GETTING ORGANIZED

An advisor helps an elderly couple get a handle on scattered funds and lower their tax exposure.

By Michael Berton

On the surface, everything looked good for Jim and Betty Wakefield.* At ages 82 and 78, respectively, they could look back on a pleasant life and were well off financially. Jim had worked hard through three different careers, while Betty had raised their three sons. As a result, he had the lion's share of the retirement assets, and had always managed the couple's finances.

Lately, however, he had become concerned about his more frequent memory lapses and some recent shortcomings in his financial management. Upon recognizing the problems, he made some adjustments, but it was not soon enough. With Betty's income currently at $47,000, and his at $128,000, Jim's entire OAS pension was clawed back and their taxes were high: $52,000 in the last year.

The couple's lifestyle had also changed. They weren't travelling as much as they once had, and therefore determined their total spendable income could be reduced to $21,700 a year. They had built a net worth of just under $2 million—including a $280,000 home, $1.05 million in registered and non-registered mutual funds, $460,000 in blue chip stocks, $122,000 in GICs and $80,000 in cash. They had been holding the stocks in certificate form and were enrolled in 13 different Dividend Reinvestment Plans (DRIPs). Jim was finding the paperwork overwhelming and was no longer able to manually track the adjusted cost bases (ACBs) of the investments. They had chosen their youngest son, John, as executor and didn't want to leave a mess for him to contend with after their deaths.

> They would leave an estate worth more than $2 million.

Jim was prepared to begin relinquishing management of the couple's financials but didn't want to feel he was losing control entirely. He asked certified financial planner Jonathan Flawn to help them. After some initial meetings and analysis, Flawn identified several planning objectives:

- Create peace of mind by organizing and simplifying the couple's affairs.
- Preserve their estate from taxes and unnecessary expenses, and ensure each of the three sons receives an equal share.

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HONOURABLE MENTION

*All client names have been changed.

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- Reduce their current taxes.
- Simplify the potential work for executor John.
- Reduce portfolio risk.
- Provide an after-tax income of $21,700 (in today's dollars) plus an annual $10,000 contingency—assuming an inflation rate of 3%.
- Pass on some portion of their estate while alive.

Flawn had the Wakefields transfer their blue chip shares, including the DRIP plan shares, to three new, non-managed brokerage accounts. There was one for each of them, as well as a joint account. The DRIP programs were altered so the dividends were paid as cash into each account, where they could later be swept out on a periodic basis and reinvested. This simplified management of those shares and the ACB tracking.

Fortunately, Jim was a good record keeper, and Flawn was able to obtain transaction records for the DRIPs going back to 1994 when there had been crystallizations. By creating a spreadsheet, he was able to calculate the current number of shares, fair market value, ACB and capital gains or losses. He then established a system for tracking future transactions. He determined their estate liability with respect to capital gains, which allowed them to make sound, tax-efficient decisions about the portfolio.

There was also little rhyme or reason to the Wakefields' mutual fund portfolio, where holdings were spread across 18 managers. The couple completed a risk questionnaire and Flawn learned they had a moderate to high tolerance. He then recommended the couple consolidate their holdings, as well as their GICs, into a managed account where they would benefit from an automatic rebalancing of the portfolio and some tax optimization.

The fixed income component of the portfolio would, where possible, be held within the registered account, while the tax-preferred stocks would be held in the non-registered component. The management expenses for the non-registered accounts would be charged to Jim directly, giving him a sizable tax deduction at his higher marginal rate. Not only did this save taxes, it also simplified management and reduced the number of quarterly statements to one.

Flawn's recommended strategy resulted in a $4,000 reduction in their income tax bill the first year.

Detailed estate planning and life goals analysis confirmed the Wakefields had considerable surplus assets. Even when the potential expense of senior care and health costs were taken into account, they would leave an estate worth more than $2 million by the time Jim turned 99. They didn't need all that money, and as mentioned, the surplus assets were driving up their taxes and causing Jim to lose his OAS. Flawn recommended they apply for a joint second-to-die universal life insurance policy funded with a total deposit of $500,000 spread over five years. This would reduce the amount of capital exposed to taxation at death and they would continue to control the cash value while it grew tax-free. After the second death, the policy would pass to their sons outside of the estate, avoiding probate taxes.

The premiums would be funded by initial liquidation of stocks in a capital loss position from Betty's non-registered stock portfolio, as well as their annual $50,000 RRIF payments. This funding scheme reduced their income for the coming year and made the $3,800 in capital gains from the gradual sale of Betty's other assets almost immaterial. Buying the policy also helped equalize Jim and Betty's current income and reduced the huge capital gain overhanging their estate, while some of the surplus funds were gifted directly to their three sons.

The trio implemented the plan, and within three years the Wakefields' goals were met. They now have greater peace of mind and vastly simplified tax reporting and accounting needs. The portfolio returns meet their expectations with less risk and their estate has been reorganized to avoid unnecessary taxation. Flawn's recommended strategy resulted in a $4,000 reduction in their income tax bill the first year, and further reductions in following years. They're happy with their current income, funded largely by Jim's pensions and RRIF, and they took pleasure in being able to give lump-sum gifts to each of their sons. **AE**

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