MacDougall Wealth Management Group Newsletter

Summer 2023

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Savaria - Site Visit and Investments Research

According to the American Association of Retired Persons (AARP) over 77% of people aged 50 or older want to remain in their homes as they age (AARP, 2021). While their desire to remain at home is high, these individuals often encounter significant challenges due to mobility and cognitive aging. A recent survey suggests that 71% believe their homes have interior and exterior accessibility issues (AARP, 2021), which significantly impacts their overall quality of life. There are companies providing solutions to enable people to stay at home longer and live comfortably.

Recently our team toured the Savaria Accessible Vehicles and Lifts headquarters in Laval, Quebec. With a goal of enhancing mobility and accessibility for all, Savaria is a worldwide leader in access and mobility solutions. Savaria is a Canadian success story, with operations starting in 1979 by the Bourassa brothers. Through organic growth and acquisitions, Savaria has built a business that has key elements to continued success. The company has 30 direct sales offices and 17 production facilities across 12 countries worldwide. With an experienced management team, disciplined allocation of shareholder capital and favorable demographic trends, Savaria is positioned well to benefit from the need for access and mobility solutions. When we visited this location, a company representative reviewed key new developments in the business including their recent purchase of Handicare AB (Europe's #1 supplier for access solutions) and an increasing strong patient care division product offering.

Our interviews with companies provide key insights to understand a company's culture, finances and competitive advantages in their chosen marketplace. Whether in person or online, we continuously research and review our portfolio companies.

Our goal is for you to own great businesses over the long term and to purchase them at reasonable prices. We look forward to our next meeting with you as we continue to grow together.

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The FHSA: The High-Net-Worth (HNW) Investor Opportunity

Beyond its benefits in supporting the purchase of a first home, the First Home Savings Account (FHSA) offers a compelling opportunity for investors to transfer wealth to the next generation or potentially increase their retirement nest egg — but planning ahead is important.

What is the FHSA? The FHSA is a tax-advantaged registered account intended for the purchase of a first home. Eligible Canadian residents ages 18 or older who are first-time home buyers can contribute up to $8,000 per year, to a lifetime maximum of $40,000, and grow these funds. Contributions are tax deductible, similar to the Registered Retirement Savings Plan (RRSP), and withdrawals are tax free, similar to the Tax-Free Savings Account (TFSA), if used for the purchase of a first home. The FHSA must generally be closed after 15 years or the year after the first qualifying withdrawal is made or the holder reaches age 71.

The High-Net-Worth Investor Opportunity: Beyond the prospect of supporting young folks to purchase a first home, the FHSA may also provide opportunities for HNW investors:

- A potential intergenerational wealth transfer tool;
- For those who haven't owned a home over the past four years, a potential tax-advantaged way to supplement retirement savings.

Many parents and grandparents choose to gift funds to future generations to help cover large expenses such as an education or a first home purchase. Some HNW investors support a child's education through the RESP but stop contributions around age 17 when the Canada Education Savings Grants cease. The opportunity to then gift funds to a child to contribute to their own FHSA, which can begin at age 18, may be compelling (keeping in mind the loss of control with gifted funds). If the FHSA was opened at age 18, it would need to be closed in the calendar year after the child turns 33. By some accounts, this is the average age of a first-time home buyer.[1]

For HNW renters, the FHSA provides an opportunity for tax-deductible contributions and tax-deferred growth. While the account would need to be closed by age 71 (if the 15-year limit isn't reached), the holder could transfer any amounts to their RRSP/RRIF without affecting any existing contribution room.

