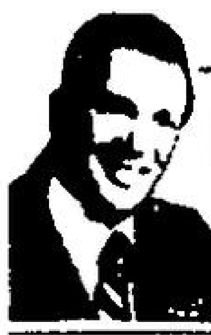
Money Matters

Canada Savings Bonds represent unique investment instruments

By PAUL ROCKEL



IT'S YOUR MONEY
Paul J. Rockel

As regular as the leaves turning color!

Moving through October, the radio and television stations are filled with commercials (paid for with your tax dollars) stressing the wonders of Canada Savings Bonds.

CSBs are unique investment instruments that are accepted unquestionably. They are perceived to be guaranteed, no risk investments and they are purchased unwittingly every fall by most Canadians.

However risk is not overcome by simply allowing an investor to get their money back anytime. When you consider the three major changes that have been discovered by the government in recent years, you'll soon discover Canada Savings Bonds hold little appeal for the discerning investor.

First, CSBs hold no minimum rate guarantee after the first year. In the past there were floor rates, but not now. There's no more built-in protection from a drop in interest rates.

Second, recent issues of CSBs have been priced less competitively than other investment alternatives and even when short term rates change significantly during the year and Canadians start cashing their bonds, the government is slow and stingy in making adjustments.

Third, tax reform has eliminated the $1,000 investment income deduction, making CSBs less attractive to investors who used that deduction to shelter bond interest from tax. They are now taxed from first dollar of interest.

Finally, there is the effect of inflation. Let's say for example that you bought a $1,000 bond and planned to hold it for 5 years. This year the rate is 10.75%, but with interest rates trending down and no rate guarantee on the bond after year one, you may average only 10% for the five years.

Lets assume inflation will average 5% over the next five years. In real terms that means that your original $12,000 will lose 5% of its value in true purchasing power each year. True it will still have a face value of $1,000, but it will only buy $773.77 of goods or groceries five years from now.

Now lets consider the effect of income tax. At the tax rate of 41%, you will have only $59 out of every $100 in interest that your bond earns.

The net effect of tax and inflation is that in this tax bracket, you will have 1.15% real growth in your money, in the lowest bracket of 27.5% you will realize 2.55% real growth and in the top bracket of 48% you will gain .27%.

Are CSBs really a risk free place to put your money? I don't think so.

Many people buy CSBs on the payroll savings plan. Do you know that you have to pay approximately $22 per week for 48 weeks to buy a $1,000 bond? That's $1,056. You are paying for the bond interest as it accumulates with after tax money, then the government taxes you on it. Neat trick, "Canajun Eh?"

What are the alternatives? Well, it depends on your investment objectives. If you're just going to cash in the bond next year to buy Christmas presents or head to Florida, why bother checking alternatives?

If you are saving for the medium term say 5 to 15 years (maybe a house down payment) you will get very little growth, it probably will take 15 years rather than 5 to reach your objective.

If you are saving for retirement either inside or outside of an RRSP, you owe it to yourself to check out the many alternatives that will best suit you.

If your objective is either of the last two (medium or long term) it could be in your best interest to talk to an independent financial planner. He or she will have knowledge of various tax saving alternatives as well as the availability of financial products from a large number of financial institutions to tailor a custom plan for you.

For more information, contact Peter C. Masson M.B.A., Regal Capital Planners Ltd., 10 Fagan Drive, Georgetown, Ontario 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.

Income tax changes should be noted

By BRIAN SLESSOR
TAX UPDATE

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Dollars and Sense

While there are no proposed changes to the basic federal income tax rates for 1990, income brackets will be indexed for inflation. The federal surtax has been increased to 5% for 1990 (4% in 1989) of federal taxes otherwise payable and the additional "high-income" surtax has been raised to 3% (1.5% in 1989) of basic federal taxes over $15,000.

In addition to the increase in the federal surtaxes, there are some other changes and planning points that I would like to bring to your attention.

ANNUAL ACCRUAL OF INTEREST INCOME

Interest on debt investments acquired after 1989, or where the terms of an investment have been extended or materially changed after 1989, must now be reported on an annual basis for tax purposes. For investments acquired before 1990 you may continue to report interest based on the three year accrual rule unless you elect to report such income on an annual basis. The old rules allowed you to defer tax on interest income up to three years.

REGISTERED RETIREMENT SAVINGS PLANS

The contributions limit to a Registered Retirement Savings Plan (RRSP) remain the same for 1990. The limit is 20% of earned income, to a maximum of $7,500, for individuals who are not members of a Registered Pension Profit Plan (RPP) or Deferred Profit Sharing Plan (DPSP). For individuals who are members of either of these plans, the limit is 20% of earned income to a maximum of $3,500, less any contributions made by an individual to an RPP.

REGISTERED RETIREMENT INCOME FUND

RRSP's must be matured before December 31 of the year that the taxpayer turns age 71. At this time the taxpayer has various options:

*receive all of the funds from the RRSP which will be subject to withholding tax and pay taxes on the whole amount received in the year;

*receive annuities which will quality as retirement income;

*transfer the funds in the plan to a Registered Retirement Income Fund (RRIF). With a RRIF, only the amount received by the taxpayer in each subsequent year of retirement is taxed. Legislation requires that a minimum amount be withdrawn each year. The remainder of the funds stay within the RRIF and maintain their tax deferred status.

A RRIF permits a taxpayer to spread the receipt of funds accumulated in their RRSP's over the years between the time that the RRIF is established to the age of 90. Previously, a taxpayer could establish a RRIF only after he reached the age of 60. Under the present tax legislation, a RRIF can be established at any age.

REGISTERED EDUCATION SAVINGS PLANS

With the tightening of the income attribution rules in recent years, the Registered Education Savings Plan (RESP) has become an attractive income-splitting instrument and option to save for a beneficiary's education.

The contributions made by the taxpayer to an RESP are not deductible when computing income, but do allow the opportunity for income-splitting and the deferral of tax on the RRSP until the funds are withdrawn.

In light of the recent popularity of the RESP, the government has put additional restrictions on RESP's in its February 1990 budget. Before this budget there were no annual limits and the cumulative contributions limit was $31,500 per plan. This allowed various contributors to designate the same beneficiary and effectively increase the total cumulative contributions per beneficiary.

The February budget introduced a restriction on total annual contributions to RESP's to $1,500 per beneficiary. The cumulative maximum by all contributors was also restricted to $31,500 per beneficiary. For existing RESP's no further contributions may be made for a beneficiary if total contributions for that beneficiary exceed $31,500. Effective for 1990 and subsequent years, an RESP that has been in existence for more than 21 years will cease to be a registered plan.

Brian Slessor is an Investment Executive with ScotiaMcLeod. Questions should be directed towards Brian who can be reached at (416) 863-2825. Call collect if outside Toronto.