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Why You Should Save Within an RRSP

By now most of you will have received your Notice of Assessment from Canada Revenue and know the amount you can contribute to your RRSP for tax year 2008. But the stock market is going nowhere; bond and treasury bill yields are down; the sub-prime crisis is still front-page news, and economists are looking for declines in second-quarter GDP. Put money into an RRSP now? You must be kidding!



No, we're not kidding. This is the very time to be investing. Remember, the old cliché, "buy low and sell high"? The wise person looking to build an RRSP will see the current market as an opportunity to invest.

The RRSP is the best retirement savings vehicle in Canada. About 68% of Canadians have RRSPs, an increase from 57% in 2002, according to the RBC Asset Management-Ipsos Reid 18th annual RRSP poll conducted last fall. The average planned contribution for the 2007 tax year was \$5,967, almost double the \$2,866 of 1993 but substantially below the 2007 allow-

able limit of \$19,000. The \$20,000 limit for 2008 rises to \$21,000 in 2009 and to \$22,000 in 2010.

Consider the following benefits and you may well wonder why everyone, even teenagers with part-time jobs, doesn't start saving as soon as they earn eligible income.

Saving is for More Than Just Retirement

An RRSP provides the contributor with an immediate tax benefit. For example, a person in a 23% personal tax bracket who invests \$1,000 will enjoy a tax savings

of \$230 for the year in which the contribution is made. Granted, this contribution and any gains resulting from it become taxable when the retirement funds are withdrawn, but the immediate reduction of taxable income provides a present benefit by increasing cash flow. If your marginal tax rate at retirement is 23%, withdrawal of \$1,000 will still generate only \$230 in tax but the original \$1,000 will have had the opportunity to grow sheltered from tax through the intervening years.

Taxpayers can also contribute a portion of their allowable limit to a spouse's or partner's RRSP. The contributor enjoys tax savings in the current year and both may benefit from income splitting upon retirement if one is in a higher income tax bracket than the other. Recent amendments to the *Income Tax Act* have broadened income splitting opportunities for couples who can now jointly elect to split eligible pension income.

There are very few situations in which the Canada Revenue Agency is willing to forego the tax on income in the year it is earned. Dividends, interest, and capital gains earned within an RRSP are such an exception; they go untaxed until withdrawn. This period of tax deferral can last from the moment of opening an RRSP as a teenager until the end of the year in which you turn 71, when you must start making withdrawals.

If you hold taxable assets outside an RRSP at the time of your death, they are deemed to have been sold at the date of your death. Capital gains taxes are paid on half the capital gain and income taxes are paid on any interest or dividend income earned up to the date of death. If you held the same assets in an RRSP, the entire RRSP is transferred intact to your spouse or common law partner without tax and continues as an RRSP in his or her hands. This is comforting to survivors who may find themselves in uncertain financial circumstances after the death of a partner.

The *Income Tax Act* also provides other opportunities for taxpayers to transfer taxable property on death to their spouses or partners on a tax-deferred basis.

The need to provide for financially dependent children or grandchildren after your death is another reason for saving within an RRSP. Funds designated for a qualified child or grandchild receive tax treatment similar to that received by the surviving spouse. This feature provides the opportunity to provide for those who may not be able to fend for themselves after your death.

RRSP savings act as a safety net. Knowing you have RRSP savings available should you lose your employment, encounter a family emergency or business difficulty provides a psychological buffer lacking to those without such savings.

An added advantage of RRSP savings is the tax disincentive to withdraw RRSP funds before the plan

matures. The institution that holds the RRSP is required to withhold and submit to the CRA 10% (5% in Quebec) on amounts up to \$5,000; 20% (10% in Quebec) on amounts from \$5,000 to \$15,000; and 30% (15% in Quebec) on amounts over \$15,000. The amounts withheld may not be enough, however, to pay the tax on these withdrawals required by your tax bracket. The possible tax consequences of withdrawing funds before maturity should discourage frivolous withdrawals.

