AN UNCERTAIN LEGACY

During their marriage, Lisa's husband Jim controlled all the money. Now that he's gone, Lisa is faced with the challenge of growing her savings so she can follow Jim's wishes and leave a large bequest to charity

BY JULIE CAZZIN ILLUSTRATION BY AMEDEO DE PALMA

Four years ago, Lisa Cox got a phone call from her husband Jim that changed her life forever. Jim was calling from the doctor's office, letting her know he was on his way home, and the news wasn't good. When he arrived at their three-bedroom condo in downtown Edmonton, he sat Lisa down at the kitchen table and gave her the diagnosis. He had Stage IV prostate cancer and only a year to live. Jim was 61. "We had just retired and were both in shock," says Lisa, 63. After an eight-month struggle, Jim died peacefully, with Lisa by his side, at a local hospice.

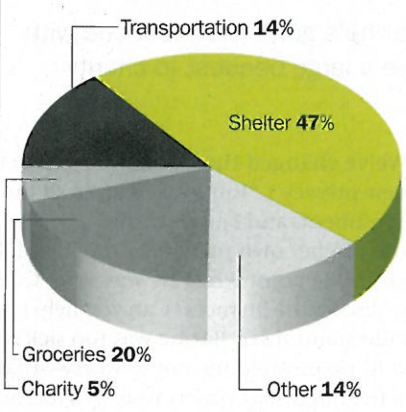
Today, four years after Jim's death, Lisa is still feeling the emotional pain of losing her partner. Adding to the burden is her anxiety about her financial situation. During their 23-year marriage, Jim, a self-employed accountant, handled all the finances. (We've changed their names to protect their privacy.) "Jim looked after all our investments and I just let him," says Lisa, who ran her own menswear shop. "I did ask at one point while he was sick, 'Can we discuss the finances? Can you help me understand this?' But he was too sick to do it. He just told me not to worry—that all the important papers were in a file. So I was left alone to sort out the pieces."

Lisa has been steadily educating herself

HOW THE MONEY IS SPENT

YEARLY DISPOSABLE INCOME	
Canada Pension Plan	$11,472
LIF payment	$7,719
Dividends from holding company	$7,500
Minus: taxes	– $1,000
NET DISPOSABLE INCOME	**$25,691**
YEARLY EXPENSES	
Debt repayment	
Total debt repayment	**$0**
Shelter	
Property taxes	$2,501
Home insurance	$580
Electricity	$1,440
Phone/internet/TV	$1,920
Condo fees	$3,480
Total shelter	**$9,921**
Transportation	
Car insurance	$800
Gas	$1,200
Maintenance	$1,000
Total transportation	**$3,000**
Personal	
Groceries	$4,200
Clothes, haircuts, etc.	$800
Charity	$1,000
Restaurants	$600
Gardening	$225
Dental/drugs	$300
Miscellaneous	$1,000
Total personal	**$8,125**
TOTAL EXPENSES	**$21,046**
Annual income available for investment (total income minus total expenses)	**$4,645**

WHERE DOES IT ALL GO?



*Figures are percentages of total expenses.

about money for a couple of years now, but she often feels overwhelmed. That's because she wants to handle the money wisely so there will be enough left to carry out Jim's final wishes. His dream was to leave a huge legacy to prostate cancer research, as well as $100,000 to each of his two sons from his first marriage. "It's the only request Jim made before his death and I'm determined to fulfill his final wishes," says Lisa. "He was a good man and left me in charge to do the right thing," says Lisa. "I plan on doing just that."

Her investment portfolio is substantial and varied. Besides her $500,000 condo, there is just over $1.1 million in RRSPs, TFSAs and GICs, and $260,000 in a holding company—an overwhelming amount for a frugal woman who grew up dirt poor. Lisa's biggest fear is that she'll squander the money—not by overspending, but by making bad financial decisions. "Jim and I worked so hard for this money and I want to make sure it keeps growing as tax-efficiently as possible."

