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TAXATION

RRSP Myth Busters

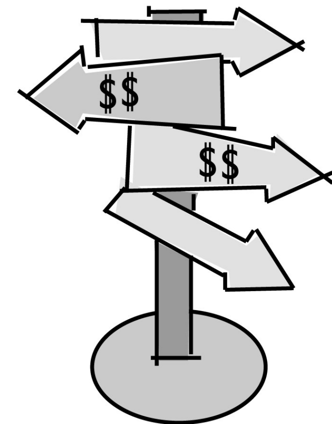
While a self-directed RRSP is still invested through a financial institution, some investors like being in charge of how they invest their money in "qualified investments" within this structure.

For investment-wise taxpayers, the self-directed RRSP may be a smart move, but sometimes an idea comes along that seems even better. Maybe you can have your cake and eat it too. Or can you?

Transferring Stocks to a Self-directed RRSP

What happens if you should have a loss on an investment that is outside of your RRSP? Some taxpayers think there is a tax advantage to transferring this investment to their self-directed RRSP.

Say, for example, a taxpayer's investment portfolio includes shares in XYZ public company that nose-dive from the original purchase price of $100 per share to $30. In the same year, the taxpayer does exceptionally well on shares invested in the public company, ABC — the shares soaring from the purchase price of $50 two years ago to $250 today. A good tax planning strategy might be to sell the shares of XYZ and apply the capital loss of $70 per share against the capital gain of



$200 per share on ABC, thereby reducing the overall tax liability for this taxation year.

However, this taxpayer decides it is more advantageous to sell the shares of XYZ to his self-directed RRSP, still claim the tax loss and hope that the stock's current value of $30 will appreciate over time as a tax-deferred RRSP investment. At first blush, the strategy would defer the future capital gains on XYZ within the RRSP while providing a loss to offset the tax liability on the $200 per share gain on the shares of ABC.

Sound like a good plan? The CRA does not agree. A loss on a disposition to your or your spouse's RRSP has been denied for many years. Since the loss is of no value to your RRSP, it is permanently lost.

In addition, a recent change in tax law sets out that the individual and the self-directed RRSP are affiliated for tax purposes. Effectively, this affiliation means that if you sell investments at a loss — whether to your RRSP or through the stock market — and the RRSP purchases identical property within 30 days of the transaction, the loss is considered to be a "superficial loss" and is denied.

In terms of the above example, the rules basically state that if the XYZ shares were sold and the RRSP purchased those shares within 30 days of the XYZ sale, the taxpayer cannot claim the loss on the sale of the shares. Once passed, the proposed change is retroactive to March 23, 2004.

If you have transferred investments to a self-directed RRSP, consult with your chartered accountant to determine if the transaction will have an impact on your personal tax liability. As a general rule, when transferring an asset to an RRSP, you should ensure the asset is transferred at its current value. Transactions that occur at other than the current value will result in adverse income tax consequences.

RRSP Investment Scams

The advertisement or e-mail extols "Take advantage of your RRSPs now — no tax to pay," or "I will loan you $5,000 to $250,000 over five years if your RRSP is locked in."

The promoters of these financing schemes promise RRSP owners that they can make tax-free withdrawals from their RRSPs. Typically, the arrangement involves using an individual's self-directed RRSP to purchase shares of a private company. The funds used to purchase the shares are then loaned back to the owner of the self-directed RRSP at an interest rate that is either very low or zero. Sound good?

In fact, taxpayers who respond to these kinds of advertisements risk losing both their retirement savings and the tax benefits of their RRSP. You cannot make tax-free withdrawals from your self-directed RRSP by investing in private companies that, in turn, agree to lend you your own money. The rules are that if you use an RRSP as security for a loan, the value of the RRSP will be added to your taxable income.

Be Tax-wary, not Tax-weary

The above discussion focuses on some of the many issues you need to consider in effectively managing your RRSP investments. As there are many different RRSP investment alternatives available, be sure to get professional advice on your tax planning strategies to ensure you take full advantage of this opportunity to save for your retirement years without undue tax consequences. ■

TAXATION

Home Buyers' Plan

With low interest rates and financial institutions vying for your mortgage business, purchasing a home today has never been easier.

