FREE!

Financial Advice

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Financial Planning

What do we mean by "financial planning"? We believe it involves developing and implementing a comprehensive program to so-ordinate and guide your personal affairs to meet life and estate objectives. That's a mouthful. What does it mean? Developing a quality financial plan involves examining six key aspects of your affairs: money management, risk management, investment management, tax planning, estate planning and retirement planning.

Consider money management as an example. Managing your finances is more than paying bills on time. It's a process with several essential components. Preparing a net worth statement, cash flow statement, cash flow realignment, saving, budgeting and other considerations are all part of effective money management. Examining your money management, investment management and retirement planning. A sound financial plan integrates all these elements.

The benefits of financial planning are manifold. You will have the assurance that you and your family are protected in a financial crisis resulting from death or disability. You will know your capital is working effectively to meet your financial objectives. Spending can be more efficiently managed, and your cash flow may be maximized through the appropriate management of debt and the minimization of income taxes. Finally, you will have peace of mind knowing your program will provide you with an increased degree of financial freedom.

Of course, failure to plan may produce the opposite effects. Many people face serious financial problems as a result of death in the family, a disability or a lack of money in retirement. A sound financial plan is insurance against future loss.

At this point, try to answer these questions:

- What financial shape are you in now?
- Are you spending your money on things you really want and need?
- Have you determined the amount of an emergency fund appropriate for your circumstances?
- What financial requirements do you have prior to retirement?
- Are you allowing for inflation and higher taxation in planning your future expenditures?
- What financial requirements will you have after retirement?
- Are you able to save money on a regular basis?
- Are your savings steadily increasing from year to year?
- Is your personal net worth increasing from year to year?
- What investment products fit your financial circumstances?
- How do you wish your estate distributed?
- What tax implications should you consider?

In thinking about these questions, you will also answer another question — what can financial planning do for me?

Who can Qualify for an RRSP

Any person who has "earned income" can qualify. RRSP's are of particular interest and value to those who are unable to participate in a registered pension plan because they are self-employed or because their employer has not established a pension plan. Even members of registered pension plans who are interested in increasing their retirement income may be allowed to make contributions to a registered retirement savings plan. Members of deferred profit sharing plans or employees profit sharing plans may similarly make contributions to an RRSP.

For the purpose of calculating your eligibility to make tax deductive contributions to an RRSP, earned includes:

1. Net employment earnings.
2. Royalties to authors and inventors for a work or invention.
3. alimony or maintenance payments.
4. Amounts received under a supplementary unemployment benefit plan but not benefits under the Unemployment Insurance Act, 1971.
5. Research Grants (Net of Expenses).
6. Income from carrying on a business as a proprietor or active partner.
7. Net rental income from real property including recaptured capital cost allowance.
8. Directors fees.
9. The taxable portion of disability income payments.
10. Taxable RHOSP Plan withdrawals.
11. Employee profit sharing plan allocations.
12. CPP/QPP Disability Plan payments.

The following amounts must be subtracted in calculating net employment earnings.

- losses from carrying on a business.
- annual union or professional dues.
- deductible alimony or maintenance payments paid.
- losses from the rental of real property.

Here's an example of a calculation for earned income for 1990 and for 1991 and subsequent years.

Salary		$40,000
Net Rental Income		$15,000
Less		
Alimony Paid		$10,000
Earned Income	$45,000	

The maximum RRSP contribution is the lesser of 18% of the previous years earned income and:

$12,500 for 1992
$12,500 for 1993
$13,500 for 1994
$14,500 for 1995
$15,500 for 1996

After 1996, the dollar limit will be increased annually by a measure of the average wages and salaries in Canada.

Is the Charity Registered

From time to time, certain individuals solicit funds from the general public under the guise of being registered as a Canadian charity when in fact, the organization is not so registered. This has created problems for taxpayers who make a contribution and later find their deduction disallowed by Revenue Canada because the organization did not have a Revenue Canada registration number.

If you have a question, you can call your district taxation office to find out whether a particular organization soliciting funds is in fact, a registered charity. The mailing address of each registered charity is also available. These calls should be made to the "General Inquires" area of a district office. Telephone numbers are listed on the back page of your T1 Return information guide and in the government blue pages of local telephone directories.

The department can also provide additional information on registered charities through its Ottawa head office. This includes data filed by registered charities as part of their annual public information return on receipted income, revenues, administrative costs, amounts expended on charitable a activities, the names of officers and the charities objects and activities. This information can be obtained by calling the department's registration directorate in Ottawa, toll free at 1-800-267-2384.

