The Francis Forum

Summer Edition 2021

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INSIDE THIS ISSUE

Capital Wealth Partners Nominated for "Advisory Team of the Year (Fewer than 10 Staff)"

In early spring, branch manager Michael Prittie was advised that Capital Wealth Partners and in particular, our team was nominated for the award category "Advisory Team of the Year (Fewer than 10 Staff)" for the 2021 Wealth Professional Awards. As the branch manager, Michael submitted a written response to a number of questions and highlighted our value proposition to the judges. In June, we were notified of inclusion in the finalist category. During a two-day virtual event, Michael had the privilege of speaking on a panel with a number of investment professional finalists for the purpose of judges determining a winner. Topics included how to build award-winning client engagement strategies, motivating and coaching team members, and software support. The ideas shared by Michael and his fellow panelists generated lively conversation and as we move into re-opening Ontario post COVID, I look forward to integrating a few new ideas into my practice. While we did not take the crown, the entrant field was large, the competition worthy and we were thrilled to be within the finalist group of ten.

Our thanks to those who nominated us, Wealth Professional and CMI Mortgage Investments who sponsored our panel discussion and the award itself. Special thanks to my team here at the branch who are top notch and whose collective traits got us to the finalist stage.

Around the Branch

COVID 19 seems to finally be dissipating…this time hopefully for good? As most are aware we have not been able to accommodate clients or visitors in the branch for months now.

Our expectation is that as of August 3rd, we will begin opening up to physical meetings at the branch. A formal announcement will go out to all beforehand. Initially, these meetings will continue to take place in the main boardroom, and therefore, we are limited to one family at a time. We also expect that all staff/team members will be double vaccinated by end of July.

Depending on COVID infection rates and vaccination numbers, we hope to open up fully later this fall. In the meantime, Natalie will continue to request your mandatory participation in COVID screening prior to attending the branch.

Please keep in mind ZOOM meetings are still available even after full reopening takes place.

In the meantime, enjoy the warmth of summer and feel free to contact us should you have any questions on the above or financial matters in general.

Thank you.

Admin Corner

What is a W-8BEN form? Why is it needed and renewed every three years?

A **W-8BEN** form is a tax document used to confirm that your country of residence for tax purposes is outside of the United States. It is regulatory requirement because of a cross-country agreement between Canada and the U.S. which requires Canadian Financial Institutions to provide this information.

A completed W-8BEN form confirms that:

1) You are *not* a resident of the U.S.

2) You *are* the owner of the income for which the form relates to.

3) You *are* claiming a reduced withholding tax rate because you're a resident of a foreign country with which the U.S. has an income tax treaty.

To meet the IRS demands, you must update and complete the W-8BEN form **every three years**, even if there is no change in your personal information. The form remains in effect from the date of signing it until the end of the third calendar year.

Natalie Nunn – Branch Administrator

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Create Wealth, Achieve Freedom

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You and Taxation! Limited Partnerships and Avoiding Double Taxation

Limited Partnerships (LP) are unique in many ways. One such way is taxation. When investing in an LP within a non registered (cash) account, it is imperative that you track your cost base and factor in capital gains or other income generated by the manager. Otherwise, you will pay tax twice! Once when you file your T5013 tax slip for the income *and again* when you sell your shares/units down the road. This is ***known as double taxation*** and can easily be avoided by tracking and <u>adding</u> any T5013 income to your original purchase price.

For example, if you invested $100,000 in a LP and the fund realizes $5,000 in capital gains from trading by the manager, your annual T5013 tax slip will indicate this. You will pay tax on the net gain of $2,500 (5,000 x 50% inclusion rate) based on your marginal tax rate. Now in addition to the earnings, the value of the investments held by the fund increased by an equal value of say 5%, your statement would show the original investment worth If in this simple explanation, this repeated for five years, you have received a T5013 slips worth $25,000 (net taxable is $12,500) and tax paid at say 50% = 6,250. The LP is now valued at $125,000 at the end of five years. You have now found a nice retirement condo in Panama and you decide to sell your LP shares. What is the tax? Many will state the tax is $12,500 ($125,000 minus the purchase cost of $100,000 = a capital gain of $25,000/2 = $12,500 taxable and alas $6,250 payable). However, this is incorrect and if processed this way results in double taxation.

