7 Tips to Financial Planning Success

I'm not going to lie to you.   Financial planning can be complicated and usually requires some help from some experts in one or more fields in order to ensure that you are maximizing savings and have no stone left unturned. On the other hand, there are lots of steps you can take on your own to save money, protect your family and increase the chances of achieving financial success. Here are 7 things you can do to put a few more dollars in your pocket and make life easier if you hit a bump on the road:

Take Advantage of RRSPs

The government wants you to save for retirement and rainy days. Accordingly, they have created some huge incentives to encourage you to put aside a few dollars now for later. To briefly recap, RRSPs work as follows:

- You earn contribution room from certain types of income, such salary, self-employment income or rental income. Any room you don't earn gets carried forward and can be used any time until the end of the year that you turn 71 or, if contributing to a Spousal RRSP, until the end of the year that your spouse turns 71.
- Any contributions are deducted from your taxable income. For example, if you contribute $10,000 and are earning $150,000 in B.C., you would have $10,000 growing inside your RRSP and would reduce your tax bill that year or even get a refund from your contribution by $4,370.
- You can choose when to claim your deduction. For example, if you are expecting a big promotion next year or think you will be triggering a big tax bill for another reason, you may wish to defer claiming your deduction for this year's contribution until then. Although you lose the use of the money for the year you wait, it can be worth it if you are going to be in a significantly higher tax bracket at that time. Likewise, consider making extra contributions in these years or even topping up your RRSP just prior to retirement if you can pull the money out the following year at a lower rate.
- Money inside your RRSP grows tax-free until you withdraw it, at which time it is taxed as income. This ability to grow tax-free until withdrawal can be a huge advantage, as this allows more money to get reinvested along the way by using money that would have otherwise been paid in tax to continue to work for you.   Moreover, if you are at a lower tax rate in retirement, you will pay less on your original contributions when you withdraw them than the refund you earned when you first contributed.

- You can withdraw the money at any time, but must start making withdrawals by the end of the year you turn 72. You will have to convert your RRSP to a RRIF, a life annuity or cash the whole thing in by the end of the year before then. You can also choose to do any combination of these options. If you convert to a RRIF, you will need to pull out a minimum amount of money each subsequent year based on a percentage of what is in your RRIF on January first. This percentage increases with age.
- Once you are over 65 and are using a RRIF, up to 50% of each year's withdrawal can be taxed in your spouse's hands rather than yours if the two of you think that this will reduce your combined tax bill (and you can talk your spouse into it!)
- Money inside an RRSP and RRIF has creditor protection in some situations and can also bypass creditors of your estate if you designate a beneficiary other than your estate. This potential creditor protection can be particularly important to businesspersons.
- While you can 'roll over' any amount remaining at your death to your spouse, the balance at the last death will be added to your final tax return and taxed all at once at that time. Admittedly, this can mean a huge tax bill at that time. On the other hand, I would rather have that problem than being worried about where my next dollar will come from during retirement. Some people also overlook the tax savings they have enjoyed earlier and the benefits of tax-deferred growth that have helped their RRSPs and RRIFs to grow.
- The Homebuyers Plan and the Lifelong Learning Plan both allow you to borrow money from yourself in order to purchase your first home (up to $25,000 per person, which can mean $50,000 per couple) or to advance your education. You do need to repay yourself, although the repayment periods are quite generous.

To some people, RRSPs are a 4 letter word. Some people complain about high tax bills during retirement (or payable by their estates) and losing OAS pension dollars because they have to withdraw more money than they need from their RRIFs. While there is some truth to these concerns, there are also ways of dealing with these problems, such as withdrawing money from your RRSP before age 72. Earlier withdrawals can mean accessing some of your money at lower tax rates than if you wait until the last minute and are stuck pulling out a bunch of the money at higher rates. If you retire before age 65, you may even want to make large withdrawals at that time, as you don't have to worry about reductions to your OAS pension at that point.

