Wealth Insights

Personal Newsletter from The Riedl Group

SUMMER 2022

The Riedl Group
National Bank Financial
Wealth Management

John Riedl, CFA®
Senior Wealth Advisor &
Portfolio Manager

Leigh Kershner, CIM®, CFP®
Wealth Advisor &
Portfolio Manager

William Real, CIM®, PFP®
Wealth Advisor

Angelina Spraggs
Senior Wealth Associate

Sylvia Cai
Wealth Associate

As advisors, we've managed through challenging economic periods and market pullbacks before. This issue of our newsletter provides some thoughts on the importance of holding on through difficult times. Longer-term investing involves enduring the inevitable cycles, entrusting that your wealth plan has been put in place to benefit your future. As always, we are here to help.

May you find time to enjoy many leisurely pursuits in the summer days ahead.

—**The Riedl Group**

The Importance of Holding On

It has been difficult to find much market commentary that suggests positive developments in the financial and economic markets over recent times. The reasons are many: high and persistent inflation, more aggressive tightening policies by central banks and the prospect of recession. This has created significant uncertainty over the path forward.

Indeed, humans can react unfavourably to uncertainty. Studies have shown that our emotions are a key driver of stock market volatility over shorter periods. One study suggested that roughly 75 percent of short-term market variation can be explained by risk aversion.[1] This is likely because, in the short term, we underestimate our ability to adapt.

Today is no exception. We have seen significant volatility in the financial markets. Market pundits have been having a field day creating worry that this time is different. However, some perspective is warranted. Let's not forget that, over time, economies and financial markets have continued to adapt and progress. We have also come from a time in which record stimulus benefitted both the markets and economies, so a period of adjustment can be expected. Many company earnings that thrived over recent times must now adjust as consumption patterns balance towards a post-pandemic world. High inflation has been a prevailing headwind and although it has been more than just transitory, consider that it will also not be permanent.

Economies, like the markets, are cyclical in nature, so anyone who forecasts a recession has a good chance of eventually being right. In Canada, first quarter GDP grew at a rate of 3.1 percent. Although GDP contracted in the U.S., labour markets in both nations continue to be robust and, for now, household balance sheets suggest consumer resilience. We should also remember that recessions vary in their duration and intensity; the past two lasted only three and seven months.

This is not to suggest that there aren't challenges ahead. We have entered a period of slower growth globally and continue to face many uncertainties. As such, it may be difficult to not take action when experiencing market pullbacks. However, for investors who may feel the urge to sell investments for fear of a greater loss during these times, this can create two issues — selling at low prices and the inevitable need to re-enter the markets. Consider also that the biggest up and down days have historically clustered together and missing the market's best performance can significantly impact future returns (see page 3). And, it's not just the inherent difficulty in timing the market: Selling and rebuying can potentially create a costly tax situation in certain accounts or forego dividend income opportunities.

Consider also that one of the most important variables for how you'll do as an investor can be how long you are able to stay invested. This is because success for many investors comes from uninterrupted compounding over years and decades. In the words of renowned investor Charlie Munger, Warren Buffett's business partner, "the first rule of compounding is to never interrupt it unnecessarily." Don't overlook the importance of holding on.

We understand the challenges that come from an uncertain near-term outlook. During periods such as these, investors should try to stay focused on longer-term goals. Keep your eyes on the horizon, stay invested and look beyond today, as better times will eventually prevail.

1. www.nber.org/papers/w19818

In this issue

- Federal Budget 2022 Recap
- Can I Sell the Cottage to My Kids for $1?
- Estate Planning: Protecting Harmony
- Reasons to Stay Invested

NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

The Riedl Group

Federal Budget 2022 Recap: Few Significant Changes for Investors

This past spring, the federal government delivered its budget with few significant changes for investors: no changes to the capital gains inclusion rate or federal income tax rates. Many initiatives address the hot housing market. Here are some highlights:

Tax-Free First Home Savings Account (FHSA). The federal government proposed a new account to help Canadians save for their first home. Expected to begin in 2023, the account will have a lifetime contribution limit of $40,000, with an annual limit of $8,000. Contributions will be tax deductible, similar to the RRSP, and withdrawals will be tax free, similar to the Tax-Free Savings Account (TFSA). When the FHSA was originally proposed in the 2021 election campaign, it came with an age limit. This was removed in the most recent budget. If this change stands, a recent article in the popular press suggests that tax-planning opportunities may be available to older Canadians by using the FHSA as a savings tool.[1] Stay tuned for updates as the rules are finalized and details become clearer.

