What Is the Likelihood that You Can Achieve Financial Independence?

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Many people talk about wanting financial freedom; however, few are able to achieve it. Perhaps the question to ask is this: *"What is the likelihood that you can achieve financial independence?"* In a country like Canada, where taxes can be almost 50% of your taxable income, saving taxes should always be a priority.

> After all, it's not how much you earn, but how much you keep that matters most.

"But I maximize my annual RRSP contribution so I save taxes." You may be paying less tax now but the taxes are still due, you are just deferring taxation to a later date—not saving them! RRSP contributions are an effective strategy to help reach your goals and accessing their trapped wealth with different strategies (*RRSP/RIF MELTDOWN*) will be addressed in a future issue. A sound investment approach incorporates tax planning to minimize your investment tax bill each year and to maximize after-tax returns. A tax-smart portfolio is a portfolio that focuses on maximizing after-tax investment returns. After all, it's not how much you earn, but how much you keep that matters most.

The concepts we are interested in are: tax-efficiency; tax deductibility; and fast tracking the building of your tax-smart financial portfolio, using other people's money through leveraging.

> Some types of income are more tax-efficient than others.

What Does Tax-Efficient Mean?

Tax-efficiency is measured by the amount of tax you must pay annually as a result of owning the investment. A tax-efficient fund ensures that as little as possible ends up in the hands of the tax collector.

The amount of tax you pay depends not only on the **amount** of the income earned on your investment, but also on the **type**: interest, dividends (small and large company) or capital gains.

Tax-Deductibility—Zero Taxation!

> FACT:
> $1000 of leveraged interest expense produces the same tax deduction as a $1000 RRSP contribution

Borrowing to invest requires an investor to pay an interest expense associated with the debt. The Income Tax Act of Canada sets out rules that apply to the tax deductibility of interest expense by taxpayers. At the time of writing, interest deduction is permitted where borrowed money is invested in common shares or mutual funds even where capital growth is the primary objective,

$1000 of Different Investment Income	Interest	Small Company Dividends	Capital Gains	Large Company Dividends
Income	1000	1000	1000	1000
Tax	**434**	**276**	**217**	**202**
After-Tax Income	566	724	783	798

Based on top tax bracket of Ontario for 2008 provided there is a reasonable expectation of income from the investment. This means that the interest expense on a loan taken out to buy mutual funds in a non-registered account (this excludes RRSPs) will be tax deductible on the borrower's tax return in the year the interest is paid[1]. $1000 of leveraged interest expense produces the same tax deduction as a $1000 RRSP contribution – AND you still have the RRSP contribution room remaining that can used to double up on the tax deduction or to defer taxes when the investment is "cashed out".

Conservative Leveraged Investment

Leveraging, or borrowing to invest, is a wealth-building strategy that has been used by the rich to get richer for years but poorly understood by most investors. Leverage is a tool that can help or hurt you, depending on how you use it. At issue is how you apply it. While borrowing to invest is a riskier strategy than leaving your money in a GIC, it is possible to leverage in a conservative, responsible way. The key is to borrow only 10-50% of what your lender has calculated you can afford, the result is limiting financial or emotional strain - the definition of conservative leverage.

> Leverage magnifies returns, making good returns better and bad returns worse. Only consider leveraging conservatively, after you fully understand the pros and cons, with the guidance of a trusted advisor.

The key to financial success is not what you know, it is what you DO. Once you are aware of the basics of conservative leverage, you must ACT if you want to benefit from:

- Tax-deductible investing beyond RRSPs
- Converting "bad debt" (expensive, personal debt used to purchase cash items by credit card) to "good debt" (money borrowed at lower interest rates to purchase instruments that will appreciate in value and has the added benefit of being tax deductible)
- Increased discipline using forced savings.

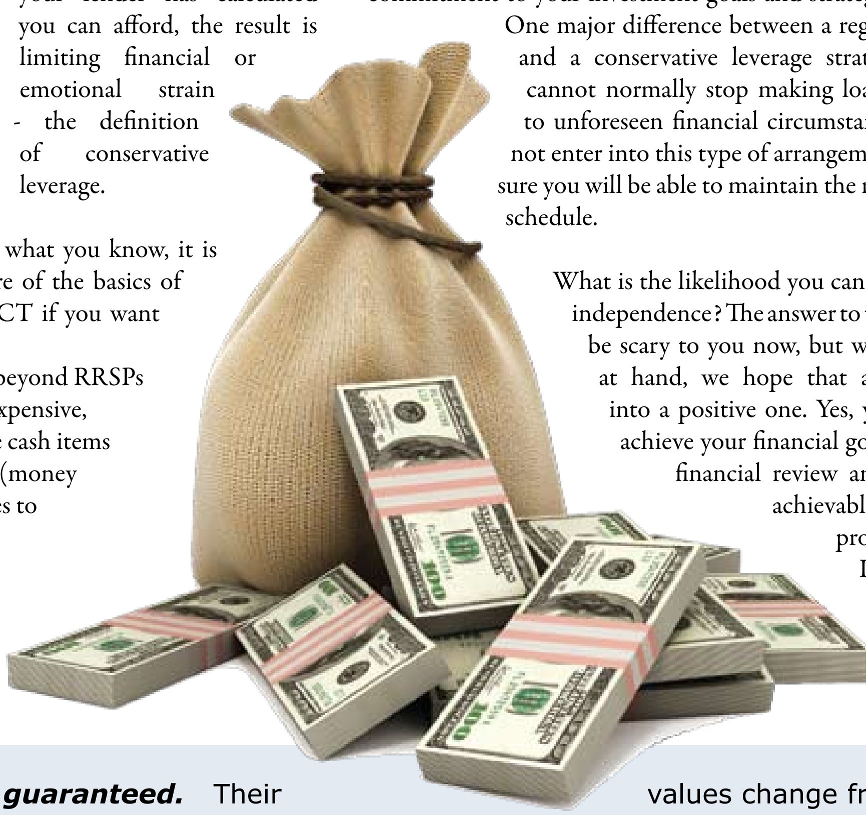
How It Works

A conservative leveraged investment strategy provides you with the potential to accumulate significantly more capital for retirement without needing to increase the amount you currently are saving once you factor in the tax refund.

