

# The Personal Financial Advisor

## In This Issue

AUGUST  
GYRATIONS... 1

SECOND  
PROPERTY  
STRATEGIES  
..... 1

TAX SAVINGS  
OPPORTUNITIES  
IN THE 2007  
BUDGET..... 2

A POSITIVE  
LIFE AND  
DEATH  
SITUATION  
..... 3

IS SOCIALLY  
RESPONSIBLE  
INVESTING  
FOR YOU?... 4

A FINAL WORD  
ON THE 2007  
FEDERAL  
BUDGET ..... 5

## AUGUST GYRATIONS

Chris Snyder, CFP, RFP

Many, including ourselves, have for some time been predicting a downturn in stock markets. What we did not know was the event that would trigger it.

The stock markets in August have been on a roller coaster ride. The TSX was down close to 12% from its high, although it has since rebounded considerably and is off about 6%. This has knocked the returns for the year-to-date to around zero.

The events of August are proof that when excesses develop, mechanisms are in place to correct them and bring them back in line. In this case, a credit crunch has developed around sub-prime loans, primarily in the US. With loans exceeding the value of the underlying assets (in many cases real estate), and people unable to service the loans, we will see a lot of reclaimed assets, losses to corporations, less money to lend and higher interest rates. (We note that the U.S. Federal Reserve has slightly lowered interest rates and has pledged to do everything it can to minimize the credit crunch).

This squeeze could result in lower earnings of companies across the board but the underlying fundamentals are still strong:

- low unemployment and wage gains
- healthy corporate balance sheets and earnings growth
- inflation appearing under control
- historically low interest rates
- easing of credit by central banks

Market gyrations such as we saw this summer create plenty of opportunities, and prudent investment managers who saw this coming and had cash will be able to make some good purchases.

We anticipate there will be continued volatility for several months and probably flat returns for a while. But after several years of strong returns, we believe a pause is in order.

As always, broad diversification in your portfolio will minimize losses.

## SECOND PROPERTY STRATEGIES

Fabio Ventolini, CFP, CDFA

There are several reasons why you might want to purchase a second property. Perhaps you need a place for summer or winter vacations, or a country getaway. Or, if you travel a great deal to a particular place, you might want to purchase a residence rather than rent. Whatever the reason, one thing is certain: second properties bring tax issues. They

also raise important questions for the owner. What happens when I sell? Can I claim the principal residence exemption? And can I pass the property on to my children?

### Principal Residence Exemption

If you sell a second property, you may trigger a capital gain if its value has increased since you

*continued on page 8*

# TAX SAVINGS OPPORTUNITIES IN THE 2007 BUDGET

Vicki Lungu, CFP

The new income-splitting provisions of the 2007 federal budget have created additional opportunities for reducing current taxes and preserving your estate.

Retroactively to Jan. 1, 2007, Canadian residents with an income of more than \$2,000 that qualifies for the pension tax credit can allocate up to 50% of that income to their spouse or partner.

Income that qualifies for pension-splitting depends on the age of the recipient, as follows:

## For recipients under age 65

- income received from a Registered Pension Plan (RPP) and Deferred Profit Sharing Plan (DPSP).

## For recipients over age 65

- income received from an RPP and DPSP;
- annuity payments from an Registered Retirement Savings Plan (RRSP) (under an annuity contract from a life insurance company) and certain foreign-sources pensions (U.S. social security and U.K. pension income);

\* withdrawals from Registered Retirement Income Funds (RRIF), Locked-in Retirement Income Funds (LIFs).

The following types of income are not eligible: Old Age Security (OAS), Guaranteed Income Supplement, Canada and Quebec Pension Plans, RRSP withdrawals and income from retirement compensation arrangements.

Unlike Canada Pension Plan income-splitting, the receiving spouse does not have to be 65 or older and the amount allocated can be changed each year. Very good news indeed!

The new rules allow for taxable income equalization by shifting income to the lower income spouse to be taxed at a lower marginal tax rate.

It has been standard advice that one should defer taxes as much as possible upon retirement by generating income from non-registered assets first and then, from your registered plans. This may no longer automatically apply.