RRSP savings may be withdrawn without tax penalty for participation in the Home Buyers' Plan (HBP) or Lifelong Learning Plan (LLP). Although the amounts borrowed must be repaid according to a CRA timetable, the taxpayer does not pay interest on the borrowed funds. Amounts not repaid as scheduled are added to your taxable income. Since you are actually borrowing your own money from your RRSP to participate in the HBP or LLP, your credit rating is not affected as it would be if you had borrowed the money from a financial institution. And, contrary to what happens when RRSP funds are withdrawn, income tax is not withheld at source.

RRSP contributors are free to choose their investments, as long as they are prescribed as qualified investments. Indeed, you may even manage your own money through a self-directed RRSP.

Even if you participate in a company pension plan you believe will provide an adequate income stream in retirement, you should consider reviewing the terms of your plan and the financial condition and performance of the company where you work to make sure it will be there when you retire. These considerations are especially important if the company pension plan is underfunded and retirees are dependent on the current earning power of the company to provide a portion of their income. Membership in a company pension plan limits the amount of RRSP contributions. There are, however, always compelling reasons to contribute to an RRSP even if the company pension plan is excellent:

- Your company may not survive until your retirement date
- Funding may be inadequate if investments do not provide adequate returns
- Early retirement or dismissal may reduce your anticipated pension
- Plans are usually subject to rules that restrict the use of pension funds
- Most plans do not allow withdrawals for emergencies
- Allocation of funds to your partner's retirement plan may be impossible
- You have little or no control over company investment policy

Your RRSP Safety Net

Saving within the shelter of an RRSP is an excellent life-long personal financial-planning strategy. With help from accredited financial advisors and tax advice from

your chartered accountant, funds placed within an RRSP will provide not only a safety net on the journey of life but also a stream of income for those golden leisure years. ■

TAXATION

Currency and Tax

Canadian companies doing business around the world often need to purchase goods, services, inventory and capital assets with foreign currencies. When these transactions are reported in the Canadian companies' financial statements, they must be stated in Canadian dollars. Correctly handling this conversion is essential for accurate accounting, reporting and income tax purposes.

There are two main treatments for the conversion: an adjustment to the value of an asset or liability, or an adjustment to income or expenses.

Since day-to-day transactions are usually converted invoice by invoice, the gains or losses on purchases and sales caused by fluctuations in the exchange rate are absorbed as incurred. Transactions that affect the balance sheet, however, are a more complex matter.

Capital Assets

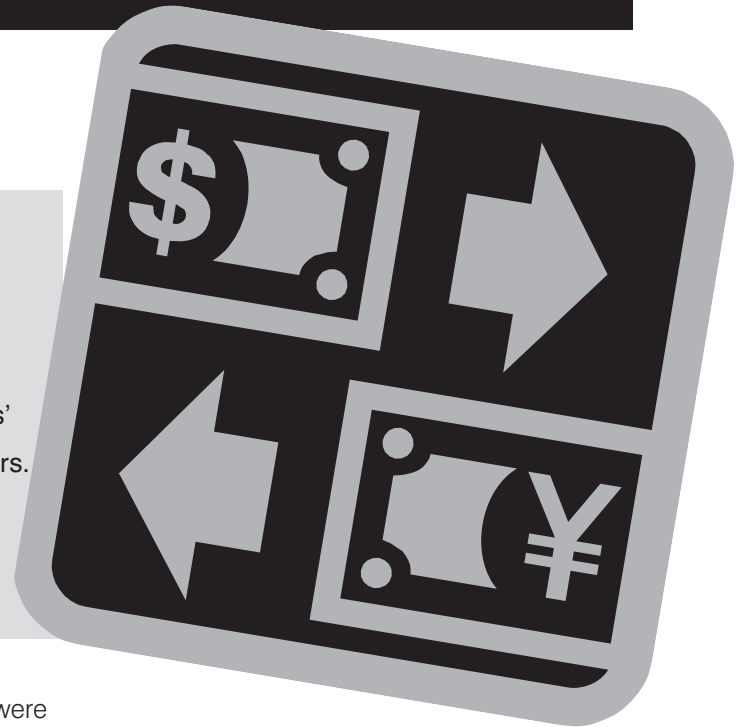
The cost of operating equipment purchased in a foreign currency must be converted to the Canadian-dollar equivalent at the time of purchase. For example, equipment purchased for \$100,000 (USD) when the exchange rate is \$0.83 (CAD) gives a conversion rate of \$1.20 (CAD) for every US dollar. The cost of the equipment now translates into \$120,000 (CAD), the amount on which the company can claim the capital cost allowance (tax depreciation). Appropriate allocation of the exchange ensures the company maximizes the capital cost allowance used to reduce the net income for tax purposes. Should the exchange be allocated instead as an expense, expenses would be overstated and net income reduced improperly for tax purposes. Given a corporate tax rate of 20%, the improper allocation would understate income tax payable by \$4,000 (CAD). If, however, the Canadian dollar

