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ESTATEPLANNING

Defensive Decisions

Never Too Soon

Mark Halpern, CFP, TEP

The world of sports provides great examples of why defense matters. Take the recent World Cup of Soccer. Occurring only once every four years, fans from around the world eagerly buy flags of 32 countries, display them proudly on cars and front porches, and root for their team while praying that they record a shutout.

The signing of hockey star John Tavares in Toronto has hopeful Maple Leaf fans cheering, while the recent signing of LeBron James by the Los Angeles Lakers gives Toronto Raptors fans hope their team will go further with LeBron in a different division.

Whatever the sport, or flag, having strong team members never hurts. But it's always a compelling defense that truly makes the difference. The World Cup goalies provided excellent examples of the importance of a stellar defense in winning the championship.

As a TaxLetter® reader, you already know the importance of defense against too much taxation. Most people we meet were focused on offense while building their business, real estate, and investment portfolios.

Here are some recent examples from actual cases where defense makes the difference.

It's Never Too Soon

An accountant invited me to meet his client, a successful immigrant businessman. He started his company many years ago and it thrived to the point where he was able to get one of his three adult children to run the business on behalf of the family.

Over the years, the family assembled a jumbled collection of a dozen life insurance policies. With no oversight, planning or ongoing review of their protection portfolio, the years passed quickly, and they found themselves paying large premiums, and at risk of losing coverage when the policies came up for renewal and became unaffordable.

Their bigger problem was the recent passing of their only son, who ran the business and died suddenly at the age of 50, leaving minor children and a divorced wife. He left a tangled legal predicament for everyone. His siblings knew little about running the family business and even less about essential basics such as digital passwords for banking, managing the website, location of brokerage accounts, etc.

Worse still, he died without a will. As a result, five lawyers are now involved, representing the varied interests of each minor child and the claims on the estate by the ex-wife. Since many issues can't (or won't) be settled amicably, it will be up to the courts to decide who gets what. They will, at some point, divvy up a smaller estate diminished by all those professional fees that could have been avoided.

When the estate finally gets settled, there will still be taxes to pay – 54 per cent of RRSPs,

Mark Halpern is a Certified Financial Planner (CFP), Trust and Estate Practitioner (TEP) and one of Canada's top life insurance advisors. He is CEO of WEALTHinsurance.com® and illnessPROTECTION.com®, with special expertise for business owners, entrepreneurs, medical professionals and high-net worth individuals and their families. He can be reached at 416-364-2929, toll-free at 866-566-2001 or mark@WEALTHinsurance.com.

45 per cent of corporate equity and 25 per cent of capital gains.

It is never too soon to get a will. Ensure it is updated, especially if there are marriage partners (past and present), guardianships for minor children and executors. Consult an experienced estate planner now to save your own family money and grief.

Immediate Financing Arrangements

A real estate investor in his late 50s was referred to us by his family office. He had built a $50 million portfolio of real estate with a cost base of $10 million and intended to pass it on to his children and grandchildren. With no estate, tax, or insurance planning in place, his estate would face a $10 million tax bill upon his death.

He had a handful of options: (1) ignore the problem while alive and leave it to his family to sell some of the investment-producing properties to pay the ultimate tax bill (2) ignore the problem and let his family borrow the required funds against the properties to pay the bill when he's gone (3) buy life insurance for himself now, the most tax-efficient and least costly choice.

He liked the insurance solution but hated the idea of paying for it, because his money was getting great returns in his business. That's when we explained the Immediate Financing Arrangement (IFA) strategy that allows him to have the insurance in place and still have the money available to invest in his business.

The IFA leveraging strategy covered the insurance premiums and allowed him to keep his money invested in his company. More importantly, his $10 million tax liability is taken care of, so his heirs won't have to sell their precious real estate to pay the taxes.

The Cash Surrender Value (CSV) of his permanent life insurance policy serves as borrowing collateral with a big Canadian bank. The loan is used to pay the premiums after his initial premium is paid, by the corporation or personally. Banks are eager to make such loans because the security of a life insurance policy cash value from a tier-one insurance company is more highly regarded than stocks, bonds or real estate.

