

■ The Personal Financial Advisor

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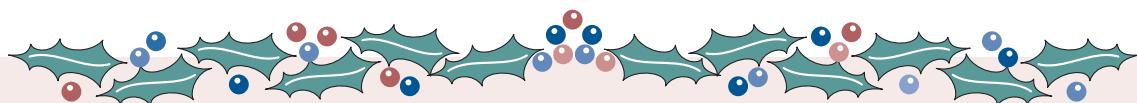
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A Chance For Others

The financial turmoil has affected everyone rich and poor alike including many great organizations who serve the poor.

As has been our custom, we are forgoing Christmas cards but will send a contribution to two grassroots organizations working on behalf of marginalized children with whom we have very close contact. They are Healthy Beginnings and Rotary. Healthy Beginnings in partnership with James Bartleman's Aboriginal Literacy Program will send one book per child each month to a number of Aboriginal children ages 0-5 in fly-in communities in Northern Ontario.

Through Rotary, our money will assist with the building and refurbishing of schools in the Kilimanjaro area in Tanzania where Rotary takes Sweat Equity teams to help build those schools. In this area approximately 20% of the children are AIDS orphans and many people live on \$1/day.

We hope 2009 will be a year which brings great meaning to your life and a chance for others.



WHAT IS YOUR INVESTMENT TIME HORIZON?

Fabio Ventolini, CFP, CDFA

With stock markets down significantly, it is a great time to reflect on your investment time horizon.

People in their 20's and 30's might think of it as several years or until they have enough saved for a reasonable down payment on a home.

Others might think of it as the difference between their current age and the age at which they are planning to retire – say 65.

Those in retirement might think of it in relation to their life expectancy - depending on their age – say to age 85 or 90.

Most investment managers buy stocks anticipating a hold for at least 3 but more probably 5 years

When it comes to investing, your time horizon is very important as classes of investments can perform very differently over different time periods

We have recently seen that investments in equities can go up or down significantly in a short time period and cash at this time is king, however, in the long run ie. at least 5 years, equities almost always outperform bonds and bonds outperform cash. From 1957-2003, large cap Canadian equities averaged 10%, Canadian bonds 7% and Bills 6%.

Furthermore, people who are able to think long term are more likely to be less concerned about the current downturn on the markets. History has shown markets always come back and when they do, they can be very powerful.

People investing now at or near the bottom of the market will likely be very handsomely rewarded while people pulling money out because of a short-term downturn will likely regret it.

Your time horizon also is significant in relation to your accumulation period. Those who have not started to save until say 10 years before they retire will likely be in for a rude awakening particularly if there is a downturn somewhere along the way. For someone who puts aside \$5,000/year for 40 years and earns 5%, they will have \$604,000. Someone who puts this amount aside for 10 years will have \$63,000. To accumulate \$604,000 in 10 years will require an annual deposit of \$48,000.

Your time horizon will also affect your mix of assets. Several investment products have been created with this in mind. For example, the Fidelity Clearpath Series has a mix of 20% fixed income and 80% equity for someone with a 40 year time line but 70% fixed income and 30% equity if they are about to retire.

In summary, this is a perfect time to reflect on your investment time line. Doing so should help reduce your anxiety, create some clarity about your financial position and help provide a realistic investment approach.

Not surprisingly, we believe this is best done with the assistance of a competent financial advisor.

TAX AND ESTATE PLANNING OPPORTUNITIES WITH TFSA

Vicki Lungu, CFP

By now you may have heard about the new Tax Free Savings Accounts. They start Jan.1, 2009 and are available through most financial institutions and financial advisors.

TFSAs provide something for everybody: young or old, rich or not so rich, savvy investor or beginner. So you could say that this is a very “democratic” product.