were trading at a premium to the US dollar, improper allocation would *overstate* income thus *increasing* the tax liability!

Cash in Foreign Banks

Businesses or individuals who maintain cash or negotiable instruments on deposit in a foreign currency are generally not subjected to income tax as long as the amounts are on deposit. This implies that cash in a foreign bank account, term deposits or other forms of short-term investments not negotiable outside the financial institution are not subject to the vagaries of the exchange rate as long as they remain within the definition of funds on deposit.

Extreme changes in foreign exchange rates should prompt businesses to review their portfolio to determine whether converting to Canadian dollars or holding foreign currency is more advantageous. If \$50,000 (USD) in term deposits were purchased at a conversion rate of \$1.20 (CAD), the asset value is \$60,000 (CAD). If the exchange rate returns to par, the term deposit is worth only \$50,000 (CAD). A \$10,000 (CAD) loss has occurred but only on paper. Until the funds on deposit are actually converted to the Canadian dollar equivalent, the loss is not considered a loss for tax purposes.



An inadvertent conversion to the Canadian-dollar equivalent may create unexpected exchange gains or losses that may impact the business and income taxes.

To ensure you do not unintentionally trigger exchange gains or losses when dealing with "on deposit" amounts, consider the following situations that will, according to CRA, create gains or losses:

- Converting the foreign on-deposit amount to the Canadian-dollar equivalent
- Converting the foreign on-deposit amount to a currency other than Canadian
- Paying a debt with the foreign deposit even if the debt is with the same financial institution or in the same country
- Using the foreign currency deposit to purchase other investments or capital items

Investment in Foreign Share Capital

The exchange rate at the time of any foreign indirect investment should be recorded. If a \$150,000 (CAD) investment is made when the exchange rate is \$0.83 (CAD) (conversion rate \$1.20 (CAD)), the Canadian dollar equivalent will be \$180,000 (CAD). Should the exchange rate change to \$0.80 (CAD) (conversion rate \$1.25 (CAD)), the investment would be worth \$187,500 (CAD). This would represent a gain of \$7,500 (CAD). This gain however is, in effect, only a paper gain and does not create tax consequences as long as the investment is held.

Realization of funds on deposit or the sale of foreign equity investments triggers two types of gains or losses at the time of the transaction. The first is an actual gain or loss regarding the value of the security. The second is the gain or loss that results when converting from the foreign currency to the Canadian dollar equivalent. Provided that a business or individual does not regularly buy and sell funds on deposit and foreign equity, i.e., becomes a trader, it is likely that both types of gain or loss will be considered a capital loss or gain.

You must determine whether the business has accumulated capital gains or losses for income tax purposes. Existing accumulated losses may suggest a strategy of selling foreign stocks whose value has increased solely through foreign exchange gains. This strategy would permit capital losses to be reported with few or even no tax consequences. If accumulated gains exist, perhaps stocks that are down because of exchange losses could be sold and the proceeds applied to reduce the overall loss created by the exchange and facilitate reinvestment.

Investors taking losses must be sure not to invoke the superficial loss rules by purchasing identical stocks within 30 days of the original sale.

It is always prudent to discuss your capital expenditure and investment strategies with your chartered accountant to ensure that the appropriate treatment of foreign asset purchases and sales does not expose your business to unnecessary investment risk or unnecessary income taxes. ■

MONEYSAVER

Keeping Track of Your Portfolio

Procrastination is like a cold: everybody suffers from a bout of it now and again. Tomorrow turns into the end of the week, the end of the month, the end of the year and, finally, never comes.

