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ESTATEPLANNING

2020 Reality Check

Thinking Forward

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Let me begin by wishing you and your family a happy, healthy and tax-advantaged New Year. You'll probably be hearing a lot over the coming months about "2020 vision". Aside from the familiar term used by eye specialists, it's the ability to leverage lessons of the past to see clearly ahead, especially as it pertains to financial and estate planning.

I am reminded of a timeless observation by our sages: "a wise person has eyes on the top of their head to look into the future and begin to plan for it now".

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A modern version of 2020 vision is available on your smartphone. It's the traffic app Waze. Without it, I'd be lost in traffic for hours.

These "2020-isms" are even more relevant when it comes to financial, estate and tax planning. Few people consider the future implications of decisions they make today.

While most people build their assets through traditional investing – RRSPs, pensions, non-registered assets and real estate – they seldom think forward to consider how to maximize their income in the most tax-efficient manner.

I meet very successful entrepreneurs, professionals, business owners and real estate investors who appear very wealthy on paper, and usually feel a degree of confidence from their accumulated wealth.

But just as people need the guidance of Waze to navigate from point A to point B, they usually need professional help with their personal estate planning. Some mistakenly think that by doing it themselves they are saving money. Truth is, that approach deprives them of the knowledge and wisdom that avoids common mistakes and can often save millions.

Tax rules and financial products are now more complicated and sophisticated than ever, so the best time to avoid mistakes is right now, before making them.

Here are a few examples of successes obtained realized by clients who got their "2020" reality checks in 2019.

Divorcee in her 70s

We were introduced to Nancy by her accountant. She is a well-respected academic, and a person who likes to do her own investing. As it happens, she is a fabulous stock picker who grew her net worth to about $10 million.

She was truly shocked when told that $10 million on paper would shrink to $6.5 million when she passes away. Like many intelligent knowledgeable people, Nancy was unaware of the tax-hits ahead. The Canada Revenue Agency (CRA) allows an RRSP or a RRIF to transfer tax-free from one spouse to another at death, but that's it. Without a spouse, roughly 54 per cent of her RRIF savings will go to taxes. In her case, $1.35 million of her $2.5 million RRIF will evaporate. That's a lot of money.

Her healthy stock portfolio of $4 million had a cost base of $1 million, so tack on additional taxes of just over $800,000, calculated at twenty seven per cent on $3 million of profit.

Because she lives in Ontario and owns everything in her own name, probate taxes will be applied. That's a further estate erosion of 1.5 per cent.

In addition, Nancy was collecting monthly Canada Pension Plan (CPP) benefits, money she really didn't need to live on. She paid taxes on it every year, reinvested what was left, and yes, was taxed on that again. She was still saving a good chunk of her income, putting away $100,000 a year, which was also taxed. She was clearly in the "Tax Grind", the subject of my June 2016 *TaxLetter®* article.

Working together, we donated some of the appreciated securities to charity to offset the capital gains taxes. We did this by setting up a Donor Advised Fund (DAF) with a community foundation, which also helped her organize her charitable giving going forward. DAFs allow generous philanthropists and their families to fund their preferred charities with low administration costs and flexibility. The donor receives an immediate tax savings based on the full value of their donation and allows them to develop a charitable giving plan for disbursing the funds to any individual charities, both for the immediate and longer-term funding needs.

We also took a page from our CPP Philanthropy™ strategy and used some of the government-supplied benefits (that she was reinvesting and paying tax on) to buy tax-exempt life insurance. We did this to preserve her $10-million estate and create a sizeable charitable donation. Implementing the strategy included naming a charity as the beneficiary of her RRIF, which converted the taxes she would otherwise pay into charitable donations.

58-year-old Real Estate Investor

Our second example is Ralph, who had assembled a formidable portfolio of $100 million in commercial real estate. But just like Nancy above, we disappointed him with the news that taxes upon death would seriously erode his estate.

Most people who bought real estate over the last 50 years are now "pregnant" with substantial profits. Ralph hadn't put into effect an estate freeze, so his estate will face a tax bill of roughly $20 million upon his demise.

