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#### To My Clients:

Many of us are welcoming spring after a cold and long winter. With the year already into its second quarter, this may serve as a wake-up call that time — one of our most valuable assets — continues to tick away.

Have you been procrastinating on certain financial decisions that can benefit your future? Is it time for a spring clean of your finances? This may be as simple as updating account beneficiaries or contributing to maximize your TFSA. Whatever the case, let me be a resource.

Enjoy the warmer and longer days ahead.

--Rafeeza

## Volatility: Back Again

Volatility is back again. As the equity markets continue their ups and downs, investors would be prudent to remember that volatility is a common part of the markets.

Just how common? Over the past 25 years, the S&P/TSX Composite index fell in over 38 percent of the time, month over month.<sup>1</sup> Over a 40-year period, this reached almost 40 percent, demonstrating just how frequent downward market movements are.

More recently, however, equity markets have been relatively placid. In fact, in 2016 and 2017, the index fell in only 20 percent of the months. We have experienced an unprecedented bull market run that has lasted for almost nine years. During strong market times, equity prices can have the tendency to overshoot their underlying fair values and sometimes a pullback is necessary.

Longer-term investors should keep in mind that many of the positives that got us to our current financial market health are still in place: growth continues and every major economy globally is expanding, unemployment rates are at some of their lowest levels and corporate earnings continue to be strong. Even oil prices have continued their moderate climb, which may

be good news for Canada's resource-based markets. South of the border, sweeping U.S. tax reform measures passed in December are expected to further stimulate growth.

What about your own portfolio? This is certainly not the time to worry or make abrupt changes. If your holdings are keeping within the objectives set out in your plan, you likely have few serious concerns. Of course, adjustments may need to be made along the way, but your investments are designed to meet your needs over the longer-term regardless of the normal periods of volatility that occur in the markets.

At the same time, it is worthwhile to remember that, more often than not, past periods of consolidation resulted in a snap-back to new highs, usually without warning. Seasoned investors may look for ways to turn lower prices to their advantage and build their portfolios, when others may be fearful to act. Downward movements should be welcomed by those looking to expand their investment positions.

Have patience and keep these things in mind as volatility returns and we weather the inevitable short-term swells of the markets.

Note: 1. S&P/TSX Composite index monthly close to 12/29/2017.

#### In This Issue

Are We Paying Too Much Tax...2  
Budget 2018: A Recap...2

Do You Have an RESP Withdrawal Strategy...3  
Cannabis: The New Kid on the Block...4

## Tax Season Again

# Are We Paying Too Much Tax?

It is tax season once again. As the U.S. implements sweeping tax reform, a look back in time shows just how much Canadian personal income tax rates have risen over 10 years (see chart).

For 2018, Canada's highest combined personal income tax rate is 54 percent in Nova Scotia (NS) for income over \$205,842. In the U.S., the highest combined rate is 50.3 percent in California, but this only kicks in at income over US\$1 million. A taxpayer earning the top NS income threshold in U.S. dollars, around US\$165,000, would only be taxed at a combined marginal rate of 41.3 percent. This means that a NS resident pays 12.7 percentage points more in tax, or over 30 percent, than their Californian counterpart. In fact, California is the only state with a higher combined federal-state top rate than Saskatchewan, the province with the lowest combined top rate.<sup>1</sup>

Are you doing all you can to reduce your annual taxes? The top marginal rates that apply to various forms of income remind us of the importance of structuring investments to take advantage of lower rates. As well, make sure you have maximized your tax-advantaged accounts or income-splitting opportunities

with a family members, and use all the deductions and credits available to you when you file your income tax returns.

### Combined Federal/Provincial Top Marginal Personal Tax Rates

Province	2008	2018 Combined Top Marginal Tax Rate*			
	Interest & Regular Income	Interest & Regular Income	10-Year Change	Capital Gains	Eligible Dividends
BC	43.70	49.80	+14.0%	24.90	34.20
AB	39.00	48.00	+23.1%	24.00	31.71
SK	44.00	47.50	+8.0%	23.75	29.64
MB	46.40	50.40	+8.6%	25.20	37.79
ON	46.41	53.53	+15.3%	26.76	39.34
QC	48.22	53.31	+10.6%	26.65	39.83
NB	46.95	53.30	+13.5%	26.65	33.51
NS	48.25	54.00	+11.9%	27.00	41.58
PEI	47.37	51.37	+8.4%	25.69	34.23
NL/LB	45.00	51.30	+14.0%	25.65	42.62

Note: 1. All 2018 tax rates as of Jan. 1, 2018. Source: KPMG Personal Tax Rates.

## Will Budget Changes Affect You?

# In Brief: Federal Budget 2018

On February 27, the third Federal Budget of the Liberal government was released.\* The Budget anticipates a deficit of \$18.1 billion for 2018-19 and no timetable to balance the books. Consistent with previous years, the themes of this Budget focus on innovation, gender equality — including the introduction of a new *Employment Insurance Parental Sharing Benefit* — tax fairness and integrity.

