,000 in a Canadian short-term bond fund as part of his fixed-income portfolio. He holds this investment in his RRSP. Thomas is following the tax-smart asset location guideline to hold fixed income in an RRSP and equities in a non-registered account.

In a non-registered account, interest income is taxed most heavily, at the same rate as employment income. Equities are more favourably taxed, with tax payable on 50% of capital gains, and only when realized. Canadian dividend-paying funds also receive favourable tax treatment, thanks to the dividend tax credit.

So Thomas holds more lightly taxed equity and Canadian dividend funds in his non-registered account, since he'd lose their tax advantages in his RRSP. And he keeps more heavily taxed fixed-income funds in his RRSP, where they can grow on a tax-deferred basis until withdrawal. Since Thomas is only 40, that could easily be 25 or 30 years in the future.

SCENARIO 2

Veronika and her TFSA

Veronika is saving up for a family trip to Europe. She puts $5,000 into a Canadian short-term bond fund that she holds in her TFSA. Her TFSA is ideal for this purpose — the money can grow tax-free, she can withdraw it tax-free, and she can replenish the funds starting the year after the withdrawal.

The funds you hold in a TFSA are dictated by your investment objective and, of course, your available contribution room. In Veronika's case, her low-risk choice suits saving for a trip. Low-risk funds would also be appropriate for an emergency fund.

TFSAs aren't just for short-term goals, however. In fact, when the goal is long term, it suits many investors to choose funds with the highest potential returns for their TFSA. The higher the returns, the greater the tax would have been if earned outside a TFSA.

SCENARIO 3

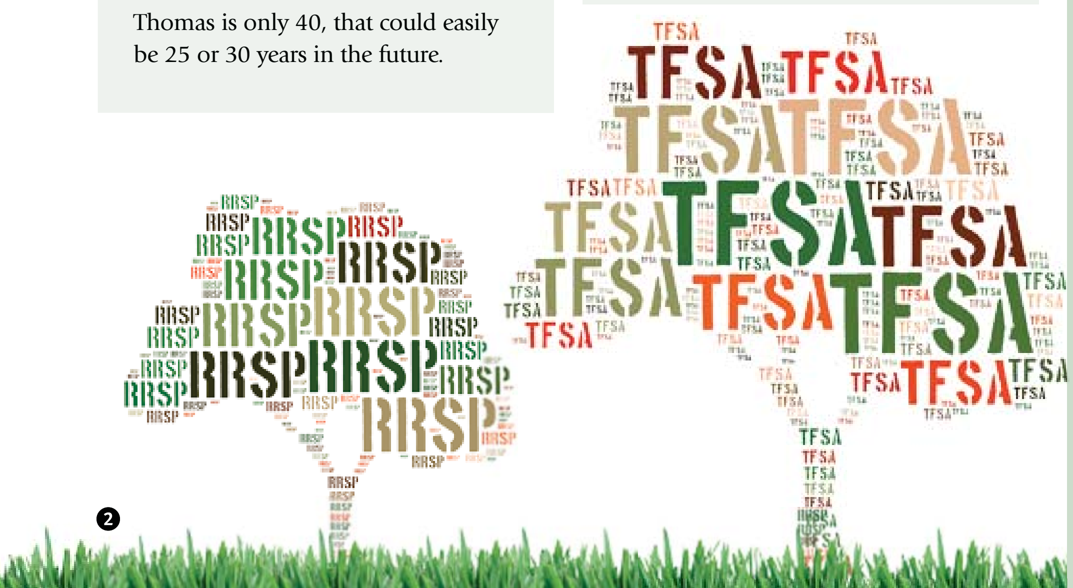
Amir and his non-registered account

Amir is four years away from retirement. He makes a large fixed-income investment in his non-registered account, including $5,000 in a Canadian short-term bond fund. It's part of a plan Amir and his advisor put together to protect against the risk of a market downturn in these critical upcoming years. He invests in short-term bonds because they had positive returns during the 2008 market crisis, though he recognizes that past performance may not indicate future results.

