



# Strategies & Tax Update

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Fedder, Gurau & Staniewski  
*chartered accountants*

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## SEGREGATED FUNDS - GUARANTEED INVESTMENTS

There has been extreme volatility in the financial markets in the past 12 months and there is uncertainty of what financial climate is in store for us in the near future. In a world of continuous market change, it's comforting to know that there is an opportunity to protect the amount of our hard-earned assets, and still have a potential for capital growth.

Segregated funds are investment funds offered by insurance companies. These funds offer benefits such as probate protection, the potential for creditor protection and capital guarantees that are not available with mutual funds. The added benefit of capital guarantees means that segregated funds usually have a higher cost associated with their management fees.

### Avoid Probate

In the event of death of the annuitant, the proceeds of an insurance contract pass directly to a named beneficiary. The benefit is that the asset avoids probate and estate administration fees. Also, the beneficiary will generally receive the proceeds without extended delays. This is a considerable benefit during the time of need.

### Creditor Protection

If the beneficiary is a parent, child, grandchild or spouse of the annuitant and the contract wasn't set up for the purpose of avoiding creditors, then the segregated fund assets may provide from creditors. This feature is attractive to professionals and self-employed business owners who are

looking to protect their assets due to higher personal liability risks.

### Death and Maturity Benefit Guarantee

Segregated funds come with guarantees that mutual funds cannot offer. On the death of the annuitant, the beneficiaries are guaranteed 100% of the premiums paid to the policy. The maturity guarantee protects a percentage of the value of an investment at the end of a specified term. Most insurance companies will have a term of 10 years and guarantee 75% of the contributions. In both cases, the amount paid is the greater of the current market value of the investment or the guarantee amount.

### Lock-in Investment Gains

A great advantage is the ability to

reset the guarantee amounts. Most insurance companies allow for 2 resets per policy year. The reset feature allows you to lock-in your investment gains to increase the value of your guarantees. For example, you deposit \$100,000 to a contract maturing 10 years later. In 3 years the investment is worth \$140,000. If you reset the investment in year 3, you have now locked-in your gains. You have a death benefit guarantee of \$140,000 and a maturity benefit guarantee of \$105,000. The term to maturity is extended by 10 years.

### Taxation

A Segregated fund is a trust and all income earned by the trust is allocated to the investor. If the fund were to have capital losses in

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any particular year, these losses would flow-through to the investor. The capital gains and losses incurred when the funds are sold are reported directly on the tax information slip and the investor requires no other reporting. If capital losses are allocated to the investor, they have the option of using these losses on

their current year tax return or carry-back the losses 3 years or carry-forward the losses to future years. In comparison to mutual funds, the fund doesn't choose when to claim capital losses the investor does. The T3 tax slip is all the tax reporting required. There is no additional accounting required by the investor.

You should consult with your investment advisor and accountant to determine if segregated funds should be added to your portfolio. One thing is certain, diversification is always a good thing.

## MORTGAGE INTEREST DEDUCTIBILITY IS IT FOR YOU?

In recent days, there has been an increasing amount of press on the topic of mortgage interest deductibility. Many are questioning whether or not they could be taking advantage of this. However, similar to many other tax motivated strategies, this isn't for everyone and requires certain circumstances to be applicable.

The concept, based on Fraser Smith's "The Smith Manoeuvre", is to convert non-deductible mortgage debt into tax deductible investment loan debt. To accomplish this, the Smith Manoeuvre advocates simultaneously paying down a mortgage and borrowing to invest. The tax refund that results from deducting the loan interest is also applied to reducing the mortgage. To better illustrate, here is how it works. As you know, the mortgage on your home is not tax deductible. However, if each time you make a principal repayment on the mortgage you make a corresponding loan, the proceeds of which you use to purchase an investment. The theory is that these monthly additions to your investment portfolio will compound in value over time. The paydown of the non-deductible mortgage and increase to the investment loan leaves your total

debt constant, however, the non-deductible debt is extinguished over time. As well, the growth to the portfolio accrues on a tax free basis until the assets within the portfolio are disposed of. The assumption is that as opposed to a person who systematically pays down their mortgage, the person who follows this strategy will have an investment portfolio that is greater than the original mortgage balance. Additionally, the funds gained by being able to write off the loan interest allows the individual to pay off the original mortgage sooner.

Make no mistake, the Smith Manoeuvre is merely a debt conversion strategy allowing you to change non-deductible interest to deductible interest. One must be disciplined to follow the plan and invest wisely in a portfolio that has a steady growth, at least a portfolio that has respectable returns and has its capital protected. One also has to feel comfortable with continuously carrying debt.

Structured properly, one can create circumstances whereby they can deduct the interest paid on their home mortgage. We would be happy to discuss your circumstances to see if

your affairs can be structured in a way to have your mortgage interest deductible.

### Healthcare Practitioners

If you are a healthcare practitioner with a professional corporation please see enclosed information

### Important Dates

*Personal Tax Installments  
Due September 15, 2008  
Due December 15, 2008*

*Corporate Tax  
Balance due 3 months after fiscal  
yearend.*

*Dividends  
Must pay before December 31.*

### Referrals

*We would like to take the opportunity to thank our clients who value our service and have recommended our firm to others. We thank you for contributing to the success of our firm.*

### Partners

**Victor Staniewski, CA  
Irving Gurau, CA**