Corporate-owned life insurance

A 70-year-old widow had plenty of money to live on from her pensions, investments and $5-million in a holding company. Her accountant told her that when she dies about 45 per cent of that money will be lost to taxes.

After reviewing all available options, we decided that the best tax-saving strategy would be a corporate-owned annuity on her life, combined with a corporation-owned life insurance policy.

Corporate-owned life insurance (either universal life or permanent whole life) is used to accumulate wealth inside a company in a tax-effective manner, while providing access to that wealth if needed or transferring that wealth tax-free to surviving beneficiaries.

The life insurance death benefit proceeds, less the adjusted-cost basis, gets paid out to heirs tax-free through the Capital Dividend Account (CDA).

With new rules on passive corporate income now in effect, consider using passive income to acquire permanent, participating life insurance. This strategy converts the passive income to a tax-exempt status, so you can preserve the small business tax rates. An incorporated individual with $150,000 of annual passive income can save approximately $70,000 taxes each year from this strategy alone.

Corporate-Owned TFSA

People like Tax-Free Spending Accounts (TFSAs) because their investments grow tax-free, and money can be accessed tax-free.

The down side is that you can only deposit a maximum of $5,500/year.

An unlimited TFSA is now available for individuals and incorporated professionals like dentists, doctors, lawyers, etc.

It's called Corporate-Owned Life Insurance.

Most people don't realize it's the TFSA for business owners – and the money earned gets passed along tax free. Another key benefit is that it allows a company to take out passive income tax-free, and not be subject to the new tax rules on passive income.

CPP Philanthropy™

A successful married couple with a thriving business, both 65, were each receiving $1,100/monthly in Canada Pension Plan (CPP) benefits, for a total of about $26,000 a year. They live in Ontario and pay tax at the highest marginal tax rate, 54 per cent.

They didn't need that money to pay their bills as it it only gets taxed, re-invested and then taxed again.

We suggested three ways to use their CPP benefits to save taxes and leave a substantial windfall for their family and the causes they care about.

#1: Life Insurance Policy Owned Personally, Tax Savings Later

Use the CPP benefits to pay the premiums on a joint-and-last-to-die life insurance policy for $1.4 million. The charity, as beneficiary, will receive the insurance payout on the death of the second spouse. Their estate will receive a donation receipt for $1.4 million and save the family about $700,000 in taxes.

#2: Life Insurance Policy Owned by Charity, Tax Savings Now

As above, create a charitable gift of $1.4 million using joint-and-last-to-die life insurance, this time with the charity as owner and beneficiary of the policy.

Use the CPP benefit to pay the policy premiums and receive an annual charitable donation receipt of $26,000, mitigating the tax payable on the pension benefit and replacing it with a large gift.

#3: Donate RRSP/RRIF By Will or Beneficiary Designation

RRSPs/RRIFs will be fully taxed as income (at up to 54 per cent in Ontario) on the second death. A $1 million RRSP/RRIF will be worth roughly $460,000 to their family, after taxes.

This strategy designates a charity as beneficiary of the RRSP/RRIF, which mitigates the RRSP/RRIF taxes.

To replace the $460,000 that would have gone to the family, use the entire CPP benefit to purchase a $1.4 million joint-last-to-die insurance policy, with the family/estate as the beneficiary.

On the second death, the life insurance policy pays out $1.4 million tax-free to the family. This represents an additional $940,000 for the family (compared to $460,000) and a large gift to charity.

More Taxes Than Ever

Canadians now pay more taxes than ever before, and that trend will continue. With proper planning, you can improve and optimise your own defensive position. There is no cookie-cutter solution, and you can't get reliable, personal advice from a robo-advisor or by Googling.

Get help now from an experienced Certified Financial Planner or Trust & Estate Practitioner. Our advisors across Canada are available to help you. ❏

Mark Halpern is one of Canada's top life insurance advisors, a Certified Financial Planner (CFP), Trust and Estate Practitioner (TEP) and CEO of WEALTHinsurance.com®.
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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