As well, if your spouse has less set aside for retirement, consider making 'Spousal RRSP' contributions; you get the some deduction as if you put it into your own RRSP but the withdrawals will be taxed in your spouse's hands if you wait 3 years after the last contribution. Finally, when setting up your RRIF, you can pick either spouse's age to determine the minimum annual withdrawals, but you must do this at set up. In other words, since the minimum withdrawal percentage is based on age and increases each year, using the younger spouse's age means that you won't have to withdraw as much each year, which means more flexibility. You can always withdraw more than the minimum if you like.

Take Advantage of TFSAs.

Tax-Free Savings Accounts have been around since 2009 and give each Canadian over 18 $5,000 worth of contribution room (although provinces with an age of majority of 19 won't allow people to contribute until they come of age) for that year. Although you don't get a tax deduction for contributions, any money contributed grows tax-free and, even better, comes out tax-free as well. To make the deal sweeter still, if you haven't maximized your contributions, you can catch up later when funds permit. Moreover, if you need to withdraw money, your unused contribution room increases by the amount of this withdrawal the next year. In other words, you can always replace the amount you withdraw from your TFSA in later years if the money becomes available at that time.

Some people confuse TFSAs with bank accounts and assume that this is their only investment option. In reality, you have a lot more choices; you can invest in essentially the same investments as you can select inside your RRSPs. Unless you don't have investments outside of your RRSPs etc. and do not have enough money set aside for an emergency account, using your TFSA as a savings account that pays 1 or 2% interest is something of a waste. Although you do save tax on the interest, there is not much interest to be taxed in the first place! Some people use TFSAs for high risk investments, as this can mean huge savings if their ship comes in. Other people with lower risk tolerances use TFSAs for investments that would have otherwise produced a significant taxable income each year. This could include a high income mutual or segregated fund, bonds, REITs, stocks with high dividends or preferred shares.

Although $5,000 per year doesn't seem like a lot, this can add up over time, especially if both you and your spouse make contributions. As an added incentive, one spouse can give the other spouse the necessary funds to invest. In addition to being a way to save for new homes, cabins, vehicles or other dreams, TFSAs are a great way to enjoy a higher standard of living during retirement without having to withdraw extra money from RRSPs at high tax rates or at the cost of grinding down your OAS pension. As well, even if you don't need the money during your life, they can be a great way of increasing the size of the estate you leave behind for your heirs; not only are they tax-free during life, but they can be received tax-free by your heirs on death!

Income Split Like There Is No Tomorrow

Our tax system is set up so that the amount of tax we pay on our next dollar of income depends on how much we have already earned; higher income earners will have to pay a higher rate on their next dollar than someone who has not earned as much. As a result, it usually makes sense to structure your financial affairs to decrease the income earned by a spouse with a high income and increase the income earned by a lower income spouse and, perhaps, your children. Although it means they will have to pay more tax, this extra tax is usually a lot less than the tax that the higher income spouse would have to pay on the same money. There are a lot of different ways to legally income-split. Some of the ones to consider that don't require additional help are:

- Spousal RRSPs. The high income spouse contributes to a special RRSP in favour of the low income spouse and gets the same tax deduction s/he would have received if contribution to his or her own RRSP. If there is a 3 calendar year gap between the last contribution and the first withdrawal, 100% of money withdrawn is taxed in the low income spouse's hands at his or her tax rate.

- Having the high-income spouse pay all the bills after first maximizing contributions to a regular or spousal RRSP. This frees up more of the low-income spouse's money to invest at lower tax rates.
- Pay your spouse and children a reasonable salary for contributions to your business. What is reasonable depends on the age of the person in question and their actual contribution. I suggest talking to your accountant if you want more guidance on what is reasonable.
- Consider incorporating your business once you are satisfied that it has turned the corner and is capable of generating at least $75,000 of net income each year if your spouse is low-income or you have children 18 years old or older. If you are already incorporated, consider changing how the share structure is organized. If you have different families owning different types of shares (or are members of a trust that owns the shares), you can allocate dividends from your company to your spouse and adult children and the money will be taxed in their hands. This can be a great way to help with university costs. As another benefit, you may be able to use your business as retirement account. Because small businesses are taxed at really low rates, some business owners choose to invest inside the company rather than personally in order to have more money working for them and so they can withdraw the money in later years at lower tax rates than they are currently paying.
- Consider a spousal loan. The tax laws allow you to loan money to your spouse and have the resulting income and profits taxed in his or her hands rather than yours. In order to do this, you need to document the loan, charge a minimum interest rate (which is 1% as of November 2012) which can be locked in for the life of the loan and have that spouse pay the required interest to you by January 30 of the next year. You must report the interest on your tax return but your spouse can claim it as a tax deduction.

