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I S S U E S

Tax-Free Savings Account

By Duncan McEachran, *Senior Vice President*

Almost everyone likes a tax-break, and the new Tax Free Savings Account (TFSA) available as of January 2009, seems like it could be a sure-fire hit among Canadians. It will allow anyone over the age of majority (age 18 in most provinces), to contribute \$5,000 annually to their own TFSA, and have the contributions grow tax-free, forever. Unused contributions can accumulate, and any withdrawals (which are always tax-free) will increase the contribution limit by the amount of the withdrawal, in the following year.

Whether these accounts could prove worthwhile will depend on an individual's own circumstances and objectives. While the idea of tax-free growth is very appealing, at a rate of \$5,000 per annum (indexed to inflation), it will take several years to accumulate an amount of capital that would otherwise be subject to significant taxes. Take the example of an investment in a yield-bearing instrument, paying 5% interest (high in today's rate environment) – it could only save as much tax as approximately \$115 per annum for a top income earner. Of course over 10 years of contributions, the annual savings, assuming the same rate of interest, would grow to be ten times that amount.

As such, in a long-term planning context, a TFSA can potentially provide a sizeable tax benefit. Eligible investments held within a TFSA generally follow the same guidelines as for an RRSP. This use of a TFSA, however, should only be made once all benefits of a couple of other savings vehicles have been used; that is, an RRSP and potentially an RESP (in the case of minors, whose family believe they will pursue qualifying post-secondary education). Unlike an RRSP, contributions to a TFSA are not tax deductible,

and unlike an RESP, there are no government grants. After all, we can't have our cake and eat it too.

Given there are no attribution rules for a TFSA, a higher income earner could contribute to a lower income earning spouse's account, and generate some income-splitting benefits. A parent could also contribute to an account in the name of their adult child to lower the tax rate of the invested funds. Other potential uses could include a short-term savings type vehicle for a future purchase, or simply a liquidity holding. Of note, income earned within and withdrawals made from a TFSA are not included when determining eligibility for income supplement programs, such as OAS.

There are some administrative issues to be aware of when considering whether a TFSA can help meet particular financial goals. These accounts cannot be opened in joint names, and although a spouse can be named as a successor account holder, it would be required to pass through probate upon the death of the original owner. Assets can be transferred in-kind to a TFSA. However, as with a transfer to an RRSP, it is done at fair market value, triggering either a taxable capital gain, or a loss, which would be denied for income tax purposes. Non-residents cannot contribute to a TFSA, although any withdrawals made as a non-resident would remain tax-free. What remains unclear is whether income within an account would be taxed for non-residents.

The Tax Free Savings Account is a new savings vehicle that can provide some tax savings benefits over the longer-term. Whether they provide a significant benefit in the shorter-term will depend on your individual circumstances.

The Big Picture: *The effect of the credit, commodity and equity markets on the Canadian dollar*

By Bryan Monchamp, *Senior Vice President*

Given the velocity of change in the markets over the past nine months, we believe it is worthwhile at this time to take a step back to review the impact of these markets on the Canadian dollar and therefore investors. Specifically, the value of the Canadian dollar has been impacted by the expansion of world money supply (credit) and the resulting liquidity-fueled speculation in commodity and to a lesser degree, equity markets.

What a ride our currency has had! If you recall, at the beginning of July the Canadian dollar hovered near parity and oil was at or near its all time high. Since then our dollar, oil and the markets in general have hit hard realities. With the Canadian dollar reaching a low of 77 cents U.S. in late October, and the TSX losing approximately 49% from its peak to most recent trough, we forgive those who were left bewildered.

Wasn't the Canadian dollar a world currency darling, a do not miss opportunity for foreign investors? For the past decade Canada has had one of the best fiscal management records of all developed nations with government surpluses and programmed debt repayment (notwithstanding pending fiscal expenditures to fight economic contraction). In addition, at a time when confidence in a country's currency is intertwined with its financial markets and institutions, Canada can boast that it has arguably the most prudent banking system on the planet.

So what happened? It's no secret that for some time the value of the Canadian dollar has been related to the fortunes of oil. A quick search on the information highway uncovers statistics indicating that between 2002 and 2005, when oil increased \$1 the Canadian dollar rose one half of one-cent (a correlation of 71% for those who enjoy their math). If we agree that the link between the dollar and the price of oil holds, let's turn now to the root of the rapid rise and fall of oil, a discussion that will provide useful insight into current conditions within currency and equity markets.

During the past five years of the commodity boom, we heard stories espousing peak oil theory, the idea presented by M. King Hubbert in 1956 that the world would experience a decline in oil supply beginning in the 1970's (Wikipedia). With world demand seeming to outstrip supply, oil should have continued in its long-term climb. An Economist article, "When fortune frowned" (included in the October 11-17th issue) discussed the oil markets and concluded that fundamentals drove prices with speculation accounting for only a small impact. With the price of oil now near \$40 per barrel has demand declined that dramatically?