The income equalization rules allow you to take more out of a registered plan and pay less in taxes by shifting the income to the lower income spouse. If the income is not required, you could simply transfer the assets from the RRIF account, in kind, to a non-registered joint account.

This strategy works best for those with lower taxable incomes or if one spouse is in a higher tax bracket and the other is in a lower.

For example, let's assume that you and your spouse have \$30,000 taxable income. You are both 65 and have about \$500,000 in your RRSP accounts. You could transfer the RRSP accounts to RRIF accounts and start receiving payments at age 65. The minimum amount to be withdrawn in the first year is \$20,000 and increases each year. The minimum payment at age 65 is 4% of the fair market value of the portfolio and at age 75 is 7.85% of the fair market value. If you do not have any other pension income, receiving income from a RRIF would also qualify you for the pension tax credit, which is about \$400 per person. This will reduce your tax by \$400 per person.

Taking out more money now at lower rates could also preserve your estate. Any amount left in a registered account after both spouses die would be taxed at top marginal rates in the year of death.

For a RRIF account valued at \$250,000, the tax liability could be as much as 46.41% or \$116,000.

If you want to implement this strategy, remember:

- You do not have to transfer the whole RRSP account to an RRIF before age 71. If it makes sense from a tax point of view, do a partial transfer, keeping in mind that you must withdraw a minimum payment.
- Keep your net income under \$63,000. If your net income is more than \$63,512, the OAS starts to be clawed back at a rate of 15%.
- You do not actually have to cash in your RRIF investments. You could transfer them in kind to a non-registered account and use the money as needed.

\* Assets generating interest income (GICs and bonds) are best left in the registered plan.

Consult your financial advisor before making any changes. Careful tax planning could save you thousands of dollars. Good luck!

# A POSITIVE LIFE AND DEATH SITUATION

Ian G. Johnson, CFP, PRP

Ron, 66, and Rachel, 64, are retiring. They are looking forward to having leisure time to travel, go sailing and be with their grandchildren. To add to their excitement, they are selling their home and buying a luxury condominium. While they love their home and garden, they want the freedom to come and go without the worry and time and energy required to maintain a large house.

They calculate the proceeds from the real estate downsizing will net them approximately \$200,000, which they wish to use to supplement their income. They will have government pensions as well as their modest private pensions. They also have some savings set aside, including bonds and balanced funds in a Registered Retirement Savings Plan that will be transferred to a Registered Retirement Income Fund when needed.

Both Ron and Rachel are conservative investors. They know what inflation can do to their income flow over time, but they view the current stock market decline and volatility with considerable concern. How can they avoid market risk and yet obtain a decent rate of return that is tax-efficient? A monthly GIC will produce a return of perhaps 4.75% but they need more. And they wish to leave their children with some financial benefit upon their death. Their financial advisor has suggested an insured annuity — sometimes called a guaranteed income plan or an estate bond.

## The Insured Annuity

The insured annuity has two components — a “prescribed” life annuity and a life insurance policy. Together they will:

- Maximize income throughout retirement;
- Guarantee the safety of the investment;
- Preserve the capital for the beneficiaries;
- Be very tax efficient.

This sounds almost too good to be true, so how does this strategy work? It appears Ron and Rachel are fit and healthy and therefore insurable. They would apply and obtain a joint “last to die” permanent life insurance policy — such as Term to 100 or Universal Life — for \$200,000. They would name their children as the beneficiaries.

With the \$200,000 net proceeds from their real estate transactions, they would purchase a joint last to die prescribed life annuity, which typically provides more after-tax cash flow than the interest on a GIC. This is because a prescribed annuity pays a blend of interest and capital, with tax payable only on the interest portion. On a GIC, the

income earned is fully taxed as interest. The annuity income is fixed, 100% guaranteed and payable to both Ron and Rachel for as long as they live.

The prescribed annuity produces enough income to cover the life insurance premiums and yet provide additional income for Ron and Rachel at a considerable tax advantage. Their children will receive the \$200,000 death benefit tax-free upon the death of their last surviving parent. The insurance proceeds may even be greater than \$200,000 if using the Universal Life investment option is successful.