How the TFSA Works

- Canadians aged 18 and older can save up to \$5,000 every year in a TFSA.
- Contributions to a TFSA will not be deductible for income tax purposes. However, investment income, including capital gains, earned in a TFSA will not be taxed, even when withdrawn.
- Unused TFSA contribution room can be carried forward to future years.
- You can withdraw funds from the TFSA at any time, for any purpose.
- The amount withdrawn can be put back in the TFSA at a later date without reducing your contribution room.
- Neither income earned in a TFSA nor withdrawals will affect your eligibility for federal income-tested benefits and credits.
- Contributions to a spouse’s TFSA will be allowed and TFSA assets can be transferred to a spouse upon death.

Let’s have a look at some of the obvious and not so obvious opportunities TFSAs offer:

Income-splitting

Because the income attribution rules do not apply, you can invest \$5,000 into your account and \$5,000 into your spouse’s account.

Emergency fund

We all need some cash on hand for unexpected expenses. Now you can use conservative investments, such as high-yield bond funds or GICs, and not have to pay tax on the interest.

Invest in dividend-paying companies

Canadian dividends may contribute to Old Age Security pension claw back. You can prevent this by gradually moving your dividend-paying stocks into a TFSA.

Foreign dividends do not receive the dividend tax credit that Canadian dividends receive. They are taxed in the same way as interest, at your marginal rate. The TFSA provides a great way to get exposure to blue chip American companies, for example, on a tax-free basis.

Short-term planning

You can save money for a car or a dream vacation in a tax-efficient manner and replace the savings in the future.

Better alternative for low-income earners than an RRSP

Low-income earners making about \$30,000 a year will get back about 21 cents on every dollar they contribute to an RRSP (in Ontario). When it comes time to take that money out, they’ll have to pay a lot of tax. If they put their cash into a TFSA instead, clients can build up savings without any tax burden in the end.

Buying a house

Those planning to make use of the Home Buyer’s Plan (HBP) to purchase a house can also invest in TFSAs to build a larger down payment, once their RRSP balances exceed the \$20,000 withdrawal limit allowed under the HBP.

Individuals receiving pension or investment income

The TFSA is a great savings option for people who do not have the required earned income for RRSP contribution purposes, and therefore have few opportunities for tax-sheltered retirement savings.

Tax shelter opportunities for seniors over 71

The tax shelter can continue for those who reach age 71 and don’t need the money in their RRSP. While withdrawals must be generated under the usual rules, reinvestment into a TFSA will allow those tax-paid funds to grow again — faster — in a tax-sheltered account, as opposed to a non-registered account.

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TAX AND ESTATE PLANNING OPPORTUNITIES WITH TFSA

Benefits for single seniors

It has always made some sense to take money from the RRSP to “top income up to bracket” in circumstances where taxes will be higher at death than during life (This needs some explanation.) For example, we generally use that strategy for singles or widows and widowers. Now surplus funds can be deposited into the TFSA so that retirees can continue to build wealth on a tax-deferred basis and keep legacies intact.

Estate planning tool

In terms of estate planning, an unused TFSA could be a benefit. If you have never used the account, you might have \$150,000 to \$200,000 worth of room. Then, if a loved one dies and leaves you an inheritance, you could put it in the TFSA, where it will grow tax-free.

Also note that the TFSA loses its tax-exempt status after the death of the plan holder, meaning that the investment income will become taxable. However, a rollover opportunity is possible when the spouse or common-law partner becomes the successor account holder.

This rollover will not be affected by the spouse's contribution room, and will not reduce existing room either. However, when a child dies without a spouse, the plan should be collapsed or transferred to another appropriate savings vehicle.

A tax-free account may not be the best option for everyone with spare cash on hand. You should weigh carefully whether it would make more financial sense, for example, to use the \$5,000 to pay down your mortgage or other debts.

As always, talk to your financial advisor about integrating this tool into your financial plan.

KEEPING A PERSPECTIVE

J. Christopher Snyder, CFP, RFP

One of the greatest fears many people have is losing their money. This fear is even more pronounced for those who are about to retire, or who rely on their investments for income.

Today, fear has been fuelled by huge declines in the stock market. The media have fanned the flames with widespread scare-mongering about a recession as if it were the bubonic plague. Most of us have been through recessions. They are not pleasant, but we do get through them and often come out better off than before.