The overall plan revolves around funding the initial years of Amir's retirement. He's going to begin drawing retirement income from his non-registered account, so that's where he is now placing this lower-risk investment.

Locating your mutual funds are especially helpful in managing asset location. Investments can be assigned to an RRSP, TFSA, or non-registered account with only a few decisions. In addition, fund companies provide tax slips identifying distributions by type of income, which helps in making tax-related asset location decisions.

We're here to help ensure your funds are in the vehicles that meet your personal investment objectives while taking advantage of potential tax benefits. ■



INVESTING STRATEGY

Tax refund? Oh, the choices

Expecting a tax refund? If you apply it strategically, you can stretch that money — even triggering tax deductions, savings, and grants. Here are six ways to make the most of your money.

1. Pay down debt

Use your refund to pay down debt on a credit card, and you'll effectively gain an after-tax rate of return equal to the interest rate. At a 20% interest rate, that's a 20% return.

2. Contribute to your RRSP

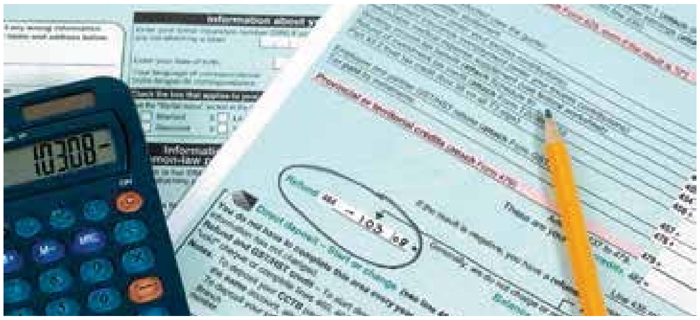
Turn your refund into a tax deduction by applying it to your 2015 Registered Retirement Savings Plan (RRSP) contribution (presuming you have sufficient contribution room available). At a marginal tax rate of 35%, a $2,000 RRSP contribution results in a $700 tax benefit.

3. Contribute to an RESP

If you have children, you may be using a Registered Education Savings Plan (RESP) to set money aside for their future post-secondary education. Depositing your refund may enable you to get "free money" from the federal government, in the form of the Canada Education Savings Grant (CESG). The CESG adds 20% to the first $2,500 contributed to an RESP annually.

4. Contribute to your TFSA

Contribute your income tax refund to your Tax-Free Savings Account (TFSA) and it will grow tax-free. A one-time contribution of $2,000 earning 5% compounded annually will generate more than $550 in five years.



5. Add to your non-registered investment account

Invest in equities and Canadian dividend securities in a non-registered account, and the investment income generated will be more favourably taxed than interest income.

6. Make a charitable donation

When you donate your tax refund to charity, not only will you be doing a good deed, but you'll qualify for a charitable donation tax credit. The federal credit is 15% on the first $200 donated and 29% on contributions above $200. In addition, if you haven't claimed the credit in the past five years, you may be eligible for the First-Time Donor's Super Credit, for an additional 25% on the first $1,000 donated.

Want to talk over your available choices? We can help you turn your tax refund into a long-term gain. ■

Source: Canada Revenue Agency (Cra.gc.ca)

TAX PLANNING

Sometimes, splitting with your spouse is a good thing

The new Family Tax Cut has put income-splitting in the news. Available for 2014 tax filing, the Family Tax Cut provides a non-refundable tax credit of up to $2,000 for eligible couples with minor children based on the net reduction of federal tax that would be realized if up to $50,000 of the higher-earning spouse's taxable income was transferred to the lower-income spouse.

But there are also some not-so-new income-splitting strategies that might enable you and your spouse to save tax.

Tax-smart investing. A lower-income spouse who contributes to family expenses often has little or no money left to invest. But if the higher-income spouse pays all the bills and household expenses, it may free up the earning of the lower-income spouse for investing. In a non-registered account, the resulting investment income will be taxed at the lower-income spouse's lower rate.

