



# The Personal Financial Advisor

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## QUITE A YEAR?

Chris Snyder, CFP, RFP

It has been quite a year politically and economically, particularly with the recent upheavals in the Middle East and Europe. Some people, however, live continuously with uncertainty. Outside Canada, this includes those who live in constant fear of stepping on a landmine and suffering the lifelong consequences.

Huge progress has been made since Canada initiated the Ottawa Treaty, in which the signatories agreed not to use landmines and to remove those already planted. In spite of this, there are still more than 15 million landmines in the world – five million alone in Cambodia and likely an equal number in Afghanistan. The victims of most of these mines are civilians.

In lieu of Christmas cards this year, our international donation is going to the Canadian Landmine Foundation, an organization of which I am a director. The foundation helps to remove landmines and give aid to survivors.

Our local donation will go toward assisting aboriginal education and mentoring programs through The Rotary Club of Toronto. The lives of many aboriginal peoples are in a continual state of upheaval, brought on partly by the effects of residential schools, poor living conditions, ill health and inadequate education. In our view, education is one way to move the First Nations people toward a better future.

If you would like to assist in either of these initiatives, please do not hesitate to contact me.

All of us at ECC wish you a year of health and happiness.

*Chris Snyder*

*Fabio Ventolini*

*Vicki Lungu*

*Julie Dunaiskis*

*Nadira Harvey*

*Renee Banaay*

*Gyuszi Berki*

# ■ IRS REACHES ACROSS THE BORDER

Vicki Lungu, CFP

As part of a major tax compliance initiative by the United States, the Internal Revenue Service (IRS) has embarked on an aggressive campaign to track down offshore accounts.

If you are a U.S. citizen currently residing in Canada or have dual citizenship or a green card, you are required to disclose your worldwide income to Canada and the U.S. In most cases, Canadian dual citizens would owe few, if any, U.S. taxes because the U.S. excludes the first US\$92,000 of Canadian income from taxation. It also offers foreign tax credits that could offset other income.

The tax treaty between the two countries offers taxpayers relief from double taxation. With tax rates in Canada generally higher than those in the U.S., Americans living in Canada usually do not owe U.S. taxes.

However, American taxpayers also must fill out forms annually to declare all of their foreign accounts that hold more than US\$10,000. This refers to aggregate value, so if you have US\$3,000 in a savings account and US\$8,000 in your non-registered investment account you will still have to declare any gains.

Some taxpayers filed their U.S. tax returns but did not know about reporting gains. Accordingly, on Feb. 1, 2011, the U.S. government launched the Offshore Voluntary Disclosure Initiative (OVDI), which ran until Sept. 9, 2011. This was an opportunity for taxpayers to file any non-filed returns going back to 2003, and pay any taxes and interest. OVDI also included a penalty of 5%, 12.5% or 25% (depending on how the IRS assessed the taxpayer) on the highest balance of any non-reported foreign account. The penalties for non-compliance are very stiff: US\$10,000 a year for each account.

## Types of Canadian accounts that need to be reported

- Non-registered Savings accounts
- Tax Free Savings Accounts (TFSA)
- RESP accounts
- An insurance policy with a cash value
- Non-registered investment accounts

There are no tax consequences for holdings in an RRSP/RRIF. However, you could easily end up owing U.S. tax on capital gains distributions and gains-on-disposition in taxable accounts, and also in TFSAs and RESPs, which the IRS does not recognize as tax shelters.

You should also be aware that certain investments will receive different treatment in the U.S. than in Canada. For example, the capital gains exemption will not be available in the U.S., nor will RRSP or flow-through share deductions. In addition, estate tax legislation provides that the first \$5 million of a U.S. person's estate will not be taxed, and the top tax rate has been reduced to 35%.

## What to do

If you are one of those affected who did not take advantage of the OVDI program, you have two options:

- File the past six years, along with any foreign account compliance forms, without formally informing the IRS that you have been non-compliant. In some cases, the IRS will process the returns without ever coming back to the taxpayer to assess further penalties.
- You could make a formal voluntary disclosure to the U.S. government, a long-standing program that exists outside the OVDI. In many cases, if the taxpayer has a compelling case for leniency, penalties may be waived altogether.