Unfortunately, if you are down with a dose of procrastination at the wrong time, income can decline and taxes increase. Attention to business now, on the other hand, can lead to money saved and a more relaxed state of mind.



Putting off a complex matter such as calculating capital gains and losses can create uncertainty about the year's income tax liability for both individuals and businesses. Rather than waiting until the end of the year to gather all the information, good business prac-

tice suggests recording the data on a spreadsheet as you go. This way, dates and prices of acquisitions and dispositions are always up to date and easy to consult.

Your Portfolio Spreadsheet

Headings should include:

1. Date of the transaction
2. Name of corporation whose securities are the subject of the transaction
3. Buy
4. Sell
5. Type of instrument purchased or sold
6. Quantities of shares or units; dollar amounts of debt instruments
7. Share or unit cost of the transactions in original currency
8. Currency type
9. Total cost in the original currency
10. Conversion rate at the date of transaction
11. Cost of the transaction in Canadian dollars
12. Brokerage, interest or other costs associated with the transaction
13. Portfolio management costs, if any
14. Total transaction costs in Canadian dollars
15. Gain or Loss
16. A running total of the dividends or interest received through the year
17. Name of the broker who did the trade

Make the initial entries when the investment is purchased. Calculate total purchase costs in the original currency, then convert the purchase costs, brokerage fees and other costs to Canadian dollars. When it is sold, record the date of the sale in the Sell column as well as the conversion rate. This will provide the total proceeds for the transaction exclusive of brokerage fees, interest, etc. Once these two figures have been established, subtract the Buy total from the Sell total to record the gain or loss.

If only part of the holding is sold, you must make a separate entry for the partial sale and a separate gain or loss calculation. If only 50 shares of an original 120-shares purchase are sold, for example, ensure that the spreadsheet reflects the original purchase cost to calculate the gain or loss for that transaction. As well, make sure that the 70 unsold shares are left at original cost since this information will be needed when these shares are sold. Always reconcile the specific shares

purchased and sold to ensure that the portfolio reflects the balance of costs for investments currently owned.

Quarterly Statements

Most brokerage houses send a quarterly statement reporting the transactions of the period. These statements should be carefully checked against the trade confirmation slips and the spreadsheet to ensure all purchases and sales are correctly recorded. If any portfolio fees are incurred, record them in the appropriate column and check to see they agree with the quarterly statement.

Match and Attach

Your broker will send confirmation slips reporting the gross amount of the transactions, commissions and exchange rates. Because these slips report each transaction, they should be attached to a printout of the spreadsheet to support the summarized data recorded on the spreadsheet.

Contact Information

Even though you are probably using only one or two brokers for all your transactions, keep the contact information at the top of the spreadsheet. In the final column of the spreadsheet, note the name of the broker for each transaction.

Manage Gains and Losses

Managing and updating the information on a regular basis will enable you to:

- Track gains and losses accurately
- Know how much dividend and interest income you have received
- Evaluate the performance of the portfolio manager
- Make trading decisions
- Plan long-term investment strategies

Third Quarter Review

The up-to-date record provided by the spreadsheet will put an end to unpleasant surprises at the end of the year that could adversely affect profits and your income tax liability. A review at the end of the third quarter and discussions at that time with your chartered accountant will enable you to plan portfolio adjustments for the fourth quarter to maximize profits and minimize losses and income taxes. If action is needed, there is still plenty of time to contact your broker and discuss your revised investment strategy.

Reduce Your Costs

Managing and maintaining current investment information provides other measurable benefits as well. For one, your chartered accountant will be able to

review the current data on the spreadsheet rather than have to rebuild your activity from a “shoe box” full of confirmation slips and monthly statements. This eliminates those frantic and costly calls asking for documentation on original costs, dates of purchase and exchange rates.

In the event that CRA audits your returns, the summary pages, confirmation slips and monthly statements will substantiate your claims. These documents

not only reduce the cost in time and money of having to rebuild the tax return data, but also shorten the time required to satisfy a CRA agent. Keep the summaries and supporting documentation for at least 10 years after original investments have been sold in case of an audit.

Managing a portfolio *is* time consuming but procrastination will steal even more precious time. And who has time for that? ■

TECHNOLOGY

21st Century Monitors

Walk into any business, see a clunky cathode ray tube (CRT) monitor on a desk and you might think you should check over your shoulder for a brontosaurus.