The actual *adjusted* cost base has risen to $125,000 because each year you (remember those T5013 slips?) tracked all your T5013 numbers and *added* them to your original purchase price. In my simple example, this adds up to $5,000 x 5 = $25,000 which you ***already*** paid tax on. If your adjusted cost base is $125,000 and the proceeds of sale are $125,000 then the tax cost is zero. Good for you…not so much for the government. Thankfully, we advise you. Anyone who has their taxes done through us here at the branch has this process applied to their LP investments – meaning we track and adjust the cost base. So should you or your accountant because if you don't, you will pay tax twice!

What follows is additional wording from James Cole, Portfolio Manager for Portland Focused Plus LP. It is directly from his 2018 Letter to Shareholders:

"The LP does not pay distributions. Instead, the LP allocates its income and expenses to its investors on a pro rata basis. These allocations are recorded for tax purposes on T5013 slips which are issued to investors annually in March in respect of the preceding calendar year. One of the attractive features of limited partnerships is that income earned and expenses incurred by them retain their tax character when they are attributed to investors. For example, most of the LP's income is tax-advantaged as it is in the form of capital gains and eligible Canadian dividends (only half of capital gains are included in taxable income and eligible Canadian dividends earn significant tax credits). At the same time, the LP's expenses (i.e., management fees, performance fees, operating expenses and interest expense on margin loans) are all fully deductible in the computation of taxable income (with the exception of foreign dividend withholding taxes, which also earn a tax credit). For tax purposes, these expense items (other than foreign withholding taxes) are all aggregated into one number (reported on the T5013 slips) called "carrying charges". *Note that since the LP does not actually pay distributions, investors must have some other means to pay any taxes owing by them on their allocation of the LP's income and expenses.* In my experience, investors generally fund their LP-related tax obligations using other resources held by them or by redeeming some of their units of the LP. Upon receiving each T5013 slip, investors should adjust the adjusted cost base ("ACB") of the LP's units that they own by increasing the ACB by the amount of income items allocated, and decreasing the ACB by the amount of expense items allocated.

In this way, investors in the LP avoid double taxation (which would otherwise arise if investors paid taxes on income allocated to them but not actually received by them, and then, when they eventually redeem their units."

Hopefully this helps. If not, please contact us and we will explain further. Whether it be a Flow Through Resource LP, Real Estate LP or the Portland Focused Plus LP, its imperative to understand the preceding and track accordingly. Many clients own these LPs and the unrealized capital appreciation is quite large in some cases. Lastly, keep in mind **this only applies to non-registered (cash) accounts.** Within an RRSP, RRIF, LIRA or TFSA, the above does not apply as all income generated in those accounts is non-taxable.

Written by Michael Prittie, Portfolio Manager CFP, CIM, FCSI, CIWM

Fundamental Analysis and Firm Value Maximization

When selecting an investment for a portfolio, the options available are vast, diverse, and seemingly endless. However, of all the available publicly traded companies on global equity indexes, narrowing down to a world class, value based, and diverse portfolio requires a strong discipline for screening out companies that do not fit your criteria. When examining equities, we prefer to use the strategy of fundamental analysis which examines potential candidates on the grounds of intrinsic value from a bottom-up approach. The primary goal of a firm is to maximize the value of the business and reflect this value maximization onto business owners. As such, one element of fundamental analysis concerns how well a firm achieves this goal, and we believe there are three broad categories that business operations fall under that help guide portfolio eligibility.

The first of which is the investment decisions of the firm. When undertaking business endeavours, the firm should examine the required hurdle rate and only invest in projects which have a positive net present value exceeding the hurdle rate. This rate is the required return based on the allocation of debt and equity used to fund the project, and the required return should also be a function of size and timing of cash flows and other monetary benefits to the firm that will be realized in the future.

The second category is the financing decision whereby a firm should seek out the optimal capital structure to fund projects and ongoing daily operations. Not only does the optimal capital structure feed into the investment decision we discussed earlier, but it also maximizes the current and terminal value of the firm. This is critical as it allows for continued growth and stability, but also benefits the equity price as it leaves as little room as possible for deadweight loss in valuations.

