Weekly Updates Issue # 558

1. Weekly Markets Changes
2. Canada won't adjust to oil plunge for years: BoC
3. U.S. gained 215,000 jobs in March
4. Life insurance companies say they could withstand negative rates
5. Who will benefit from new family tax regime?
6. China becoming a global banker for criminal economy: AP investigation
7. Life insurance loophole closed: example

1. Weekly Markets Changes

[April 1, 2016]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
13,440.44 +82.33 +0.62%	2,072.78 +36.84 +1.81%	17,792.75 +277.0 +1.58%	4,914.54 +141.0 +2.95	$0.7688 +1.56¢ +2.07%	$1,223.60 +5.60 +0.46%	$36.63 -2.96 -7.48%

2. Canada won't adjust to oil plunge for years: BoC

[April 1, 2016] The Bank of Canada says the majority of companies polled in its latest business outlook survey say they've benefited from the oil price shock driving down the Canadian dollar.

The central bank's quarterly survey of about 100 Canadian firms has revealed that, in most cases, the weaker loonie has helped exporters boost their margins through products sold abroad.

The bank has also found some of the surveyed companies have enjoyed less competition from their U.S. counterparts, while others have reaped benefits from increased tourism in Canada.

However, some firms have faced significant pressure in cases where a large portion of their costs for inputs and equipment are priced in U.S. dollars. And, the bank's survey finds companies with ties to the energy sector view stubbornly low oil prices as a big negative for their outlooks.

"Firms' perspectives continue to diverge sharply, depending on whether they are tied to the commodity sector and on their exposure to foreign demand," says the BoC. But, "Expectations for future sales growth remain positive, with clear signs of support from U.S. demand."

Overall, the bank describes the poll results as improved but subdued. "The positive impetus coming from the sustained foreign demand continues to be largely offset by the persistent drag and spillovers from the oil price shock."

The Bank of Canada has indicated that the economy has been undergoing a complex adjustment ever since the exchange rate began to tumble in mid-2014, along with the steep drop in world crude prices.

Lynn Patterson, the central bank's deputy governor, said in a speech Wednesday the bank's "best guess" is it will take more than two years for Canada to fully adjust to the commodity price plunge. Patterson said sliding oil and other commodity prices have translated into losses of about $1,800 for every Canadian.

More highlights

The outlook for domestic sales is guarded in light of sluggish demand and ongoing adjustments to lower oil prices, says the BoC.

Its survey says investment and employment intentions among businesses have increased since the January poll, but remain modest. Once again, the bank said, there was a sharp divergence in opinion depending on how closely tied the company was to the energy industry.

From its interviews, the bank said the negative effects from the oil slump seemed to be levelling off, though companies close to the energy sector still "face a difficult environment."

The survey results show planned layoffs and hiring freezes remained "disproportionately high" among respondents in the oil-rich Prairies.

But, the report says that while capacity pressures have ticked upwards, few companies are concerned about facing major obstacles in meeting an unanticipated jump in demand.

3. U.S. gained 215,000 jobs in March

[April 1, 2016] U.S. employers notched another solid month of hiring in March by adding 215,000 jobs, driven by large gains in the construction, retail and health care industries.

Despite the jump, the Labor Department said Friday that the unemployment rate ticked up to 5% from 4.9%. But that increase includes some good news: more Americans came off the sidelines to look for work, though not all found jobs.

The figures suggest that employers remain confident enough in their business prospects to add staff, even as overall growth has slowed since last winter. Many analysts estimate that the economy grew at a 1% annual rate or below in the first quarter. Continuing job gains indicate that employers may see the slowdown as temporary.

Steady hiring is also contributing to higher pay, which rose a modest 2.3% from a year earlier to $25.43. That figure has increased since the early years of the recovery, but is below a peak of 2.6% reached in December.

Sluggish wage growth has been a weak spot in the economy and a source of frustration for many workers since the Great Recession ended in 2009. Paychecks typically grow at a 3.5% pace in a strong economy.

Construction firms added 37,000 jobs, likely aided by warmer weather. That helped offset another month of job losses in manufacturing, which has been hit by slower growth overseas, and mining, which includes the oil and gas drilling sector. Low oil prices have cost that industry 185,000 since September 2014.

More jobs can help fuel consumer spending, which is a critical source of growth this year. Other potential drivers of the economy, such as exports and business investment, have weakened.

Consumer spending has faltered since last winter after healthy gains in 2015. Spending ticked up just 0.1% in February for the third month in a row. That tepid trend caused many economists to slash their growth forecasts.