From a personal and small business tax perspective, the Budget did not propose any changes to personal or corporate tax rates. However, two areas are worth mentioning that may impact tax planning for Canadian business owners and high-net worth individuals:

**Taxation of Private Corporations** — As expected, the Budget addressed changes to the tax treatment of passive income earned in Canadian-controlled private corporations (CCPCs). The Budget now proposes a more simple approach to limit perceived tax-deferral advantages from holding passive investment income, gradually reducing access to the small business tax rate for CCPCs that have significant passive investment income. As well, there are proposed limitations on the ability for CCPCs to receive refundable taxes on payments of eligible dividends.

If a CCPC (and associated corporations) earns more than \$50,000 of passive investment income in a given year, the amount of income eligible for the lower small business tax rate will be gradually



reduced. The small business deduction limit is proposed to be reduced by \$5 for every \$1 of aggregate investment income above the \$50,000 threshold, such that the business limit of \$500,000 would be reduced to zero at \$150,000 of investment income. This measure will apply to taxation years beginning after 2018.

**Trusts: Expanded Reporting Requirements** — The Budget proposes enhanced income tax reporting requirements for certain trusts on an annual basis. New reporting requirements will require certain trusts to file a T3 return where one does not currently exist, and to report the identity of all trustees, beneficiaries and settlors of the trust. This will apply to “express trusts” (i.e., generally trusts created with the settlor's express intent) that are resident in Canada and to non-resident trusts currently required to file a T3 return, with exceptions for specific types of trusts. This measure is expected to apply to returns filed for the 2021 and subsequent taxation years.

For greater detail on Federal Budget 2018, see [www.budget.gc.ca](http://www.budget.gc.ca).  
\*At time of writing, these measures are in proposal stage & may not be enacted into law.

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## Planning Ahead

# Do You Have an RESP Withdrawal Strategy?

Spring may be an exciting time if you have a student waiting to receive post-secondary school acceptances. If you have an RESP, it may be a good time to think about withdrawal strategies.

Recall that the RESP has three components: i) original contributions; ii) grants paid by the government, such as Canada Education Savings Grants (CESGs); and iii) accumulated income payments (AIPs), income/gains on contributions and grants. Grants and AIPs may be paid to the beneficiary in the form of an Education Assistance Payment (EAP), which is taxable in the student's hands. Original contributions can be withdrawn tax-free at any time.

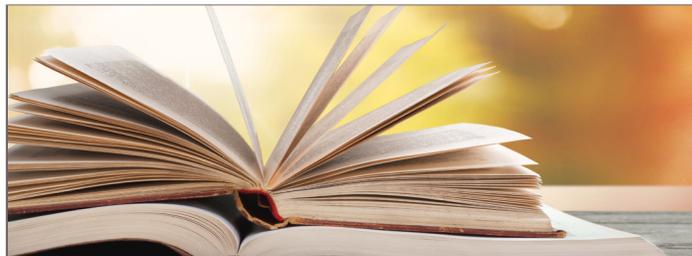
### Why Have a Withdrawal Strategy?

The RESP can generally remain open until the end of the calendar year that includes the 35<sup>th</sup> anniversary of the plan's opening. If funds are not used, there may be financial consequences. Unused grant money must be repaid and there will be a 20 percent penalty tax on top of the regular income tax due on AIPs. As such, consider giving some forethought to your RESP withdrawal strategy:

#### **When a child qualifies for the EAP..**

**Structure withdrawals early to minimize taxes.** EAPs are taxable in the hands of the beneficiary. Once a beneficiary starts a qualified program, begin drawing EAPs to, at a minimum, use the child's "basic personal amount" each year. This is a non-refundable tax credit, so unused amounts cannot be carried forward. Plan ahead to minimize taxes. Consider that the tuition credit can offset EAP income and can be carried forward indefinitely, but other sources of income, such as a summer job, may impact the student's marginal tax rate.

**Exhaust EAPs first.** When withdrawing funds, you must specify



the amount considered the EAP versus a refund of contributions. Exhaust EAPs first; contributions can be paid tax-free at any time.

**Draw down EAP funds before enrolment ends.** There are no restrictions on the use of EAP monies, as long as the child is enrolled in a qualifying post-secondary program. (An initial limit of \$5,000 applies for the first 13-weeks of full-time enrolment.) EAPs can only be made until six months after the student ceases enrollment, so if (s)he drops out it may be beneficial to withdraw as much as possible to avoid tax penalties on unused funds.

#### **When a child does not qualify for the EAP..**

If beneficiaries are at least 21 years old, AIPs may be generally be made to the plan owner starting in the 10<sup>th</sup> year following the year the plan was opened. To avoid penalty tax on AIPs, consider this option:

**Transfer AI to a parent's RRSP account.** This can be done if a parent has RRSP contribution room available (subject to certain conditions). If no RRSP room is available, one option may be to delay collapsing the RESP for a few years (if permissible) to build up the parent's RRSP contribution room. With this transfer, grants must be repaid.

