Silicz Birdsall Advisory Group

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Maintaining Optimism

It is interesting how quickly the primary focus of many market commentators can shift as they look for things to worry about.

A major change in global trade continues to dominate the news as the U.S. imposes tariffs globally. At home, Canada remained sidelined in NAFTA negotiations throughout the summer and the Trans Mountain pipeline project continued to experience setbacks. Italy's ongoing debt issues, complicated by new political changes, as well as Turkey's currency and debt crisis have been a focus; all of which have kept investors on edge. There's even increased chatter of possible impeachment proceedings against President Trump should the upcoming mid-term elections end the Republican control of Congress (click here to read more about that from our Geopolitics team). Doom/Gloom continues!

This is not to say that today's economic headwinds should be ignored. But think about just how much opportunity would have been missed if you followed the underlying pessimistic narrative over recent times! For years, the media has been claiming that equity markets have reached their peak. But we here at the Silicz Birdsall Advisory Group encourage you to adopt the mindset of "half full" not just for markets, but for life in general!

So, why is pessimism so seductive? First, it is innate: Organisms that treat threats as more urgent than opportunities have a better chance to survive and reproduce. A Harvard study showed that pessimism is perceived to be more expert, intellectual and competent. Daniel Kahneman, who won a Nobel Prize for his work on cognitive psychology, showed that people respond more strongly to loss than gain. Optimism often means staying the course, which can appear oblivious to risks. Pessimism requires action, which appeals to human nature because we are more inclined as a species to act than wait.

Being an optimist doesn't mean believing that short-term setbacks won't happen. After all, financial and economic markets are cyclical by nature. But what looks like tomorrow's problem often is not the real issue when tomorrow rolls around. Economies have proven remarkably resilient over time and the future is likely to be no different. We often underestimate our ability to adapt: people, businesses and economies move on from even the toughest setbacks.

How can investors keep perspective in the face of pessimism? One way to do this is to step back from the headlines. Focus on your end goals, not the news of the day. Continue to save and invest steadily for the future. Leave the worry over day-to-day developments to those of us who oversee your investments.

Equally important, invest confidently with your longer-term objectives in mind. Your portfolio is being managed with the expectation that markets will experience both ups and downs. Remember that patience, along with time and the virtues of compounding, are likely to be some of your greatest allies.

So, despite the headlines, we encourage you to be discerning when watching FOX, CNN and even the CBC and instead remember – the glass is half full!

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Offsetting Capital Gains: Tax Loss Selling

Given the extended bull market run, some investors may be considering realizing gains to rebalance their portfolios. As capital gains are subject to tax, one of the more common ways to offset this tax is to use available capital losses. Here is a reminder on how losses may be an opportunity from a tax perspective – it's a stretch here but remember the glass is half full :)

In general, when you sell an investment you must calculate the gain or loss, which is the difference between the proceeds from the sale and the security's adjusted cost base. For tax purposes, the amount included in income is 50 percent of the total gains less 50 percent of the total losses. If losses exceed gains in a particular year they cannot be used to offset other types of income. A net capital loss may be carried back to one or more of the last three taxation years to recover capital gains taxes previously paid and/or carried forward indefinitely to reduce these taxes in the future.

Don't Forget the Superficial Loss Rules

When claiming a capital loss, be mindful of the superficial loss rules. In general, these rules will disallow a capital loss if, during the period that begins 30 days before and ends 30 days after the transaction's settlement date, you (or an "affiliated party") acquire the same security (or property) that was sold at a loss and continue to own it (or have a right to acquire it). An affiliated party includes a spouse (partner), a corporation controlled by you/your spouse, or a trust for which you are a beneficiary. This rule also applies when transferring securities in a loss position from non-registered to registered accounts: the loss will be denied.

Consider Transferring Losses to a Spouse

There may be an opportunity to transfer capital losses to a spouse/partner, such as to offset a spouse's realized capital gains. Or, a spouse may be in a higher tax bracket and your capital losses would provide a larger tax benefit in their hands. This involves using the seemingly problematic superficial loss rules to your advantage. Here, you would sell your loss securities to your spouse at fair market value and file an election in your tax return. Your spouse would hold the securities for at least 30 days and then sell them in the market. To ensure that this is done correctly, consult a tax advisor.

