Business Outlook

Tax reform - what it means to your investments

IT'S YOUR MONEY

Paul J. Rockel

Lower tax rates?

But are we going to pay lower taxes? The answer is probably "yes," our tax bill may be a lower percentage, but we will be paying that lower percentage on a higher taxable income. The one thing we know for sure is that the government will continue to extract at least the same amount of money from us, the tax-paying citizens, and the corporate world that employs many of us.

We Canadians are good savers. (I wish I could say we are good investors, but in practice we are poor investors of those savings). I believe we here in Canada are the second highest saving nation in the world, exceeded only by Japan. Statistics tell us we save over 14 per cent of our earned income, whereas in Japan they save over 20 per cent. (In the United States the savings rate is below 5 per cent).

What do we do with those savings? Mostly put them (and keep them) in banks, trust companies, credit unions, and other places where we "lend" our money to that institution, and they pay us "rent" (interest). Often people from other countries then come to our banks, etc. borrow our monies to buy our industries, develop our natural resources, and the profits then rightly belong to them, not we Canadians, even though it was our monies that were "lent" to these "foreign" people.

When we "lend" our money to banks, etc., we earn interest. The government loves us, because interest earnings are fully taxable at your tax rate. They have even now taken away the $1,000 investment income deduction, which made the first $1,000 of interest, or dividends, or capital gains, tax free. Now it's gone.

The government has always provided "incentives" for you and I to "invest" in ownership. If you invest by owning shares of profitable corporations, or an apartment building, etc., you receive dividends (distribution of the profits) and hopefully, a capital gain (increase in value of the company, or apartment building).

When I entered the mutual fund industry over 25 years ago, there was no tax on capital gains, and very little dividends. Today, dividends are taxed about one third less than interest for the average wage earner, a little higher for the higher income person, and come virtually free to the lower income person. (It all revolves around something called a "dividend tax credit").

In 1972, the government deemed that Capital Gains would now be taxed. They have played with capital gains ever since, and a few years ago introduced a capital gains "holiday" (phased in over several years) of up to $500,000 without any tax liability. The new proposed tax rules (thanks to the June 18th white paper) will make 75 per cent of capital gains subject to tax, with only $100,000 tax-free.

When you have ownership (as I do in equity mutual funds) you get two types of return, namely dividends, and capital gains (or losses). With interest (lending) you get only one type of return... interest.

Let's compare interest earnings vs. Capital Gains from a tax point of view. If you have $10,000 earning 10 per cent interest, and I have $10,000 invested earning 10 per cent capital gains (plus dividends), what is the difference in taxes, assuming a 44 per cent tax rate (combined federal and provincial).

Your $1,000 per year would lose $440 to taxes, leaving you with $560 gain. My $1,000 capital gain would only have 75 per cent taxed, namely $750, at 44 per cent, resulting in taxes of $330, leaving me with $670 gain (vs. your $560). Yet we both earned 10 per cent.

(If I have not used up my $100,000 capital gains "holiday", there would be no tax at all on my $1,000).

Assuming all the capital gains were subject to tax, at the end of 10 years I would have an after tax-value of $20,677, whereas you, who earned exactly the same amount in interest, would have a value of $17,244.

Yet we both "earned" the same $1,000 per year, and let it compound (after taxes).

For a free brochure on mutual funds, ask for "Why Doesn't Everyone", contact: Peter C. Masson, 10 Fagan Drive, Georgetown, Ont. Or phone 877-7216.

Paul J. Rockel is the author of the best seller "Why I Invest in Mutual Funds" and President of Regal Capital Planners Ltd.

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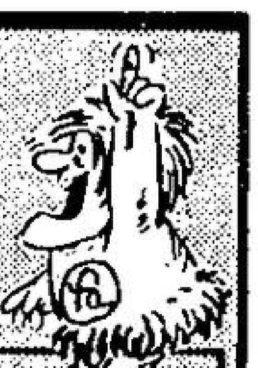

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