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## Rising Rates and Your Portfolio

Interest rates have been held at historically low levels for many years, helping to support economic growth and propping up the housing market, much to the chagrin of retirees who would like to depend on interest for income. But what is in store as rates continue their gradual rise?

Many investors understand the inverse relationship between interest rates and bond values. As interest rates rise, the capital value of existing bonds go down. Here's why: Consider an investment of \$100 in a 10-year bond that pays a 2 percent coupon. If interest rates rise to 3 percent, you wouldn't be able to sell the same bond at its \$100 face value, because you could buy a new bond for \$100 with a higher coupon rate. As such the bond's market value will decrease to offset its lower interest rate.

We manage this change in different ways. In a rising rate environment, it is important to keep maturities of bonds relatively short to protect capital. As bonds mature, the capital

can be reinvested in new bonds that provide higher interest rates. A laddering approach, with maturities spaced over time, may also help to manage interest rate changes and offer predictability in generating future income streams. Various types of bonds (government, investment-grade, high-yield, etc.) may perform differently when interest rates are rising or falling so depending on the investor's particular situation, diversifying across fixed income investments may help to provide protection.

A rising interest rate environment can also affect equity markets. A popular belief is that rising rates put downward pressure on stocks. But this shouldn't be cause for alarm. Interest rates typically rise during a strengthening economy, which easily can offset any softness over the longer term.

Remember that fixed income plays an important role, helping to preserve capital and create diversification for your investment portfolio. Please call if you would like to discuss.

# Cannabis: The New Kid on the Block

With the federal government's target of July to pass legislation on cannabis, Canada will join Uruguay to become only the second country in the world to legalize its consumption and sale. Since Canada announced its intent to legalize marijuana, the market has rapidly changed. According to Bloomberg, there were 84 cannabis-related companies trading on Canadian stock exchanges at the start of the year, collectively worth \$37 billion.<sup>1</sup>

As equity prices have skyrocketed over recent months, attracting significant attention, with many investors curious about the sector. Here are some thoughts:

**Companies are in their infancy.** Few cannabis companies trading on the Canadian markets have positive earnings and many have modest sales. The total revenue in 2017 for the four largest publicly-traded firms was only \$119 million, which is very small. Of course, this is expected to rise once legalization occurs.

**Valuations are high.** A considerable amount of euphoria has surrounded the industry since the end of last year, with valuations becoming extremely high. As an example, the largest publicly-traded firm by market capitalization, Canopy Growth, was valued at \$5.4 billion at the start of February and was trading at a price to sales (P/S) ratio of 73. Compare this to tech giant Amazon.com, which has a P/S ratio of only 3.6.<sup>2</sup>

**There are many market players.** The market appears saturated, with over 80 publicly traded companies and at least another 20 privately held firms. To put this in perspective, the Toronto Stock Exchange (TSX) consists of only 251 publicly traded companies.<sup>3</sup> Given relatively low barriers to entry, it has been easy for start-ups to enter the market. It is expected that many of these companies will fold and significant consolidation will occur.

**Political and regulatory changes will impact the industry.** The evolving regulatory environment may put downward pressure on the industry. As an example, last year the Canadian Securities Administrators warned Canadian companies with U.S. operations that they were violating



U.S. laws and therefore not compliant with the TSX exchange's requirements. This is because cannabis is currently a prohibited substance under U.S. federal law (despite it being legal in certain states). Other regulatory changes, such as Australia's intention to export medical marijuana, may impact market share.

**Concerns about reporting.** Accounting rules have allowed for variability in how cannabis companies assess a value on their plants, which may overstate profitability. In some instances, inventory may have been given higher values relative to future pricing and demand, which will become more clear once legalization occurs.<sup>4</sup>

## The Bottom Line: These Are Early Days

There is no doubt that the industry's growth opportunity is real, and it will be interesting to see how the industry evolves once legalization is in place. Some reports have estimated that future recreational cannabis sales will reach \$6B by 2021, with a potential market of up to \$22B.<sup>5</sup>

As the sector continues to generate excitement, it may be tempting to be lured by the prospect of growing equity prices. We remain mindful of the many risks associated with investing in the sector today. As with most investments, the potential for high returns comes with high risks. While there will be winners in this sector, there will also be many losers, and investors should remember that these are early days.

Notes: 1. <http://www.cbc.ca/news/business/canada-pot-investing-1.4505353>; 2. P/S figures as at 2/18/18. 3. At Jan. 31, 2018. Source: TMX; 4. <http://www.macleans.ca/economy/canadian-weed-stocks-have-a-serious-accounting-problem/>; 5. [https://www2.deloitte.com/content/dam/Deloitte/ca/Documents/Analytics/ca-en-analytics-DELOITTE%20Recreational%20Marijuana%20POV%20-%20ENGLISH%20FINAL\\_AODA.pdf](https://www2.deloitte.com/content/dam/Deloitte/ca/Documents/Analytics/ca-en-analytics-DELOITTE%20Recreational%20Marijuana%20POV%20-%20ENGLISH%20FINAL_AODA.pdf)

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