Increasingly, financial institutions are offering consumers the financing flexibility that allows them to purchase a house or condominium with a low or no down payment. Although wonderful in theory, having a larger mortgage increases the financial pressures of meeting mortgage payments, household bills, day-to-day expenses and the inevitable additional expenses that arise with a home purchase.

With the Home Buyers' Plan (HBP), a withdrawal from your RRSP may be the solution that will provide more disposable income. As long as you make the required repayments, this withdrawal will not be subject to tax.

The “First-time” Home Buyer

The HBP allows you to withdraw up to $20,000 from your Registered Retirement Savings Plan (RRSP) to buy or build a qualifying home for yourself (as a first-time buyer) or for someone who is related to you and is disabled.

A great feature of the HBP is if you are buying the qualifying home with your spouse or common-law partner, or with other individuals, each of you can withdraw up to $20,000.

You are considered a “first-time” buyer if you have not owned a home that you occupied as a principal residence at any time in the last five years.

However, if your RRSP is locked-in, you may not be able to withdraw funds for the HBP. A locked-in RRSP is usually the transfer value of pension benefits you have built up in a former employer’s pension plan, which is subject to the restrictions and limitations of the *Pension Benefit Act* in your province or territory. Contact your issuer if you are not sure if your RRSPs are locked in.

Participating in the HBP

In order to participate in the HBP, you must meet a number of conditions, some of which must be met *before* you make the withdrawal from your RRSPs and others that must be met *when* or *after* you receive the funds.

Generally, you must meet all the HBP conditions yourself although in some situations, the conditions may apply to another person, such as when you withdraw the funds to buy or build a home for a related disabled person. However, regardless of the situation, you are responsible for ensuring that all HBP conditions are met.

The key conditions are that you must:

- Be considered a first-time buyer unless buying a home for a disabled person or assisting that person to buy a home;
- Intend to occupy the qualifying home as your principal place of residence;
- Be a resident of Canada; and
- Buy or build the qualifying home before October 1 of the year after the year of the withdrawal.

Neither you nor your spouse or common-law partner can own the qualifying home more than 30 days before a withdrawal is made. Therefore, it is important to apply early enough so that the funds can be received no later than 30 days after the home is acquired.

There are other considerations with respect to outstanding HBP loans, common-law relationships, separation agreements and divorce settlements, so it is important to investigate whether you qualify in these situations.

Before you proceed with a HBP, be sure to discuss your eligibility with your financial advisor or chartered accountant.

Making the Withdrawal

Before applying to withdraw the funds, you must first have entered into a written agreement to buy or build a qualifying home. Obtaining a pre-approved mortgage does not satisfy this condition. If you are withdrawing the funds to help a related disabled person who is buying or building a qualifying home, then it is the related disabled person who must have entered into the written agreement.

To make the withdrawal under the HBP, you must complete a prescribed CRA form and provide this to your RRSP issuer. You can withdraw a single amount or make a series of withdrawals throughout the same year, as long as the total of your withdrawals is not more than $20,000. If your withdrawals exceed the amount allowed under the HBP, the excess amount will be included in your taxable income for the year you received it.

Repaying Your RRSP

You have up to 15 years to repay the amount withdrawn under the HBP in annual amounts that are 1/15 of the total withdrawal. You can repay more than this amount in any year, but you will still have to make the required, albeit smaller, payment the following year. Your first payment is due the second year following the year in which you made your withdrawals. If you do not make the required payment, the amount will be included in your income and you will not be able to repay that amount to your RRSP in future years. This reduces the amount of your tax-deferred retirement savings.

For example, if you withdraw $20,000 from your RRSP under the HBP, the designated annual payment would be $1,333 per year until the total amount withdrawn is repaid. So if you contributed $8,000 to your RRSP in a particular year, you could designate $1,333 as a repayment under the HBP and claim the remaining RRSP contribution of $6,667 on your tax return. If you applied the entire $8,000 against the HBP in the first year, the required payment in the second year would be $857 ($12,000/14 remaining years).