- You apply for an investment loan, once approved the full amount is invested based upon your risk tolerance.
- Interest only payments are made at regular intervals to service the investment loan. (This requires an 8 plus year time horizon.)
- Invest borrowed funds NOTE: to offset market risk, segregated contracts (similar to mutual funds except purchased from insurance companies) can be used that have the benefit of both maturity and death benefit guarantees of up to 100% of the investment.
- Prior to retirement you withdraw sufficient capital from the investment to payout the investment loan.

Although borrowing to invest can be one of the most effective long-term wealth-building strategies, the real benefits of any RESPONSIBLE leverage plan are the forced higher level of commitment to your investment goals and strategy diversification. One major difference between a regular savings plan and a conservative leverage strategy is that you cannot normally stop making loan payments due to unforeseen financial circumstances. You should not enter into this type of arrangement if you are not sure you will be able to maintain the required payment schedule.

What is the likelihood you can achieve financial independence? The answer to that question may be scary to you now, but with the resources at hand, we hope that answer will turn into a positive one. Yes, you can certainly achieve your financial goals with a proper financial review and implementing achievable targets with proper monitoring. It definitely can be done, and it does not have to be a dream.



Mutual funds are not guaranteed. Their values change frequently and past performance may not be repeated. Commissions, trailing commissions, management fees, and expenses may be associated with mutual fund investments. The purchase of mutual funds using borrowed money (i.e. leverage) magnifies the gain or loss on the cash invested. Investors considering a leveraged purchase of mutual funds should be aware that a leveraged purchase involves greater risk than a purchase using personal cash resources only. The extent of that risk will vary depending on the circumstances of the investor and the type of mutual fund purchased. If you borrow money to purchase securities, your responsibility to repay the loan and pay interest as required by its terms remains the same even if the value of the securities purchased declines. Before investing, read the prospectus and speak to a financial advisor.

[1] **Note:** At time of writing, the interest deductibility rules are under review. Ask your financial advisor for an update of any potential change that may affect your strategy.

Conservative Leveraged Investment Example

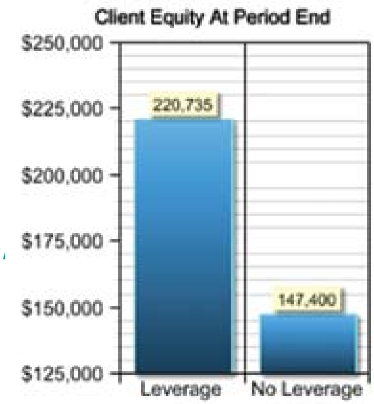
Your Deposit	
Your initial deposit	$50,000
Your loan	$100,000
Total initial investment amount	$150,000
Your Loan	
Leverage ratio	2:1
Loan interest rate	5.25%
Number of years outstanding	10
Loan payment option	Interest only
Your Costs to Borrow	
Marginal tax rate	46%
Taxable portion of return	0%
Tax rate on investment income	46%
Your Investment	
Investment asset class	Equity
Investment return assumption	9.5%

Your Detailed Investment Results
(based on the parameters listed above)

Investment Results	Leverage	No Leverage
Your initial deposit	$50,000	$50,000
Total initial deposit including the loan amount	$150,000	$50,000
Total cash contributions	0	$28,350[2]
Tax on fund income	0	0
After tax loan interest (assuming interest payments are fully deductible)	$28,350[3]	0
Outflow	$28,350	$28,350[4]
Total cost of investing	**$78,350**	**$78,350**
Investment at period end	$371,734	$168,025
Less repayment of loan principal	$100,000	0
Capital gains on the investment	$221,734	$89,675
Less CG tax on liquidation	$50,999	$20,625
Client equity at period end	**$220,735**	**$147,400**
Total net gain/loss on investment	**$142,385**	**$69,050**
Internal RR (after tax)	**12.9%**	**7.9%**

[2] Yearly total of deposits added to non-leveraged account
[3] Yearly total of loan interest – payment interest only loan on $100,000
[4] Outflow of dollars are equal for "out-of-pocket" costs

Investment Results
The value of a leveraged vs. non-leveraged investment: Based on the above assumptions, after 10 years the net leveraged investment exceeds the non-leveraged investment by **$73,335.75**. This illustration assumes that interest payments on the loan are fully deductible.



Based on these assumptions, **after 10 years the net leveraged investment exceeds the non-leveraged investment by $73,335.75.** Using a leveraging strategy allows you to start with a larger initial investment amount. Because a larger amount is growing on day one, performance is magnified through compounding. Due to the tax deductibility of interest payments in non-registered accounts, the costs associated with this strategy are significantly reduced. To confirm the eligibility for this deduction, please consult with a tax specialist.