Unfortunately, doing nothing may not be an option. Starting in 2014, foreign financial institutions will be required by the U.S. government under the Foreign Account Tax Compliance Act to report information to the IRS regarding accounts of U.S. persons who hold more than US\$50,000 with that institution. This law requires foreign financial institutions such as your local bank, stock-broker, pension fund, insurance company and trust to report directly to the IRS all their clients who are U.S. citizens. Backing up the request is a tough new penalty: foreign financial services firms that refuse to report on their American clients will be assessed a 30% withholding tax on the institution's income from U.S.-based sources.

Although OVDI was introduced to bring in American tax evaders with hidden offshore accounts, the program also attracted some ordinary non-filers who had otherwise been compliant with their tax-filing requirements in Canada. The IRS has collected \$2.7 billion so far from offshore account holders who came forward in a pair of partial amnesties, and paid back taxes and reduced penalties to minimize the chances for prosecution.

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## IRS REACHES ACROSS THE BORDER

It is important to note that each taxpayer's situation is unique. The IRS may or may not assess penalties, regardless of the fact that the taxpayer may have taken advantage of OVDI. For most people, the decision on how to proceed will be based on their own risk factors. Professional tax advice is a must.

As of the date of this article, a new policy shift will come in the form of new guidance from the IRS before the end of 2011:

- If a U.S. citizen files tax returns late and owes no taxes, there are no penalties for late filing.
- U.S. citizens who were unaware of the bank account reporting requirement can file petition reports now, along with a letter explaining why they are late. No penalty will be imposed if the IRS determines the cause to be reasonable.
- Individuals who took part in earlier amnesty programs in 2009 and 2010 can reapply and get back the penalties already paid.

## TAXES & SERVICES

Chris Snyder, CFP, RFP

Everyone hates paying taxes. The late Eric Nicol, a Canadian humorist writer, once said, "We should change Canada Day to April 30th – tax day. It is the only day in the year when Canadians are unified." On the other hand, Franklin Roosevelt commented that "taxes are the price we pay for a civilized society". I agree with both.

The events taking place in many countries of the world right now revolve around this very issue. There are two basic questions for a country to answer: *how much do you need to tax people to provide the services you have promised or society wants?* and *what is provided by government and what is provided by the private sector?*

If governments promise a lot, it is evident that you need to raise most of the money through taxation.

There are those who say, "We should have high taxes and high services," but if taxes are too high, it will give rise to cheating, loss of incentives, moving money out of the country and relocating businesses to countries with lower taxes. It will take money out of the hands of consumers who will spend less and limit the growth of the economy.

There are those who say cut taxes. The private sector will take these savings and spend them. This will create growth and jobs and in turn, will provide more revenues to the governments to provide the services. But it is a recipe for disaster if you want low taxes and high government services.

The right balance is elusive, complicated and must be worked out country by country. In the process, consideration must be given to the type of tax – income

versus sales, corporate versus individual – as well as the levels to be set for different income earners.

We in Canada believe we are highly taxed, but what is happening in other countries?

One study carried out for the Organization For Economic Cooperation and Development (OECD) shows the eight most heavily taxed countries, calculated as a portion of Gross Domestic Product (GDP):

Denmark	48.2%
Sweden	46.4%
Italy	43.5%
Belgium	43.2%
Finland	43.1%
Austria	42.8%
France	41.9%
Norway	41.0%

It is interesting to note these are all European countries that provide many social benefits.

In this study, the U.S. and Canada by contrast come in at 28.9% and 32.1% respectively. It should be noted this does not include all taxes, including corporate taxes.

What does all of this mean? It means we, in Canada, have probably reached a reasonable, albeit not perfect, balance between taxes and services. It remains to all of us to ensure the balance remains in place, priorities are appropriate, the spending is efficient and governments do not make too many promises.