Americans appear to be pocketing much of their savings from lower gas prices rather than spending them. The savings rate rose to 5.4% in February, the highest in a year.

Other economic data has been unusually mixed. Several reports suggest that manufacturers may be stabilizing after a difficult 2015, when weak overseas growth and the strong dollar hurt production.

Americans have pulled back a bit from home-buying. Sales of existing homes fell a sharp 7.1% in February, held back by a lack of available supply that has pushed up prices.

4. Life insurance companies say they could withstand negative rates

[March 31, 2016] Two of Canada's largest life insurance companies say they're prepared to weather the storm if interest rates continue to trend lower, or even turn negative as they have in Japan, over the next decade or so.

Executives at Manulife Financial and Sun Life Financial were asked during a financial services conference hosted by National Bank how their businesses would fare if economic conditions in Canada mirrored those in Japan.

The Bank of Japan adopted negative interest rates earlier this year, a policy that seeks to stimulate spending by charging financial institutions for depositing money with the central bank.

Manulife CFO Stephen Roder says the company has been gradually shifting towards less interest-rate sensitive products over recent years. "Today we sell a lot of product that really has no interest rate sensitivity, so we're far less exposed in terms of new business today than we would have been five years ago."

Low interest rates are typically bad for life insurance companies, which invest the revenues from premiums in investments such as bonds and stocks.

Roder notes Manulife's experience in Japan leaves the company well-positioned to cope with similar challenges in Canada, should they emerge. "We're an active player in Japan and we've learned how to navigate these low interest rate markets, and in fact we've had very, very strong growth in Japan."

That growth was achieved by selling products that are not exposed to interest rate risk, Roder adds. "I'm not pretending I like them. But I think in many ways we've mitigated the impact of them. So it's not something that keeps me awake at night."

Colm Freyne, the CFO at Sun Life, was also asked about how the company would fare under a Japan-style economic scenario.

Freyne says that despite the headwinds of rock-bottom rates, there are also some opportunities created by such a scenario — for instance, to sell consumers on investment products such as mutual funds and segregated funds. "We're seeing opportunity, notwithstanding the impacts. Yes, it's a headwind, but it's not insurmountable."

5. Who will benefit from new family tax regime?

[March 30, 2016] For most wealthy families, the elimination of the Canada Child Tax Benefit (CCTB) and Universal Child Care Benefit (UCCB) means a loss of government benefits.

The Liberals have introduced the Canada Child Benefit (CCB) as a replacement, effective July 1, 2016. But this new system favours low- and middle-income families.

The CCB is a simpler system that's tax-free and targeted toward such families (while one element of the old system, the UCCB, was taxable and given to all families), says the budget (scroll down to see "Old versus new benefits").

The maximum CCB benefit is $6,400 per child under age six and up to $5,400 per child aged six through 17. The benefit will be awarded based on families' net incomes, and the budget says that the average annual increase in child benefits for targeted families will be $2,300 for the 2016 to 2017 year.

Curtis Davis, director of tax and estate planning at Mackenzie Investments, says families who receive CCB payments won't have to include it as income on future tax returns, given the benefit is entirely non-taxable.

Debbie Pearl-Weinberg, executive director of tax and estate planning for CIBC Wealth Strategies Group, points out another positive of the non-taxable aspect. "Unlike UCCB payments, the new CCB won't reduce GST and HST credits and won't be included in income to determine other amounts, such as GIS under the OAS program. It also won't affect families who have RESPs and RDSPs, since it won't impact the grants and bonds in those."

The winners and losers

Take a typical Ontario family with three children under age six. If this family makes $30,000 per year in gross income ($29,546 after tax), they will receive $315 more in government support per month, reports *MoneySense* (based on calculations by Evelyn Jacks, contributing editor, and founder of Knowledge Bureau).

For higher-income families, the benefit of the new tax system is mixed. For example, if a family with three children under age six makes $70,000 per year in gross income ($58,091 after tax), that family would get $233.75 more in government benefits per month, calculates *MoneySense*.

In comparison, if a family with three children under age six makes $160,000 per year ($110,621 after tax), the new benefit isn't as useful. This family will receive $810 less per year, or $68 less per month, than they would've with the UCCB. "This family's marginal tax rate is quite high when the claw back of the CCB is taken into account," reports *MoneySense*.

The upside, however, is more high-income families will receive benefits under the new CCB regime. For example, families with one child under age six will receive benefits as long as they make less than $188,437 per year in net income, notes *MoneySense* (for the CCTB, the cutoff was $118,251). And, a family with three children under age six can make as much as $221,875 before being cut off (formerly $157,601 for the CCTB).