Other Considerations

Given today's weak Canadian dollar, don't forget the effects of currency fluctuations if securities have been purchased in a foreign currency. Take, for example, a security purchased at US$100 in 2012 when the U.S. and Canadian dollars were at par. If it has fallen in price to US$80 and you sold 100 shares, the capital loss would be US$2,000. However, with an exchange rate at the time of sale of US$1=C$1.32, selling the shares for US$8,000 would yield C$10,560, resulting in a capital gain of C$560.

Reasons to Be Thankful

If you've been following the headlines of late, it may seem as though optimism is in short supply. But with Thanksgiving and December holidays falling in Q4, why not take the time to reflect on why we should be thankful. Here is a start – fill up your glass more than half full!

Oh, Canada! – Consider yourself lucky to be living in one of the best nations in the world! Canada was ranked #1 as the world's most admired country in 2017.[1] Calgary, Vancouver and Toronto consistently place in the top 10 cities to live globally each year.[2] What do Canadians think makes our nation great? "Peace", "freedom to live as we see fit", "health care", "being polite" and, of course "Leonard Cohen"![3]

We are living longer and better lives – We have one of the highest life expectancies: over 82 years old.[4] In just two generations, this has increased by almost a full decade. Our standard of living has more than doubled over 50 years: GDP per capita was around $27,600 in 1968 (2018 terms, inflation-adjusted); today it is around $60,000. Necessities and luxuries alike have become cheaper: consider that 30 years ago a microwave cost almost $580 (680W); today it is only $140 (1100W).[5] This, while 70 percent of the world still lives on less than US$10 per day.

There has never been a better time to be an investor – Today, we have access to greater markets, more choice, and better information. Over 50 years, the S&P/TSX Composite Index has appreciated by around 5.9 percent on an annualized basis, with the equity market continuing to be one of the greatest wealth generators of all time.[6]

Your future looks bright – According to a recent survey, 32 percent of Canadians nearing retirement have no retirement savings.7 Advised Canadians save more for retirement, amassing 2.73 times greater assets than non-advised households, and have greater financial confidence about the future.[8]

1. Reputation Institute; 2. Economist EIU; 3. http://abacusdata.ca/the-true-north-friendly-free-what-makes-us-proud-to-be-canadian/; 4. WHO 2018; 5. Report on Business Magazine, 04/12; 6. 1/1/68 to 4/30/18. 7. https//bnnbloomberg.ca/ 32-of-canadians-are-nearing-retirement-without-any-savings-poll-1.991680; 8. After 15 years, IFIC Canada, 2012.

The Positives (and Perils!) of Joint Ownership

(NOTE: NOT APPLICABLE TO QUEBEC RESIDENTS)

Joint ownership of assets has been growing in popularity — with spouses, and now more frequently between parents and children. While there may be benefits, be aware of the potential pitfalls prior to transferring assets into joint ownership.

Joint ownership occurs when an asset is owned by more than one person. Generally, there are two forms of joint ownership: i) "joint tenancy" (with the right to survivorship), an arrangement in which the ownership of the asset passes directly to the surviving owner(s) upon the death of one of the owners.* As such, assets pass outside of the deceased owner's estate; and ii)"tenants in common", in which owners each hold separate ownership interests in the asset that can generally be sold, transferred, or bequeathed without the consent of the others.

Here, we focus on joint tenancy, which is being increasingly used in the estate planning process. Here are some of the positives and potential perils to be aware of prior to entering into this type of arrangement:

First, the positives...

Ease of asset transfer — Upon the death of one owner, the surviving owner(s) automatically becomes the owner of the asset, with few legal or administrative hassles upon transfer.

Bypass probate — Since assets pass to joint owners outside of the will, no probate or estate administration fees are assessed in provinces where applicable.

And now, the potential perils...

Tax implications — There may be tax consequences. For example, if real estate is owned jointly between a parent and a child who already owns a residence, there may be a proportionate loss of the principal residence exemption. Adding a joint owner to a property could also result in the incidence of land transfer tax. For jointly-owned investment accounts, even if tax slips may be received in the names of the joint owners, the Income Tax Act could require attribution of the income earned and owned by one taxpayer to another taxpayer for tax purposes, based on who provided the capital to acquire the assets in question. Depending on the circumstances, adding another party as joint owner could also result in the recognition of some gains or losses for tax purposes.

Loss of control — Joint ownership may mean that the original owner no longer has total control over the assets. With property, decisions regarding its maintenance or sale need to be made jointly. With financial accounts, such as a bank account, a joint owner would generally have the ability to withdraw or use funds.