# WHAT'S A MILLION? WHAT'S A BILLION? WHAT'S A TRILLION?

Chris Snyder, CFP, RFP

Some of you may remember the famous words, "What's a million? Spoken by C.D. Howe, Canada's cabinet minister of almost everything in the 1950s. The Liberal government at that time was tossed out of office partly because of the perception of arrogance this statement generated.

Since that time, much has happened. Inflation and real growth have meant one million is now a relatively small number in the financial world of government, corporations and many individuals. Now the number one trillion is being tossed around like a Tom Brady forward pass.

Much of the recent mention of one trillion has to do with sovereign debt. Because of the magnitude and unfamiliarity of the number, many people are frightened by it.

Numbers presented in certain ways can look bigger than they really are. For example, when you advise someone that they will need one million (\$1,000,000) to generate enough income on which to retire, they might wince and say, "What, a million? You're crazy." But if you tell them that by investing \$850 a month for 30 years, earning 7% a year, they'll have a million, it becomes more realistic and doable.

That's one million dollars. But how about a trillion? Let's look at what it really means.

- In cold, hard numbers, it is 1,000 billion or 1 followed by 12 zeros(1,000,000,000,000)
- 1 trillion represents about 2/3 of the money under management at each of Vanguard Investments, Fidelity Investments and the Capital International Group. Together these three companies manage in excess of \$4.5 trillion.
- It is the amount of extra taxes that can be collected if tax rates for the wealthiest 1% of Americans were brought up to the same level as those paid by the average American. In the U.S., there are 94,000 people making one million dollars or more who pay lower tax rates than their secretaries. Reliable sources estimate there are 8,000 who make over \$10 million. More than 236,000 make more than \$1 million per year in the U.S.
- It represents 2/3 of Canada's Gross Domestic Product (GDP). (GDP is the market value of all final goods and services produced in the country by individuals, governments and corporations).

- It represents 6% of the U.S. GDP (their total is \$15 trillion – about 20% of the world's total).
- It is about 1/3 the size of the 2010 U.S. deficit, currently about three trillion dollars, and 6% of its public debt, currently 15 trillion.
- One trillion dollars represents about \$3,000 for every person in the U.S.
- It is two times the amount of exposure European banks have to all of the debt of Italy, Spain, Greece, Ireland and Portugal. If you eliminate Spain and Italy, the combined debt is \$135 billion.
- It is the amount in Euros (\$1.4 x \$1) that the European Union has pledged to support the current crisis.
- It is 1/15 of the real estate loans in the U.S. in 2008, of which \$5 trillion was held by the U.S. banks and \$45 trillion was held by mortgage lender Fannie Mae and Freddie Mac.
- It is the amount Bill Gates' \$50 billion will be worth in less than 45 years, invested at 7% - if he does not give it all away. Carlo Slim, the world's richest person, will get there in about 37 years.
- It is 15% of the real estate value of Manhattan. The Dutch paid \$32 for it in 1626. It is now worth an estimated \$7 trillion. This represents a 7% compound rate of return.
- It is about 85% of what the U.S. spends every year on its military – approximately 6% of its GDP. Canada spends 14% of its GDP on our military.
- It is 10 times the amount given annually in foreign aid.
- One trillion represents four times the amount economists estimate would be required annually to completely eradicate poverty in the world.
- It is 1/2 of all the individuals' money in cash in U.S. banks and 1/3 of the money in the U.S. in money market funds.
- It is six times the amount General Electric and Apple Computer together have in cash in the U.S.

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## WHAT'S A MILLION? WHAT'S A BILLION? WHAT'S A TRILLION?

- It is 1/9 of the money individuals and companies have deposited in offshore banks, estimates the Boston Consulting Group. Taxed at 11%, this would produce one trillion a year.
- It is \$14 for every man, woman or child alive today in the world.
- It is 30 times the annualized profits of Apple Computer, based on the most recent quarterly reports.
- According to the organization Global Financial Integrity, it is a fraction of the uncollected taxes all over the world.
- It is the amount that escapes every year from poor countries to tax-free offshore banks.
- It is 2 ½ times Walmart's annual sales.