The department notes that it will continue its efforts to enhance the quality and quantity of information on charities it can provide to the public, subject to the confidentiality rules in the Income Tax Act. If you have any reason to be concerned about the status of an organization holding itself out to be a charitable organization, Revenue Canada can be of help.

Assessing Risks

Almost everything we do involves exposure to risk of one sort or another. Owning property involves the risk of [illegible]oss, damage or destruction. Driving an automobile, boat or using any other transportation means risking our lives, property, or the lives and property of others. Disability could shorten our working lives, resulting in our families suffering. The four general areas of risk may be classified as property, income, liability and life.

Did you ever wonder what your chances are of risking something you hold dear? the following charts indicate some of the probabilities.

Number of Deaths by Age 65
Out of 1,000 individuals alive at Various Ages

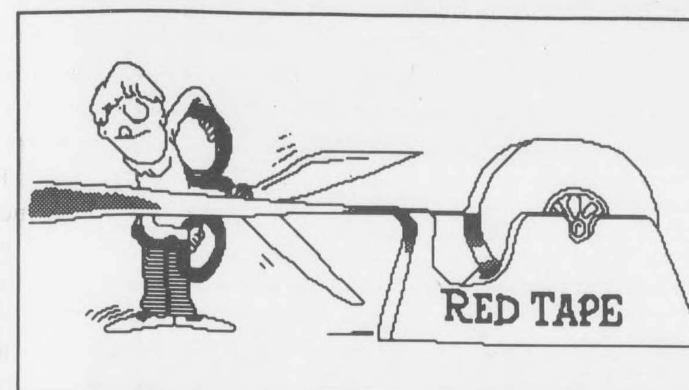
Age	No.	Age	No.
25	175	45	152
30	171	50	137
35	167	55	113
40	161	60	72

Age	Probability of Long-Term Disability Before Age 65
25	47.2%
30	45.8%
35	44.0%
40	41.5%
45	38.2%
50	33.7%
55	27.3%

Age	Average Duration of Disability
25	2.2 years
30	2.2 "
35	2.2 "
40	2.2 "
45	2.2 "
50	2.3 "
55	2.4 "

Long-term disability is defined as a disability lasting at least 90 days.

It's interesting to note the probability of a 30-year-old having long term disability before the age 65 is 45% while the probability of dying is 17%. Statistics are interesting, but other questions also arise. For example, should the various types of risk be classified in a hierarchy? If so, what criteria should be used? If you have a car accident and cause damage, the loss may be less than if you injure a person. If the same accident caused you serious injury, perhaps your income would be limited or impaired for life.



In discussing the hierarchy of risks, it would appear that loss of life is the most important because no earning power is available subsequently. The impact on dependants is immediate. Disability would rank second since, although disability may permit some form of employment and would likely qualify you for government benefits, your earning power is substantially reduced. Damage to others through permanent disability or death would appear to be third while damage to property occupies fourth spot..

The concept of insurance is based on the principle of risk sharing. Using historical records, an actuary can determine that of every 1,000 dwellings, a certain number would be substantially damaged by fire in each year. The actuary does not know of course, which homes will be damaged, but he is able to determine the number per 1,000. Using a simplistic example, if we assume two homes of every 1,000 would be damaged to the extent of $100,000, then if each homeowner contributed $200, there would be a fund of $200,000 to repair or replace the two damaged homes. The same principles apply to life and disability insurance. By pooling their money, each purchaser of a contract provides the funds to pay the benefit to the recipients. Proper risk management is an essential ingredient in financial planning. We suggest you undertake an analysis of your risk exposure and of the requirements to cover those risks.

The Concept of Life Insurance

To many people, life insurance can appear as a complex and confusing subject. Perhaps a discussion of life insurance as a financial planning technique may dispel some of these concerns.

Life insurance is an important financial planning tool because it offers one of the simplest, most economical methods of providing the funds necessary to guarantee that your financial obligations and objectives will be met. Generally speaking, life insurance in financial planning is used to provide the capital and income for your dependants and to provide cash for the payment of taxes and certain other charges which may be payable by your estate.

