

TAX ALERT



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YOU OWE YOUR FAMILY A PERSONAL FINANCIAL PLAN

You live in the home you always dreamed about. The kids are moving along in school as planned. Each year you ski at Whistler and enjoy cottage life in the summer. Everything is pretty darn good. Life is busy but there is just not enough time in the day to look at family finances – tomorrow maybe! Finally you pick up the phone and make that dreaded call to get some help in doing a personal financial plan. Isn't everyone supposed to have one?

What's In a Financial Plan

Personal financial plans are talked about a lot but seldom does anyone really say what should be in a good plan. A financial plan – that's about making sure I save enough money so my spouse and I are not in the poor house when we retire, right? That is partially correct but by no means the total objective of a personal financial plan.

We do lots of personal financial plans for our clients. The opening part of every plan should define its objectives.

- ◆ Meeting lifestyle needs and expectations.
- ◆ Protecting and growing family capital.
- ◆ Managing taxes effectively.
- ◆ Transferring wealth to the next generation.
- ◆ Guarding against the unexpected.
- ◆ Fulfilling social and philanthropic goals and commitments.

It's obvious that the above list goes well beyond cash flow and net worth projections to show that you can pay the bills – now and in the future. A good plan also needs to have a strong personal ingredient tailored to the specific objectives of the individuals. They might be as follows:

- ◆ We want a financial plan that allows us to consciously draw down our assets, because we expect to live full and meaningful lives in our retirement. We want the financial element taken care of so we can do other things.
- ◆ Our plan should provide a step by step route that we feel confident in and will completely buy into so that when we execute it and it will deliver financial independence when we retire.
- ◆ We want to minimize taxes and maximize our after tax income.

- ◆ We want to guard against possible loss of employment income.
- ◆ We want to mentor our children in handling and respecting the financial resources they receive and be able to pass our wealth to them effectively.

A good plan must meet the needs of the individuals in a very personal way and this requires a review of many documents – usually guided by the use of comprehensive questionnaires that asks probing questions about every aspect of the individuals’ financial DNA. Goals and priorities must be defined. The plan should identify strengths and weaknesses of the current situation and identify specific recommendations for change. Financial plans themselves have both strengths and weaknesses and trade-offs need to be found between the wish list of personal goals and the ability to meet them. Recommendations in the plan must meet the comfort level of the individuals or they should be discarded and re-worked until everyone is satisfied.

What Does a Financial Plan Do?

A financial plan in the end does many things. It allows individuals to take more control of their future. It sets realistic and attainable goals. It reduces the impact of negative events such as disability, death, investment losses and other financial threats. Finally, a good financial plan can be adjusted for new goals as circumstances change, laws change and new issues evolve. The plan is not just about confirming the importance of staying the course but it also must show new and better options as assumptions are altered.

Financial plans typically make projections of the financial future to the time of death. Although plans project ones entire financial future, they are seldom reliable beyond four or five years and need to be reviewed and redone frequently. The major defect of financial projections is that they are generated by spreadsheets and for the most part they are straight line projections that cannot account for financial tsunamis and day to day events that take things off course. They are obviously useful documents but should be read with a dose of common sense.

Projections are Still Nice to See

Naturally, a personal financial plan must be backed up by detailed financial analyses that support the conclusions. Otherwise individuals don’t really understand or see the tangible outcomes. The following schedules should back up the plan.

- ◆ Current balance sheet showing asset ownership of each asset and classified as personal assets, investment assets, insurance and retirement assets.
- ◆ Analysis of current and projected return on investment by asset class.
- ◆ Projected income from portfolio and retirement capital
- ◆ A calculation of personal income taxes, marginal tax rates and average tax rates that drive the projections.
- ◆ A detailed analysis of today’s cost of living and projected cost of living based on assumptions on inflation and changes in spending patterns.
- ◆ A schedule of future RRSP and pension payments.
- ◆ A projected schedule of net worth confirming adequacy of capital.

Most people view projections of net worth, income and expenses as the essence of a financial plan. While they are interesting and need to be understood, they are only part of the plan as discussed earlier.

Getting More Specific

A good financial plan should look at each aspect of financial planning and deal with each one in detail in the report.

- ◆ Lifestyle issues and philanthropy
- ◆ Investment and retirement funds
- ◆ Tax planning and minimization
- ◆ Personal risk management
- ◆ Retirement planning
- ◆ Financial independence
- ◆ Estate planning and wealth continuity

In each of these areas, the financial plan should review the individuals' wishes, the changes (if any) that need to be made and the related strategic recommendations to accomplish all of this. For example, in the Lifestyle Issues and Philanthropy area, an individual may have the following specific objectives.

- ◆ Remain in the same house but downsize at retirement
- ◆ Mentor children in financial responsibility
- ◆ Have funds to make sure children can attend university
- ◆ Devote modest amount to philanthropy

The financial plan should discuss all of the objectives in a personal way. How can the individuals attain their desired goals? What must they change? What are the threats and challenges – and so on.

As you can imagine, any plan will contain many conclusions and recommendations scattered throughout the report from beginning to end. It is beneficial if all of these recommendations are laid out in point form in a Summary section which will act as a master checklist. The individuals can then drill down and set out to implement the plan one issue at a time. One by one, they can tick off each item as it is completed and move on to the next one.

Personal Financial Plans Need to Be Holistic

Financial plans can look like legal documents prepared by accountants and lawyers for accountants and lawyers. They need to have some empathy, personal thought and be understandable so they meet the user's needs in a holistic way so something gets done. Not an easy task! *This Today's Issues first appeared in the Exchange Magazine.*

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