While one trillion is indeed a large number, it does not seem so large when you consider there is plenty of money around to pay these debts. What is needed, in part, is a fair tax system in all countries, tax collectors who enforce the rules and people having a reasonable perspective of what it means.

In my mind, the current sovereign debt crisis is as much political as economic. There are great motivations to solve it and I, for one, believe it will be solved.

## POTENTIAL OPTIONS FOR GENERATING INCOME

Fabio Ventolini, CFP, CDFIA

With interest rates still near historic lows and inflation fears rising, building an income-producing portfolio has become a challenge, raising difficult questions. Do you stick with historically "safe" treasury bonds and their paltry yields around 1%, or do you buy bonds yielding from 2% to more than 9% and live with the risks that come with them? Do you consider good dividend-yielding stocks yielding 4%, or real estate investment trusts?

There is no right answer and for many investors, it could mean a mix of options.

### Investment Options

**Dividend-paying stocks.** Dividend-paying stocks offer a combination of income and growth potential at tax-effective rates, although owning stocks has generally meant more ups and downs than owning fixed income investments such as bonds. Recently, however, strong corporate profits and low interest rates have led more income-oriented investors to be more comfortable with buying dividend-paying stocks.

Dividend-paying stocks can also offer a rising income stream over time as dividends grow with earnings. The banks are good examples of this, some paying dividends in the 4% range compared to a five-year GIC that now offers less than 3%.

Dividends on Canadian common stocks qualify for the Dividend Tax Credit, which means the after-tax return is superior to that of a GIC, on which the interest is all taxable.

**Bonds** come in many forms. Depending on the duration, yields on government bonds range from about 2.5% for five years to about 3% for a 30-year bond. Corporate bonds normally pay more than government bonds, but they are not immune from volatility. If interest rates go up, the value of the bond goes down, and vice versa. So-called junk bonds can yield more than 9%.

There are also convertible bonds, which can be converted to common stock of the company based on a predetermined formula. You can benefit from the increase in value of the stock, but you will suffer if the stock goes down.

Income from bonds is fully taxable, however, the gain in capital value is viewed as a capital gain, therefore, only 50% of it is taxable.

**Preferred stocks.** These have characteristics of both stocks and bonds. While they are equity securities – that, they represent an ownership stake in the issuing company – they are higher in the pecking order than common stocks if the company gets into trouble. Yields are comparatively attractive but do not have the same potential for growth as common stock.

## POTENTIAL OPTIONS FOR GENERATING INCOME

Preferred stocks can also have call provisions, meaning the company can buy back the shares at its discretion. This happens when interest rates decline and the issuer calls back the shares and reissues them with a lower dividend yield.

**Real estate.** For a long time, residential and commercial real estate has been considered a safe investment, thanks to its ability to produce regular rental income, as well as preferable tax-treated deductions. While the outlook for income-producing residential properties is less certain these days, many investment properties – such as those in highly desirable neighbourhoods near stable institutions – are shielded from the overall economic environment.

Interestingly, in the most recent cycle, the fundamentals of the commercial real estate market have been more stable than the residential real estate market. As a result, real estate investment trusts (REITs), while potentially volatile, have been good income-generators and are tax-effective.

Sectors like senior housing and healthcare facilities also may offer long-term value, given the demographics of an aging population.

If you are a lower risk investor, you are likely going to find yourself more attracted to real estate or fixed income investments. As your risk tolerance increases, you might want to consider preferred or common stocks.

Developing the right mix requires an understanding of your particular needs, goals and temperament. There are a number of different ways you can try to achieve your income goals. You may want to build your own portfolio, either as an individual or in partnership with a financial advisor. Or, you may choose an investment fund that combines different asset classes. A managed account can deliver professional portfolio construction management and simplicity

### A Warm Welcome

We would like to extend a warm welcome to Renee Banaay.

Renee will be working with us in the investment and financial administration area where she has had many years of experience. We are looking forward to a long and beneficial relationship.

Renee has a son, Ronald, age 14 — a keen football player.

You can reach her by email at [renee@eccgroup.ca](mailto:renee@eccgroup.ca) or by telephone at 416-364-0181 ext. 2505.

## The Personal Financial Advisor

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