Spousal loans. The higher-income spouse can lend money to the lower-income spouse to invest. As in the previous strategy, the resulting investment income will be more favourably taxed. Note that the loan must charge interest at a rate that is at least equivalent to the government's prescribed rate, which is currently just 1%. The interest must be paid no later than 30 days after the end of the year and reported as income by the spouse who made the loan.

TFSA times two. The higher-income spouse can contribute to his or her own Tax-Free Savings Account (TFSA) and give his or her spouse the funds to contribute to a TFSA as well, resulting in more money in a tax-sheltered environment.

Spousal RRSP. If you and your spouse will be in different tax brackets during retirement, you can open a spousal Registered Retirement Savings Plan (RRSP) now for a tax advantage in retirement. Pension-income-splitting allows you to split up to 50% of eligible pension income, but with a spousal RRSP you can split more than 50% of retirement income.

Remember that tax strategies can be complex, so before implementing any of the above, we recommend that you consult with your professional tax advisor. ■

Give your kids a head start, with life insurance

What's one of the most valuable gifts you can give your children to help them get off to a good start in life? Believe it or not, the answer may be life insurance.

Purchasing life insurance when your children are young can give them a head start on insurance protection that can last a lifetime. It's also a great way to increase your children's financial options as they grow older. And in most instances, coverage for a young, healthy child is very affordable.

Life insurance for children provides the basis for coverage that can continue when they are adults. Down the road, your children are likely to appreciate your foresight at a time when they may have high expenses and it may be difficult to find money to start life insurance coverage from scratch.

Guaranteed insurability

Arranging coverage early in life can also help avoid problems your children might have obtaining insurance when they're older. Many companies offer options that guarantee the insured's right to purchase additional insurance in the future without having to pass insurability tests. This can be a huge relief for someone who develops a medical condition in adulthood that would otherwise make him or her uninsurable or make insurance extremely costly. Some career or lifestyle choices can also make it difficult to obtain coverage. If your child makes one of those choices, life insurance will already be in place.

Cash value

If you opt for insurance that has a cash value, you're building up a source of funds that your child can use in the future. Your child could use it for education funding or perhaps for the down payment on a home. The policy does not have to be cashed in order to access its value. The cash value can be used as collateral for a loan. It's important to be aware, however, that the value of the policy will be reduced by the amount of any loan outstanding.

If your child doesn't need the cash, the investment portion of the policy continues to grow tax-advantaged for your child's later benefit.

Financial support for your family

In the unlikely event that anything does happen to one of your children, life insurance can prevent you from suffering financial hardship in addition to your emotional loss. You may want to take time off work, beyond your employer's allowed bereavement leave, and the tax-free insurance funds could give you the flexibility to take as much time as you need.

In addition, you might need the money to cover outstanding medical bills if your child was ill for an extended period.

Take action today

There's no better time than now to talk to us about life insurance coverage for your children. We can show you how buying a policy today can provide your children with a brighter tomorrow. ■

Creating a tax-smart inheritance

There may come a time, either approaching or during retirement, when you have a certain amount of savings earmarked for your heirs. Ordinarily, these would pass through your will to your intended beneficiaries. But there may be a better way.

When these funds are fixed-income investments in a non-registered account, interest income is fully taxable each year at your marginal tax rate. With a few simple steps, you can move these funds into a tax-sheltered environment, resulting in a larger inheritance for your loved ones.

How it works

The vehicle is a universal life insurance policy, which includes both an insurance and investment component. You make a series of deposits over time, with part of the deposit covering the insurance premium and the rest invested.

You have a wide choice of investments, including fixed-income and guaranteed choices suitable for the inheritance. No tax is paid on investment income within the policy — that's the key benefit of this strategy.

The net result

With this strategy, your heirs receive the proceeds of the insurance policy directly, without delays of estate administration. This includes the balance in the tax-exempt investment component as well as the life insurance portion — so if you purchased a $500,000 policy, that's $500,000 for your loved ones. All proceeds are tax-free. Sound like something that might suit your estate planning needs? Then give us a call to talk about this tax-saving inheritance strategy. ■