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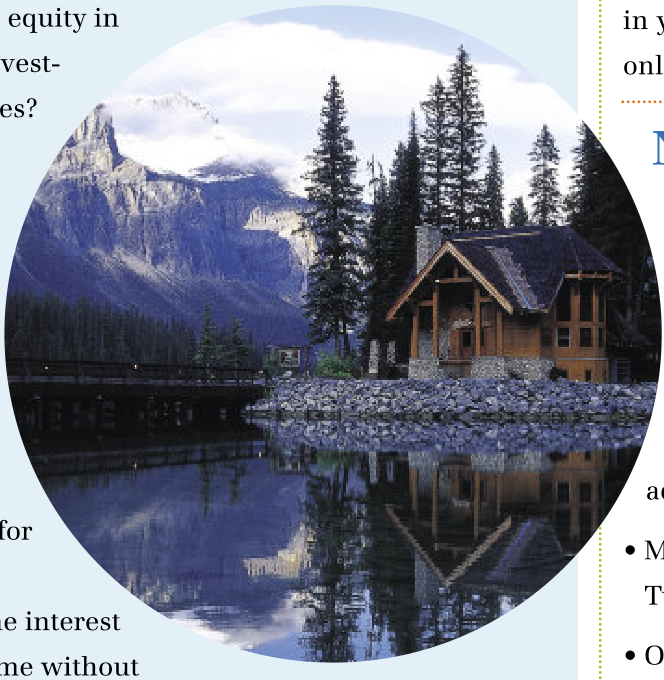
Fun and Tax Savings at the Cottage

by Evelyn Jacks

If you're looking for new capital to build a significant investment or retirement portfolio while giving you a tax break, perhaps you should think cottage country. It's great to have a vacation getaway, someplace to relax and enjoy well-deserved time off with family and friends. But did you know you can also use the equity in your cottage to expand your investment portfolio and save on taxes?



When you leverage the equity in your cottage to back an investment loan, you can deduct the interest, providing there's a reasonable potential for income from the property – interest, dividends, rent or royalties. On your tax return, you claim a deduction for the interest paid as a carrying charge – significant because the interest cost can fully offset other income without restriction at your marginal tax rate. The higher the income, the bigger the benefit.

Example: Let's say your annual income is $63,000. The cottage is valued at $300,000, and you arrange a $100,000 loan, using the equity in the cottage as collateral. The money is invested in the marketplace in a non-registered account, with the potential for earning dividends and interest. The interest paid is deductible and is used to reduce the $63,000 taxable income without restriction.

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Fun and Tax Savings at the Cottage (cont'd)

The table below provides a financial breakdown of the investment details and earnings.

INVESTMENT DETAILS	
Amount invested	$100,000
Interest cost of investment loan (at 5%)	$5,000
Before-tax return of investment (at 8%)	$8,000
Before-tax return on the investment	$3,000

INVESTMENT EARNINGS	SOURCE	
	Interest	Dividends
Taxable income before investment	$63,000	$63,000
Taxable interest income	$8,000	
Taxable dividend income (45% gross-up)		$11,600
Less interest cost of investment loan	($5,000)	($5,000)
Revised taxable income	$66,000	$69,600
Tax[1] on revised income	$17,848	$15,786
Tax on income before investment	$16,754	$16,754
Tax on investment income	$1,094	($938)[2]
Gross return on investment	$8,000	$8,000
Less interest on investment loan	($5,000)	($5,000)
Less tax on investment income	($1,094)	$938
Net after-tax return on investment	$1,906	$3,938
Return on investment ($100,000)	1.9%	3.9%

When you consider the tax savings, together with the potential of current investment returns, the result can be quite attractive, depending on investment income source.

Take another look at the potential for enjoyment from your family cottage. It could be used to create more than just fun in the sun. Leveraging the property's equity may provide a new avenue for investment growth and tax savings, leading to increased wealth.*

Evelyn Jacks is the author of over 35 best-selling books on personal income taxation, including her latest, Essential Tax Facts, and Make Sure It's Deductible.

[1]Assuming an estimated marginal rate of 39% on interest income and 26% on dividends. Taxes will vary by province (taxes calculated for a single taxpayer in Manitoba).
[2]Dividend tax credit exceeds increase in taxes resulting in a reduction in tax.

Note: The annual tax-deferred gain on $100,000 equity invested in the stock market should also be factored in, as well as the evaluation of risk and return, which fluctuates in the marketplace. Ask your tax advisor to prepare possible scenarios to assess potential costs and savings.

COMING SOON! CHANGES TO THE EQUITY & OPTION ORDER ENTRY

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Based on your great feedback, we've changed the Equity and Option Order Entry to give you a better trading experience.

