October - December 2014

Assante® WEALTH MANAGEMENT

Be well-advised.

MONEY *matters*

GUARANTEED INCOME IN A LOW INTEREST RATE ENVIRONMENT

Interest rates in Canada rose fairly steadily from 1957 to 1981* with the prime lending rate reaching an all-time high of 22.75% in August of 1981. From that point on, Canadians experienced a declining interest rate environment from 1982 to 2012. While this has been a boon for those holding mortgages and debt, it has negatively impacted retirees relying on fixed income investments for their retirement income and conservative investors who have opted for higher fixed income and GIC holdings in their portfolios to reduce risk and exposure to stock markets. The ten year government of Canada bond yield stood at 2.16% at the end of September 2014 and 5 year GICs paid an interest rate of 2%.

While there is talk about interest rates starting to move up in 2015 once the Federal Reserve in the U.S. starts hiking rates, this is more likely to impact short term interest rates. Given the fact that inflation rate in Canada is low (2.10% at the end of August 2014) and is expected to stay low for an extended period of time, the low interest rate environment with regards to long term rates could continue for the foreseeable future.

So what should investors seeking yield do to get higher rates of return without exposing themselves to undue risk? Understanding how a low interest rate environment impacts your retirement income and putting in place proper asset

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"Even in a low interest environment like today, life annuities can provide the highest level of guaranteed income for as long as you live, in the most tax effective manner."

allocation and guarantees in place to manage the risk of outliving your money in retirement are key issues to be considered in your financial planning at this juncture.

One of the instruments overlooked by many Canadians that can be useful in this kind of environment, are life annuities. Even in a low interest environment like today, life annuities can provide the highest level of guaranteed income for as long as you live, in the most tax effective manner.

Annuity income is made up of three components: interest rates, insurance credits, and return of premium. The greatest portion of annuity income over time could be made up of the insurance credits. This is particularly true for those who live beyond their normal life expectancy and since life expectancy has been steadily on the rise in Canada in the last few decades, this could be true for many Canadians.

While many people think that interest rates have the greatest impact on the income they receive from life annuities, it is in fact not true. Interest rates actually affect the income you can receive from a life annuity less than you may have expected. You may be surprised to learn that a rise in interest rates from 2% to 2.5% will not result in a proportional increase of 25% in the income you can expect from a life annuity.

The improvement in the after tax income from an annuity compared to investing in a GIC or bond can be dramatic. For example a 77 year old female, who purchases a $100,000 life annuity with no guarantee (i.e. if she passes away the insurance company would keep the balance of the funds), can receive $8818 after tax income per year or 8.81%. If she is in the highest marginal tax bracket of 46.4%, she would have to earn $16,451 per year from a GIC or bon, or 16.45% per year equivalent before tax interest to equal the results of the life annuity.

Of course, if she invested her money in a GIC or bond, then her heirs would inherit the balance left in her account upon her death but if she purchases a life annuity with no guarantee then her heirs will receive nothing. To remedy this she can purchase a life insurance policy with a $100,000 death benefit that would replace the principal amount that she had paid to purchase the life annuity upon her death and this way her estate would not shrink.

In the example above, the cost of a $100,000 life insurance policy for a healthy 77 year old female would be $5930 per year. Therefore, the net income from the life annuity would be $2888 ($8818 - $5930) or 2.88% net of taxes. To earn 2.88% net of tax, she would need an annual rate of return of 5.39% in a GIC or bond. Therefore, purchasing a life annuity combined with a life insurance policy to guarantee the principal for heirs on death, could improve the after tax return by 115.53% in this case. The older you are the more significant the improvement would be over investing in bonds or GICs.

The following table shows a comparison of the life annuity backed by a life insurance policy with a GIC or bond with 2.5% annual rate of return.