Multigenerational Home Renovation Tax Credit. This proposed refundable tax credit offers up to $7,500 by allowing qualifying families to claim 15 percent of up to $50,000 in eligible renovation and construction costs incurred to construct a secondary suite for a senior or adult with a disability.

Residential Property Flipping Rule. Under proposed rules, property sold that is held for less than 12 months would be considered "flipping" and any profits would be subject to full taxation as business income (with certain exceptions). Where the new rule applies, the Principal Residence Exemption would not be available.

Small Business Deduction. Under current rules, access to the small business deduction is reduced when a Canadian-controlled private corporation has taxable capital greater than $10 million, reducing to nil with taxable capital of $15 million or more. The budget proposes to change the formula such that the small business deduction will not be reduced to nil until the corporation has taxable capital of $50 million.

Minimum Tax for High Earners. The federal government announced an intention to revisit the current Alternative Minimum Tax regime with a view to ensuring high-income earning Canadians pay a minimum level of tax. Further details are expected in the 2022 fall economic update.

At the time of writing, these proposals have not been enacted into law. For greater detail, please see the Government of Canada website: https://budget.gc.ca/2022/home-accueil-en.html

1. "Three ways to make the most of the new tax-free savings account for home buyers," Erica Alini, The Globe and Mail, April 30, 2022, B15.

Luxury Vehicles: Prices Are Set to Increase

The federal government quietly released revised draft proposals in the spring to introduce a luxury tax on certain vehicles. As of September 2022, this luxury tax is set to apply to cars and aircraft with a retail sales price over $100,000 and boats over $250,000.

The tax will be based on the retail sales value of the good and is proposed to be calculated as the lesser of:
(a) 20 percent of the retail sales price that exceeds the thresholds: $100,000 for cars/aircraft, $250,000 for boats; or
(b) 10 percent of the full value of the luxury car, boat or aircraft.

For more information, see the Government of Canada website: www.canada.ca/en/department-finance/news/2022/03/government-releases-draft-legislative-proposals-to-implement-luxury-tax.html

You Asked: Transferring Family Property to the Next Generation

With the arrival of summer comes cottage and cabin season once again! Many family properties have been owned over generations and there is often a desire to keep them in the family for decades to come. Yet, many children do not have the funds needed to buy the property.

In working with clients, we are often asked questions about cottage/cabin succession planning. One question that is commonly asked is: Can I sell the cottage to my kids for $1, or a value substantially lower than its fair market value (FMV)? This is often to try and avoid the capital gains tax. When a cottage is not considered a principal residence, capital gains tax will generally be due on the difference between the FMV and adjusted cost base (ACB) of the property.

However, selling less than FMV is likely to lead to significant tax consequences. The child's ACB will be determined by the actual price paid, which may lead to the child paying tax on a gain already realized by the parent when the child eventually sells the property.

Take, for example, a cottage that is sold for $1 to a child. If the FMV is $1 million and the ACB to the parent was $400,000, the taxable capital gain to the parent would be 50 percent of $600,000 (or $300,000). For the child, a purchase at $1 results in the child's ACB being $1, rather than the property's FMV.

So, if the property is sold in the future for $2 million, the capital gain would be the full $2 million less $1. This results in double taxation as it includes the parents' earlier capital gain, as well as the original amount paid for the property. Instead, there may be better options, such as gifting the cottage. Although there will be a substantial tax liability to the parent at the time of gifting, the child's ACB will be equal to the FMV at the time and double taxation will be avoided.

As always, consult with legal and tax advisors familiar with cottage succession planning to help you understand the options available.

Your Estate Plan: Are There Ways to Better Protect Family Harmony?

An estate plan should consider more than just how you distribute your assets. It can also include strategies for preserving family values and relationships. This may be important: it isn't uncommon for even the most harmonious of families to undergo bitter disputes when dealing with the distribution of assets of an estate. As such, the time you invest in planning has the potential to leave a lasting legacy of family harmony. Here are some thoughts:

1. Keep documents updated — Consider reviewing your estate plan periodically to ensure it reflects your current thinking and to avoid future conflict. If you have a Will in place, how old is it? Perhaps this may be a good time for a thorough review of your estate planning documents, especially if circumstances have changed. Equally important: reviewing your designated beneficiaries, where applicable. Many investors fail to revisit these designations to account for major life changes, such as marriage, divorce or the birth of a child.