Under the old rules, there's no cutoff for the UCCB.

For a full analysis of the impact of the new benefit, and for a look at how new tax brackets come into play, click here.

Tips

New CCB benefits for the 2016 to 2017 year will be based on families' net incomes for the 2015 year. So families should maximize their deductions on their 2015 returns.

And, for future years, Pearl-Weinberg suggests the following strategies:

- deducting any child care expenses incurred;
- maximizing RRSP contributions;

- considering whether investments could be held within a TFSA, "since the income earned within TFSAs is not included in net income. And, TFSA withdrawals won't impact net income and entitlement to the CCB;"
- claiming eligible carrying charges and interest paid to earn income from investments; and
- where there's an opportunity to control when income is received, such as when families receive dividends from a private company, "deferring such dividends to subsequent year[s] could increase CCB entitlement in a current year."

Families could also look at how to deal with investment income earned outside a registered plan. "For instance, Canadian dividend income is taxed at a more favourable rate than interest. [But], because of the dividend gross-up mechanism, [this income] will result in a higher net income for the purposes of calculating entitlement to the CCB—overall, [a family's] tax rate will drop due to the dividend tax credit but that doesn't impact net income. [Also], a family could defer the realization of a capital gain to a future year if that could increase entitlement to the CCB."

Clients should also know they'll still be able to request retroactive payments of both the CCTB and UCCB as far back as 2006 if they would've been eligible.

Other family tax changes

The budget included plans to eliminate both the children's fitness tax credit and arts credit, effective as of 2017, says Pearl-Weinberg.

Currently, the children's fitness and arts credits are worth up to $150 and $75, respectively, per child on up to $1,000 and $500, respectively, in eligible expenses. So, regardless of income levels, "All parents will have to keep in mind the elimination of [these] credits, and look at all of the tax cuts in conjunction," she adds. "The fitness credit was refundable. That meant that even if your tax rate was [low], you still received a refund."

Davis says cutting the two children's credits will have a small impact, but notes you should remind clients to make claims for 2015 and 2016. "The credits will be cut in half in 2016, but they'll still be available."

Old versus new benefits

You have until June 30, 2016 to take advantage of the UCCB and CCTB.

UCCB

The UCCB will provide a $160 monthly taxable benefit to all families for each child younger than six, and $60 per month for each child between the ages of six and 17.

CCTB
This benefit will be paid monthly and is made up of three components. These are:

- a base benefit that's available to low- and middle-income families, which provides up to $1,490 each for the first and second child, and $1,594 for the third and each subsequent child;
- the national child benefit supplement that's available to low-income families, and which provides up to $2,308 each for the first child, $2,042 for the second child and $1,943 for each subsequent child; and
- the child disability benefit that's available to families caring for children who are under age 18 and eligible for the disability tax credit.

As of July 1, 2016, the new CCB will replace the CCTB and UCCB.
CCB
It will be paid monthly, won't be taxable, and will provide families with up to $6,400 a year per child under the age of six, and $5,400 per child aged six to 17.
Families will only receive the full benefit amount if they make less than $30,000 in net income. For those making between $30,000 and $65,000 in net income, the benefit will be reduced at a rate of 7% for a one-child family, 13.5% for a two-child family, 19% for a three-child family and 23% for larger families.
And for families whose net income is above $65,000, they'll see their benefits reduced even more for the portion of their income above that threshold. The rate of the clawback for that portion of the benefit will be 3.2% for a one-child family, 5.7% for a two-child family, 8% for a three-child family, and 9.5% for larger families.
Families with disabled minors will continue to receive extra support each month, along with CCB payments. These families will receive up to $2,730 more per child that's eligible for the disability tax credit. The government says the phase-out rates for this amount will generally align with the rates proposed for the CCB. For example, effective July 1, 2016, the maximum amount will be reduced by 3.2% for families with one disabled child and by 5.7% for families with more than one disabled child, on the portion of net income that exceeds $65,000.

6. China becoming a global banker for criminal economy: AP investigation

[March 29, 2016] The email seemed unremarkable: a routine request by Mattel Inc.'s chief executive for a new vendor payment to China.

It was well-timed, arriving on Thursday, April 30, during a tumultuous period for the Los-Angeles based maker of Barbie dolls. Barbie was bombing, particularly overseas, and the CEO, Christopher Sinclair, had officially taken over only that month. Mattel had fired his predecessor.

The finance executive who got the note was naturally eager to please her new boss. She double-checked protocol. Fund transfers required approval from two high-ranking managers. She qualified and so did the CEO, according to a person familiar with the investigation who spoke on condition of anonymity because he was not authorized to speak about the matter. He declined to reveal the finance executive's name.