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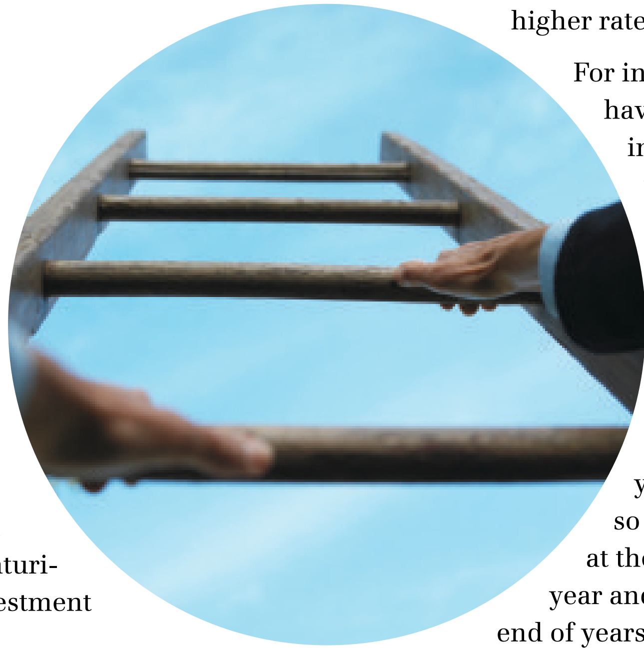
- New side-by-side layout allows you to review your order details as you enter them. You can see the impact of your order on your real-time cash balance and buying power as of the previous days close, in CDN$ or US$
- A simplifed navigation with key information tabs in one location for Account Balance, Quote and Order Status
- A "Remember this contact information" feature that saves you time if you place multiple orders on the same day - you will only have to enter it once during your session
- Step-by step Help and Tutorial sections to give you support when you need it

Watch for changes soon at **bmoinvestorline.com.**

> CLIMBING THE LADDER OF FIXED-INCOME INVESTING

Even when equity markets are hot, the importance of fixed-income investing doesn't cool off. Maintaining an allocation of fixed-income investments can help prepare your portfolio for any turn of the market. One classic strategy for managing your money is laddering, which can be used with any type of fixed-term investment, such as government bonds, corporate bonds, GICs or a combination thereof. With laddering, you create a portfolio with a wide range of maturities, mitigating interest rate risk on reinvestment and diversifying your portfolio.

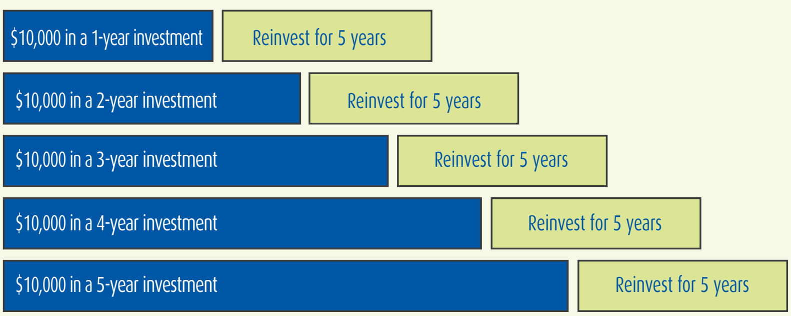


REDUCE INTEREST RATE RISK

The fixed-term nature of investing in individual bonds and other interest-bearing securities can expose you to reinvestment interest rate risk. For example, if you invested your entire fixed-income allocation in one five-year bond and rates declined around that bond's maturity date, you would earn a lower rate when you reinvested in another security.

Constructing a fixed-income investment ladder

The example shows $50,000 invested in 1-5 year investments



Laddering uses investments with varying maturities, with each security representing a rung on the ladder. Staggered maturities allow individual investments to be reinvested every year or so, softening the effect of interest rate fluctuations over the longer term.

Staggered maturities also mean that you can take full advantage of interest rate fluctuations. When rates fall, your existing securities will pay above-average rates when they mature. And when interest rates rise, you can reinvest at those higher rates.

For instance, if you have $50,000 to invest for five years, you can buy five different $10,000 fixed-income investments instead of one $50,000 five-year investment. Structure your investments so that one matures at the end of the first year and the rest at the end of years two, three, four and five. That means you'll have part of your principal available for reinvestment as each bond matures. You'll enjoy a measure of liquidity when rates are high, and your bonds won't all come up for reinvestment when rates are low.

IMPORTANCE OF DIVERSIFICATION

In addition to reducing reinvestment interest rate risk, laddering can also diversify fixed-income investments, to help enhance the stability you count on from that portion of your portfolio. Since a ladder can be composed of various fixed-term investments, a wide range of diversification is possible.

To get started up the ladder, research the types of fixed-income investments you want to hold, based on your goals, time horizon and risk tolerance. Then select specific securities with a range of maturity dates. This strategy offers liquidity and portfolio diversification, and can help you manage reinvestment interest rate risk and protect your portfolio from market fluctuations. It's that simple.

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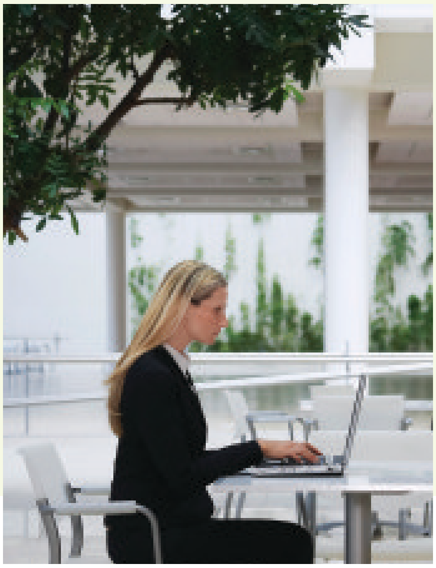

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