His beneficiaries will have to settle that account, with just a few options available. They could use cash, and simply write a cheque to pay the taxes, but few people, especially successful real estate investors, have $20 million lying around and not invested. They could borrow the money from a willing lender, but that loan would have to be serviced with ongoing interest payments and ultimately repaid. They could sell some of the real estate portfolio, but that would eliminate a big chunk of rental income, and but who can predict real estate market conditions years from now?

We suggested the least costly way to solve the problem was to use permanent cash value life insurance with an added twist. Instead of depleting the cash flow from his rental income, we used a leveraging strategy to acquire all the insurance he needed. It's called Immediate Financing Arrangements (IFA), the subject of my March 2016 TaxLetter® article. This way, he gets the insurance at just a fraction of the true premium cost.

With the IFA, you use the cash value of the life insurance policy as collateral for a line of credit with a Canadian chartered bank. The line of credit allows the insured to "repatriate" his premiums back into investments while still having necessary insurance in place. The loan is ultimately repaid from the life insurance payout at death, and the remaining proceeds go to the beneficiaries – who use it in this case to pay off the tax bill.

For the right individuals, an IFA is an ideal solution - especially for people not fond of tying up their money in life insurance premiums. It's an efficient mechanism that improves cash flow, provides access to cash, and includes tax-free benefits for families and other heirs.

IFAs need time to be developed by experienced professionals who can help you determine the best financial institution for you and navigate the entire process smoothly and in the most tax-efficient manner.

Business Owner With 3 Kids

Kevin's family-run company is worth $25 million. All three adult children work in the business, with no shareholder agreements in place.

Still in his early 60s, he had never considered what would happen to the thriving enterprise if they couldn't open the doors because he, or one of his adult children became ill or died. When a family shareholder dies, do you, as one of the surviving shareholders, want their surviving spouse, lawyer and other advisors as your new partners?

We explained the necessity of shareholder agreements - not for only his family, but also his employees, suppliers and customers - basically, the entire company.

Several different structures were available, each with its own merits, tax and legal outcomes. One structure provides for the surviving shareholders to buy the deceased's shares, with the result that each shareholder is the owner and the beneficiary of a life insurance policy on every other shareholder. When one of the shareholders dies, the life insurance proceeds are paid tax-free to the surviving shareholders, who then use the proceeds to purchase the deceased's shares.

Buy-sell provisions in a shareholder agreement set out how shares will be transferred if a partner retires, becomes disabled, dies, goes bankrupt or has a marriage breakdown. It can also stipulate what steps should be taken for staff and key people should one or more of the shareholders decide to sell their stakes.

Parents often want additional financial consideration for adult children who are not active in the family business. This can be accomplished easily using tax-exempt life insurance proceeds.

Additional planning tools should be considered, including the implementation of an estate freeze or family trust, which can be used for estate planning in this situation.

Over the years, we've met hundreds of successful people who did take the time to make a financial plan, but their planning was done many years ago, often just as their business was taking off. Along the way, those plans were seldom reviewed or updated. I compare this to having old financial furniture that doesn't fit your current architecture. Now is a good time for you to get an updated and unbiased second opinion of your own planning, for your personal benefit and for future generations.

One size does not fit all, and there's no cookie-cutter solution for every TaxLetter® reader. This article, limited by space considerations, does not present many additional strategies available to meet your unique needs.

Our team of experienced advisors is available to help you across the country. Contact us for a no-obligation consultation. ❑

Please visit our new website WEALTHinsurance.com

Watch "The New Philanthropy", my recent "Ted Talk" at Moses Znaimer's ideacity conference http://bit.ly/MarkHalpern

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He guides successful business owners, who are already challenged for time, through the complex process of ensuring the people and organizations they care about are taken care of.
If you are like his other successful business owner clients, you are looking to reduce your tax obligations, preserve your wealth and leave a legacy. Incompletions rob us of energy. Mark collaborates with your professional advisory team to achieve your desired outcomes. His approach is simple. He makes sure what is important to you gets done. He gets you organized, provides a big picture view of your financial affairs, determines your strategy and helps you take action. He will simplify the complicated, so you and your family can rest easy. He can be reached at 416-364-2929, toll-free at 1-866-566-2001 or Mark@WEALTHinsurance.com.

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