2. Rely on professional support — Improper documentation or vague instruction can lead to misunderstanding, conflict and even escalate to a costly court battle. While you are able to create estate planning documents on your own, such as by using an online Will service, even if the document is valid, do you fully understand the family and succession laws of your province, or income tax and investment rules? These can change over time and should be evaluated against your estate plan. With the rise in blended families, balancing competing interests from children, stepchildren and a new spouse may be challenging. The support of estate planning professionals can help ensure assets are distributed as intended.

3. Communicate — Sharing your intentions with beneficiaries can help manage expectations and prevent future conflict. While the topic of death is not always easily broached, consider

communicating with loved ones while you are alive about your estate. In-depth details do not have to be provided, but high-level conversations can be beneficial to avoid future surprises. These conversations can also help you understand the wishes of loved ones for when you are gone, including for items of sentimental value, which can commonly become the centre of conflict.

4. Understand the implications of joint ownership with children — Joint ownership* is sometimes used to simplify the transfer of assets on death. In certain jurisdictions, it is used to minimize probate fees. Yet, it has the potential to lead to complications, often relating to estate equalization. It is a common cause of stressful lawsuits that will easily surpass the cost of probate — perhaps the exact situation you were trying to avoid in the first place! There may also be unintended consequences, such as tax implications or exposing assets to potential creditors.

5. Consider the support of a professional executor — It may be money well spent to consider a corporate executor. This can help to preserve impartiality if you have children you were considering appointing as executor(s). More important, it can help take the burden off of loved ones during what is often an emotionally difficult time.

Please seek the support of estate planning specialists for your situation.

*Not applicable in the province of Quebec.

Perspectives for Volatile Times: Reasons to Stay Invested

During periods of significant volatility, it may feel difficult to be invested in the equity markets. However, without risk there would be no returns — and equities continue to be one of the greatest generators of wealth of all asset classes. Maintaining discipline and patience throughout volatile times and staying invested is important.

Volatility is a reminder that portfolio growth does not occur at a steady rate. Yet, time reduces the volatility of returns. As history has shown, negative market performance smooths out as an investor's time horizon increases. Over the past 30 years, the likelihood of the S&P/TSX Composite Total Return Index experiencing a negative monthly return is 38 percent. This drops to 13 percent over a three-year rolling holding period, and 0 percent over seven-year rolling holding periods and beyond (chart 1).

Time in the markets also allows investors to participate in the best performing periods in the markets, which, as discussed in our cover story, can often cluster around the worst market declines. Missing these periods can be costly. The chart shows the impact of missing the best performing months of the S&P/TSX Composite Total Return Index over a 30-year period. By staying invested, a notional investment of $1,000 would have grown to $12,693. By missing the five best months, this would fall to $7,503 (chart 2).

These are just two reasons to continue to keep perspective and stay invested during volatile times.

Chart 1: S&P/TSX Composite Index % of Negative Returns Since 1991

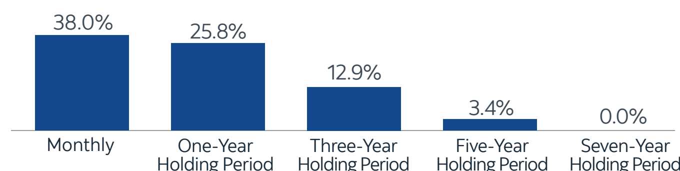
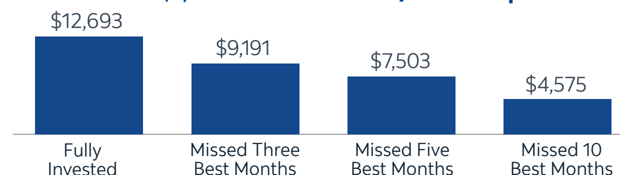


Chart 2: Return of $1,000 Invested in S&P/TSX Composite Since 1991



Source: S&P/TSX Composite Total Return Index from 12/31/91 to 12/31/21.

Estate Planning: Will You Join the Top One Percent of Taxpayers?

When we reach retirement, it is common for many individuals to have a marginal tax rate that is lower than during their prime working years. However, at death, this may change substantially. This is because our property is deemed to have been disposed of at fair market value at death and subject to taxation. In some cases, individuals will join the top one percent of taxpayers as the estate will be subject to a high marginal tax rate.