Life insurance contracts are of two separate types: term and permanent. Term insurance because it terminates either at a specified age or at a given date. Term plans that end at a given date often have renewable provisions which allow the contract to be continued for another specified period. These renewal provisions often end at age 65 or 70. By its very nature, term insurance is used to protect temporary liabilities such as mortgages, university expense for children, or bank loans. To overcome the drawbacks of term insurance, some companies have developed a universal life policy which combines the advantages of both term and permanent.

Many people either have or previously had group life insurance through their employment. Group life insurance has all the attributes of personal insurance in the event of your death but the similarity ends there. You do not own group insurance in the same manner as personal insurance coverage. For this reason, group insurance is temporary at best. For example, if the employer goes out of business or if employment is lost the group insurance terminates. Most plans provide for conversion to personal insurance, but at older ages this can be very expensive. Group rates may be increased or the terms of the plan can be altered without your consent. The person whose life is insured under a group policy is not a policyholder. He or she is a group certificate holder and not a contractual party to the life insurance policy, which is between the life insurance company and the policyholder. The group certificate holder has no control over the policy.

For this reason, you have at least 50% of your required life insurance protection (either permanent or term) personally owned. This may result in some over-insuring at times, but it leaves you in the position of not being dependent on the actions of others over whom you have little or no control.

How Much Life Insurance Do You Need

Life insurance is an important financial planning tool because it offers one of the simplest, most economical methods of providing the funds necessary to guarantee that your financial obligations and objectives will be met. Generally speaking, life insurance in financial planning is used to provide the capital and income for your dependants and to provide cash for the payment of taxes and certain other charges which may be payable by your estate.

Life insurance frequently forms a substantial portion of the amounts available to dependants. The question then arises as to the amount of income required. You should be very careful in determining the amount.

When the income for the family has been determined, there are two generally accepted methods of estimating the amount of capital necessary to fulfill the requirements: an interest-only approach which preserves capital; and a capital and income depletion procedure whereby a blend of capital and interest is consumed annually.

Under the capital-retention procedure, an interest rate is assumed - for example 10% - and the amount of capital required to produce the desired income is estimated. If the desired annual income is $25,000 and assuming a 10% return, an amount of $250,000 of income producing capital would be required.

Under the capital-depletion approach, the procedure involves estimating the number of years the proceeds will be required and assuming an interest return. The amount of capital required would then be a function of the assumed rate of return along with the number of years of payout. As an example, consider a person aged 60, who requires an annual income of $25,000 for the remainder of his or her life. Based on annuity rates as of the date of writing, an amount of approximately $224,000 would be required to provide the $25,000 per year with the income paid monthly. In [illegible] instances, inflation should be taken into consideration.

Life insurance need not be complex. Armed with these basic concepts, you should be able to assist your agent in evaluating your requirements.

Insure Your Child Now

The legislation allows you to purchase a life insurance policy on your minor child when rates are low and subsequently transfer ownership to your child. The transfer can be made on a tax free basis. this means the policy will be transferred at the cost basis of the owner and taxation will only arise when the new owner disposes of the policy. The transfer will be permitted where a child of the policyholder or a child of the transferee, is the person whose life is insured in the policy.

There is, however, one tax warning which should be noted. If you transfer property to a minor, then any income from the property will be attributed to you while the child is a minor. As a consequence, if a life insurance policy were assigned to a minor and surrendered while the child was a minor, then any gain in the policy would be attributed to the assignor. However, if the child had attained age 18 at the time of the surrender, then any gain in the policy would be reported to the child.

The legislation presents insurance planning opportunities. You could purchase a life insurance policy on your child at a young age and transfer the ownership when the child is mature. The policy could then remain in force and the child would have the advantage of the low cost associated with purchasing the insurance at a young age.

Investing the Child Tax Benefit

Revenue Canada and Revenue Quebec had a policy of allowing a parent to invest the family allowance for the benefit of a child. The interest earned on the investment was considered to be income of the child and not of the parent. When the parent received a T5 for the interest in his or her name, the parent did not include the amount in income. Rather, the T5 was included in the Tax Return with an explanation written on it to the effect that the interest is from a family allowance investment.

Since the amounts were relatively small, it's unlikely the annual interest income would exceed the child's personal credit. Thus no tax return need to be filed on behalf of the child since there was no tax payable by the child. The upshot is that no tax was payable on the family allowance earnings by the family unit.

The family allowance was changed to a comprehensive child tax benefit. Revenue Canada has confirmed that they will apply the same tax treatment to interest earned on the credit as is available to interest earned on the family allowance.