Milestone Elements

THIRD QUARTER 2014 NEWSLETTER

Branch Manager News

by Steve Booker BComm, CFP, CLU, CIM

Those of you on our email distribution list would have received notification in July that Milestone Asset Management went live on Facebook. Our advisor profiles can now also be found on LinkedIn, and we are actively building out other areas of our social media presence to make it easier to connect with our clients and share relevant insights and information.

The Milestone team has had an innovative web presence since the late 1990s, which has helped us to connect with and better serve our clients. As with all of our communications, our goal with social media is to provide timely and interesting content to reinforce our values and enrich our communication with you.

If the investment industry seems like a late adopter of this technology, it's because we operate in a highly-regulated environment. To protect investors, the Investment Industry Organization of Canada (IIROC) has a number of rules surrounding how and what an advisor may communicate to the investing community.

As an example, all information must be pre-approved before being disseminated, which can seem counterintuitive to the perceived spontaneity and timeliness required of an effective social media strategy. The result is that the use of social media to connect with clients has been a challenge for Investment Advisors.

Canaccord Genuity Wealth Management has put a solution in place to help advisory teams like ours communicate with their online audience. Through this tool, we can submit our social media content that is reviewed internally and simultaneously posted to Facebook, LinkedIn or Twitter in a way that is both compliant for the regulators yet timely for our clients.

To all of you who have already connected with us on LinkedIn and "liked" us on Facebook, we look forward to engaging more actively with you. We are excited to further build out our online presence and we invite all of our clients, friends and stakeholders to be part of our social community.

Principal Residence Exemption and Capital Gains Tax

by Florin Dumitrescu CPA Auditor, CGA

Contrary to the popularly held belief that any capital gain – or increase in value – made on a primary residence is not taxable; in Canada, it is. However, there is a stipulation in the Canadian Income Tax Act known as the "Principal Residence Exemption" (PRE), which allows taxpayers to pay a reduced rate on the capital gains accrued.

Properties that qualify for the Principal Residence Exemption include the obvious: Standard houses, detached and semi-detached houses; and the less obvious, such as: condominiums, cottages, mobile homes and houseboats. The criteria attached here is that the structures are one-half of a hectare (1.2 acres) or smaller and they must be "ordinarily inhabited". Furthermore, no capital gain is taxable on a principal residence if such a residence has been your principal residence for the whole time that you owned it.

In explanation: The term "ordinarily inhabited" is defined loosely in accordance with each individual case. The catch here for taxpayers is that according to the Canada Revenue Agency (CRA), the property is ordinarily inhabited even if a homeowner stays only a relatively short period in the given residence. So even if you sold a property early in the year, or bought a property late in the year – the PRE will still come into effect, granted the property meets the criteria to qualify it as ordinarily inhabited. In addition to this, holiday homes would also qualify as ordinarily inhabited if used during vacations as long as the primary purpose of owning such a property is not commercial.

You can still earn some incidental income and qualify for the PRE; although vacating your home with the successful intention of bringing in a tenant will disqualify the residential status as ordinarily inhabited. In the event of such a conversion of inhabitant status, the CRA recognizes that a transaction has taken place; however, it is such considered that the property has been sold and reacquired at the same price for which it was sold. In this light you can avoid any income tax on the increase in value of such a property. You could also defer the payment of such capital gains tax to a later year. The only

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way property can still qualify as a principal residence and therefore for the PRE, even if the grounds for the property being ordinarily inhabited are not met, is if a special election is sought. This, fortunately enough, makes it less expensive for Canadian residents who need to relocate for purposes such as work and return to their primary residence at a later stage, as such a property can, in this case, qualify for principal residence exemption for four years.