For couples, the taxes that are incurred on death may be deferred by using the spousal rollover — the transfer of certain registered funds (such as the Registered Retirement Savings Plan (RRSP) and Registered Retirement Income Fund (RRIF)) and/or capital property to the spouse (common-law partner) upon the death of the other. With this transfer, there will be no immediate tax consequences to the surviving spouse. However, once the surviving spouse passes away, the transfer of these assets may result in the estate being subject to the highest marginal tax rate, potentially leaving a tax bill that may significantly reduce the value of an estate.

As many of us wish to pass along as much of our hard-earned wealth to our beneficiaries, are there ways to better plan for the eventual tax liability?

Here are three considerations that may require forward planning:

The RRSP exit strategy. While postponing withdrawals from the RRSP until retirement by using the RRIF takes advantage of the tax-deferral opportunities, waiting too long to draw down significant savings may have consequences. If you have other taxable income streams in retirement, you may be pushed into a higher marginal tax bracket. This may also result in a clawback of OAS benefits. As you approach retirement, and if you are in a lower marginal tax bracket, it may make sense to slowly draw down RRSP/RRIF funds. If you aren't in need of these funds, a potential opportunity may be to use these withdrawals to fund a Tax-Free Savings Account to benefit from the future growth opportunity of the investments, as well as their eventual tax-free withdrawal.

Converting a portion of the RRSP to fund insurance. Often, for high-net-worth investors who have contributed significantly to their RRSPs over their working years, there will still be funds available within the RRIF accounts at death. A partial drawdown to fund insurance can help to minimize the overall lifetime tax bill, especially when withdrawals occur in years in which the marginal tax rate is not at its highest. Funding a life insurance policy may be a way to provide an inheritance on a tax-free basis to the beneficiary(ies). Joint last-to-die life insurance is commonly used for this purpose by spouses, as insurance proceeds are paid out only upon the death of the surviving spouse.

Electing to not use the spousal rollover. There may be reasons to elect out of a spousal rollover for certain assets upon the death of the first spouse when there are opportunities to offset the potential tax liability. This can be done on a property-by-property basis. One common reason may be to use the deceased taxpayer's lifetime capital gains exemption (where available). It may also make sense when the deceased's marginal tax rate is low on the date-of-death return. Finally, the first spouse may have unused capital losses carried forward that can be used to offset the resulting capital gains. A tax professional can help explore the options.

Seek Assistance

These are just some of the potential tax-planning opportunities to consider as you plan ahead. Please seek the advice of a tax planning professional as it relates to your particular situation.

With the compliments of...

The Riedl Group, National Bank Financial Wealth Management
The Exchange Tower, 130 King Street West, Suite 3100, Toronto, Ontario M5X 1J9
TF: 1-800-636-3675 Fax: 416-869-1498

John Riedl, CFA®
Senior Wealth Advisor & Portfolio Manager
416-507-9049
john.riedl@nbc.ca

Leigh Kershner, CIM®, CFP®
Wealth Advisor & Portfolio Manager
416-869-2993
leigh.kershner@nbc.ca

William Real, CIM®, PFP®
Wealth Advisor
416-507-9010
william.real@nbc.ca

Angelina Spraggs
Senior Wealth Associate
416-869-6785
angelina.spraggs@nbc.ca

Sylvia Cai
Wealth Associate
416-507-8898
sylvia.cai@nbc.ca

Please note that comments included in this publication are not intended to be a definitive analysis of tax law. The comments contained herein are general in nature and professional advice should be obtained in respect of any person's specific circumstances. This newsletter has been prepared under contract for the Investment Advisor noted by J. Hirasawa & Associates and is published for general information only. Contents copyright by the publishers. The opinions, estimates and projections contained in this publication are those of the author as of the date indicated, are subject to change without notice and do not necessarily represent the opinions of National Bank Financial, its affiliates and subsidiaries. The information contained herein was obtained from sources which we believe to be reliable; however we cannot represent that it is accurate or complete. National Bank Financial is not a tax advisor and we recommend that clients seek independent advice on tax-related matters. Neither the information nor any opinion expressed constitutes a solicitation by us of the purchase or sale of any securities or commodities. These comments and opinions are not necessarily the opinions of National Bank Financial. Securities mentioned may not suit all types of investors. National Bank Financial may act as financial advisor, fiscal agent or underwriter for certain companies mentioned herein and may receive remuneration for its services. National Bank Financial is a member of CIPF and is an indirect wholly owned subsidiary of National Bank of Canada. The National Bank of Canada is a public company listed on the Toronto Stock Exchange (NA:TSX).