The third and final category of value maximization is the dividend decision. This decision is extremely important as it allows someone analyzing the firm to see how the business treats excess capital. If the firm is unable to find investments that exceed the hurdle rate, a decision must be made on how to best return capital to owners. The options on the table include:

(1) Sidelining cash for future projects that do meet the hurdle rate.
(2) Buying back equities if the firm believes the share price is undervalued.
(3) Distributing excess capital in the form of dividends.

When examining these categories, while they seem relatively simple and reasonable, there is a large portion of the equity market that disregards at least one of these fundamentals and any major flaws in the structure can be an indicator of future problems if the firm has not already acknowledged and outlined a plan to correct the course. As such, when conducting portfolio research, we seek out firms that actively work to meet the criteria in all three categories. In summary, when conducting a fundamental analysis, the steps in determining whether the firm is actively maximizing value is to ask whether they wisely invest funds in positive net present value projects, optimize their capital structure to properly finance activities, and finally how they treat excess capital (preserved, distributed, or squandered).

Fundamental analysis goes much deeper than this, but every successful portfolio requires a stable and disciplined framework, and the value maximization model is an excellent framework to utilize as it asks strict questions and works to deliver best in class equities to the portfolio when paired with deeper fundamental analysis.

Written by Adam Prittie, Investment Advisor

Should I Stay or Should I Go?

As well as being a hit song for the Clash, this is a dilemma that many employees may find themselves in when leaving an employer or retiring. If they are part of a company pension plan, they may have to make some very important decisions.

Two potential options, are leaving the pension with the employer or transferring the commuted value to a Locked-In Retirement Account (LIRA). Each pension plan is unique in their benefits and each employee has their own unique circumstances and situations to take into account. These are some of the factors that need to be considered before you make that decision that will have long term consequences.

In a pension plan, the plan administrator will make the investment decisions for the Defined Benefit Pension Plan. Their goals and risk tolerance may not align with yours. In a LIRA, the annuitant will have more involvement and choose from a much wider range of investments.

If you take the pension, initially you will have the full dollar value, though some company contributions may take 1 to 2 years to fully vest to you. In a LIRA, there may be a maximum Transfer Value that can be rolled to a LIRA. If you have available RRSP room, some can be transferred to a RRSP. The difference may have to be taken as cash and added to your taxable income. A cash payment from a commuted value may assist a person if they have any debt, such as a mortgage. Your personal circumstances are always a factor in your decision making.

The pension has limited flexibility once your payments have begun. Benefits are payable for life and no lump sum withdrawals are allowed. When converting a LIRA to a LIF, you have much more flexibility. You can start at any age between 55 and 71, though the annual income will be subject to minimum and maximum amounts. Pensions registered in Ontario, can be unlocked up to 50%. This can be transferred to a RRSP or even taken as cash, with its tax consequences.

If pension payments have started, if the owner passes away, the spouse usually receives a reduced amount payable monthly. The reduced amount payable to the surviving spouse can vary by plan, and in some plans, the payments are only for a limited period of time. There is no estate value once the surviving spouse passes away. In a LIF, the surviving spouse may receive 100% of the remaining value tax deferred. Once the surviving spouse passes away the remaining value is payable to any named beneficiary or the estate. The estate is responsible for paying taxes on this amount. A LIRA or LIF can also be unlocked and made accessible for financial hardship, shortened life expectancy, lesser amount or medical expenses.

A company pension is invested as the plan administrator chooses. Some administrators choose to invest in GICs. Lack of flexibility in their investment mandates may make it difficult to maintain funding objectives. The commuted value of a pension plan has an inverse relationship with interest rates. The commuted value, when paid out, represents the present value of what would be needed to pay a given stream of future payments. The lower the interest rates are, the larger the lump sum payment you will receive. We are presently at historically low interest rates, which will most likely not change soon.

In Ontario, the Pension Benefits Guarantee Fund protects up to $1,500 per month of your monthly pension payout. The difference could be lost if the employer has financial difficulty or employer bankruptcy. With a LIRA/LIF you can more control the guarantees of your investment and diversify as you wish to ensure its continuity.