Estate equalization issues — If the majority of assets are held in joint ownership (outside of the estate), the estate may not have sufficient assets to fund legacies or gifts outlined in the will, or potential tax liabilities due. If an estate is to be divided equally but a jointly-owned asset hasn't been considered, expensive and divisive legal action could result. It also may not be clear if a joint-tenancy arrangement was done for ease of administration or if a change in beneficial ownership was intended.

Exposure to creditors or matrimonial claims — Jointly-held assets may be exposed to claims by a joint owner's personal or business creditors, or ex-spouse. This could force the sale of an asset to cover the payment of debts or claims of the joint owner.

As always, please seek the advice of legal and tax advisors as it relates to your particular situation.

*Not applicable in Quebec, where laws differ and an automatic right of survivorship does not exist.

Did You Know...

The TFSA may be known as the Tax-Free Savings Account, but it isn't always "tax free". Not all investments within a TFSA are held free of tax: Foreign dividend-paying shares may be subject to a withholding tax on dividends paid. For example, the U.S. imposes a 15 percent withholding tax on the dividends paid to Canadians by U.S. corporations. Registered Retirement Savings Plan (RRSP) and Registered Retirement Income Fund (RRIF) accounts are exempt from this tax under the Canada-U.S. tax treaty. For non-registered accounts, this withholding tax can potentially be recovered by claiming a foreign tax credit. However, you can't recover this withholding tax within a TFSA. Also, be aware that eligible Canadian dividend payments held within a TFSA will forego the dividend tax credit.

This is a good reminder that different types of investment returns are taxed in different ways, and each investment account is governed by different tax rules. Thus, the location in which your assets are held (i.e., registered or non-registered investment accounts) can make a difference on your tax bill. Having an overall view of your assets and their location can help with tax efficiency. Please call if you would like to discuss.

Have you thought about opening a USD RSP? As us how! This is a great way to create a future stream of income in USD that you can use to travel when you are retired. Think of this as a glass half full opportunity – your main RSP to fund your retirement living and a potential USD RSp to travel to the US. We are able to buy US-listed securities and avoid the 15% withholding tax on the dividends in such an account. Talk to us for more information.

Business Owners: Tax-Planning for Year End

Is it too early to think about year end? As a business owner, if you are thinking about tax-planning strategies, not at all. Now is the time to take steps in order to help minimize 2018 corporate taxes and plan ahead for 2019. Here are some ideas to review with your professional advisors:

Consider the new passive income and refundable dividend rules...

- For taxation years starting after 2018, certain passive income earned in the company, and associated companies, in excess of $50,000 will reduce the small business deduction (SBD). If you are at risk of exceeding the threshold in future years, there may be options: defer passive income (i.e., wait to trigger capital gains, etc.), realize capital losses or review options to reduce active business income. Be sure to ask us about tax-efficient investments if this affects you!
- With the new income sprinkling rules in place restricting the payment of dividends, consider whether family members can be paid a reasonable salary.
- Changes to the company's refundable dividend tax on hand ("RDTOH") account will be effective for taxation years after 2018, so consider whether RDTOH should be refunded in the current year.

Minimize the impact of taxes on bonuses...

- Bonus payments can be deferred up to 179 days after a corporation's year end and the company can still claim the amount as a deduction for tax purposes in the current year. With federal corporate tax rates decreasing in 2019, it may be beneficial to get the deduction at a higher rate. However, consider whether you believe personal tax rates will change in 2019, potentially offsetting the benefit.
- For year-end bonuses, consider having the company contribute directly to the employee's Registered Retirement Savings Plan (RRSP). While this is considered employment income, there are no income tax withholdings required (CPP and EI withholdings will apply if maximums have not been reached in the calendar year).

Evaluate how funds are extracted from the corporation...

- Review your remuneration strategy to determine if it is more tax effective to receive salary or dividends, especially if the company's SBD will be reduced by the amount of passive income earned in the company. Changes to provincial and/or federal tax rates may change "integration", so there may be advantages to paying one over the other.
- Since other-than-eligible dividend tax rates will be increasing in 2019, determine whether it is more advantageous to declare dividends in 2018. This is critical!
- If you require funds before year end, consider repaying shareholder loans, declaring capital dividends or reducing the paid-up capital of your shares in order to extract funds on a tax-free basis.

Time the purchase of capital assets...