Be Careful When Taking on a Mortgage

In places like Vancouver and Toronto particularly, many people really need to stretch their finances in order to get into the housing market. While a home can be a great investment and everyone does need a place to live, be sure to crunch the numbers carefully before taking the plunge on a new home. Some things to take into account include:

- Try to avoid amortization periods longer than 25 years. There is a huge difference in the amount of interest you'll pay over the life of the mortgage if you pick a 30 year amortization period instead of a 25 year or shorter option. You'll be shocked at how little of the principal you are actually paying over the early years of the mortgage if you select one of the longer amortization periods.
- Even if you're keen on variable mortgages, factor in increases in interest rates when determining the maximum you can comfortably afford. Some types of mortgages will only let you borrow as much as you could have afforded if you could have also qualified for a 5

year fixed mortgage and this is not a bad thing. Even better, if you want a variable mortgage, have your payments based on what you'd have to pay if interest rates were a couple points higher than at present. This gives you a buffer when interest rates do rise and will also mean that you'll pay off your mortgage that much quicker.

- Factor in future life plans when deciding how much to borrow. If you are qualifying for a mortgage based on 2 incomes and no kids, you'll need to take into account what your finances will be like if you have children, especially if one of you plans on staying home for any extended time period. You don't want the stress and expense of having to downsize in a few years if you cannot afford your home, as well as additions to the family. Likewise, although owning a house is a wonderful thing, so is having enough money for vacations, investing for retirement and so that you don't have to pinch pennies every month to meet mortgage payments.
- Investigate and take advantage of prepayment privileges. Many mortgages allow you to increase your monthly payments each year by a set percentage of the original mortgage or to increase your regular payments by a set percentage, or both. I particularly like the idea of increasing your regular payments every time you get a raise so that you make paying down debt a habit. Some people take out mortgages with longer amortization periods but increase their regular payments under the prepayment privileges so that they are still on track to pay down the mortgage for 25 years but so they can reduce payments easily in the future if their finances change, such as having a child.
- Consider biweekly or weekly payments rather than twice monthly or monthly options. You will end up making an extra payment few payments per year which will make a big different down the road.
- If you are a disciplined saver, investigate some of the all-in-one mortgage products like the Manulife One or Envision Financial's Redfrog. In Australia, this type of product is very widely used. These products combine all of your bank accounts and loans into a huge line of credit that you can pay down on your own terms. Instead of earning paltry interest on your savings (which is even smaller after taxes), you use the money against your line of credit until need it. In the meantime, your money is working harder for you, by reducing your interest costs until then. As an added advantage, you can create subaccounts within your overall line of credit for different types of expenses. When making payments against your overall debt, you can allocate how your money is applied against the subaccounts. If some of your debt is tax deductible and some is not, you pay the interest only on your deductible debt and focus on repaying the non-deductible portion first. This will reduce your taxes along the way and ultimately allow you to pay down the entire line of credit quicker. If you are not a disciplined saver, however, stay clear from this product, as the same flexible payment options that can help you pay down your mortgage sooner can also result in financial catastrophe if used unwisely.
- Rather than taking out life or critical illness insurance at your bank, consider owning personal insurance through an insurance advisor instead. There are numerous reasons why

this is a better option and, despite what the lender may tell you, the bank or credit union cannot require you to purchase insurance from them as a condition of getting the loan.