Right now, Lisa lives on about $26,000 a year, made up of Canada Pension Plan benefits, $7,500 in dividends from the holding company and $7,700 annually from a Life Income Fund (LIF) that Jim had built up from a job he held in his 20s. She's living comfortably on this income for now—mainly because she's debt-free—but soon her income will increase substantially when forced withdrawals from RRSPs kick in, meaning higher tax bills. Between her CPP, Old Age Security payments that start at 65, upcoming RRSP withdrawals and liquidating her holding company, her taxable income will remain high for years.

LISA ASKED JIM FOR HELP MANAGING THEIR MONEY, BUT BY THAT POINT HE WAS TOO SICK WITH CANCER

Lisa has two main goals: to create a plan for withdrawing her RRSP money as tax-efficiently as possible, and to take out the money from her holding company with minimal tax consequences. "I want to make Jim's dream of donating to cancer research a reality," she says "I think I can do a good job with a bit of guidance."

One thing is sure—Lisa is a hard worker. She grew up outside Edmonton, the only child of two workaholic parents who owned a local diner. "My mom and dad worked from 6 a.m. to midnight, seven days a week. Dad was sick a lot so Mom ran the show. I pretty much took care of myself from the age of 10 because they were never home."

In her 20s, Lisa got a job as a secretary at a local mining company, and at age 35, she met Jim. The accountant was 38 at the time and going through a nasty divorce. Jim was honest with Lisa from the beginning. "He told me he had nothing—absolutely nothing. He had given everything to his ex-wife and two sons and was basically left with four spoons, four forks and four knives. We always lived so tight because we started from scratch."

Jim took his parental responsibilities seriously and always made sure his kids were well cared for. "In those days, a father was responsible for his children until age 18," says Lisa. "Jim crossed that out on the divorce papers and wrote in '21' instead. For years, we paid child support and made sure those two boys had everything they needed. We also saw them regularly."

In 1986, Jim and Lisa bought a small house outside Edmonton for $71,000. In 1987 Jim left his full-time accounting job and started his own business, while Lisa opened a menswear shop. Over the years, Lisa spent most of her days at the shop as she worked hard to grow the business. She devoted every waking moment to it. "The store was my baby. I practically lived there and didn't take more than two weeks off in 15 years."

All along, Jim handled their finances and Lisa credits him with growing their nest egg substantially in only 23 years. In 2007, knowing they had enough money for a comfortable retirement, they sold the menswear shop and the couple retired permanently. They sold their home and bought a large three-bedroom condo right downtown.

Lisa's largest asset is her condo, worth $500,000. Her liquid assets include an RRSP worth around $1 million, $260,000 in shares in the holding company, $46,000 in a LIF, $26,000 in a TFSA and another $31,000 in cash and term deposits. The total? Around $1.4 million in liquid assets. Lisa will need to grow that money, partly to make sure she doesn't outlive her investments, but also because she wants to leave the Prostate Cancer Canada Network at least $500,000 when she dies.

Right now, her RRSPs and holding company shares are invested in mutual funds and several blue-chip stocks, and are averaging 4% annually. Lisa is happy with that, as well as with the help she's received at the bank from managers who continue to make her investments run smoothly. She's more concerned about the company shares, which she hopes to cash in all at once without taking a tax hit. But her biggest task will be making sure she withdraws money from her RRSPs as tax-efficiently as possible over the next few years, and she says she has no clue how to do that.

Lisa currently spends most days living a simple life. She walks her two Boston terriers, Lila and Jackie, in the local park, and goes on the odd outing for lunch or shopping with friends. "I have to learn how to enjoy my money more. I want to do some volunteer work and a bit of travelling," she says. "A trip to Italy for two weeks may be a good place to start. All I want is to do is settle my finances and move forward."

WHAT THE EXPERTS SAY

With a net worth of almost $2 million, Jim and Lisa did a great job of preparing for retirement. But even though Jim planned their finances well, he made the crucial mistake of not communicating with Lisa about how to manage their money if something should happen to him. "With Jim, Lisa had her own personal accountant and adviser," says John Mott, a chartered accountant in Toronto. "Even though Lisa is willing and able to do a lot of the money management herself now, she still needs to make sure she has an adviser—either at the bank or elsewhere—that she trusts and can communicate with going forward."