The Importance of Planning Ahead: Since the FHSA can remain active for a maximum of 15 years once it is opened, here are some ways to potentially maximize the growth opportunity:

- **Start early** — If the holder intends to purchase a first home, keep in mind that the FHSA must be closed in the year after making the first qualifying withdrawal, so the account's life may be shortened. As such, helping a child to open it closer to age 18 may be beneficial to allow for compounded growth over the longest period possible.
- **Maximize contributions from the onset** — Consider making full contributions at the start of each year to maximize the growth potential. Although unused portions of the annual contribution limit carry forward, the carryforward is limited to $8,000 each year.
- **Consider the way that funds are invested** — The FHSA offers a substantial tax-advantaged opportunity to grow funds. As such, we believe that investing funds in quality securities has the potential to provide meaningful growth and return potential.

The Compelling Outcome: By maximizing contributions from the onset, assuming a five percent annual rate of return, the account could grow to over $75,000 by the end of 15 years, and this doesn't include the tax benefit from the initial contributions!

- **A substantial down payment** — If both first-time buyers, a couple could each access the FHSA alongside the Home Buyers' Plan (HBP). The HBP allows first-time buyers to withdraw up to $35,000 from the RRSP, subject to repayment in 15 years and other conditions. Together, this could provide a substantial down payment — using the example above, over $220,000.
- **Increase retirement savings** — If the holder decides not to purchase a home, the FHSA can be transferred to the holder's RRSP/RRIF without affecting the available contribution room.
- **Defer the tax benefit** — Generally, contribution amounts not claimed as a deduction on an income tax return in the year made can be claimed in a future year — even beyond the FHSA's closure! If saved for future years, this may provide a substantial tax benefit when the holder's marginal tax rate may be significantly higher.

To learn more about the FHSA, please call the office.

1. cdn.nar.realtor/sites/default/files/documents/2021-highlights-from-the-profile-of-home-buyers-and-sellers-11-11-2021.pdf

The Principal Residence Exemption: Your Questions Answered

Summer is often one of the busiest seasons for residential home sales. With many investors owning multiple properties, thinking ahead to their eventual disposition may be worthwhile.

As a reminder, when you sell your home and a capital gain is realized,* the resulting tax may be eliminated/reduced if the property is designated as a "principal residence" by claiming the Principal Residence Exemption (PRE). As of 2016, you must report the sale of a principal residence on your income tax return and claim the PRE. If you own multiple properties and sell one, you will need to decide which one to designate as the principal residence for each of the years it was owned: only one can be named each year.[1] Generally, you should consider designating the property with the largest average capital gain per year to reduce the overall tax liability. Yet, the decision is rarely straightforward and may involve multiple factors, such as predictions about the future value of the remaining residence(s).

Here are six common questions relating to the PRE:

1 **To qualify, do I have to live in the unit most of the time?** A principal residence generally refers to a housing unit that is "ordinarily inhabited." This doesn't mean that the taxpayer needs to live there the majority of the time. The property may qualify if the taxpayer or member of the family unit lived in it at some point during the year.

2 **Can a cottage/cabin qualify?** Yes, seasonal residences, even those outside of Canada, may be designated as a "principal residence."

3 **What if I forget to report the sale on my income tax return?** The Canada Revenue Agency (CRA) may charge a late-filing penalty of $100 per month, up to a maximum of $8,000. As well, the PRE may be denied at a further date.

4 **Can I use my property for rental/business income?** If a property is predominantly used to produce income, it will not be eligible for the PRE. If part of a principal residence is used for rental/business purposes, you may be able to claim the PRE for the portion used as a residence. If you change the use of a property, if it was a principal residence prior to the change, the PRE may be claimed for those years. Note: a "change in use" may result in additional tax implications.[2]

5 **What if I leave Canada for extended periods?** If you weren't a resident of Canada for the entire time you owned a designated property, the period of non-residence may reduce/eliminate the PRE.

6 **What if I move into a care home?** The PRE is only available if the unit is ordinarily inhabited, so a property may not qualify during the time an owner lived in a seniors' facility. As you plan ahead to use the PRE, one option may be to have an adult child occupy the home during this time.

