



NAKAMUN

# ADVISOR

AN INFORMATION SERVICE OF THE NAKAMUN FINANCIAL GROUP

SUMMER  
06

## THE BUDGET AND YOU

By Garry Keiller,  
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**O**N MAY 2ND, Finance Minister James Flaherty tabled the first Conservative Budget in 13 years. This Budget provides more than \$20 billion in tax relief for Canadians, an amount greater than the last four federal budgets combined.

The following are highlights of the Budget that are most likely to affect our Nakamun clients.

### PERSONAL TAX

The Budget offers personal tax reductions as well as increases, new and increased tax credits, new tax deductions, and changes in capital gains taxation. Specifically:

- **GST reduction** — as promised during the election campaign, the Conservatives reduced the GST from seven percent to six percent, effective July 1, 2006. The average Canadian family will save a few hundred dollars a year. If you're planning a significant purchase, the one percent tax saving could be sizable. Look for the promised additional one percent GST reduction in a future budget
- **Lowest personal tax rate increase** — during the election campaign, the Conservatives indicated they intended to reverse the reduction on the lowest personal federal tax rate from 16 percent to 15 percent that the Liberals introduced last fall. Fortunately for those in the lowest tax bracket, the Conservatives



delivered, but not completely. This Budget increased the lowest tax rate to 15.5 percent starting July 1, 2006, making the effective tax rate for the whole year 15.25 percent for people in this category. After this year, the annual rate goes up to the full 15.5 percent

- **Basic personal tax exemption increase** — the basic personal tax exemption increases from \$8,640 in 2005 to \$8,839 for the 2006 tax year. In subsequent years, this amount will be indexed to inflation plus \$100

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# UNDERSTANDING REVERSE MORTGAGES

By Floyd Murphy, CFP, CLU, CHFC, The Nakamun Group, Vancouver



**R**EVERSE MORTGAGES ARE BROADLY ADVERTISED, and while at first glance the concept might appear intriguing, a thorough analysis is essential to understand its financial impact. Reverse mortgages are particularly tempting for those who are cash-poor and house-rich.

## DESCRIPTION OF REVERSE MORTGAGES

A reverse mortgage is basically a one-time cash advance on the value of a home. The maximum amount that can be borrowed depends on the value and location of the home, as well as the age of the homeowner — the older the homeowner, the larger the loan allowed. Typically the maximum reverse mortgage is about 25 percent of the value of the property and rarely is it more than 40 percent.

The funds advanced to the homeowner are tax-free and payments on the loan are not required. Interest rates are usually significantly higher than they are on conventional mortgages and the interest compounds each year.

Do the math — a 25 percent reverse mortgage at 7 percent compounding interest over 20 years will, during that period of time, equal the current value of the home. Here's an example:

Value of home = \$400,000  
25% reverse mortgage = \$100,000  
7% compounding interest doubles the mortgage every 10 years  
Mortgage after 10 years = \$200,000  
Mortgage after 20 years = \$400,000

## REASONS PEOPLE CONSIDER REVERSE MORTGAGES

There are four scenarios that typically drive people to consider a reverse mortgage:

1. A couple retires on a modest income that doesn't quite meet their financial

needs and they would like to free some capital from their biggest asset — their home

2. A family crisis occurs, for example a daughter is divorced and needs financial assistance
3. The homeowner faces a major, unexpected home repair expense, such as a roof replacement or a condominium special assessment
4. A retired homeowner would like to enjoy a more luxurious lifestyle

## DRAWBACKS OF REVERSE MORTGAGES

A reverse mortgage is unlikely to be a financial panacea. At the very most, the one-time amount of money that can be withdrawn is 40 percent of a home's value. The interest rate is likely to be significantly higher than on a traditional mortgage and the compounding feature makes the loan grow even faster. Then, depending on the length of time the reverse mortgage has been in existence, there may be a penalty to pay it off; and if circumstances change and the loan must be paid off earlier than anticipated, that could be very costly.

## THE ALTERNATIVES

For most situations that would drive people to a reverse mortgage, there are alternatives that should also be considered.