- Consider purchasing fixed assets before the end of the company's tax year. Currently, you can claim one-half the amount of tax depreciation, or capital cost allowance (CCA), to reduce business income in this fiscal year and claim the full amount next year.

As always, please seek professional advice for your situation.

Preparing for a Recession in a Bull Market

Is a recession imminent? Renowned economist John Kenneth Galbraith once said that the "only function of economic forecasting is to make astrology look respectable." While we still encourage you to see the glass as half full, we are realists and know that historically, sooner or later, a pull back will happen.

With the current economic expansion now over 10 years old — one of the longest in recent history — whenever there is negative news, certain voices of the media can be quick to suggest that we are moving towards a recession.

A recession is a period of decline in economic activity, generally defined by two consecutive quarters of falling gross domestic product (GDP). This slower growth is often characterized by weakening employment, slower sales and production and lower discretionary spending. During recessionary times, it isn't uncommon for equity markets to experience a bear market.

Your portfolio has been positioned for the longer term, with the expectation that economic and financial markets will experience both ups and downs. Each element of your portfolio has been put in place for a reason, including income protection or growth, income generation, tax-efficiency, and geographic or sector diversification, among others and will depend on your personal circumstances, such as risk tolerance or stage of life. Here are some ways in which it can be structured to help weather the inevitable down periods:

Quality — A focus on quality equity investments can help to provide protection during more difficult market times. High-quality, well-established companies are often better positioned to endure prolonged periods of market weakness. Companies with strong balance sheets, little debt and healthy cash flows can better fund operations during a recession. Many quality companies continue to pay, and even increase, dividends during market downturns.

Diversification — A well-diversified portfolio can help to spread risk and minimize the potential for loss. Certain industries, such as consumer staples, may provide a buffer to shield against the downside because they serve consumers' basic needs throughout every market cycle. Different geographies may be in earlier stages of the economic cycle. Even asset classes may perform differently during down periods: fixed income may provide downside protection when equity markets experience volatility.

Income-generation — For investors with specific income needs, such as retirees, a fixed income strategy may help cover these needs should the equity portion of a portfolio require time to return to more stable levels. A "ladder strategy", structuring fixed income investments with maturity dates spaced over time, can help to address the need for income.

Rebalancing — If the value of one holding has increased so much that it makes up a disproportionate part of the overall portfolio, it may be an opportune time to consider selling it to restore balance. Rebalancing when the markets aren't under recessionary pressure may help to better achieve the objective of selling high.

All of these elements point to the importance of managing risk, not eliminating it. Avoiding all risk often means forgoing most return as well. Most importantly, when recessionary times eventually arrive, remember that they are temporary. This is not a time to abandon your plan — it has been put in place to help you meet your longer-term goals. It is worthwhile to remember that past consolidations have resulted in a return to new highs each time, and often without warning. Have confidence in your plan and please call if there are concerns.

Preventing Elder Abuse

Nobody wants to believe that someone they love or trust could be capable of elder abuse. But with estimates indicating that around 10 percent of elderly individuals may be victims,[1] there is reason to be concerned. Financial abuse is one of most common types of elder abuse and it can take many forms, from bullying and manipulating to outright theft. Sadly, it is often close relatives or friends who are responsible for the abuse.[2]

Here are some signs that may indicate financial abuse:

- **Unusual financial activity –** Unexplained account activity, including withdrawals or credit card charges, may indicate that an elderly individual is being coerced. Sometimes funds are "borrowed" but never repaid; cheques may be cashed without authorization, or by forging a signature.
- Missing valuables – Lost items may indicate abuse, but can easily be dismissed if an elderly person suffers from cognition problems. Helping to locate missing valuables can determine if the issue is simply confusion, or if it signals a larger problem like abuse.
- Appearance of a new caregiver/friend – A new companion may be a cause for concern if warning signs are present, such as unusual financial activity or missing personal effects.
- Changes to important legal documents – Unexplained changes to important documents, such as a will or power of attorney documents, may indicate potential abuse. Sometimes seniors are coerced or deceived into signing documents.

While there are often signs, elder abuse may be difficult to uncover and can continue for long periods of time. Victims may become secretive because they feel ashamed or embarrassed, or they may fear punishment or retaliation from their abuser.

One way to help prevent elder abuse is to take steps in advance to protect those who may be vulnerable:

Prevent isolation – Form a wide support network of family, friends and professional advisors. These individuals can help identify problems and intervene where necessary. Widening an elderly person's network can help to provide support from trustworthy sources.