*Or a deemed sale for tax purposes
1. Per family unit. For years before 1982, each spouse can designate a different property
2. www.canada.ca/en/revenue-agency/services/tax/individuals/topics/about-your-tax-return/tax-return/completing-a-tax-return/personal-income/line-12700-capital-gains/principal-residence-other-real-estate/changes-use.html

A Reminder: The TFSA is a Valuable Tool For Every Stage of Life

Do you have available TFSA contribution room? Many of us are not fully maximizing tax-advantaged accounts — even the wealthiest Canadians are overlooking the opportunity. At last count, only 30 percent of taxpayers earning $250,000 or more had fully contributed.[1] Beyond the significance of growing funds on a tax-free basis, here are some reminders of how the TFSA can be a valuable tool:

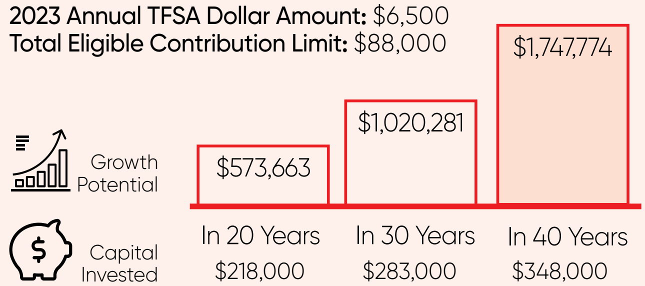
Transferring Wealth While Alive — The TFSA may help to gradually transfer wealth to beneficiaries while you are alive. Gifted funds can be used by adult children to contribute to their own TFSA to grow over time, keeping in mind the loss of control of funds. This can also simplify an estate and potentially minimize taxes upon death.

Approaching Retirement: RRSP/RRIF Meltdown Strategy — There may be benefit in gradually drawing down RRSP/RRIF funds as you approach retirement. One significant reason is if you are in a lower tax bracket than you will be in the future. A strategy may be to use RRSP/RRIF withdrawals to fund TFSA contributions. As the TFSA grows, this tax-free income can augment or replace RRIF withdrawals later. At death, these funds can pass entirely to heirs; residual RRSP/RRIF income could potentially be subject to the highest marginal tax rates.

Funding Retirement — The TFSA can help optimize retirement income and cash-flow streams. TFSA withdrawals are not taxable and won't affect income-tested benefits such as Old Age Security. A TFSA may also help with tax planning. For example, if generating RRIF income will put you in a higher marginal tax bracket, you may be able to minimize tax by withdrawing only the required RRIF amount and using TFSA withdrawals to supplement income. On the other hand, if your marginal tax rate is lower than you expect in the future or at death, funds in excess of the RRIF minimum requirement can be withdrawn and put into a TFSA where they can continue to grow. This can reduce an overall lifetime tax bill. The TFSA can also supplement cash flow if a retiree chooses to defer Canada Pension Plan benefits.

The Extra $1.7 Million: Don't Overlook the Opportunity

2023 Annual TFSA Dollar Amount: $6,500
Total Eligible Contribution Limit: $88,000



This assumes full contributions since 2009 and ongoing $6,500 annual contributions compounded at a rate of 5 percent annually.

Your Estate — The TFSA can be an excellent way to pass along assets on a tax-free basis. Consider the way you have designated beneficiaries: a named "beneficiary" will receive proceeds upon death tax free. However, if a spouse/partner is named as "successor holder," they can continue operating the account "as is" going forward. Please contact the office if you require an update to beneficiary designations.

The bottom line? Ensure you have fully contributed to your TFSA!