Satisfied, the executive wired over $3 million to the Bank of Wenzhou, in China.

Hours later, she mentioned the payment to Sinclair.

But he hadn't made any such request.

Frantic, Mattel executives called their U.S. bank, the police and the FBI.

The response? You're out of luck. The money's already in China.

Mattel's millions were swept up in a tide of dirty money that passes through China and that Western police are only beginning to understand. The scam the company fell victim to — known as the fake CEO or fake president scam — has cost companies, many of them American, over $1.8 billion, according to the FBI. Most of the stolen money passes through banks in China or Hong Kong, the FBI said.

An Associated Press investigation this week showed that China is emerging as a global hub for money laundering. The dark money that courses through China has long been considered a domestic issue, with Chinese illicitly moving money for other Chinese. That's no longer the case. Mounting evidence indicates that China is becoming a global banker for the criminal economy, according to interviews with police officials, court records in the U.S. and Europe, and intelligence documents reviewed by the AP.

Years of mutual mistrust have hindered law enforcement co-operation between China and the West, adding to China's appeal as a money laundering hub. The U.S. State Department said in a report this month that China has "not co-operated sufficiently on financial investigations." China's inability to enforce U.S. court orders on China-based assets "remains a significant barrier to enhanced U.S.-China co-operation," it added.

In a regular briefing with reporters Monday, Chinese Foreign Ministry spokesman Hong Lei said that the government "places great emphasis" on fighting crimes such as money laundering and is working to expand international co-operation. "China is not, has not been, nor will be in the future a centre of global money laundering," he said.

Mattel wasn't going to let go of $3 million without a fight. What the company really needed was luck. And when it came to Mattel's China operations, luck had been in short supply.

Mattel's misadventures in China are so spectacular they've become the stuff of business school seminars. In 2007, Mattel recalled 19 million made-in-China toys, including Pixar cars covered in lead paint and Barbie sets embedded with tiny, hazardous magnets. Then, in 2009, Mattel opened the "House of Barbie," a glowing pink, six-story shrine on one of Shanghai's ritziest shopping boulevards. It had a spiral staircase encased with over 800 Barbie dolls, a spa and a fashion runway. But the flagship flopped, and Mattel closed it after just two years.

Rising costs and labour shortages weighed on China production, even as the $5.7 billion toy giant limped back into the Chinese market with dolls — including a Violin Soloist Barbie — aimed at Chinese "tiger moms."

The thieves struck as Mattel was aggressively pushing its China business, positioning itself as a child development brand, which helped grow China sales 43 per cent in 2015 over the prior year.They had done their homework, mining social media and likely hacking corporate emails to penetrate Mattel's corporate hierarchy and payment patterns, according to the person familiar with the investigation.

The criminals had the $3 million sent to Wenzhou, a gritty enclave on China's eastern coast that is emerging as a significant transit point in global money laundering networks. The city is the destination for 90 per cent of the funds stolen through fake CEO scams in Europe, according to an intelligence memo reviewed by the AP.

Wenzhou city officials declined to comment.

Squeezed by mountains against the sea, Wenzhou is known as the birthplace of underground finance in China.

Decades of official neglect allowed an unusual, business-oriented culture to thrive here. After Mao's anti-capitalist rule, a private economy began to re-emerge in Wenzhou in the late 1970s. But those first peasant entrepreneurs — and the informal financing mechanisms that sprang up around them — inhabited a legal grey zone, said Chen Zongshi, an assistant sociology professor at Zhejiang University. It would be a decade before Wenzhou was officially authorized to develop private enterprise, according to Zongshi. Those regulations were among the first in China.

Poverty, underdevelopment and a lack of arable land also made Wenzhou an ideal place to leave. Strivers heading for Europe and North America poured out of Wenzhou, and in their wake, the informal financial systems that served the area's entrepreneurs went global.

Today, money that ends up in Wenzhou doesn't have to stay there — thanks in part to the pawn shops and corner grocery stores that quietly double as money-transfer agents, said Yan Lixin, the secretary general of the China Center for Anti-Money Laundering Studies at Shanghai's Fudan University.

"From Wenzhou, the money could scatter to any other place," he said.

Luck arrived for Mattel in the form of a bank holiday. Friday, May 1, was Labor Day in China.

That, crucially, gave Mattel time. The company notified Chinese police, who quickly launched a criminal investigation, according to a letter from Mattel thanking Chinese authorities, which was obtained by the AP.