	GIC	Insured Annuity
Deposit Amount	$100,000	$100,000
Annual income from investment*	$2,500	$8,818
Taxable income from investment	$2,500	$0
Marginal tax rate	46.40%	46.40%
% of income that is taxable	100.00%	0.00%
Tax due	$1,160	$0
After-tax income	$1,340	$8,818
Cost of insurance	$0	$5,930
Net income	$1,340	$2,888
Net return	1.34%	2.89%
Gross equivalent rate**	2.50%	5.39%
% improvement over GIC		115.53%

The downside to investing in life annuities is that once you have committed your money you would no longer have access to your funds. In effect you will be exchanging your cash with a guaranteed pension-like income and your decision is irreversible. Therefore, this is a strategy that works best when used in combination with other types of investments and income sources to ensure that you have the desired flexibility and liquidity in your retirement years.

The life annuity part of your income mix will give you a guaranteed lifetime income while your investment portfolio can provide you with liquidity and market exposure, therefore creating a more balanced and sustainable investment portfolio.

Including a life annuity in your retirement income mix will also help you limit your market exposure and minimize the sequence of returns risk – the risk of depleting your portfolio by starting to withdraw funds in a dropping market environment.

Most importantly, with the higher income generated by a life annuity you can protect yourself against longevity risk, or the risk of outliving your money.

Therefore, be sure to look at life annuities as a viable alternative to be considered for your retirement income mix and discuss the pros and cons with your financial advisor.

- *Source: Bank of Canada, Data and Statistics Office, 2012
- ** This advantage isn't applicable to Quebec, where

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notarial wills don't need to be probated, and holograph wills and wills made in the presence of witnesses have minimal probate fees.

THE NEW SMALL BUSINESS JOB CREDIT (SBJC)

On September 11, 2014, Finance Minister, Joe Oliver, introduced the new Small Business Job Credit (SBJC). This credit will reduce the EI bill of small businesses paying under $15,000 in EI premiums (or about $570,000 in EI assessable payroll) by 15% in 2015 and 2016.

This is welcome news for small businesses as this credit will save small business owners over $500 million over the next two years. The government says almost 90 per cent of all E.I. premium-paying businesses in Canada will receive the credit.

Currently the EI premium that small employers have to pay is 1.4 times the employee rate, but for the next two years, small employers will pay 1.2 times the employee rate. The credit will be automatically administered by the Canada Revenue Agency, meaning businesses will not have to apply.

In 2017, employees and all employers (small and large) will see an even larger EI rate cut."All employers and employees will benefit from a substantial reduction in the EI premium rate in 2017 when the new seven-year break-even rate-setting mechanism takes effect," states a Department of Finance news release.

TRANSFER YOUR WEALTH TO THE NEXT GENERATION GRADUALLY

Many people who have minor children or beneficiaries with no money management expertise struggle with how best to transfer their wealth to the next generation without the risk of their heirs spending it frivolously and depleting the wealth that was accumulated by hard work over many years and was meant to protect the future of their heirs.

While you can set up trusts in your will and direct the distribution of assets by your executor to ensure against this risk, another alternative is to use annuity settlement options offered by life insurance companies. By using this option you can automatically transfer the death benefit of an insurance-based investment to an annuity for the beneficiary.

This solution is ideal in the following situations:

- You want your beneficiaries to receive the money you leave for them over a period of time or at a certain age because you have concerns about their spending habits or lack of money management expertise.
- You have minor or financially dependent beneficiaries.
- You want some beneficiaries to receive the money all at once, and others to receive it gradually.
- You want to leave money to a charity by making annual donations
- You want to control how your legacy is distributed
- You want your legacy to skip a generation and go directly to your grandchildren.

If you own a life insurance policy, segregated funds or term certain annuity contract issued by a life insurance company you can achieve any of the above objectives by simply choosing the annuity settlement option by way of completing a simple form. This will allow you to gradually distribute your inheritance to your beneficiaries without setting up a formal trust and with no fees.

By choosing the annuity settlement option, the death benefit from your life insurance or segregated fund policies is used to purchase an annuity which is a series of regular, periodic payments that provide a steady, reliable source of income for life (life annuity) or for a specified period (term certain annuity).Since the annuity income is paid to a name beneficiary, it will not form part of your estate and it will bypass probate and estate administration fees**.