Check in – Call and visit as often as possible or find a trusted confidante to check in. This can help identify warning signs that indicate abuse. Listen closely to the elderly person when they share information. Ask questions and never dismiss potential red flags.

Offer support – Offer simple support with finances, such as conducting a quick scan of bank or credit card statements to make sure things are in order. Or offer support for larger projects, such as helping to update financial documents or conduct a credit check. These reviews may uncover abuse.

Put safeguards in place – Plan ahead and find trusted individuals to act as power of attorney. This may include appointing a professional (such as a trust company) to work alongside a family member to help provide a safeguard, if necessary.

Many resources are available to provide support. A starting point is the Government of Canada website: canada.ca/en/employment-social-development/campaigns/elder-abuse/financial-reality.html

Bonus Tip – set up an RESP – If you're able, you may want to capitalize a grandchild or great grandchild's education via an RESP. Talk to us about this because you have many options – you could capitalize it in entirety upfront, allowing the growth to compound over 18+ years, or you can take advantage of grants of up to $7,200 over time. Does this situation apply to you? Please let us know if it does.

Notes: 1. http://www.carp.ca/2016/10/14/elder-abuse-widespread-problem/; 2. https://cnpea.ca/images/canada-report-june-7-2016-pre-study-lynnmcdonald.pdf

Rental Properties: Don't Let Taxes Surprise You

With interest rates on the rise and price cooling measures introduced by the government, many people have been reassessing their real estate rental holdings. As part of this exercise, it is important to understand the impact of income taxes so that there aren't any surprises upon sale of the property.

Annual Taxation

In your personal tax return, you report the rental income received and any expenses incurred to earn that income, such as insurance, property taxes and other related expenses. Mortgage payments cannot be fully deducted; only the interest component of the mortgage payment is tax deductible. However, it may be possible to annually amortize the cost of the rental property (other than the land value) for tax purposes to reduce the amount of rental net income reported each year. The amount of amortization that can be claimed in a year is limited to the net income of the rental property (so you cannot create or increase a loss from the property to use against other income). While claiming amortization provides an immediate tax benefit, it can create a future tax liability when you sell the property.

Seek Assistance

Income tax should be considered when evaluating real estate as an investment as it can significantly impact the effective rate of return. Consult a tax advisor to review your situation.

Sale of Property

When the rental property is eventually sold, there are at least two major tax issues to be aware of. First, if the property is not your principal residence, you may be subject to capital gains tax. This is equal to the difference between the proceeds received and the adjusted cost of the property (the original purchase price plus any capital improvement costs). One half of any gain is subject to tax.

Second, and often overlooked, is a tax "recapture" that applies when a property is sold for an amount that is above its depreciated tax base. If you have benefitted from claiming amortization in previous tax years, you may need to bring all (or a portion of) this amount back into income for tax purposes. The amount included in income is the lesser of proceeds received and the adjusted cost basis minus the undepreciated capital cost of the property.

For example, assume Mary bought a rental property for $380,000 a few years ago. She claimed a cumulative amount of amortization over the years of $90,000. If Mary sold the property for $600,000 in the current year, she would report a taxable capital gain of $110,000 ($600,000 – $380,000 = $220,000 X 50%). In addition, since both the proceeds received ($600,000) and the cost basis of the property ($380,000) exceed the unamortized cost of the property ($380,000 – $90,000 = $270,000), her recapture amount would be $90,000 (the lesser of $600,000 and $380,000 minus $270,000). In Mary's case, her modest employment income normally puts her in the lowest tax bracket, but including the taxable capital gain of $110,000 and recapture of $90,000 of income now puts some of her income in a higher tax bracket. As a result, she could be taxed on the recapture at a higher tax rate than the deduction she received previously on the amortization at the low tax rate.

Bonus Tip – Way to increase RSP room for statute professionals/business owners

Rental income claimed personally can increase your RSP contribution room. Are you a professional or business owner still being paid in dividends from your corporation? If so, talk to us immediately – tax rules have changed and you may want to consider this as a way to increase your RSP room that you might not otherwise have! Josh Mitchell on our team is the one to talk to about financing. Let us know if you'd like to discuss this further!