The following is a comparison example of this strategy:

	<b>Insured Annuity</b>	<b>GIC (4.75%)</b>
Investment	\$200,000	\$200,000
Annual Income *	\$13,149	\$9,500
Annual Tax Portion *	\$4,779	\$9,500
Tax Payable (45%)	2,150	\$4,275
Annual Insurance Premium **	\$3,304	N/A
Net Annual After-Tax Cash Flow	\$7,671	\$5,225
Annual Income Difference	\$2,446	---
Equivalent Pre-tax Yield	6.97%	4.75%

\*On prescribed annuity, income tax applies only to the taxable portion, which is an estimate only, based on the current Income Tax Act and regulations. The income rate is based on an annuity for life with no guaranteed payments after both deaths.

\*\* Annual premium quoted for both non-smokers on Term to 100 policy with premiums paid until the first death.

Ron and Rachel can increase their net income by \$2,446. Equivalent to receiving income from a GIC earning almost 7% before tax. The after-tax cash flow calculated above will be further enhanced when the pension income credit (recently increased from \$1,000 to \$2,000) is factored in.

## Cautions

This strategy may not fit everyone’s plans. First, you must be in good health and therefore insurable. Then you need to understand that you lose access to your capital unless, in an extreme case, you may be able to use the policy as collateral for a loan. This would jeopardize the eventual death benefit payable to your beneficiaries.

*continued on page 4*

## A POSITIVE LIFE AND DEATH SITUATION

Arranging the insured annuity is somewhat complicated since both the annuity and the life insurance must be written independently. The issuance of the policy cannot be contingent on the purchase of the annuity and not all insurance companies will handle both products at once.

However, for retired clients or those about to be retired like Ron and Rachel, the insured annuity can supplement income and yet guarantee the preservation of capital. It can provide a long-term enhancement to one's retirement lifestyle. If you think your circumstances could fit this strategy, contact your advisor for advice and quotes.

## IS SOCIALLY RESPONSIBLE INVESTING FOR YOU?

Chris Snyder, CFP, RFP

With environmental issues and climate change appearing on the front pages of every newspaper daily, more and more people are beginning to think about the social and ethical aspects of their investments.

While we may think of socially responsible investing as a relatively new phenomenon, it actually dates back thousands of years. In biblical times, Judaic laws laid down directives on how to invest according to ethical values. In the 18th century, the Quakers, who believe in human equality and nonviolence, practised socially responsible investing and became key catalysts in the abolition of the slave trade. However, it has only been in the last 20 or 30 years that socially responsible investing has become universally popular.

This shift started largely because of the changing social climate in the U.S. in the late 1960s. Key factors in this change were growing opposition to militarism, the swelling U.S. civil rights movement and author Rachel Carson's wake up call on the environment in her book, *Silent Spring*. Apartheid in South Africa raised the ire of much of the world and many western hemisphere churches began questioning whether the companies in which they invested their money were helping to support apartheid policies.

The term socially responsible investing immediately raises the basic question — what is it? In fact, it raises as many questions and contradictions as there are answers. For example, certain banks appear on many socially responsible investment platforms, yet banks anger many people who object to their interest rate policies, tied selling and “nickel and diming” with fees. Yet overall, banks have well-established social policies and are major contributors to social causes in communities across the country.

Fortunately, some parameters have been established to help define socially responsible investing. In general, there are three components — screening, advocacy and community.

**Screening** — This involves choosing investments that either meet or do not meet certain ethical criteria. On the negative radar screen of Canadian asset management companies, the 9 most unacceptable areas for investment are tobacco, poor environmental practices, military weapons, gambling, pornography, nuclear power, a poor human rights record, bad labour practices and little community involvement. In our opinion, nuclear power generation itself creates questions, as one could argue that nuclear energy is cleaner and less expensive in the long run than coal. This, you could say, would make it a socially responsible investment.

On the positive radar screen are companies that:

- demonstrate open and effective corporate governance;
- promote sound environmental practices;
- uphold exemplary health and safety standards;
- provide good employment conditions;
- offer community and social development programs;
- respect the rights of indigenous people.