- For those sudden, unexpected requirements for cash, such as a special assessment on a condominium or an emergency house repair, consider borrowing from the bank on a line-of-credit — payments can be spread over time to make them more manageable

and the interest rate will definitely be lower

- If retirement income has become inadequate with increased costs of living, consider downsizing in accommodation to free some cash and still have no debt — and significantly, no accumulating compounding interest
- If a family member faces a financial crisis, consider pooling resources for a suitable solution — for example if a child and grandchildren are forced to find a new home, consider finding accommodation everyone can share and paying the debt with combined income
- When an elderly couple or individual needs or wants cash out of their home, consider selling the home and renting possibly more appropriate

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## DEFERRED PROPERTY TAXES

Deferred Property Taxes are a form of reverse mortgage, without the high interest rates and costly penalties. In British Columbia and other jurisdictions where allowed, qualified homeowners can defer their property taxes until the property is sold. In BC, the government sets the simple interest rate every six months and currently the interest rate is a mere 2.25 percent. Those who meet the age and minimum equity qualifications and choose not to pay their property taxes each year, can apply for deferral. Check with your property tax collector for more information.

# REVISITING YOUR RETIREMENT INCOME IN YOUR LATER YEARS

By Floyd Murphy, CFP, CLU, CHFC, The Nakamun Group, Vancouver

**T**HERE ARE TWO TIMES IN YOUR LIFE when you must make important decisions regarding your retirement income. The first time is when you retire and require income from your retirement savings, or at age 69, when the government requires that you make annual withdrawals from your registered retirement savings. The second time is when you reach your mid-80s and want to ensure that your retirement fund will continue to provide you with income for the rest of your life.

## OPTIONS FOR YOUR RETIREMENT SAVINGS

The year that you turn 69 is the last year you can make contributions to your own Registered Retirement Savings Plan (RRSP). If your spouse is younger than you are, you can continue to contribute to a spousal RRSP until your spouse turns 69.

In the year that you turn 69, you are required to terminate your RRSP. You have three options with the funds:

1. Remove the cash and pay income tax on the entire amount that year
2. Move the funds into a Registered Retirement Income Fund (RRIF). The only significant differences between your RRSP and your RRIF is that you must withdraw a minimum amount from your RRIF each year and you cannot make contributions to a RRIF. The minimum withdrawal amount starts at 5.00 percent at age 69 and increases each year to about 10 percent by the time you reach age 85
3. Establish a life annuity, which pays you a fixed income for the rest of your life. This is the least flexible option because you cannot change the terms once they're set and you no longer have any input in the investment decisions. You can opt for an annuity that continues to make payments to your surviving spouse

Most people between the ages of 69 and 85 choose a RRIF, because it's flexible in both withdrawal amounts and investment options. However, once people reach their mid-80s, they should revisit their decision.

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accommodation — the proceeds from the sale of a primary residence are tax-free and when the individual or couple needs to move into assisted living accommodation or a care facility, moving from a rented home is simpler than having to sell the family home. As well, rental prices tend to be fairly stable, so they are unlikely to face unreasonable price increases for their accommodation

## SOMETIMES THE ANSWER

There are some situations when a reverse mortgage is the answer. For example, when a home has been customized to accommodate specific physical disabilities, there may not be alternate appropriate accommodation and a reverse mortgage might be the best way to free capital. If there is no desire to leave an estate and

the only remaining asset is the home, again, a reverse mortgage may be the solution for a cash-flow shortage.

Each situation should be reviewed and analyzed to determine whether or not a reverse mortgage is appropriate. Your Nakamun Advisor would be pleased to assist. 🌱

## RETIREMENT INCOME IN LATER YEARS

The average life expectancy of an 85-year-old non-smoking male is another six years and for an 85-year-old non-smoking female, another seven and a half years.

If you reach your 80s in relatively good health, we advise that you consider switching from a RRIF to a life annuity, if you haven't already done so. A life annuity assures that the funds you have saved will continue to provide income for the rest of your life.

Without a life annuity, you could outlive your savings. For example, a single male at age 85 with \$100,000 in a RRIF earning 6.5 percent per year and drawing an income of \$15,000 per year would run out of funds by age 93. On the other hand, if this same person at age 85 switched to a life annuity, he would be paid about \$15,000 per year for as long as he lived.

Here are some situations in which life annuities are strongly advised:

- An individual, 85 years old, single, and in good health
- A couple, both in their mid-80s and both in good health
- A couple, one in failing health, especially if that individual is the one who has always looked after financial matters

A switch to a life annuity may not be as strongly advised for singles in their mid-80s who are not in good health.