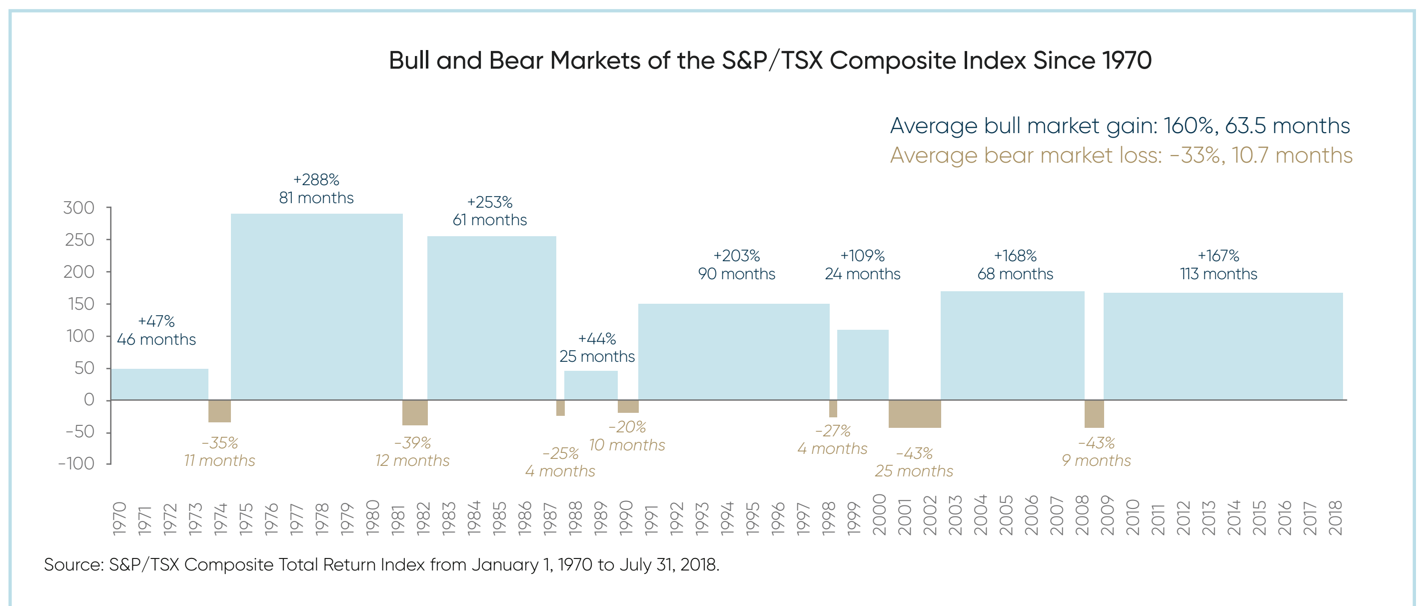
The Bulls and the Bears

This past August, both Canadian and U.S. equity markets boasted a new record for having one of the longest bull markets in modern financial times. A bull market is often defined as a period in which stocks have increased by at least 20 percent, over at least a two-month period. A bear market occurs when stocks have fallen by at least 20 percent.

Let's take a look back at the history of the bull and bear markets of the S&P/TSX Composite Index since 1970. There have been eight bull markets and seven bear markets. Bull markets have been longer, averaging around 63.5 months, whereas bear markets have lasted on average only around 10.7 months. Bull markets have provided a more significant percentage change in value — given that it takes a 100 percent gain to make up for a 50 percent loss, the gains were enough to produce significant returns, as shown in the chart below.

Does the current aging bull market still have legs to run? Nobody can predict the direction of near-term markets, except to say that equity markets are cyclical. Given that there are differing ways to define a bull market, by some accounts this isn't the longest run in recent times,[1] which may provide comfort to those who support the old adage that bull markets never simply die of old age.

But, as history has shown, the upturns, on balance, have lasted much longer than the downturns and have taken stock prices to much higher levels than their former peaks. Regardless, we continue to manage portfolios with the expectation that stock markets will experience both bull and bear markets. All good food for thought, as we continue to look forward.



Source: S&P/TSX Composite Total Return Index from January 1, 1970 to July 31, 2018.

1. bloomberg.com/news/articles/2018-08-21/longest-bull-market-in-history-comes-with-jumbo-sized-asterisk

What's new around the office?

We'd like to introduce you to the newest member of our extended family – Winston Boutet!

This ravishing young pup is only 14 weeks-old and has found a loving home with Tracy and her family! Be sure to ask her how Winston is doing! Winston's favourite things include chewing on the kids' toys and shoes of all sorts, going for walks, bath time and frequent visits to the pet store for treats. Welcome to the extended family Winston!

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