To begin the 21st Century the world has undergone a massive expansion of credit (money supply). The overall market reaction to an oversupply of money is widespread asset appreciation (inflation). In order to protect the real purchasing power of their portfolios (due to the effects of inflation), investors responded by flocking to real assets such as real estate, gold, and other commodities. While this shift initially was rational, there are few mechanisms in markets to signal when prices no longer reflect economic fundamentals. Once the price of "hard" asset classes had taken flight, it gave justification for other asset classes such as the general stock market to increase in value. A self-reinforcing cycle begins where increasing prices justify further increases in price. Note, however, that this was dissimilar to the Tech Bust, where only one asset class experienced bubble phenomena.

Market boom and bust cycles are created through the shared belief of a fundamental story that is expected in some way to change the world, just as technology at the turn of the century was to transform all aspects of our lives. Since 2002, with an ample supply of available credit, the world had multiple prevailing stories to justify the long-term appreciation of oil. The belief that cheap oil has vanished, that emerging markets would drain world resources, that oil supply is controlled by unfriendly nations in addition to current and potential conflict in the Middle East, all made increasing oil prices a well supported belief.

Furthermore, over the past several years, investors have obtained unprecedented access to the futures markets. A key attribute of the futures markets is the ability to use leverage. Leverage is provided by the amount of margin required (initial investment) as compared to the economic exposure that an investor gains. Today hedge funds, day traders and other active investors (speculators) trade on markets that historically were the sole domain of suppliers and users of commodities. On the NYMEX (New York Mercantile Exchange) the annual volume of energy contracts changing hands rose from 63 million in 1998 and eclipsed 220 million for nine months ended September 2008. The combination of the increase in market volume, with shared belief in the long-term prospects for oil, exacerbated by the leverage inherent in futures markets, make it easy to see how the price of oil rose exponentially.

Designers of investment products also picked up on the desire of the investing public to access the futures and commodities markets. Commodity ETFs (exchange traded funds) were a new class of investment that purchased physical commodities (such as gold and silver) or took positions in the futures markets for

commodities such as oil and natural gas. The result again was an increase in liquidity, leading to increased demand in the commodity and futures markets.

The impact of speculation is a question that may never be resolved. Regardless, a turning point in the price of oil occurred when Ben Bernanke, Chairman of the U.S. Federal Reserve System, decided in conjunction with the SEC in late September to place a temporary ban on the short sales of a wide variety of financial stocks. A short sale occurs when an investor borrows stock and simultaneously sells it in the market with a view to profit from a decrease in the price of the share. The definition of financial stocks to whom this trading rule applied was broad, resulting in companies such as IBM, who extend credit to customers, being held safe from short sellers.

The impact of this measure was that hedge funds en masse needed to unwind their pair trade positions. Pair trading is a strategy that hedge funds implement to benefit from the decline of one asset and the appreciation of another. It is a risk management measure of sorts if the right assets are picked as a pair. In this case, a large number of hedge funds representing billions of investment dollars purchased oil futures and/or stocks and had sold short financial stocks. With the temporary ban on short selling financial stocks, Mr. Bernanke provided the signal to hedge funds that the window for this pair trade had closed. The result was that commodity positions were liquidated and financial stocks purchased to repay borrowings. This measure and the collapse of both Lehman Brothers and AIG have been cited as key drivers of the loss of confidence in the financial markets.

Not only did institutional investors borrow securities; they also used low cost credit available in the U.S. and Japan to make their commodity investments. Once the price of oil began to decline, investors that used leverage were also forced to sell. As leveraged investments were liquidated, credit was repaid in both of these countries driving up the value of each respective currency. All of this occurred at a time when the fundamental value of each currency should have been in decline. The Canadian dollar remains caught in the crossfire of capital repatriation to the United States and Japan at the expense of oil.

The lesson learned from these events is that the fair value of any particular asset is difficult to determine when its price is driven by global macro-economic events (an increase in money supply) whose affects are difficult to quantify. The relationship between the variables involved in the credit crisis are simply too complex for anyone to accurately predict its final outcome. As a result, while the contraction in global credit continues to impact the value of our investments in Canadian dollars, it reaffirms the benefit of diversification by asset class, country and sector.

How Do You Spell Relief?

DNCL

By David Vicic, Chief Compliance Officer, CPA Securities Inc.

