# The Despas Advisory Group
# Investment Focus

Summer 2024

## In this edition




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## The Largest Wealth Transfer in History is Here

It's been termed the "greatest wealth transfer in history." As the last of the Baby Boomers reach the age of 60 this year, and the oldest approach 80, an estimated $1 trillion of wealth has begun to change hands.[1]

The boomers are now commonly referred to as the "luckiest generation" due to their significant leap in prosperity, benefitting from substantial price growth in the housing and financial markets. Consider that the average price of a Canadian home has risen about 800 percent since 1981, when most boomers were in their 20s and 30s — the prime years for household formation.[2] At that time, a house cost around $75,000,[3] though we mustn't forget that a five-year mortgage back then reached a crippling 21 percent! Over the same period, the S&P/TSX Composite Index Total Return has risen by more than 3,000 percent.[4]

While much of this wealth is anticipated to be passed along, some suggest that we are instead witnessing a shift in the spending habits of the boomers. The ***Wall Street Journal*** published an article late last year suggesting that U.S. boomers were the "economy's silver bullet," with increases in spending by retirees propping up economic growth to largely avert a recession.

Regardless of the extent to which wealth will transfer, the inevitable generational shift should prompt questions about our own wealth management. Are you prepared for this transition?

According to recent surveys, we may not be doing the best job. Studies continue to show that around one-half of Canadians still don't have a will; surprisingly, this hasn't changed over many decades. Only one-quarter of us appear to have a plan for our assets if we are unable to make financial decisions, and only 21 percent have had detailed discussions with beneficiaries or executors of their will.[5] How about you?

Even if we do have a detailed plan to pass along our assets, many of us do not feel confident in the next generation's ability to preserve or grow their inheritance.[6] The old "shirtsleeves to shirtsleeves" adage still holds true, suggesting that wealth gained by one generation is often lost by the third. The first works hard to accumulate wealth, the second benefits and maintains it and the third, having not experienced the hardships of wealth creation, ends up losing it. Planning ahead may be one way to mitigate this risk. Whether it is working alongside you to facilitate a generational wealth transfer plan or assisting younger folks with wealth management education or investing support, we are here to help.

Summer often affords us a bit more downtime, making it an opportune time to assess your own wealth transfer plan. If you've yet to give your estate plan the attention it deserves, why not make this a priority? It has the potential to enhance your overall wealth management and can be one of the greatest gifts you leave for your loved ones.

1 https://financialpost.com/personal-finance/retirement/canadian-inheritances-could-hit-1-trillion-over-the-next-decade-and-both-bequeathers-and-beneficiaries-need-to-be-ready
2 Based on CREA April 2024 average national home price of $703,446 and 1981 price of $75,000. These figures are not adjusted for inflation, however consumer prices have risen about 200 percent over those 43 years
3 https://policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2010/08/Canadas%20Housing%20Bubble.pdf (page 4)
4 S&P/TSX Composite Total Return Index 1/31/81: 2,658.85 and 1/31/24: 84,500.02
5 https://www.ig.ca/en/media-room/media-releases/ig-estate-planning-study-despite-aging-population-most-canadians-lack-estate-plan
6 https://financialpost.com/personal-finance/family-finance/high-net-worth-families/most-high-net-worth-individuals-lack-inheritance-plan-despite-largest-transfer-of-wealth-coming-study

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## Planning Ahead: A Rising Capital Gains Inclusion Rate[1]

It has been over 20 years since we've seen changes to the capital gains tax. Since late 2000, 50 percent (½) of realized capital gains have been subject to tax. As of June 25, 2024, the inclusion rate increases to 66.67 percent (⅔) for corporations and trusts, and on the portion of capital gains realized in the year that exceed $250,000 for individuals.[1] The table shows the impact on a capital gain of $500,000 for an individual (assuming no other gains). Are there ways to manage the potential tax bite? Here are a handful of ideas:

### A History of Capital Gains Tax in Canada

**Pre-1972** – Capital gains were not taxed

**1972** – Capital gains tax introduced; Inclusion rate set at 50%

**1985** – General capital gains exemption introduced – Up to a lifetime maximum of $100,000

**1988** – Inclusion rate increased to 66.67%

**1990** – Inclusion rate increased to 75%

**1994** – General capital gains exemption abolished

**2000** – Inclusion rate reduced to 66.67% (Feb.) and then reduced to 50% (Oct.)

**2024** – Inclusion rate increased to 66.67% ($250,000 threshold for individuals)

Source: "A Primer on Capital Gains Taxes in Canada," CBC, 10/18/2000.