Everyone is affected by this downturn. In fact, the greatest investor alive today, Warren Buffett, has seen his Berkshire Hathaway Fund drop 36%. The fear that the whole world is about to collapse has caused many people to sell stocks and do their own bailout. People who are still able to generate an income can at least offset some of the market

decline with their earnings, but those who are relying on their pensions and investment income are more vulnerable.

Times such as these can make one reflective, asking questions such as, “How did all this happen? What did I do wrong? What do I really want my money to do?” Most people probably did nothing wrong; they followed the advice of their advisors and other professionals. Furthermore, they relied on the integrity of the system and the assurance that things were regulated.

But perhaps what went wrong was that our society as a whole was caught up in the feeling that the good times would go on forever, and we overspent on credit. Few people noticed this and even those who did, did little about it. This led to the credit crunch, which precipitated the events of the past few months.

KEEPING A PERSPECTIVE

Many blame Wall Street and the Republican administration in the United States and lack of proper regulation. But I believe it was more than this. It was our free enterprise system and our own human nature that always wants more, more, more. The free enterprise system is the best system yet created to encourage growth, innovation, human creativity and initiative. It does, however, come with a huge price tag of extremes. At one end is greed, which prompts people to spend more, and at the other end is fear, which results in people spending less — and that can lead to collapse. I believe that Newton's theory "for every action there is an equal and opposite reaction" is one of the great universal truths. What we in the financial world have not learned to do is find a proper balance.

The G20 have been meeting to discuss some of the things that can be done to prevent a collapse such as this occurring in the future. It will be no easy task to find a mechanism to do this, as there is a risk of over-regulating and limiting growth.

For many years, most of us have been beneficiaries of this growth and most of us have not had to contend with a war. We have goods and services our parents and grandparents never imagined. In fact, we have things that we probably never dreamed of having when we were children. Life seemed to go on quite nicely in those days. When I was a young boy, many of my friends did not even have indoor plumbing but that was not a big deal — it was just the way it was. Many families then did not have cars. In the U.S. today, there are 1.2 cars for every licensed driver, and in Canada there are 0.7 cars. Perhaps one of the reasons for the automobile slump is we have enough cars — maybe too many.

I remember the first television set our family purchased. It was a major expense. Now televisions can be purchased for a song. Cell phones were not even thought of then, and of course, personal computers came into existence just a few years ago. Taking a trip to Europe was, for many, a once or twice in a lifetime happening. In short, we have much to be thankful for.

I believe the events that we are caught up in represent an opportunity to reflect on what really is important. Perhaps we will have to do a few more things for ourselves, instead of hiring someone to do it for us; use public transit more

frequently; or keep wearing last year's wardrobe. Some people may yearn for a return to the "good old days," but I suspect we will not be returning to the "good old days." There will, however, be an opportunity for us to shape the new future.

The world has placed enormous faith and a high level of expectation on Barack Obama. I don't think anyone could fulfill all the expectations people have of him, but perhaps he can help calm people down, provide us with more realistic expectations and encourage values that are less consumption-oriented and more focused on experience and relationships. This will not be an easy task, and there has to be a balance. If everyone stopped buying, unemployment levels would soar and we would be in the paralyzing and self-perpetuating grip of deflation.

We humans are nothing, if not resilient and innovative. I have no doubt that we will get out of the financial mess we are in and while the future is unknown, I am excited about some of the possibilities that might lie ahead. Perhaps we will make progress toward raising out of poverty the billion people in the world who live on a \$1 a day. Maybe we can move forward by creating social business, where an enterprise's goal is not to make a profit, but to further a cause such as providing health care for the poor. This concept is being promoted by Mohammed Yunus, the founder of the Grameen Bank and winner of the 2006 Nobel Peace Prize.

Or perhaps we could initiate a thrust toward green infrastructure spending. We could also see more people working together to reduce destructive tribal tensions — this could also apply to our own developed world "tribes." We have seen some evidence of this already in the growing cooperation of our provincial premiers, and with the G20's expression of a new world economic order.