Let's face it, you have encountered this all too familiar situation too many times in your life. You get home after a long day at the office and you sit down to have a relaxing meal, free of distractions. Just as you are about to dig into that sizzling steak, you hear the dreaded "Brrring, brrring" of the telephone (for those of you old enough to remember when the telephone actually "rang"). You guessed it – the call of the dreaded dinner-time telemarketer.

These calls *could* be a thing of the past due to recently enacted changes to the Federal Telecommunications Act. This Act has given the Canadian Radio-television and Telecommunications Commission or CRTC (the government body given the authority to monitor all things related to telecommunications in our country), the authority to introduce new Rules around unsolicited telecommunications. Effective September 30, 2008, these new rules consist of three main components:

- the National Do Not Call List (National DNCL);
- requirements to keep an Internal Do Not Call List (Internal DNCL) and
- other general Telemarketing Rules

I think that everyone knows what telemarketing is, but in case you need a refresher, telemarketing is marketing conducted using telecommunications facilities such as phone or fax. Most telemarketing calls are unsolicited meaning the recipient of the call has not requested that your organization contact them. The purpose of the call is to sell, promote or solicit products and services.

Calls to clients to "service" an existing client within the normal investment advisor-client relationship are *not* considered telemarketing. Such calls therefore do *not* fall under the Telemarketing Rules and the National DNCL requirements. In addition, e-mails and direct mail are not subject to the Rules.

NATIONAL DO NOT CALL LIST

Consumers now have the right to register up to three personal phone/fax numbers on the National DNCL by calling 1-866-580-DNCL or on-line at www.Innte-dncl.gc.ca. The idea is that registering phone/fax numbers will reduce the number of telemarketing calls that you receive. However, they **will not** be eliminated as there are a number of exemptions in place.

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How Do You Spell Relief? DNCL

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National DNCL rules do *not* apply to the following types of calls:

- Telemarketing calls where the call recipient has an existing business relationship
- Telemarketing calls made to a business (prospective clients & clients) for the purpose of selling business products or services
- Telemarketing calls for the sole purpose of collecting information for a survey.

An existing business relationship is defined as including consumers who:

- Are currently doing business with an organization
- Have done business with an organization in the last 18 months
- Have made an inquiry regarding an organization's product or service in the past 6 months.

All organizations that conduct telemarketing must register for the National Do Not Call List. This will require that these organizations subscribe to and pay the associated fees with downloading the list.

INTERNAL DO NOT CALL LIST

In addition to the National Do Not Call List, all organizations must keep their own Internal DNCL. Organizations must accept Do Not Call requests from "prospective clients", i.e. individuals who are not currently doing business with them. Such requests are to be captured and recorded in an appropriate place including the individual's name, phone number and postal code. When you ask to be put on the Internal DNCL, you will be advised that your request will be recorded by the organization immediately so that no future calls are made unless you provide a separate consent. Existing clients can also request to be put on an Internal DNCL.

OTHER TELEMARKETING RULES

The new Act also introduces other telemarketing rules, some of which are highlighted below.

Information Required During a Call

The following information must be provided in the introduction of any call to a non-client/client:

- The name of the individual making the call
- That the employee is calling on behalf of your organization

The following additional information must be provided upon request:

- A local or toll-free number and/or mailing address for inquiries or comments

The telephone number provided to a non-client/client on request must be:

- Local or toll-free
- Answered by a live operator or with a voice mail system.
- The voice mail message must advise the caller that their call will be returned within three business days.

Faxing Rules

When sending a telemarketing fax, the following information must be set out clearly at the top of the first page of the fax in font size 12 or larger:

- Name of the individual sending the fax
- Name of the business line sending the fax
- Date and time of the fax
- A return voice and fax number
- Full address of the individual sending the fax

Calling curfew

Calling or faxing is restricted to the following hours, based on the time zone of individual receiving the call or fax:

- 9:00 a.m. to 9:30 p.m. on weekdays (Monday to Friday)
- 10:00 a.m. to 6:00 p.m. on weekends (Saturday and Sunday).

PENALTIES FOR NON COMPLIANCE

The penalties to organizations and individuals who do not comply with the new rules are quite onerous. Each violation of the Rules may result in fines up to \$15,000 for the organization and up to \$1,500 for the individual.

Could the call of the telemarketer go the way of the dodo bird? Probably not completely, but at least you might be able to eat in peace.

Announcement

Please join us in congratulating Janice Sloan on her new position as Senior Tax Manager.

Janice joined CPA as a part-time tax consultant in 2006. She has been a member of the CPA seasonal tax group since 1998. Janice is a Chartered Accountant and graduated from the University of Toronto with a Bachelor of Commerce. Janice articulated at Clarkson Gordon (now Ernst & Young). She has held various tax positions in the industry as well as several years in public accounting.

Congratulations Janice and all the best, as you prepare for another busy tax season!

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