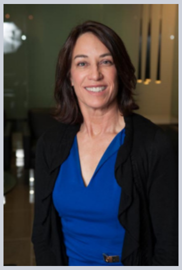
Clarke Wealth Management's

Quarterly Newsletter



Views and opinions
for the clients and friends of

Heather Clarke
Investment Advisor
604-535-3856
heather.clarke@rbc.com
www.heatherclarke.ca

Sean Sullivan
Associate Advisor
604-535-3848
sean.sullivan@rbc.com

Ruby Emms
Associate
604-535-3885
ruby.emms@rbc.com

Changing of the Guard

The winds of change swept Justin Trudeau and the Liberal Party into power with a resounding victory. Specific details of Trudeau's promises of change are not likely to be unveiled until next spring, so we examine the key points of his ambitious campaign platform and show the impact they should have on Canada's ailing economy.

We believe the election platform of the Liberal government likely to have a net positive impact on the Canadian economy. While the incoming government is unlikely to table its first budget until spring 2016, there are key events on the horizon investors should be watching before that time. Prime Minister Justin Trudeau's selection of his cabinet will be closely watched given his majority government has many first-time MPs on steep learning curves, some of whom will be enlisted to implement an ambitious platform. The Speech from the Throne, inaugurating Canada's 42nd Parliament, will likely occur before the end of the year and will outline the government's legislative agenda and priorities. The government's first budget will provide specific details on the cost of spending initiatives and changes in tax policy, but we believe some conclusions can be drawn at this point from the platform the Liberals campaigned on.

Liberal Platform

The key aspects of the Liberal election platform included:

1) Significant infrastructure investment;

2) Significant tax cuts for the middle class;

3) Tax increases on high earners; and

4) Federal deficits of approximately $10B per annum over the next few years.

RBC Global Asset Management expects these proposals will add 0.3%–0.5% per annum to growth over the next three years.

Infrastructure Investment

According to the Canadian Centre for Policy Alternatives, net infrastructure investment in Canada dropped from nearly 2% of GDP in the late 1950s to below zero in the late 1990s. And while this trend reversed in the past 15 years (rising to nearly 1% of GDP), Canada's infrastructure gap has been estimated at as much as $500B. Thus, any commitment by the Federal government to invest directly in infrastructure should be positive for the Canadian economy, in our view.

Many studies have shown that not only do investments in infrastructure tend to generate a higher return than do other Federal programs, they also tend to have a significant positive multiplier effect. That is, a dollar put in tends to generate more than a dollar of economic activity. Thus, all else equal, we believe GDP growth in Canada has the potential to be higher over the next several years than it would have been absent this investment.

Tax Cuts

The Liberal election platform outlined a number of tax cuts that would impact those families with combined spousal incomes of less than $200,000 per annum, including a reduction in marginal tax rates and an increase in childcare benefits. Since those folks that the Liberals have targeted tend to spend a large percentage of their disposable income, the Canadian economy is likely to be positively impacted by these cuts. Unlike infrastructure investment, there is unlikely to be a 1:1 or better impact as some of the reductions are likely to either be used to pay down debt or saved, but the estimated $2B–$3B of combined annual reductions should increase consumption for those income cohorts affected, which again would positively impact the Canadian economy.

Tax Increases

To finance the proposed tax cuts, its platform outlines a series of tax increases for families with combined spousal incomes of greater than $200,000 per annum. These proposals include: (1) a new marginal tax rate that kicks in for incomes above $200,000, (2) the elimination of childcare benefits, and (3) a reduction in maximum annual contributions to Tax-Free Savings Accounts. Since the families affected- would presumably benefit from any reduction in the marginal tax rates on their first $200,000 of income, the threshold beyond which they would actually be paying more in tax would probably be somewhere between $250,000 and $300,000.

Economists generally agree that pushing marginal tax rates above the psychologically important 50% level (as they would now be in several provinces) often leads to lower tax collection than anticipated as it acts as a disincentive to work, and tax avoidance tends to increase. Furthermore, marginal tax rates above 50% also act as a deterrent to attracting foreign talent to the Canadian workforce as this talent will, in part, seek out those countries with the lowest tax rates.

Federal Deficits

While structural budget deficits of a significant magnitude are problematic, proposed deficits of $10B per annum for a few years in an economy the size of Canada are unlikely to be much of a problem, in our view. The proposed levels amount to about 0.5% of Canadian GDP. Given that we expect the economy to grow by about 2%–2.5%, Canada's debt-to-GDP ratio should continue to fall over the three years of deficits. However, we would caution that politicians often call deficits "temporary," but getting rid of them often proves much harder than forecast.

Charitable Giving

In our last newsletter I discussed the Kidney Foundation and the various ways they assist those in need. I have been a part of the Kidney Foundation for quite a while now as a benefactor, as a volunteer and as a charitable donor, and I know the foundations' success is largely due to the philanthropy of those who are concerned with kidney health issues. In this newsletter I would like to touch on charitable giving, because it is something that I'm quite passionate about.

The Mechanics of the Tax Credit

When a donation is made to a qualifying charity, the donor is entitled to claim a tax credit on their personal tax return. Now remember that tax credits directly reduce the amount of tax that the donor has to pay in a given year by reducing the federal and provincial taxes payable.

For the first $200 of donations being claimed, a non-refundable federal tax credit of 15% will be granted. This means that the amount of federal tax payable will be reduced by $30. After the first $200 threshold is passed, any remaining donation amount being claimed on the tax return for that year will result in a non-refundable federal tax credit of 29%. Thus if an individual claims a total of $1,000 in donations, the first $200 will generate $30 in federal tax credits, while the remaining $800 will generate $232 in federal tax credits for a total of $262 in federal tax credits. Provincial taxes payable will also be reduced. Charitable donations in excess of the first $200 will result in a tax savings approximately equal to the top marginal tax rate.

Elimination of Capital Gains

When you donate a publicly listed security with accrued capital gains, you benefit from the elimination of the capital gain plus the donation of tax credit. The combined tax savings can be quite impressive. Take the following illustration for example: you own a security with an adjusted cost base (ACB) of $10,000 but a market value of $50,000. Let's assume you decided to donate the entire position:

1)you eliminate the capital gain of $20,000 ($40,000/2)

2)You receive a credit of $23,000 (46% of $50,000)

3)Your total cost of donating the position is $27,000 ($50,000 - $23,000).

Several strategies may be combined with the elimination of capital gains on donated securities to enhance the tax benefits.

Donate Some Shares to Eliminate Tax on Sale of Securities

If you sell securities with an accrued capital gain, then you will most likely trigger a tax liability on the taxable capital gain. Donating the securities may be one alternative to eliminated the taxable capital gain. However, you may not wish to donate all the securities since you may want to reinvest the proceeds or use them for lifestyle expenses. In this case you may want to donate a portion of your securities and sell the remaining portion.

You can use the donation tax credit on the portion of the securities that you donate to eliminate the tax liability on the capital gain triggered on the disposition of the remaining portion. I can make these calculations for you so that you can realize a sizeable portion of your capital gain while paying no tax.

These are just a couple of the benefits of charitable giving. While it may not be a completely altruistic act, taking advantage of the tax opportunities of charitable giving while doing something good is a win, win situation. Should you be interested in learning more about charitable giving, the various benefits and opportunities RBC Dominion Securities has to offer please don't hesitate to contact myself or my Associate Advisor Sean Sullivan.


Clarke Wealth Management Wishes you a Merry Christmas & a Happy New Year!