When it comes to the size of a property, as mentioned earlier, in order for a property to qualify for the PRE, it must not exceed half a hectare. However, there is an exception here – if the property owner can prove that the portion of the property that exceeds the half hectare contributes to the "use and enjoyment" of the property or residence then the exemption may still be granted. Such examples include: A long driveway that joins the road which exceeds half a hectare. In cases where local municipal laws stipulate minimum lot size or do not allow severance (the authorized separation of a piece of land) of the lot, the excess plot of land will still qualify for this exemption. If there is no land in excess of half a hectare and severance is acquired, both lots will still qualify.

Prior to 1981, each individual Canadian tax payer could stipulate one property as a principal residence. So if a taxpayer and their spouse owned a house and cottage, respectively, they could designate both properties individually and both properties could qualify for principal residence exemption. However, since 1981 you can only stipulate one property as your principal residence per family unit in Canada. However, there is a bonus year built into the principal residence exemption which allows you to cover a portion of a secondary residence capital gain in view of a future sale whilst still covering your principle residence´s capital gain completely. The equation looks as follows:

$$\frac{(\text{Number of years principal residence} + 1) \ \times \ \text{Capital Gain}}{\text{Number of years home is owned}}$$

The bonus year in this equation further stipulates that if you move, both your old and new residence will be your principal residence for the year of the move although only one of them can be stipulated as a principal residence in this year.

Bear in mind: you have to decide which your principal residence is during the year that you sell one of your properties. Furthermore, you can decide for how long you want to elect a residence as a principal residence. This allows you to evaluate your options properly. Say, for example, you have a cottage that you have owned for 10 years, as well as a house, and you sell one of them at a profit. You need to decide whether to designate the sold property as your principal residence and for how long. This determination should depend on which property has the most significant capital gain – as you cannot stipulate both properties as a primary residence for these 10 years (in this example). So if the cottage has a greater capital gain – it should be designated as the principal residence, and if the house has one – then the house, in this example, should be designated as your principal residence.

So in summary, for these and other reasons the correct application of the principle residence exemption can drastically reduce or even eradicate capital gains tax paid by property owners in Canada. Knowing how to apply it is the secret.

RESP Withdrawals by Shawn Boos CIM, CFP and Steve Nielsen B.Comm, CIM, CFP

RESPs are a great way to save for your child's or grandchild's post-secondary education. The biggest benefit is that the federal government matches 20% of your contribution up to a certain maximum each year. However, a big question contributors' often ask is, what are the consequences when we begin to make withdrawals from the RESPs to send the child or children to a post-secondary institution?

When a child is enrolled either full-time or part-time in an eligible post-secondary institution, the contributor can begin making withdrawals. A portion of the withdrawal will be considered the original contribution or principle and the remaining portion, comprised of grant and growth (referred to as accumulated income), will be considered a taxable withdrawal which is taxable in the child's hands for that year. You have the option to select the type of withdrawal. There is only one limit to this, and that is in the first 13 weeks of enrolment, the annuitant can only withdraw a maximum accumulated income amount of $5,000.

If the RESP is for more than one child (called a Family RESP), the money can be distributed out unevenly to each child. This can help if one child has higher post-secondary expenses than another, or if one has more taxable income as a result of part-time employment.

If there is money in the RESP after all the children have finished school (there is a six month grace period), the remaining amount can be withdrawn by the contributors. If there is only principle remaining, it can be withdrawn without any tax consequences. Usually the government's portion and any growth gets withdrawn early on when the children are in school; however, if there is any government grant money left in the RESP, that would have to be paid back to the government.

If there is growth remaining as well, that can be withdrawn and is taxable to the contributor at their marginal tax rate plus a 20% penalty. To avoid this penalty, there is one provision where you can defer the tax and penalty by transferring it to your RRSP (up to $50,000) as long as you have the contribution room. With proper tax planning, the latter scenario of paying a 20% penalty is an unlikely one due to the fact that RESPs can stay open for 35 years.

The last termination option is to donate the RESP earnings to an education institution in Canada. No tax receipt is issued for this as it is considered a gift.

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