Weighing the Pros and Cons

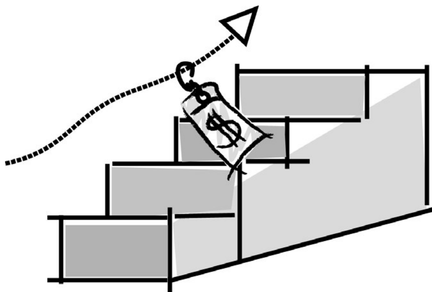
The key advantage of the HBP is the interest-free borrowing. As well, the amount is not subject to withholding taxes when the funds are used under the HBP, as they would be if you withdrew other funds from your RRSP. If you have withdrawn funds from your RRSPs under the Lifelong Learning Plan and you have not yet fully repaid the balance owing, you can still participate in the HBP.

A key disadvantage is that the amount you withdraw will not be earning tax-deferred income as it would within the RRSP thereby reducing the amount of your retirement savings. A further disadvantage is that if you miss a repayment, the amount will be included in your taxable income for that year.

If you are planning to participate in the HBP, talk to your chartered accountant about how you can take advantage of this program while at the same time maximizing the tax advantages of your RRSP. ■

Raising the Price

The success of your business depends on your ability to remain profitable. When expenses are rising and profit margins are shrinking, you have two options: reduce the quality of your product or services or raise your prices.



With comparison shopping available at the click of a mouse, it is little wonder that owner/managers are hesitant when they have to increase prices to keep up with increasing costs or a changing market. While you may rightly fear a negative response from your customer base, a properly implemented price increase will not alienate your customers. You may lose a few during the transition but the alternative of cutting back on quality could drive them to your competition.

Why do you need to raise your prices? It could be that you:

- Have not used a very scientific method to set your prices in the first place;
- Have to increase staffing or buy new equipment;
- Need to even out an erratic cash flow;
- Have been giving away the store with too many discounts or giveaways;
- Have checked out your competitors' prices and wonder if you have been cutting your profit margin more than you need to; or
- Simply want to earn more money for all your efforts.

Arriving at the Right Price

How do you arrive at the right price? Sometimes the price of a product is based on calculating the breakeven point and adding 20 to 30%. However, simply crunching the figures to arrive at a price is not necessarily the best way to determine a product's value.

You should also consider pricing from the consumer's perspective, including:

- The objective price — what consumers would consider a logical price if they had the same data that your business uses for pricing. The objective price can therefore be viewed as the price that includes a fair mark-up over the breakeven point and is ultimately what the consumer is willing to pay.
- The reference price — the price that the competition charges. Most customers do some comparison shopping before making a purchase decision. If your price is lower than that of your competitors and your product or service is comparable, you have room to increase the price. If your price is in line, perhaps you need to create a premium version or make more efforts to communicate the greater benefits and value of your offering.
- The expectation price — what consumers expect to pay for the product, based on what they have paid for similar products and what they perceive to be fair. While a person expects to pay, say $1 for a can of pop in a convenience store, they expect to pay $3 in a restaurant and even more at a sports event.

The Key to Effective Pricing

The key to effective pricing is to turn most of your pricing into expectation pricing by ensuring that the market expects to pay more for your product. Achieving this goal may be challenging, but it can be done.

First, recognize that the major motivator for purchasing is that the price is perceived to be fair. The fact that one will pay a higher price for a pop at a sports event when they know they can buy the same pop for a dollar at the corner store is an indicator that "fair" is a relative term that is cushioned by the consumer's expectations and, of course, convenience. Establishing a fair price given the location or the consumer's whim is the challenge.

Reference pricing may also be used to a seller's advantage; however, marketing savvy is also a factor. A retailer of home sound systems that carries only high-end expensive products may be limiting itself to a narrow economic band. This may be satisfactory if the retailer can attract enough upper income clientele. To attract other customers, the retailer needs to carry less-expensive equipment. These customers may ultimately purchase the high-end equipment, as they perceive that they are receiving more value. On the other hand, they may be willing to pay the maximum retail on the lower-priced equipment simply because they perceive the lower-priced equipment must be good value in comparison to the higher-end products.

Increasing Prices

Determine if you should raise all your prices or just those of a few key offerings. It is important to explain why the price increase is necessary. Customers understand that when costs increase, a company needs to make changes to stay in business.