Some companies that demonstrate these characteristics are:

- Phillips Electronics, which produces TVs, VCRs, DVD players and other electronics and is also the leading manufacturer of high-powered LED. Its energy-efficient street lights use 50% less energy than traditional ones and have been adopted in many cities across Europe;
- PSA Peugeot Citroën, a French automaker that has developed a diesel electric hybrid engine that is 25% more efficient. The company has teamed up with BMW to produce small, high-tech gas engines;
- The Mackenzie Universal Sustainable Opportunities Fund includes companies such as Canon, Deutsche Bank, Mitsubishi, Swire Pacific, Vodafone and Zurich Financial Services.

## IS SOCIALLY RESPONSIBLE INVESTING FOR YOU?

**Advocacy** — Shareholder and other advocacy groups, including Greenpeace and the David Suzuki Foundation, use their influence to bring about positive social and environmental change in corporations. An example of such activity occurred about a year ago when Coca-Cola was criticized for ads showing a polar bear standing on an ice flow. Environmental groups upbraided the company because of its use of certain types of environmentally-damaging and climate-warming gases in its cooling systems. To make their point, the environmentalists showed the same ad with the polar bears, but on a shrinking piece of ice. Coca-Cola removed the ads and changed some of its policies.

**Community investments** — This generally relates to companies that are cause-related and could include, for example, those who have community loan fund programs; invest in micro-business or alternative energy companies; build world peace; demonstrate the dignity and value of all people; or are active in their community and practise environmental stewardship. The Royal Bank comes to mind with its community loan programs in Toronto, as does merchant banker Goldman Sachs, which turned huge tracts of lands it held in the South American Andes into a conservation area. Wal-Mart is a bit of a paradox. It is not liked by many because of its perceived poor labour practices and the way in which it overpowers small retail operators. On the other hand, in Ontario, Wal-Mart is buying its energy from Bull Frog, a company that supplies alternative and clean energy. Two other candidates in this category would be the Criterion Water Fund, run by Switzerland's respected Pictet Group, which invests in many facets of water, and Investco, a Toronto-based pooled fund investment whose portfolio contains a solar energy company, a water-pumping company and an organic milk company (their minimum investment is \$150,000).

While the practices of companies such as Enron and Tyco still linger in our minds, and the antics of people such as Conrad Black receive the headlines, it is a fact that business is more value-driven and ethical today than ever before. An increasing number of companies realize that not only is it good business to be socially responsible, it is the right thing to do.

### Growth and Monitoring

In Canada, socially responsible investment assets have grown from \$65 billion in 2004 to more than \$503 billion in 2006. Much of this new investing is led by public pension funds and most recently, the Canada Pension Plan has

integrated socially responsible investment policies into its investment criteria. In the U.S., the amount of money under management has risen to \$2.3 trillion or \$1 out of every \$10 under professional management.

Socially responsible investments can be monitored many ways but the most popular and respected analysis is carried out by Jantzi Research, which monitors the environmental, social and governance performance of global securities as well as their returns.

### How Have They Done?

When all is said and done, investors' main concern is the bottom line. The Jantzi Social Index tracks 60 Canadian companies with a history of ethical practices. Its figures show that for the seven-year period ending December 31, 2006, socially responsible investment company returns increased an average 8.58% annually compared to 8.11% for the Standard & Poors Index. The Dow Jones Sustainability Index has outperformed the MSCI World Index, returning an average compound annual rate of 13.4% versus the MSCI's average return of 12.4%.

The following chart, compiled by the Social Investment Organization, gives some indication of how socially responsible investment funds have fared compared with the general index.

