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TAXSTRATEGY

Lower your tax bill and help your grandchildren at the same time

Building a legacy

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Do you know the names of your great-grandparents? I know one thing for sure: many of my clients certainly want their great-grandchildren to remember their names.

That's because as medical technology advances, so does the duration of our lives. The chances of my generation being around to watch our great-grandchildren grow increases dramatically every year.

And how about while you're doing that, you also leave a charitable legacy worthy of your name, help untold numbers of people, and pay less tax?

Read on.

There are three possible beneficiaries to each person's estate. And each of us has the option of picking only two. They are:

- ✓ Family
- ✓ Government
- ✓ Charity

Which two would you choose?

Without a doubt everyone picks family and charity as the two groups they would like to be the beneficiaries of their wealth.

You may not realize, however, that after the death of both spouses the government automatically gets a tidy tax sum from the remaining estate.

For example, 46 per cent of your RRSP/RRIF savings goes to taxes. So does 32 per cent of your holding/operating company assets and approximately 23 per cent of your accumulated capital gains from investments, real estate and business equity. That's a lot of tax to pay.

The good news is that by using the expertise of a professional advisor now, you can save on taxes and use your money to a better benefit – like your family and favourite charities.

Children and grandchildren

I encounter many adult children who are well established and working hard with good jobs. They don't need much financial help from their parents. I also find many grandparents who want to look after the needs of their grandchildren.

Start an RESP

If that's you, there are a number of options open. You can easily start an RESP for a grandchild and minimize the burden of ever-increasing costs for education.

The average undergraduate student in Canada pays about $6,000 a year in tuition fees. And a graduate program like an executive master of business administration has tuition fees of close to $40,000 (the regular MBA program costs around $24,000).

With an RESP, a family can begin to save with very little per month. As an example, by saving only $100 per month in an RESP at an average annual return of three per cent, and savings starting at birth, the RESP can expect to accumulate to more than $30,000 by the time the child is 18.

And the best part is that the government will give $400

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of free money for each $2,000 of RESP investment. That's a 20 per cent return right from the start!

Life Insurance

Some grandparents buy life insurance for their grandchildren. They know it's least expensive when the kids are young and healthy enough to qualify.

This is especially important if there is a strong history of illness in the family, such as diabetes or cancer. In "grandchildren" life insurance plans, coverage lasts forever but premiums can be made payable for only a set number of years (for example 5, 10, 15 or 20 years) and then the policies are fully paid up for life.

And the grandchild can apply for more life insurance coverage later when needed – without a medical exam or having to answer any health questions.

In addition to these benefits, the life insurance policy builds up a cash value and increases every year that premiums are paid.

The money is available if, say, the parent needs to borrow against those funds, or take it out in cash in case there is an emergency. Other uses include helping their child buy a house, or contributing to the cost of a university education.

It can also be set up so that the grandparent pays for the premiums, putting the ownership of the policy in the hands of the parents. Should the parents die prematurely, the ownership of the policy can then be transferred to the grandchild without any taxable disposition. He or she would then own the policy outright.

Many grandparents are willing to set aside $2,500-$10,000 for premiums per year for a period of 10 years.

Grandparents can also set up a "wealth cascade" by buying insurance on their adult children. This will provide protection for their grown offspring in case of a premature death. They can then overfund the life insurance policy and transfer the policy to their children or grandchildren without a taxable disposition.

This is an effective way for grandparents to have control of an asset, yet also be able to pass along money to family tax-free. In addition, the cash value can be used by the parents or grandchildren during their lifetime for education, purchasing a home, helping with a business or providing retirement income.

Many grandparents are concerned about the state of health care in Canada. For a different twist, they can also purchase a critical illness policy for grandchildren with $250,000 of maximum protection.

If the grandchild gets diagnosed with one of about two dozen illnesses, the policy will pay out tax-free to the parents. The money can be used for any need. Premiums are paid for only 20 years and after that, the policy is fully paid up for life.

And if the policy has not been used, the grandparent who paid the original premiums can get their premiums returned, or can give the refund to their grandchildren.

If you start payments on your newborn grandchild today, the policy will be paid up when they are 20 – and the policy benefits will last for the rest of their lives. If, heaven forbid, a child gets sick, the money is there for the parent to look after the needs of the child.

Charity

There are many ways you can give to charity now and in the future – and involve your grandchildren.

As a grandparent you can set up a strategy that provides charitable giving through an endowment. This will provide an irrevocable gift to a private foundation or a donor-advised fund (DAF) within a public foundation for, let's say, $10,000.

This method is just perfect for those wanting to ensure a sustainable legacy in which your family can be involved, rather than a one-time gift.

That's because once a DAF has been set up, the foundation needs a board of directors to distribute that money – and that's where the adult children or grandchildren come in. They can take an active interest in where the funds go by sitting on the board.

Ahead of time, grandparents can talk to their grandchildren about the importance of not only giving to charity, but the giving of themselves and their time that comes with actively participating in a non-profit organization.

Perhaps the grandparents can talk to the children about which charity they would like to become involved in, why and in what capacity. Then the grandparents can determine a set sum of money to be distributed to a charity of the grandchild's choosing.

Once those two items are settled, the money (through a tax-efficient investment vehicle) can be distributed to those worthwhile organizations.

If you decide to provide for a charity through life insurance, it's important to remember that the proceeds of the policy are usually many times greater than the value of the premiums.

And life insurance usually means a larger gift to the charity than if you had donated cash. Keep in mind that life insurance proceeds flow immediately to the designated beneficiary and, in doing so, typically avoid estate taxes.

For example, an estate with an ultimate tax bill of $500,000 could purchase a joint last to die insurance policy for $1 million on the grandparents.

The cost of this type of insurance is surprisingly inexpensive in older aged clients. If the beneficiary of the insurance is a public or private charitable foundation, it would generate a charitable receipt of $1 million, offsetting any taxes owing by the estate.

In this case, the grandparents will be remembered for leaving $1 million to charity instead of $500,000 to the government. And their grandchildren and great-grand children will learn much about giving back as they distribute the $1 million of proceeds in perpetuity.

There are many ways you can teach a child about charity and giving back to the community.

By helping to build up a legacy that will affect many generations to come, not only will your great-grandchildren remember your name, they will also remember what you stood for. ❐