Also consider other ways that you can increase your profit margin, for example:

- Review the add-ons you may have been giving away for free and start charging for them. If you provide free delivery, institute a charge for the service. When you give a quote for a project, set out what the price includes and the costs of additional services or overtime that could be incurred if unforeseen circumstances arise or if the customer requests changes once the work has begun.
- Change your terms and conditions. For example, eliminate a discount that you provide for clients that pay within 30 days.
- Maintain the current price but reduce the number of units. For example, change your packaging from six to four units. Improve your packaging and highlight the added benefits and value of your product.
- Offer fewer discounts. Only offer incentives when you want to accomplish a specific goal, such as encouraging customers to order greater quantities or pay with cash rather than credit.

Helping the Customer Understand

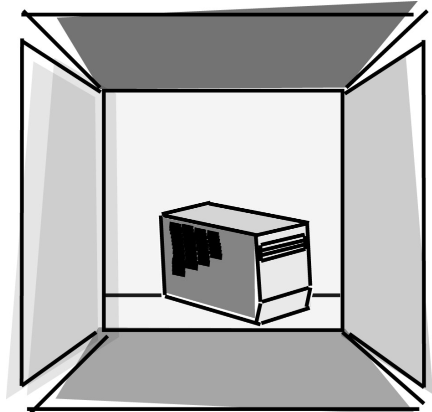
Are you nervous about raising prices in case you offend your existing customers? Surprisingly enough, studies show that when a company explains why prices must increase, most remain loyal. Customers understand the economic realities of rising costs and business survival. Long-time customers who trust, need and value the quality of your company's products or services want you to stay in business. With careful planning and communication, strategic marketing and the additional revenues you will generate for new initiatives, you also have a good chance of attracting new customers. ■

TECHNOLOGY

Good Things Come in Small Packages

Computer manufacturers are continuing to improve their small-scale systems, squeezing a full-size processor, graphics card and hard drive into a box that is the size of a shoebox.

The SFF (Small Form Factor) is a powerful small-sized personal computer. It is certainly a lot easier on the eyes than an ATX tower, incredibly compact and takes up minimal space on or under your desk. Most of the units on the market measure a mere 20 centimetres high (8 inches) and 38 centimetres wide (15 inches) with a depth of 25 centimetres (10 inches). The most popular SFF boxes today from Shuttle, MSI, and Biostar are all of similar size, having roughly square dimensions in height and width and being somewhat longer. Apple also has



a type of SFF called the Mac mini. Just 6.5 inches square and 2 inches tall, the Mac mini fits anywhere and works with both Mac and PC-compatible peripherals.

SFF computers have great attributes. While the earlier versions had their limitations, today's models rival even the most powerful full-size computers. But before you become completely enamored by the small footprint and replace your towers with SFFs, read on.

Expansion

The smaller cabinet size may make it difficult to expand your system. For instance, if you need additional drives for reading or storage, the box may not be able to accommodate the traditional front-end load slots. Most SFFs have at least 4 USB ports for add-ons if required (some have ports on the front and rear of the cabinet and others offer a PCI card slot with 3.5 drive bay). For some users, the peripherals may defeat the purpose of purchasing the smaller footprint but for others, the portability of the box may be the biggest attraction.

Speed

While speed can be an issue with some down-sized systems (consider the speed of a laptop when matched against the tower speed), the SFFs are not slouches in processing speed. The upper units on the market are running 3 plus Gigahertz processors, which matches a tower's speed.

Graphics

Graphics ability is not an issue with most of these units. Small is beautiful – especially when the SFF comes with a 17-inch or even a 20-inch flat monitor. Further, to do away with the clutter of desktop speakers, some monitors have built-in speakers while others have built-in speakers on the sides of the PC. Both approaches are effective for those who may listen to music while they work but don't need a fancy sound system.

Price

The price of a system with a monitor is competitive with the traditional tower system. Alternatively, consider buying just the SFF and connect it to your current monitor and peripherals.

Memory

Hard drives range from 40 GB to a whopping 320 GB, the same as the traditional tower PC. But most SFFs only support one or two hard drives. And just in case you feel the need to fill all that space with software, pictures or music, all of the units are equipped with a DVD-ROM/CD combination drive.

Before You Buy

Talk to your computer consultant, review your current networking system and assess your future requirements to determine whether smaller is better for your organization.

As components come down in size, the ability to provide more functionality in a smaller footprint is an opportunity to create a clutter-free working environment. If your business still needs the flexibility of the tower, it may be possible to purchase the neater, smaller units for the office and connect to the tower hidden in the mail or storage room. ■

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