Table 1

<b>CANADIAN EQUITY</b>	<b>1 yr.</b>	<b>3 yr.</b>	<b>5 yr.</b>
Acuty Clean Environment Equity	26.5	15.8	14.2
Acuty Social Values Cnd Equity	17.5	15.4	17.2
Ethical Growth	23.5	15.4	10.8
Generations Growth (Ethical)	21.9	13.9	9.3
Inhance Canadian Equity –A	21.3	NA	NA
Investors Summa	25.0	13.3	NA
Mavrix Sierra Equity	31.4	21.8	15.9
<b>CANADIAN EQUITY FUND</b>			
<b>AVERAGE</b>	<b>19.5</b>	<b>15.6</b>	<b>12.3</b>
<b>S&amp;P/TXS TOTAL RETURN</b>	<b>22.7</b>	<b>20.1</b>	<b>16.6</b>
<b>CANADIAN EQUITY PURE</b>			
Desjardins Environment	23.5	22.4	17.3
Ethical Canadian Index	21.1	NA	NA
GWL Ethics	25.0	18.8	15.5
London Life Ethics	24.2	18.2	14.4
Meritas Jantzi Social Index	22.3	17.2	15.4
PHN Community Values Cnd Equity	25.8	18.4	NA

continued from page 5

## IS SOCIALLY RESPONSIBLE INVESTING FOR YOU?

CANADIAN EQUITY PURE FUND AVG	21.8	17.7	13.9	Ethical Global Equity	17.1	6.5	3.9
S&P/TSX TOTAL RETURN	22.7	20.1	16.6	Inhance Global Leaders –A	18.9	5.1	NA
CANADIAN SMALL CAP EQUITY				Mackenzie Universal Sustainable Opportunities	19.6	9.9	4.5
Ethical Special Equity	11.7	18.7	18.8	PHN Community Values Global Equity	13.6	3.0	NA
CDN SMALL CAP EQUITY AVERAGE	20.2	18.1	16.4	GLOBAL EQUITY FUND AVERAGE	16.8	8.7	6.6
BMO NESBITT BURNS CND SMALL CAP INDEX	22.1	20.0	18.5	MSCI WORLD (\$CDN)	18.4	8.6	6.7
US EQUITY				CANADIAN BALANCED			
Ethical American Multi-Strategy	9.3	0.1	-0.5	Inhance Balanced A	12.8	8.3	NA
Generations North American Equity (Ethical)	7.5	-1.6	-2.1	Meritas Balanced	9.6	6.1	NA
Meritas US Equity	9.2	-1.8	-2.1	MLI Bal Ethic	11.5	6.8	6.1
US EQUITY FUND AVERAGE	12.2	3.3	3.0	Acuity Clean Environment Balanced	17.4	13.1	13.1
S&P 500 COMPOSITE (\$CDN)	15.0	3.4	3.1	Desjardins Ethical Canadian Balanced	11.4	7.0	5.6
INTERNATIONAL EQUITY				Ethical Balanced	13.9	9.5	7.2
Ethical International Equity	15.2	9.0	NA	Generations Balanced (Ethical)	12.3	8.0	5.8
Meritas International Equity	18.6	10.6	5.0	PHN Community Values Balanced	13.4	8.8	NA
INTNL EQUITY FUND AVERAGE	19.6	11.9	7.9	CDN BALANCED EQUITY FUND AVG	11.5	10.4	8.6
MSCI EAFE (\$CDN)	21.6	13.6	10.1	BALANCED INDEX (60% S&P/TSX, 40% SC BOND)	19.0	16.8	14.1
GLOBAL EQUITY							
Acuity Clean Environment Global Equity	15.6	6.3	5.8				
Acuity Social Values Global Equity	12.2	7.3	6.2				
Ethical Advantage 2040	14.7	NA	NA				

As you can see from these figures, having some socially responsible investments as a portion of your portfolio is a comparatively safe and responsible thing to do.

## A FINAL WORD ON THE 2007 FEDERAL BUDGET

Robert DeMelo, CFP

Most sections of the March 19 federal budget received royal assent on June 22, 2007, bringing in new provisions that will affect many of us.

The budget provided no changes to tax rates in any bracket, however, the capital gains deferral proposal was not part of the document. The tax on distributions from income trusts and other flow-through entities and the splitting of pension income and related tax measures that were announced on Oct. 31, 2006 will be implemented.