**Weigh the benefits of a lower inclusion rate —** Tax deferral is commonly viewed as a way to create greater returns since funds that would otherwise go to pay tax can remain invested for future growth. However, individuals may wish to evaluate the possibility of accelerated taxation at a lower rate versus deferred taxation at a higher rate: a higher inclusion rate for gains over $250,000. For example, based on a capital gain of $100,000 and a marginal tax rate of 48 percent, an investor would save $8,000 in taxes by realizing a gain at the lower inclusion rate. Yet, this comes at the cost of "pre-paying" $24,000 in capital gains tax today. If this amount was invested with a return of 6 percent per year, it would take 7 years of tax-deferred growth, based on a ⅔ inclusion rate, to beat the $8,000 in tax savings.

**Spread gains over multiple years —** If possible, consider realizing gains over multiple years to take advantage of the lower inclusion rate (under $250,000) versus a larger realized gain in a single year.

**Crystallize gains —** Deliberately selling and rebuying stocks to trigger a capital gain ("crystallizing") can reset the cost basis over time. This strategy, often used in years when an investor is in a lower tax bracket, may help to capitalize on the lower inclusion rate each year.

**Plan to cover increased tax liabilities —** Plan ahead for an increased tax liability. The use of insurance or other planning techniques may be considered to cover the eventual higher tax liability, such as for the transfer of family property.

### How Much More For a $500,000 Gain?

| Province | Tax Rate on Capital Gain* | | Additional Tax |
|---|---|---|---|
| | ½ Inclusion | ⅔ Inclusion | |
| BC | 26.75% | 35.67% | $22,292 |
| AB | 24.00% | 32.00% | $20,000 |
| SK | 23.75% | 31.67% | $19,792 |
| MB | 25.20% | 33.60% | $21,000 |
| ON | 26.76% | 35.69% | $22,304 |
| QC | 26.66% | 35.54% | $22,213 |
| NB | 26.25% | 35.00% | $21,875 |
| NS | 27.00% | 36.00% | $22,500 |
| PEI | 25.88% | 34.50% | $21,563 |
| NL/LB | 27.40% | 36.53% | $22,833 |

*For individuals based on top marginal tax rates 01/01/24.

**Donate securities —** Assuming new rules apply to the deemed disposition of assets at death, if you're considering donations in estate planning, consider using publicly-listed securities to a registered Canadian charity as any accrued capital gain is excluded from taxable income and a donation receipt equal to the value of the donated securities is received. Note: If managing over a lifetime, this doesn't apply to a situation in which the AMT is triggered.

**Business owners —** Evaluate whether certain assets should be held in the corporation or owned personally. For corporations, there is no $250,000 threshold; realized gains are taxable at a ⅔ inclusion rate. The use of corporate-owned insurance or an individual pension plan may be considerations for a business' tax strategy. Plan ahead to use deductions, such as the lifetime capital gains exemption, to reduce taxes payable on the disposition of qualified shares.

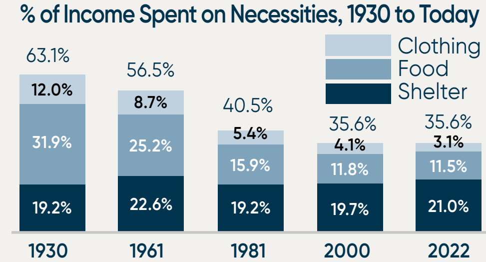
As always, seek advice from a tax expert regarding your situation.

1 Note: At the time of writing, legislation has not been enacted.

## The Increasing Cost of Living: A Taxing Time

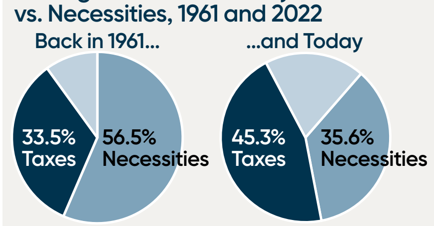
While the growing cost of living continues to be top of mind for many, a differing perspective has emerged on our cost pressures. Despite the rising prices we see today, the proportion of income spent on necessities like food and clothing has declined substantially over time. In 1961, Canadians allocated one-third of family income to these costs; today, they make up less than 15 percent.

### % of Income Spent on Necessities, 1930 to Today



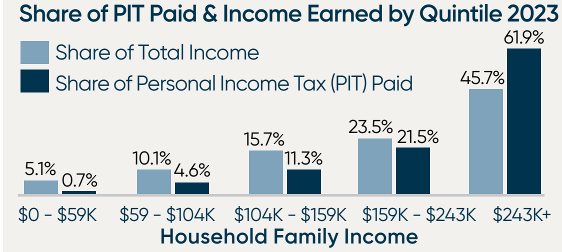

Instead, a recent report suggests that the burden of escalating expenses weighs more heavily on taxes.[1] The Canadian Consumer Tax Index tracks family expenditures on necessities (food, shelter, clothing) and taxes. Today, the average Canadian family spends 45.3 percent of income on total taxes (pie chart). Since 1961, there has been a 2,778 percent increase in the taxes we pay, far outpacing the 863 percent increase in the Consumer Price Index that measures changes in prices.