1. https://www.canada.ca/content/dam/cra-arc/prog-policy/stats/tfsa-celi/2019/table1c-en.pdf

The Start of a Revolution? The Age of Artificial Intelligence Has Arrived

"In my lifetime, I've seen two demonstrations of technology that struck me as revolutionary…the graphical user interface, the forerunner of every modern (computer) operating system…and artificial intelligence (AI)." — Bill Gates[1]

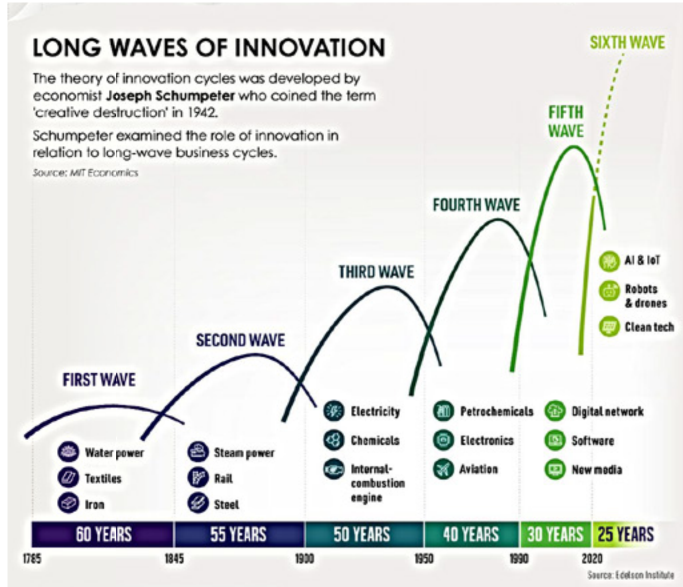
In the summer of 2022, technology pioneer Bill Gates met with the team that developed the algorithm ChatGPT and left them with a challenge: *"Train an artificial intelligence to pass an Advanced Placement biology exam…if you can do that, you'll have made a true breakthrough."* Expecting to keep them busy for two or three years, they came back to Gates in less than a few months. ChatGPT would correctly answer 59 of 60 multiple choice questions on this college-level test and provided outstanding answers to six open-ended questions. Then, to further amplify its capabilities, it masterfully answered this non-scientific question: *"What do you say to a father with a sick child?"* The experience, according to Gates, was "stunning."

Indeed, the age of AI has begun. The remarkable capacity of artificial intelligence is increasingly demonstrating its potential to be a significant disruptor. Quite understandably, it has also ignited a new debate about the threat of our technological advances. Yet, beyond this deeper existential debate, the evolution of AI should remind us of the continued pursuit of humans to constantly advance.

Earlier revolutions, such as those sparked by the development of railroads, electricity and the automobile ignited upwaves of economic growth that lasted for many decades. Consider the impact of the global petroleum industry or the assembly line introduced by Henry Ford — the latter changed global manufacturing processes forever. Will this revolution be any different?

Economist Joseph Schumpeter developed the theory of innovation cycles suggesting that business cycles operate under long waves of innovation (infographic). These new waves emerge as the markets are disrupted by "creative destruction." One observation is that as time progresses, these waves are getting shorter — some suggest that this is because there are diminishing marginal returns for innovation.

What does this mean for investing? Innovation will continue to drive economic growth, just as it always has. Taking a step back, let's not forget that when we invest in the equity markets, we are investing in the businesses that underlie the economy. Over time, economies have continued to progress and grow because of the motivations of individuals and businesses to innovate and advance, as we are witnessing today.



Of course, in the face of increasingly rapid change, our willingness to adapt also remains important. In the third wave of innovation, Ford and GM had hundreds of competitors that caught the imagination of investors. And do you remember Wang and Commodore? They were the high-tech leaders of the 1980s that have faded from view. Investing involves assessing the changing world, with careful analysis, selectivity and a nimble approach.

Though we may currently be enduring slower economic times, we should expect innovation to support the new growth yet to come — and investors can share meaningfully in the change that lies ahead. Continue looking forward!

1. https://www.gatesnotes.com/The-Age-of-AI-Has-Begun

Infographic source: https://www.visualcapitalist.com/the-history-of-innovation-cycles/

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