If nothing else, the current crisis may spark a return to good old common sense — and that would be a big plus.

REDUCE ANXIETY AND STRETCH YOUR RETIREMENT INCOME

J. Christopher Snyder, CFP, RFP

Yes, everyone these days is affected by the current economic conditions. Much of the reaction is emotional, but the fear is real. Here are a few ideas that could help you stretch your retirement dollars and reduce your anxiety.

- Draw up a retirement projection, showing how much income you will have from your investments. This should clarify your position. In reality, many portfolios have fallen less than the market.
- Know the investments you have — they should be diversified. Seek advice from a good advisor. Remember, your advisors and investment professionals should all have an interest in you doing well.
- Split your pension income with your spouse. Eligible sources include RRIFs, pension income and CPP. Note: Spouses can withdraw \$2,000 each, tax-free, from a RRIF or pension plan.
- If you like to go south in winter, perhaps you can rent out your home while you are away. Rent your second property if you have one. If it is practical for you, take in a boarder.
- If you own more than one property, possibly sell one. Consider using the equity in your home to create income through a reverse mortgage, or borrow against the equity to purchase income-producing investments.
- Consolidate your debt, possibly through a line of credit. You will receive the best rate if you have good collateral, such as your home. With lower interest rates, you may also be able to stretch your payments and improve your cash flow.
- If you are withdrawing money from a RRIF but do not need the income, consider transferring it out in kind, without cashing in your investments. This will give your investments time to recover.
- Based on the recent new rules, you can transfer 25% of your 2008 RRIF payment back into a RRIF. You have until March 1st to do this.
- Re-visit your budget. There are probably many ways you can cut back. There is no shame in this and even if it is not a necessity, it can be a useful thing to do. Even the great Winston Churchill, during the Depression, moved to a cottage when the family fortune was hit heavily by stock losses.
- Spend prudently, but spend. If everyone stopped, we would be in real trouble. Look for bargains — there are lots out there. Comparison shop but also ask yourself, “Do I really need this?”
- Take money from fixed income investments if you need the income, and leave your equity investments intact to allow them to recover.
- If you want your children to receive an inheritance, consider some life insurance. This will allow you to draw down more heavily on your investments.
- Make sure your investments outside your RRSP are tax-effective as possible. Put some of them (\$5,000 per person) into a tax-free savings account. Invest in stocks with capital growth potential, dividend-producing stocks or an annuity.
- Work longer or work part-time if you can.
- Move to a community where the cost of living, particularly housing, is not as high, or move to a smaller home.
- This could be an excellent time to invest in equities — although you may have your doubts after the recent downturn.
- Consider setting up your own business. This should be a genuine business, one that reflects your interests and can generate some money. Certain expenses, including some of the costs of your home and travel, if related to the business, can be deducted.
- Do not be spooked by the media. Much of their reporting is sensationalized and misleading. For example, the drop in employment of 76,000 reported in November included 24,000 who were employed during the election. In fact, while unemployment is increasing, there are still more employed full-time than in January and well ahead of the 1980’s and 1990’s.

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REDUCE ANXIETY AND STRETCH YOUR RETIREMENT INCOME

Good things are happening too. The price of gas is down, the lower dollar should help Canadian manufacturers and governments have intervened in a major way, which should help.

- Have faith. These downturns always have an end. Some people say today's downturns are unprecedented, but they are part of life — nothing goes up forever. The magnitude of this downturn is larger than usual, but contrary to the media comments, we have been here before, recovered and prospered.

In November 1974, the year ECC was started, the markets were way down and in the U.S., the Dow was at 603.

The following was written by Jim Fullerton, chairman of the Capital Group of Funds, quoting popular sentiment:

“There are so many bewildering uncertainties and so many enormous problems still facing us, both short-term and long-term, that there is no hope for more than an occasional rally until the uncertainties are cleared up.”