The biggest financial risk for people who live well into their late-80s, 90s, and beyond, is that they outlive their retirement savings. A life annuity eliminates that risk.

Regularly review your retirement income plan with your Nakamun advisor to ensure your needs are met now and into the future. 🌱

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- **New tax credits** — thanks to the Budget, effective July 1, 2006, the following new tax credits are available:
  - **Universal Child Care Benefit** — for each child under the age of six, the family will be provided with a taxable benefit of \$100 per month that should be included on the tax return of the lower-income parent. This benefit will not adversely affect income-tested benefits nor will it reduce the amount of expenses claimable under the childcare expense deduction
  - **Canada Employment Credit** — a tax credit on the lesser of \$500 and the individual's employment income for the year comes into effect mid-year, making the credit for 2006 a maximum of \$250, which represents a tax benefit of only \$38. However, the credit increases to \$1,000 for 2007, providing federal tax relief of \$155
  - **Public Transit Pass Tax Credit** — this tax credit applies to monthly or longer duration public transit passes and was introduced to encourage Canadians to utilize public transit. The credit may be claimed by the pass holder or that individual's spouse or parent, if the dependent child is under the age of 19
- **New Textbook Tax Credit** — for the 2006 tax year, for each month a student qualifies for the full-time education tax credit, the student, spouse, parent, or grandparent also is eligible for an

additional \$65 tax credit for the cost of textbooks. Part-time students qualify for a \$20 tax credit for each qualifying month

- **Scholarship Tax Exemption Increase** — for the 2006 tax year and beyond, qualifying scholarship, fellowship, or bursary income will be exempt from tax. Previously, only the first \$3,000 had been exempt
- **New Children's Fitness Tax Credit** — starting with the 2007 tax year, parents of children under the age of 16 who are enrolled in eligible physical fitness programs will receive a federal tax credit of up to \$500, which amounts to a reduction of up to \$77.50 of federal tax, per child
- **Pension Income Tax Credit Increase** — another Conservative campaign promise was to increase the pension income tax credit. Effective with the 2006 tax year, the tax credit will double from the current \$1,000 per year to \$2,000 per year, which represents an additional federal tax reduction of \$155
- **New Tax Deduction** — effective May 2, 2006, trades people working as employees are entitled to deduct a maximum of \$500 for tools required to perform their jobs
- **New Capital Gains Taxation Exemption on qualifying donations** — effective with the 2006 tax year, donations of publicly traded investments such as stocks and mutual funds or ecologically sensitive land are no longer subject to capital gains taxes for the donor
- **New Capital Gains Taxation Exemption on disposition of qualified property of a family fishing business** — effective immediately, the capital gains exemption of \$500,000 previously available to only qualified small business shares in farming properties, has been extended to qualified property used in a family fishing business. As well, a tax deferred rollover is now allowed on qualified fishing property transferred to an owner's child or grandchild

## CORPORATE TAX

Income tax reductions, a new tax credit, and other tax improvements were included in the Budget for corporations:

- **From the previous Liberal government** — the following were reintroduced:
  - Reduction of the general corporate income tax rate by two percent by the year 2010
  - Elimination of the four percent corporate surtax by January 1, 2008
  - Elimination of the federal capital tax as of January 1, 2008
- **Small Business Deduction Increase** — effective January 1, 2007, the small business deduction will be increased to \$400,000. Currently, the first \$300,000 qualifies for the federal tax rate of 12 percent. That rate will be reduced to 11.5 percent for 2008 and further reduced to 11 percent for 2009
- **Non-capital Loss Carry-forward Period Extension** — from the current 10 years to 20 years. This provision now also applies to farm losses
- **New Apprenticeship Job Creation Tax Credit** — as of May 2, 2006, employers will receive a 10 percent non-refundable tax credit, to a maximum of \$2,000 per employee per annum, for salaries and wages paid to qualifying apprentices
- **Tax Depreciation Increase** — effective May 2, 2006 businesses can claim tax depreciation at a rate of 100 percent for tools costing \$500 or less, an increase from the previous maximum of \$200

This Budget, which focuses on broadly based tax relief, certainly appears to provide benefits to all Canadians.

Noticeably missing is any reference to an election promise to defer capital gains taxation on the sale of assets when the proceeds are reinvested within six months. Hopefully this will be introduced in a subsequent budget, as we believe this would be of great benefit to our clients. 🌱



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