Other important factors to take into consideration when making your decision include the following. Surviving spouse benefits from a pension plan are usually only paid to the spouse at the date of retirement. A new spouse after retirement will not receive survivor benefits. Some pensions are not fully indexed to inflation. You will find your purchasing power quickly eroding as the years add up. If you have worked for a number of different companies, you can consolidate your LIRAs into one LIRA. Taking the commuted value may provide an opportunity for an inheritance to a non- spouse. Usually, only retirees who receive a pension qualify for medical and dental benefits after age 65.

Working with a trusted advisor, you can review the pros and cons of your specific options. Each pension plan is structured differently and should be analyzed for your unique situation to achieve your goals and objectives. Ensure you have a financial plan in place. This may reduce the temptation to deplete funds that have been set aside for retirement. Looking at your overall goals use the plan as an opportunity to create a financial future that achieves your objectives.

Written by George Comminos CFP CIM

Must-Try Summer Activities

With the chaotic year that we have just had, it is time we enjoy a little sunshine! The good news is that brighter days are on the horizon, and it is now time that we take advantage of all the summer activities Ottawa has to offer. Whether you're new to the city, have lived here for your entire life or are looking to play tourist in your own city, this short activity list is for you!

Ontario-Quebec Zipline

The Ottawa and Gatineau zipline is not only Ottawa's newest summer attraction, but it is also the world's first interprovincial zipline! How cool is that? Adventure seekers will zip across the Ottawa River and enjoy some beautiful panoramic views of the Chaudière Falls, Parliament Hill, and other surrounding views. Now until October 1st, thrill-seekers will have their chance to zip at a speed of up to 50km/h and take in the breath-taking views of Ottawa's interprovincial zipline. What do you think about this one, are you checking it off your bucket list?

Outdoor Trails

Ottawa offers many scenic paths; whether you are a cyclist, a walker, a runner, or a hiker, there are routes for every outdoor activity preference and type of ability. The Capital Pathway provides more than 200 kilometers of multi-use paths linking gardens, museums, attractions, wooded areas, and open areas from Ottawa to Gatineau onto the Greenbelt. The Greenbelt offers many kilometers of multi-use paths, check out this interactive map to learn more. The Trans-Canada Trail is the world's longest network of multi-use recreational trails, which offers 27,000km of urban and rural trails from coast to coast. Every weekend from May to October, The National Commission of Canada (NCC) closes several pathways in Ottawa-Gatineau to cars, Sir John A. Macdonald Parkway, Sir George-Étienne Cartier Parkway, Colonel By Drive and Gatineau Park. This is just a short list, but check out this resource for a more extensive list and before your next bike ride, take a look at this interactive bike map to plan out your next route!

Watersports Equipment Rentals

If you're searching for a way to get on the water this summer, there's no better way than to rent out some water sports equipment and have a blast with your pals. Ottawa SUP is a stand-up paddleboard rental company located at 1314 Bank St. at the waterfront on the Rideau River at Billings Bridge. SUP offers various packages; whether you plan on renting by the hour, are interested in taking lessons, or want a takeaway rental, they have got you covered! Dow's Lake Marina is another location to rent water equipment, including Canoes, Kayaks, Stand-up paddle boards or paddle boats. These rentals are available until October, so rent out some water equipment and make your Dow's Lake experience one to remember. For more locations, check out this list!

We hope that you will add some of these summer activities to your bucket list this summer. Take advantage of all the activities and scenic views that Ottawa-Gatineau has to offer and make your summer an unforgettable one!

Client Seminars and Upcoming Event

- Due to Covid-19 we have postponed our in-person seminars and client events until further notice as the safety of our clients and staff is always our first priority. We will continue to host our monthly ZOOM seminars beginning in September.

- The new provincial COVID-19 restrictions prohibit us from having clients in the building and these rules change frequently, however as mentioned above, we hope to begin re-admitting clients to the branch in August (in limited numbers). However, please note our services are considered essential (taxes, securities trading, etc.) and therefore staff will always be present to handle any inquiries and business needs. We are continuing to do reviews via ZOOM and telephone depending on your preference until we fully reopen to the public

Sincerely,

Duane