### FOR FAMILIES:

The government is introducing a \$2,000 annual child tax credit for each child under age 18, retroactive to Jan. 1, 2007. The tax credit will be calculated as \$2,000 per child

multiplied by the lowest personal income tax rate (15.5%). This works out to a maximum benefit of \$310 per child, and will be indexed for inflation.

The so-called "marriage penalty" has been eliminated by a proposal to increase the spousal benefit to provide up to \$209 of tax relief for a supporting spouse or a single taxpayer supporting a child or relative.

The maximum amount that can be contributed to a Registered Education Savings Plan (RESP) is being raised to \$50,000 per child from \$42,000. The \$4,000 annual limit for RESP contributions has been eliminated, which

continued on page 7

## A FINAL WORD ON THE 2007 FEDERAL BUDGET

means that some families may choose to make a lump-sum RESP contribution and shelter the growth. This could mean foregoing the government grant — however, benefits of tax-deferred compounding may outweigh the benefits of the grant.

The Canada Education Savings Grant (CESG) has been boosted from the previous \$400 a year to \$500. So for those without the resources to put a large lump sum into an RESP from the start, the optimum strategy might be to contribute \$2,500 a year, which would generate the new maximum grant of \$500. Previously, the optimum was to contribute \$2,000 a year in order to get the \$400 generated by the 20% grant.

If there is unused grant room because of contributions of less than the maximum in previous years, the maximum CESG for a year will increase to \$1,000 from \$800. The lifetime CESG limit per child remains at \$7,200.

### FOR BUSINESSES:

The lifetime capital gains exemption for farmers, fishermen and small business owners will rise to \$750,000 from \$500,000.

The budget proposes to allow small Canadian-controlled private corporations with taxable income at or below \$400,000 in the current or preceding year to pay tax instalments quarterly (instead of monthly) for taxation years starting after 2007.

### FOR SENIORS:

The age credit amount will be increased by \$1,000 to \$5,066 for anyone over age 65. This should provide about \$155 in extra tax relief this year for low and middle-income seniors.

The age limit for converting a Registered Retirement Savings Plan (RRSP) will increase to 71 from 69 for those Canadians who wish to continue working longer. Assuming they have sufficient RRSP contribution room, those who turn 69 this year will be able to make RRSP contributions in 2007 and 2008. Those who turn 70 or 71 this year will be able to make an RRSP contribution for 2007. Since the maximum annual RRSP contribution amount is now \$20,000 (for those with enough earned income), this means potentially \$40,000 in additional RRSP room. It also means a longer time for investments to grow on a tax-sheltered basis.

Those aged 70 or 71 may choose to transfer an existing RRIF back into an RRSP (as long as it's converted back to

a RRIF by the end of the 71st year). Also, the government will be waiving the required minimum withdrawals for both this year and next year for those annuitants who turn 70 or 71 in 2007.

### FOR THE DISABLED:

A new Registered Disability Savings Plan (RDSP), which commences in 2008, will help parents and others save toward the long-term financial security of people with severe disabilities. It will be similar to a Registered Education Savings Plan, with some government contributions and untaxed withdrawals. Eligible contributors will be able to save up to a lifetime maximum of \$200,000, with the last contribution during the year the beneficiary turns 59.

Annual RDSP contributions will generate Canada Disability Savings Grants at matching rates of 100% to 300%, depending on family income and a lifetime CDSG limit of \$70,000. Canada Disability Savings Bonds of up to \$1,000 a year will be provided to RDSPs created by low- or modest-income families. Starting in 2008, grants will be geared to family income, matching the first \$1,000 of contributions for those with net family income above \$74,357. For families with less income, grants will be triple the first \$500 contribution and double the next \$1,000 contribution. Maximum grants of \$70,000 and bonds of \$20,000 could be collected before the child reaches age 60. Government assistance and the income it generates will have to be repaid under some circumstances, for instance, if the child dies or is no longer eligible for the existing disability tax credit. The parents will not pay tax on investment earnings on contributions and grants, but will not get a tax refund for contributions.



The Personal Financial Advisor is published by the ECC Group.

The ECC Group are fee-based financial advisors, and have offices and affiliates in Toronto, Montreal and Vancouver. We are affiliated with The Investment Planning Counsel of Canada network who have offices in all 10 provinces.