Fullerton went on to encourage people to have the courage to stick with it and invest. Fortunately, they did. The Dow is now at 8,500, even after the recent declines, and Capital now manages about US\$1.5 trillion.

These are just a few ideas. I am sure you have some of your own. If so, please tell us and we can share them with our other readers.

AN EXECUTOR'S TAXING ISSUE

Ian G. Johnson, CFP

Ron and his sister, Shirley, had always been close and when Shirley got divorced, Ron was a strong source of support and advice to her and her family. He helped her with financial decisions and consented to be her power of attorney and executor.

Unfortunately, Shirley died last year. Ron diligently carried out his executor's duties, which included filing her final income tax return. After receiving the assessment notice, he paid the balance owing and distributed the remaining assets to Shirley's three children, the beneficiaries of her estate.

Some months later, Ron received a re-assessment notice for Shirley from the Canada Revenue Agency (CRA) for the year 2005, requesting an additional \$28,000 in income taxes, including penalty and interest. Apparently Shirley had transferred the ownership of her cottage to the children without considering and reporting the capital gains involved in the transaction. The CRA had finally caught up with her, but Ron had no assets left in the estate to settle the outstanding amount.

Ron went back to the children, requesting the money. Two of them had used some of their share to pay down their mortgages and debts, and claimed they were not in a position to repay him. The other child, driving off in his new car, refused to help.

Ron was understandably upset and sought professional advice. The tax accountant was sympathetic but stated that Section 159 of the Income Tax Act was very clear. It requires an executor or legal representative (both known as a “personal representative”) to obtain a Clearance Certificate prior to the distribution of property in the estate. If the personal representative does distribute the assets before receiving the certificate, he or she will be personally liable for any unpaid amounts of tax, including interest and penalties.

The Clearance Certificate covers all tax years to the date of death and confirms that all taxes, interest and penalties, CPP contributions and EI premiums attributable to the deceased have been settled. If there is a trust involved, a separate Clearance Certificate is needed for it.

AN EXECUTOR'S TAXING ISSUE

The Process

A request for a Clearance Certificate is made using a TX19 income tax form called Asking for a Clearance Certificate. It should be submitted by the personal representative, but not until all the required tax returns have been filed and the notices of assessment, including the final one, have been received.

The TX19 should be accompanied by a copy of the will (unless submitted earlier with the final return), codicils and any probate or certificate of appointment documents. The tax authorities also want to receive:

- A list of assets at the date of death (with adjusted cost base and market values at the date of death);
- A statement of the distribution of assets, at the chosen date of windup, including names, addresses and SIN numbers of the beneficiaries.

Obviously, CRA does not want to leave any stone unturned!

The beneficiaries are often anxious for their inheritance, and can put pressure on to get their share. In those cases, the personal representative can make partial distributions without requesting a Clearance Certificate, as long as enough assets are held back to pay any estimated liability to the CRA.

However, unless the personal representative is intimately familiar with the deceased's financial history, this can be dangerous and should be done only with great caution. It may be prudent to ask the CRA to advise if there are any tax returns or monies outstanding in the name of the deceased.

It is important to note that the issuance of a Clearance Certificate relieves the personal representative only from any unpaid amounts. It does not cancel the estate's liability. The CRA can still seek payment from the remaining assets in the estate, if any, or it can go after the beneficiaries to the extent of their inheritance.

Conclusion

So Ron could have avoided his dilemma if he had realized that his tax liability as a personal representative could be avoided by obtaining a Clearance Certificate.

He could have checked the CRA booklet, Preparing Tax Returns for Deceased Persons, or visited the CRA website (www.cra-arc.gc.ca), to determine the steps he should take. But any personal representative needs to seek professional advice, especially in technical areas outside his or her expertise, and when required, share that advice with the beneficiaries.

Ron did eventually get restitution. The estate had held adequate assets and upon further reflection, the children appreciated the devotion Ron had shown towards their mother, and reluctantly reconsidered their actions.

The Personal Financial Advisor

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