Based on her budgeted expenses, Marc Lamontagne, a fee-only adviser with Ryan Lamontagne in Ottawa, reassures Lisa she will not run out of money before she dies. "In fact, she could easily increase her spending by $20,000 a year and still have $1 million at age 90," says Lamontagne, after running the numbers. So here's what Lisa should do to accomplish her financial goals and enjoy her life.

WHERE SHE STANDS

ASSETS	
Condominium	$500,000
RRSP	$1,061,770
Life Income Fund	$45,706
TFSA	$25,603
Holding company	$260,205
Term deposits	$11,000
Chequing account	$20,000
Car	$5,000
Total Assets	**$1,929,284**
Total Liabilities	**$0**
NET WORTH (total assets minus total liabilities)	**$1,929,284**

Wrap up the holding company. The experts say there is no way Lisa can take the money out of her holding company tax-free. "People have holding companies to *defer* taxes, not avoid them completely," says Mott. "I'm sure Jim knew taxes would have to be paid at some point. And while Lisa could keep the company until she dies, her estate would still owe taxes at that time." The experts say a sale of the company or a loan based on the assets could work in some cases, but these options aren't suitable for this kind of holding company.

Most people would simply withdraw the funds from the holding company as ordinary dividends, which are taxed at a lower rate than regular income. But in Lisa's case, closure of the company is her best option. She should take the full $260,205 out of the corporation this year. "It will cost her about 25% in taxes on average, but then she'll no longer have the trouble and expense of maintaining a corporation," says Lamontagne.

Have a systematic RRSP withdrawal strategy. Lisa does not need to withdraw money from her RRSPs right now, but she will have a tax problem once she turns 72. (RRSPs have to be converted to a Registered Retirement Income Fund or annuity at age 71, meaning you need to start taking out the money the following year.) The minimum withdrawal at age 72 is 7.5% of the balance, a percentage that rises every year. The problem is not just the taxes paid on higher incomes. Once her net income is above $69,562, she will also be hit with the Old Age Security clawback. "The clawback essentially adds another 15% tax on top of your regular rate for every dollar above the threshold," says Lamontagne. "Lisa can reduce the overall tax bite throughout her life by starting to make RRSP withdrawals now. This will decrease the balance in her RRSPs and reduce the chance of being hit with the clawback."

How much should she withdraw? Lamontagne proposes increasing her annual taxable income to about $83,000 prior to age 65. This would keep her marginal tax rate at about 32%. "Once she turns 65, her taxable income cap would be the OAS clawback threshold," says Lamontagne. To make this strategy worthwhile, Lisa would then take the after-tax funds and invest them in a non-registered account. "If she's happy with the returns from her investment portfolio, she should adopt the same strategy with her non-RRSP investments," says Lamontagne. "She should focus on building a low-volatility portfolio of 60% equities and 40% fixed-income securities that includes blue-chip stocks, exchange-traded funds (ETFs), mutual funds and real estate investment trusts."

LISA NEEDS TO GROW THE MONEY BECAUSE SHE WANTS TO LEAVE $500,000 FOR CANCER RESEARCH

Make the charitable donation tax-efficient. Because she has such a large RRSP, Lisa's estate will be subject to significant taxes when she passes away. The RRSP will be deemed fully withdrawn on the day before she dies. Lamontagne figures that with her modest spending, she'll still have at least $1 million left at age 90. "Unfortunately, that means she could face a final tax bill of about $500,000," says Lamontagne.

There are a couple of strategies people use when faced with such a large tax bill. The first is a large charitable donation. "If Lisa donated $1 million upon her death, that would reduce her estate's tax bill by about $400,000," says Lamontagne. A second strategy is to buy a life insurance policy to cover the estate taxes. "A $500,000 term life insurance policy would cost her about $12,000 annually, but the premium would not be tax-deductible."

To fulfill Jim's wishes and make her charitable donation tax-efficient, Mott suggests Lisa buy a $500,000 term-life policy and declare Prostate Cancer Canada as her beneficiary "If she does this, then the $12,000 annual premium will be tax-deductible—making her final gift of $500,000 truly tax-efficient." M

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Julie Cazzin is an award-winning business journalist and personal finance writer based in Toronto. For previous Family Profiles and other stories by Julie, please visit our website at MoneySense.ca