The monitor is one of the longest-lived components of a PC; in fact, it often lasts far longer than the original computer. In recent years, improvements in technology and lower production costs have made thinner, flat-panel, liquid-crystal-display (LCD) monitors comparable in price to those antiquated-looking CRTs. The new monitors also have the added benefit of taking up a fraction of the desk space and are not only better looking, they are, quite literally, easier on the eyes since they do not need to refresh in the same linear way as a CRT.

Multiple Screens

Not so long ago, it was necessary either to turn the monitor to enable another person to view the screen or to install a dual-headed graphics card that would permit the use of a second monitor. To accommodate users demanding more viewing space without calling in the IT specialist to install the video cards, Display-Link will now allow you to connect up to six monitors in a daisy-chain to one computer. This new technology permits you to connect a desktop to a laptop, for example, through their USB ports, then link both to auxiliary monitors. Now you will be able to share and explain information to clients on a second monitor as well as use additional monitors to increase the number of windows that can be opened without reduction or screen overlay. Imagine adjusting a spreadsheet on one screen, editing a report on another while touching

up a picture for presentation on a third – all with the same mouse. Now that’s multitasking!

Screen Sizes

Since an LCD does not have the imposing bulk of a CRT, displays with a larger viewable area are now much more practical and affordable. Multitasking is a fact of life. Providing employees with the ability to view multiple windows or applications simultaneously is one of the most cost-effective ways to increase productivity within your organization.

The 17” monitor has been a standard for years. More data, more aging eyes, and the need for larger imagery to view the increasingly complex graphics have pushed the 19” monitor to the forefront with 23” and 24” widescreen displays also becoming popular. A larger screen area, however, will not necessarily display more information since the amount of information displayed depends on image resolution. Resolution, in turn, depends on the number of picture elements (pixels) or electronic dots used to create the image: the higher the number of pixels, the higher the resolution, and the greater the amount of information displayed. In other words, 17” and 19” displays of the same resolution do not carry more information when the image

resolution is the same; the individual pixels on the 19" monitor are just larger.

When making a screen purchase, you may wish to consider a 16:9 widescreen display ratio rather than the traditional 4:3 ratio since the human field of vision is naturally more comfortable viewing something that is wider than it is high. On a 24" widescreen LCD you can work comfortably on two documents side by side or on a large spreadsheet.

Dual Purpose?

Are you thinking of using a high-definition LCD television as a computer monitor? It can certainly be done, as modern TVs are simply computer monitors with a built-in tuner. That HDTV, however, probably has lower image resolution than your LCD computer monitor. A good computer monitor will provide a much sharper image than a TV using the same technology, since the pixel count on a typical 32" LCD television is about half that of a similarly sized LCD monitor. If you want to save space by using a single monitor for your TV and desktop PC, consider getting a Media Centre PC instead, with the TV tuner built into the computer rather than the monitor. The Media Centre PC has the added advantage of including a PVR function to record TV programmes onto the hard drive for later viewing.

Features Worth Considering

1. Ensure your monitors can tilt and swivel to permit the user to adjust it to the position most comfortable for the neck and eyes. Most monitors allow this. Some monitors allow pivoting to the portrait position, which is an ideal feature for those

working with text, pictures or graphs that are best viewed in standard 8½" x 11" page format.

2. Consider purchasing an LCD panel compatible with a standard VESA mounting system. The VESA system enables you to mount your display on a wall or desk using a monitor arm. With this system you will have more desk space and be able to adjust the height or location for perfect comfort.
3. Check that the monitor has a DVI or HDMI port with HDCP (high band width digital content protection) compatibility, if your business is contemplating playing a copyright-protected medium such as Blu-ray. Most, but not all, newer monitors have incorporated these features.
4. Check that your monitor comes with built-in speakers. If not, see whether they are offered as clip-on options that attach directly to the monitor and thus take up no desk space.
5. Consider a built-in web cam to reduce clutter and encourage interaction over distances.

Buy Right

Buying a new monitor is a long-term investment. Consider getting the largest screen size with the highest available image resolution that fits your space and your budget. ■

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