When the Bank of Wenzhou opened the following Monday, a China-based anti-fraud executive from Mattel strode past the sculpted lions that flank the entrance to the bank's headquarters, marched upstairs to the International Business Department and presented a letter from the FBI, according to two people familiar with the investigation who were not authorized to speak publicly.

Chinese police froze the account that very morning. Two days later, on May 6, Mattel got its money back, according to the letter.

Mattel wrote that the Wenzhou police "showed a great sense of responsibility and enforcement capability."

"We hereby reiterate our appreciation," Mattel wrote. "We also hope that this case can pave the way for future international co-operation in fighting similar transnational crimes."

International co-operation has grown in importance for Beijing. China's ruling Communist Party is campaigning to purge corruption from its ranks, pursuing officials who have fled overseas with ill-gotten wealth, in an effort to shore up its legitimacy as China's economy slows.

"If we need help getting corrupt officials or bribes back, we need to offer assistance when other countries need it too," said Huang Feng, Director of the Institute for International Criminal Law at Beijing Normal University. "The problem is not that the Chinese authorities have been unco-operative, it's that we don't have a relevant legal framework to implement."

He said Mattel fought the fraud correctly, imploring Chinese authorities to use Chinese law to get the money back.

The Bank of Wenzhou confirmed that its staff handled Mattel's case but declined to comment. Police in Wenzhou confirmed that an investigation was ongoing but declined to discuss details. Mattel also declined to comment for this story, citing the ongoing investigation.

Since its near miss in Wenzhou, Mattel has tracked a dozen more attempted hacks.

It's still not clear who was behind the scam.

7. Life insurance loophole closed: example

[March 28, 2016] Last week's budget nixed the tax advantages of a popular life insurance strategy.

A loophole in the tax act had allowed business owners to transfer their life insurance policies to their corporations in return for tax-free proceeds of the policy's fair market value (FMV), usually in the form of a note. Then, when the business owner died, the corporation would receive the proceeds of the death benefit – again, essentially tax-free. Private corporations would then add the value of the benefit, less the adjusted cost basis, to their capital dividend accounts, and then pay out capital dividends, which aren't taxable in the hands of shareholders.

The 2016 budget proposes to tax the initial transfer from the policyholder to the corporation as full income, says Kim Moody, director, Canadian Tax Advisory at Moodys Gartner Tax Law.

On his blog, Moody has written up an example to illustrate the changes being proposed.

He assumes the following facts:

1. Mr. Apple is 75 years old and in poor health.
2. Mr. Apple owns a T100 life insurance policy with a death benefit of $1 million. The cash surrender value of the policy is nil.
3. The adjusted cost basis (ACB) of the insurance policy is nil.
4. An actuary has recently valued Mr. Apple's policy at $800,000.
5. Mr. Apple is the sole shareholder of AppleCo, a Canadian-controlled private corporation.
6. AppleCo has retained earnings in excess of $10 million.

Before Budget 2016

Before Budget 2016, if Apple transferred the life insurance policy to AppleCo for FMV consideration of $800,000 using a promissory note, Moody explains, that non-arm's length transfer of the policy would not have triggered any taxable income inclusions since there is no cash surrender value (CSV) of the life insurance policy. Further, there was no specific rule that would have taxed the $800,000 of consideration received by Apple from AppleCo. "Thus, effectively, he [was] able to extract $800,000 from his corporation without tax," Moody writes.

After Budget 2016

Assuming the proposals go through, if the transfer occurs after March 21, 2016, the $800,000 will be included in Apple's proceeds of the disposition of the life insurance policy. Crucially, “Mr. Apple will now be required to pay income tax on such amounts received in excess of the ACB of the policy at normal rates.”

There’s more, says Moody. “In addition, for dispositions that occur on or after March 22, 2016, a new rule under paragraph 148(7)(b) will require the ACB of the insurance policy to be increased by the amount of the deemed proceeds received by Mr. Apple on the transfer. Given that the ACB has been increased, the capital dividend account addition for AppleCo will be reduced upon Mr. Apple’s death — thus reducing the amount of funds that can otherwise be extracted from AppleCo tax-free. Ouch!”

Moody explains that policyholders who made these transfers before Budget Day and die after Budget Day are also affected. “Proposed amendments to the definition of ‘capital dividend account’ will require a reduction of the CDA by the $800,000 (since the $800,000 is in excess of the CSV of the policy),” he writes. What does that mean? “This, in effect, [retroactively] punishes policy transfers prior to March 22, 2016, since the ability to extract the life insurance proceeds from AppleCo will now be reduced by the value of the consideration received in excess of the CSV of the policy disposed.”

Have a nice and fruitful week!