Personal Financial Planning

余政昌

Personal Financial Planning

Personal Financial Planning is the process of creating strategies, considering all relevant aspects of your financial situation, to manage financial affairs to meet life goals. The planning helps you determine where you are, set your future goals, and plan the path to get there. Each of us goes through different life stages-early career, mid career and late career, the goals, resources and priorities are different during different stages.

The major components for typical financial planning include: budgeting and savings planning, credit and borrowing planning, tax planning, investment planning, insurance planning, retirement planning, and estate planning. Each component has its own considerations and objectives. At different life stages, to an individual certain planning components may be more important than others. We will briefly discuss some of the planning components as below.

Budgeting and savings planning

Here you determine your net worth by subtracting the debts you owe from the assets you own. This gives you the starting point for other financial planning components. Annual and monthly budgets are prepared. Part of the budgeting exercise is to get you the discipline to save for the future and make sure you face the reality that over time your expenditures should not exceed your income so that you don't end up incurring more debts.

Credit and borrowing planning

It is common to see during your early career stage that you work hard and strive to save every penny possible for the down payment to buy your dream home. Your new home purchase comes with the price tag of a mortgage, typically the largest debt for a household. You gain more equity in your home as you pay down your mortgage.

Some of you may use the equity you build up from your home to establish a home equity line of credit. The benefit of using your home as a security for your credit line is to obtain lower borrowing costs. If you use the money drawn down from your line of credit to invest, the interest expenses are deductible against your investment income. However, borrowing to invest, or leveraged investment, has its inherent risks and may not be suitable for every one.

Part of the credit planning is to reduce and optimize your borrowing costs. You accomplish this by saving and paying down debts. You borrow debts at lower after-tax rates to replace those debts at higher costs. Borrowing from credit cards, with interest rates not uncommonly seen at 15% to 20%, should be avoided or minimized.

Personal Tax Planning

The federal government continues to revise tax laws and regulations to reduce the loopholes and clamp down aggressive tax avoidance techniques. Tax planning from income splitting, for example, has over the recent years been greatly handicapped. Some planning ideas to reduce your tax bills, nonetheless, are still available.

Contributions to RRSP (registered retirement savings plan) continue to be one of the deduction items that greatly reduce your tax liabilities. Your taxable income is reduced by the contributions you make to your RRSP account, assuming you have the RRSP contribution room built up from prior years. For couples with substantial uneven income levels, it saves the overall tax bills in the long run to establish a spousal RRSP account. The spouse with lower income is the account holder, or annuitant. The spouse with higher income makes the RRSP contributions and uses the contribution

receipts for tax deductions. For those people in the middle or highest tax brackets, you may want to look into purchasing labour sponsored venture funds (LSVF). Your investment cost for an LSVF purchase of $5,000, the annual maximum purchase limit, may only be about $1,200 after you take the RRSP tax deduction and the tax credits from such a purchase.

Your carrying charges and interest expenses for non-RRSP investments can be utilized to reduce your investment income. It may make sense to structure a home equity line of credit and reduce your non-deductible mortgage to incur such investment expenses.

Contributions to Registered Educational Savings Plan (RESP) are not tax deductible. However, RESP is a valuable tool to save for your children's post-secondary education in the future. Contributions to RESP attract educational savings grants from the government. Combined with the tax deferrals from investment income generated in the account over the years and possible tax reductions when RESP withdrawals are taxed in the hands of children possibly with lower income, RESP is an effective vehicle to save for your children's education. RESP gives your children a jump start as they do not leave universities with large student loans to pay off in their early careers.

Closing Remarks

Personal financial planning is a continuous process. You will probably need experts' advice and guidance throughout the process. Your consciousness in knowing where you are and what you want to strive for in the future goes a long way in achieving financial adequacy and efficiency as you go through your life journey. I have briefly discussed some of the financial planning components in this article. Given space limitation, I will in the future address the remaining components-investment planning, insurance planning, retirement planning and estate planning.