### Average Canadian Family's Tax Burden vs. Necessities, 1961 and 2022




Who shoulders the heaviest tax burden? When comparing the share of tax paid to share of income, the highest-income earners do. The top 20 percent of income earners (family income over $243,000) pay 61.9 percent of personal income taxes (PIT) but represent only 45.7 percent of total income. Every other income group pays a smaller share of PIT versus share of income.[2]

### Share of PIT Paid & Income Earned by Quintile 2023




1 https://www.fraserinstitute.org/studies/taxes-versus-necessities-of-life-canadian-consumer-tax-index-2023-edition
2 https://www.fraserinstitute.org/studies/measuring-progressivity-in-canadas-tax-system-2023

## Your Home Is Not a Retirement Plan

Summer — the season for home sales — is here! With real estate prices continuing their rise, it may be tempting to see your home's value as a potential source of retirement income. However, when supporting clients in planning for retirement, it's generally not recommended to factor in a home's value as a primary part of that plan. While some homeowners consider downsizing as a way of unlocking retirement funds and others may look to borrow against their homes, there are reasons to exercise caution in relying on home equity for retirement. Here are a handful:

**You may not move —** If you are planning to sell your home and downsize, there is a good chance you may eventually decide not to move. Recent reports suggest seniors are now less likely to sell their homes before age 85; the sales rate among those ages 75 or more has been trending downward since the 1990s.[1] This may not be surprising. Selling a lifelong home can be more emotionally difficult than many anticipate. Many seniors remain in their dwellings to stay close to family, friends or their community and to maintain their sense of independence. Some have instead chosen to "downsize from the inside," using a small part of their homes to reduce costs like heating.

**Low housing supply —** Even if you do plan on downsizing or renting, will you be able to find suitable accommodation? While selling a home in this market may be easy, finding a suitable replacement may be more challenging given low inventories, including rental properties.

**Moving can be expensive —** The costs associated with moving homes may be greater than anticipated: real estate fees, lawyers' fees, land transfer tax, staging and other expenses can add up to be significant. There may also be other unanticipated expenses that come with a new dwelling, such as maintenance, renovations and, if you end up in a condo, monthly management fees. All of these costs can erode the net financial gain by downsizing.

**Higher interest rates —** Recent reports suggest that around 25 percent of retirees carry mortgages as individual wealth has shifted to real estate.[2] Many mortgage holders have seen mortgages reset at higher rates, leading to lower disposable income, especially for those on fixed incomes. While it's possible to access home equity for retirement, consider that this has become more costly with rising rates. Reverse mortgages, although not common in Canada, may allow you to borrow against home equity (usually up to 55 percent) with minimal proof of income. Yet, reverse lenders charge very high rates and there are few large providers. More commonly, a home equity line of credit, often secured prior to retirement when income is high, allows you to draw on the line as needed and pay interest only on what you borrow.

These are just a handful of reasons to exercise caution when considering home equity for retirement. For a deeper discussion on this, or any other aspects of retirement planning, please call the office.

1 "Canadian seniors not downsizing, partly owing to lack of options," S. Peesker, Globe & Mail, 02/12/24
2 "Wealth tied up in real estate can hurt your retirement," R. Carrick, Globe & Mail, 11/30/23, B10.

## Timing Is Everything: Why Some Regret Taking Early CPP Benefits

With most Canadians choosing to start their Canada Pension Plan (CPP) benefits early, there's been growing attention to the potential advantages of waiting. Recall that starting CPP benefits before age 65 (as early as 60) decreases payments by 0.6 percent per month, whereas delaying beyond 65 increases payments by 0.7 percent per month, up to 42 percent (age 70). Actuarial studies continue to show that many people are better off delaying benefits as the break-even age[1] is often below the average life expectancy. Those who live past the break-even age will receive a higher overall benefit by waiting.

Of course, this decision is influenced by various factors beyond just life expectancy, such as immediate income needs. As more Canadians work past age 65, the impact of retiring early, or late, should also be a consideration. Working past age 65 and delaying benefits can lead to a potentially greater benefit. This is because CPP benefits are generally calculated using the best 40 years of income, usually between ages 18 and 65. Since lower-earning years tend to be at younger ages when first starting a career, extending the working years past age 65 may add higher-earning years to the calculation, thus increasing the benefit.

### CPP Timing: Change Your Mind?

If you start benefits and change your mind, you can cancel CPP within 12 months of its start. The cancellation must be in writing to Service Canada and you must pay back the benefits received.