The information contained in this letter is obtained from various sources believed to be reliable, but cannot be guaranteed.

Circulation Enquiries: Julie Dunaikis

Editorial and Consulting Enquiries: J. Christopher Snyder, CFP, RFP; Ian G. Johnson, CFP, PRP; Robert DeMelo, CFP; Fabio Ventolini, CFP, CIFA, Vicki Lungu, CFP

100 Simcoe Street, Suite 100, Toronto, ON M5H 3G2  
Tel.: 416-364-0181, Fax: 416-364-5394, Toll Free: 1-800-665-0181, E-mail: info@eccgroup.ca

## SECOND PROPERTY STRATEGIES

purchased it. Vacation properties, could be designated as a principal residence and exempt from capital gains tax. However, each family can designate only one property as its principal residence each year. Which one you choose involves some financial calculations.

### *Maximize Your Adjusted Cost Base*

If you are selling a property, whether it's a vacation property or any other property, it is important to calculate accurately any resulting capital gain. You want to ensure that you are using the proper adjusted cost base (ACB) — if it is too low, your capital gain increases, as does your resulting tax liability.

Note: you spend money making capital improvements to the property, this should be added on to the ACB. Capital improvements include items such as a new roof, windows or major renovations. Annual upkeep costs do not qualify. Make sure you keep receipts.

### *Passing on a Second Property*

Dealing with a second property in terms of estate planning can be a sensitive issue, particularly if there are children involved. Are you going to transfer ownership during your lifetime, or upon your death as part of your estate?

### *A Lifetime Transfer*

If the second property is going to pass to the children or grandchildren at some point, you might consider transferring it during your lifetime. This does not necessarily mean giving up use of the property. There are two obvious benefits to an inter vivos (lifetime) transfer. Your children will assume the tax liability on any future capital gains (assuming it does not become their principal residence), and your estate will avoid probate fees on the property upon your death.

There are four options for a lifetime transfer. In each case, you'll be deemed to have sold the property at its fair market value, so there could be tax to pay when making the transfer if the principal residence exemption is not used.

*Gift to children.* You can simply give the property to the children. You will need legal assistance to decide whether joint owners should be "tenants in common" or "joint tenants."

*Sell it to the children.* This may be your best option if you need the proceeds to support you in retirement. Your children could arrange their own financing or you could take back a mortgage on the property.

*Transfer the property to an inter vivos trust.* If you are transferring ownership to a minor child or grandchild, or if

you simply want maximum control over the property during your lifetime, setting up a trust now may be your best option.

*Set up a non-profit corporation.* If a large number of people are interested in inheriting a vacation property and you are afraid there might be future conflicts, you could set up a non-profit corporation, of which each member of the family would be a "member." The members could be voting or non-voting. Voting members would participate in any decisions related to the property, such as making capital improvements. Each member would be required to pay a membership fee annually to help cover the costs of maintaining the property. If a member doesn't pay the fee, they could eventually lose their membership. The bylaws of the corporation would dictate how the property is to be shared among the members of the corporation.

### *An Estate Transfer*

In some cases, dealing with the property by way of your will, may be your best option. If you still hold the property on your death there may be tax to pay, as it, (along with all your other assets) will be deemed to be disposed of for fair market value proceeds unless the property is being left to your spouse.

The three most common ways to deal with a vacation property in your will are to:

Leave it directly to the children. If this is done, your children will be left to determine ownership, access, control and cost-sharing issues on their own. One suggestion is to make your thoughts known by way of a "letter of wishes."

Sell the property. Sometimes the only way to avoid family disputes once you are gone is to sell a property and distribute the proceeds. You may consider giving each child the right of first refusal to ensure that any children interested in the property can purchase it before it is sold to a third party.

Set up a testamentary trust. A trust created on your death by your will can avoid conflicts between siblings because the trustee acts as an arbitrator. A trust can also protect the property from a child's former spouse or creditors.

Since real estate properties can be one of the most valuable assets you own. Working with a trusted accountant, lawyer and financial advisor is a must to help you minimize taxes and avoid other pitfalls.