Be Smart When Paying Down Your Debt

There is nothing I hate more than when people are paying unnecessary interest. If you have debt, consider the following when deciding how to pay it down:

- If you have a lot of higher interest rate loans, consider setting up a secured line of credit to borrow money at a lower rate, and then using this to pay down the higher interest rate loans. You'll still owe the same amount of money but will have lower interest payments. If you use the interest savings towards your debt, you will be debt-free that much faster.
- Be careful about hidden interest rates, such as if you select monthly payments instead of yearly payments for things like car insurance, gym or yoga passes. If necessary and you're a disciplined saver, use your line of credit to pay these expenses yearly if this is at a lower interest rate than you'd really be paying if you chose the monthly payment options.
- Take into account tax deductibility when deciding what to pay first and try to convert more of your debt to deductible debt. If you borrow money to earn an income from your business or investments, you can generally claim the interest as a tax deduction, which really means that the true interest rate you pay on this expense is a lot lower than it may appear at first glance. For example, if you are borrowing at 4% for business purposes and your marginal tax rate was 40%, your actual cost of borrowing is really 2.4% after taking into account your tax deduction. In some cases, you can convert non-deductible debt to deductible debt. For example, if you have a non-registered investment portfolio worth $100,000 and a $100,000 mortgage just coming up for renewal, you might consider the following: sell your investments and pay off your home. Then, take out a line of credit against your home and reinvest the money. You would still owe $100,000 but this debt has now magically transformed itself into an investment loan, which is 100% deductible so long as the investments have the chance of paying you income.

Bite the Bullet and Look into Life or Health-related Insurance

I don't know many people who get particularly excited about paying life or health insurance premiums, nor do I. On the other hand, not having sufficient coverage means taking a huge chance with your financial future. When people are early into their careers, their biggest assets are usually their future ability to earn income. If something happens to hamper your ability to earn a comfortable living, the results to you and your family can be devastating. Likewise, many people contemplating retirement are aware that the cost of their future healthcare is one of the biggest variables going forward. Moreover, they are aware that if there isn't enough money, it will likely fall on their spouses or other family members to be caregivers. I believe that it is definitely in your best interests to at least find out more about what products and their cost that are available to protect you and your family from premature deaths or health emergencies. Although people are generally familiar with life, disability and extended health insurance, most do not know much about critical illness and long term care insurance. The former provides a single lump sum payment if you survive certain diseases or illnesses like cancer, a heart attack or stroke for 30 days. The latter provides a weekly benefit for as long as you qualify if you cannot perform any 2 of the 6 functions of daily living or are cognitively impaired. Neither of these products are dependent on your income – you decide how much coverage is appropriate and what you can afford. Both of these products can help protect a family if one spouse isn't earning an income. Critical Illness coverage on your children can also help protect all of you if something happens to a child. Moreover, this coverage can stay with them as they get older so that they can protect their own families.

Get Legal Documents Like Your Will and Power of Attorney In Place

If you die without a Will or get sick without a Power of Attorney, this can mean a lot of unnecessary expense and hassle. Dying without a Will can also lead to several nasty problems, such as unnecessary taxes, the wrong people getting the money and right people getting the money, but at the wrong time. In particular, the government has a formula determining what happens to your money if you don't have a Will. This may not be what you would have wanted. Moreover, even if your assets do flow to the right people, such as your children, it might be up to the Public Trustee to manage the money until your children turn 19, at which point they would get a cheque to spend any way they would like. Most parents I know aren't too keen on that idea!

Take the Time and Pay the Money to Get a 'Real' Will and Estate Plan in Place

Just like going to the dentist or insurance agent, most people dread going to get their Will done and want to get it done as cheaply as possible. As a result, many lawyers and notaries have accepted this reality and have streamlined their systems so that they provide a basic Will to clients at a relatively low price. Unfortunately, although clients may save money now, the end result may be:

- Significantly higher tax bills and expenses for their estates or for their heirs;
- A greater chance of Will challenges and family discord; and
- A higher chance of unintended or unfair results by not addressing as many contingencies as a more detailed Will might plan against.

There are often opportunities to structure your estate so that your money can go further in your heirs' hands by tax sheltering their inheritance, providing potential creditor protection and putting safeguards in place so your heirs don't get control of money they are not equipped to handle. In other words, perhaps a simple Will is not an adequate response to a complicated world. A well-drafted Will and comprehensive estate plan can pay for itself many times. Consider investing the time and effort to work with an experienced lawyer to organize your affairs and encourage your other family members to do the same.