The good news? It doesn't work the other way: Any low-earnings years after age 65 will have no effect on the benefit calculation. Yet, if you retire before 65 and wait to take benefits, the zero-earnings years can negatively impact the benefit. Retiring at 60 and waiting to collect CPP at 65 could add five zero-earning years to the calculation.

### Regrets, We've Had a Few...

Indeed, the old words of Frank Sinatra may be a reminder to carefully consider the timing decision. A recent article in the Globe & Mail highlighted Canadians who had "regrets" after starting benefits early:[2]

**Impact on survivor benefits —** One widow discovered that starting her own CPP reduced her maximum entitlement from survivor benefits. She was also unaware that survivor benefits would change when she turned 65 and hadn't considered the impact of deferring her own benefits beyond that age.

**Legacy considerations —** A man who wasn't in immediate need of the funds wished he had delayed his CPP after realizing how much more he would have left for beneficiaries. One study suggests that taking CPP at age 60 instead of 70 can forgo $100,000 of lifetime benefits.[3]

**Inflation adjustments —** Another retiree noted that had he waited, the multiplier for starting later would have further enhanced the inflation-indexed benefits.

**Returning to work —** One man who began receiving CPP at 60 and retired at 63 decided to return to work. He regretted starting early due to the taxes paid on CPP income during his subsequent employment.

1 The age at which total benefits received by delaying payments exceed total benefits received by starting payments earlier.
2 https://www.theglobeandmail.com/investing/globe-advisor/advisor-news/article-these-canadians-wish-they-had-waited-to-take-their-cpp-benefits-heres/
3 https://www.fpcanadaresearchfoundation.ca/media/5fpda5zw/cpp_qpp-reseach-paper.pdf

# Spring Recap: Budget 2024 — Five Things Investors Should Know

On April 16, 2024, the federal government released its budget, with a focus on home affordability and reducing the cost of living to "strengthen the middle class."[1]

From a housing perspective, the government has suggested its intention to convert public lands into housing, form a new housing infrastructure fund and increase the mortgage amortization for first-time homebuyers for new builds to 30 years (as of August 1, 2024). The budget also proposes increasing the Home Buyers' Plan (HBP) withdrawal amount from $35,000 to $60,000 after April 16, 2024. The HBP allows first-time home buyers a tax-free withdrawal from their Registered Retirement Savings Plan (RRSP), subject to repayment and other conditions. The budget proposes to temporarily defer the start of the 15-year HBP repayment period by an additional three years for those making a first withdrawal between January 1, 2022, and December 31, 2025.

There were no changes to the personal tax rates or the corporate income tax rates. However, some notable changes may impact tax and wealth planning for which investors should be aware, including:

**1. Capital gains inclusion rate —** The budget proposes to increase the capital gains inclusion rate from 50 percent to 66.67 percent for corporations and trusts for capital gains realized on or after June 25, 2024. For individuals, the increased inclusion rate will be applied to the portion of capital gains realized that exceeds a threshold of $250,000 per year.

**2. Lifetime capital gains exemption (LCGE) —** The budget proposes to increase the LCGE from the current amount of $1,016,836 to $1,250,000 to apply to dispositions that occur on or after June 25, 2024, and this would be indexed to inflation beginning in 2026.

**3. Canadian entrepreneur's incentive —** This new incentive proposes to reduce the tax rate on capital gains on the disposition of qualifying shares by an eligible individual by reducing the capital gains inclusion rate to one-half of the prevailing rate on up to $2 million of capital gains per individual over their lifetime, subject to various conditions. The limit will be phased in by increments of $200,000 per year, beginning January 1, 2025, and reaching the $2 million value by the year 2034. Once fully phased in, at current inclusion rates, this would essentially allow two-thirds of $2M in capital gains to be sheltered by this tax incentive (as only one-half of the current 66.67 percent would be subject to tax).

**4. Alternative minimum tax (AMT) —** The budget further amends the AMT rules. The AMT is a "parallel tax" calculation that prevents high-income earners and some trusts from paying little or no tax as a result of certain tax deductions and credits. Notably, the rules surrounding donations have been amended to now allow individuals to claim 80 percent of the charitable donation tax credit when calculating the AMT, instead of the previously proposed 50 percent. Employee ownership trusts would be fully exempt from the AMT.

**5. Employee ownership trusts (EOT) —** An EOT is a trust that holds shares of qualifying businesses for the benefit of employees to support succession planning and promote employee ownership of small businesses. The budget further clarified the conditions required to meet the $10 million capital gains exemption on the sale of shares to an EOT, as proposed in the 2023 Fall Economic Statement. Most notably, the exemption can be shared among multiple individuals and the exemption applies to qualifying dispositions of shares that occur between January 1, 2024, and December 31, 2026.

1 Note: At the time of writing, these budget proposals have not been enacted into law. However, it is expected that these changes will achieve the support of the NDP and pass as intended.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