Since beneficiary designations are not public information (unlike wills), only you, the insurance company and your beneficiaries will know about the arrangements made. This can be very attractive if you want to distribute assets to one beneficiary over time and to others in a lump sum. This way you can ensure that information is not included in your will and stays private and only the affected beneficiary knows about it.

The annuity settlement option is very easy to set up and can be changed at any time if you change your mind with regards to the way you want your estate to be distributed.

PLAN YOUR CHARITABLE DONATIONS BEFORE YEAR END

To be able to claim a tax credit for charitable donations on your 2014 tax return you need to make your donations by December 31, 2014. Donations made to charities in Canada are eligible for a charitable donation tax credit. The first $200 of your donations is eligible for a tax credit equivalent to 15% of the donation amount. Depending on your province of residence you can also claim a provincial tax credit of 4% to 20% of the donated amount. On average this amounts to a 25% tax credit, which means that you save $50 on a $200 charitable donation.

If your donations exceed $200, then you will receive a 29% federal tax credit and will be eligible for a provincial tax credit of 11% to 24%, resulting in an average refund of 45% of your donation.

Since you receive a tax credit that reduces the amount of taxes that you owe, rather than deduction from income, when you make a charitable donation, the tax savings are the same no matter what tax bracket you may be in.

If you cannot use your tax credits in the year of your donation, you can carry forward your donations for five years. While during your lifetime, you can claim charitable donations up to 75% of your net income, the tax credits are more generous after your death. In the year of your death, you can claim donations of up to

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100% of your net income and can carry back any excess donations to offset 100% of your income in the preceding year. If you make a donation through your will it will be treated as if it was made immediately before your death and can be deducted on your final return. Plus you will have the ability to carry back any excess donations to offset 100% of your previous year's income as well.

First-time Donor's Super Credit

The 2013 federal budget proposed a temporary one-time credit for first-time donors on up to $1,000 of monetary donations, in an attempt to encourage charitable giving by new donors. If a donor, or his/her spouse or common-law partner, did not claim a charitable donation tax credit or this new credit in any taxation year after 2007, the donor would be considered a first-time donor and would be eligible for this new tax credit.
The new 25% super credit will be added to the existing charitable donation tax credit, resulting in a tax credit rate of 40% on the first $200 of donations and 54% on the next $800. The new credit applies to donations made after March 21, 2013 and before 2018. The maximum limit of $1,000 applies to both individuals and couples, so that there is no doubling of the credit for couples.
To maximize the tax credit, donors may want to carry forward and not claim smaller donations until the $1,000 threshold is reached as this is a one-time credit.

ABOUT THE EDITOR

Tina Tehranchian MA, CFP, CLU, CHFC, is a Branch Manager and Senior Financial Planner with Assante Capital Management Ltd. is one of Canada's largest wealth management firms, offering integrated financial solutions to create wealth and prosperity for you and your family. Our 900 www.assante.com advisors in 300 offices across Canada take pride in the exceptional service they offer to clients through trusted face-to-face relationships and a level of service excellence second to none. Money Matters is published as a special service for clients of Tina Tehranchian.

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Igniting the Spark
In Your Relationship

The Joy of Aging 2014 Panel of Experts:

- Dr. Jessica O'Reilly
- Dr. Michelle Crispe
- Dr. Stacey L. Grossman
- Dr. Oren Amitay

Sunday, November 9th, 2014
9:30 am—1:00 pm
Bellvue Manor, Vaughan

www.TheJoyOfAging.ca
Single Tickets $75, Table (10) $650

*Healthy Breakfast * Information Booths * Silent Auction * Gift Bags

905.707.5220 info@TheJoyOfAging.ca

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Richmond Hill Branch

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"Since you receive a tax credit that reduces the amount of taxes that you owe, rather than deduction from income, when you make a charitable donation, the tax savings are the same no matter what tax bracket you may be in."