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ESTATEPLANNING

Future Attractions

When and How Much?

Mark Halpern, CFP, TEP, MFA-P

If only we could see into the future and know what lies ahead. Winning the lottery would be easy-peasy if we knew in advance which numbers to pick. People would score 100 per cent on every exam and easily find their perfect life companion. If the current pandemic provides any lesson, few of us would have been ready for this plague, even with the latest, top-of-the-line crystal ball.

While we mourn the deaths of more than 2 million people globally (and growing), here in Canada more than $200 billion has been spent by our government to prop up damaged businesses and ease the loss of jobs during COVID-19.

Most Canadians support the government's efforts to ease the pandemic's economic fallout, but we know that one day, probably sooner rather than later, we will be asked to address the skyrocketing federal deficit, expected to be reach $388.9 billion for 2020-21.

Significant tax increases are coming – the only questions are when, and how much? Ottawa has never hidden the fact that it has its sights set firmly on the "1%" - wealthy Canadian families and anyone with any significant wealth, for a hike in income taxes.

Canadians earning more than $220,000 annually already pay up to 53.53 per cent in taxes (in Ontario). They already keep less than half of what they earn, and it will likely get worse.

There's a looming possibility of capital gains tax increases and the elimination of our beloved principal residence exemption.

With tax hikes in mind, now is the time for you to take advantage of current opportunities that will help lessen the tax bite, so we have the following suggestions.

Will: As of now, Canada does not have an inheritance tax; the estate pays any taxes that are owed to the government by the deceased, but beneficiaries receive their inheritances tax free. To ensure that your assets go the people you choose, it's crucial for you have a proper and up to date will. Without it, the government will determine who gets what, and your estate will incur unnecessary legal and accounting costs, probate fees, and taxes.

Be sure to choose a trusted executor to administer your estate to ensure that instructions in your will are carried out according to your wishes.

If there is no will, everything is frozen until creditors are paid, taxes are paid, and funeral expenses are paid. Provincial governments then step in to decide who gets what's left. All of that costs time and money and can be easily avoided with a proper will.

Estate Freeze and Refreeze: Many estate plans are based on valuation. By "freezing" the tax on death at their current value

Mark Halpern is a Certified Financial Planner (CFP), Trust and Estate Practitioner (TEP), Master Financial Advisor - Philanthropy (MFA-P) 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.

you can retain voting control while passing any future growth on to children or other designated beneficiaries.

This reliable strategy should be considered sooner than later, because it's important that you not wait too long. This recent case underscores the importance of timing.

We were contacted by a lady who was very concerned about her parents' tax liabilities – she wanted to know what kind of life insurance Mom and Dad could get, so the proceeds could be used to pay the estate taxes.

Her parents, aged 85 and 90, were too old and unhealthy to qualify for life insurance. Had they thought about it earlier, they could have purchased inexpensive life insurance and used the death benefit to pay the anticipated $10-million tax bill that will come due when the parents die.

The family soon realized they will have to sell valuable income-producing assets to pay taxes when the parents die.

Her parents could have instituted an estate freeze, a tax planning strategy in which owner/parents give their children shares in a family business. This technique allows families to cap their own tax liability when transferring their shares to someone else. That way, the future growth of their business would have accrued to the children, who could do their own planning.

Many Canadian businesses has sharply declined in value due to the pandemic. If you had instituted an estate freeze when the market value of your business was $15 million and it's now worth $10 million, think about re-freezing at the $10 million value and buying life insurance to cover that tax exposure.

Immediate Financing Arrangement (IFA): This strategy is used by wealthy Canadians to buy Life Insurance without tying up their money paying premiums.

Life Insurance is the least costly and easiest way to create wealth, but most people don't want to reduce funds available for business and investment. The IFA gets permanent Life Insurance at a fraction of the premium cost.

The insurance policy serves as collateral to secure a loan with a Canadian chartered bank. You pay the initial premium with your own money, then use the policy cash value, and likely some additional collateral, to secure a loan to reinvest in your business, securities, real estate or private equity. You pay only the loan interest, which is tax-deductible. The loan is typically paid off at death with the Life Insurance proceeds. The balance goes to family and charity, virtually tax-free.

This way, you get the life insurance, enjoy tax benefits, and increase the value of your estate.

Active Businesses: If you operate a Canadian-controlled private corporation, on top of either deferring or saving taxes on death, you can get additional tax savings on a future sale of your business.

Here's an example: A company that was previously valued at $1.77 million dropped to $885,000 because of the economic fallout from COVID-19. If the shares in the corporation had been sold pre-pandemic, the total taxes payable would have been about $230,000 – assuming the company was eligible for the lifetime capital gains exemption.

If you put into effect an estate freeze and bring in a spouse or child as a new shareholder at the lower valuation of $885,000 and assume the business value reverts back to its $1.77 million, taxes payable on a share sale reduce to zero. That's because each additional capital gains exemption that can be claimed is about $230,000 in tax savings. In most cases there is a two-year holding period required to benefit from these additional capital gains exemptions, but in some cases the holding period can be dropped altogether.

On top of the tax savings, there can be income-splitting opportunities before the sale like paying dividends to lower-income family members.

Transfer assets to a family trust: Again, because of a lower valuation due to the pandemic, you may want to think about transferring assets to a family trust in exchange for an interest-bearing promissory note owed back to you. Family trusts are often used to maintain control over the assets being transferred. Cash is usually used in this strategy because the gains on the assets transferred must be realized on the sale or loan to the trust. Because of current economic conditions this might be an opportunity to put this type of planning in place -- a plan that may have been too costly previously.

Capital gains planning: The difference in taxes between dividend income and capital gains has widened but there is a plan in which you can create a capital gain by removing corporate funds. Let's take the example of a business owner who wants to take out $1 million of corporate funds as a capital gain. That person could get a tax savings of $206,400 rather than pay a non-eligible dividend.

One proviso with this: this is a very technical idea and one that requires a specialist so as not to be challenged by Canada Revenue Agency. But it can be a particularly useful strategy if a taxpayer has a large shareholder loan balance owing to the company which needs to be repaid.

Post-mortem planning: If you are an executor looking to wind up and distribute corporately owned assets to the deceased's beneficiaries, you might want to look into a mechanism in which the estate can extract corporate funds at a capital gains rate. Provided certain technical requirements are followed, the CRA appears to find this method generally accepted. There are other types of post-mortem planning strategies that may also be appropriate.

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

Mark's corporate goal is the creation of $100 million in new charity each year working with clients, generous donors of non-profits and collaborating with allied professionals.

Prescribed rate loan: Former business owners should look at prescribed rate loans to help reduce the overall family tax bill when income splitting is used.

So, for instance, if you make an investment loan to a spouse or family member or even a family trust and charge interest on the loan at the prescribed interest rate, the income they earn on the funds will be taxable to the family member and not the taxpayer. Canada Revenue Agency sets the prescribed rate quarterly. As of this writing, the rate remains at 1 per cent and provides a great opportunity.

Interest on the loan must be paid no later than 30 days after the end of the calendar year. If the interest is not paid on time, the loan will be subject to the attribution rules until repaid.

Gifting to adult children and grandchildren: Parents often gift assets to children or grandchildren either during their lifetime (inter vivos) or at death, through a will.

The problem with gifting through a will is that there is likely to be an increased capital gain on the assets. By gifting assets while you are alive at a lower fair market value, the tax payable can be reduced or even eliminated in some cases. If the assets produce income, the child or grandchild must be at least 18 years of age.

Don't do this alone: There are many ways to help reduce taxes now and, in the future, but they require comprehensive estate planning and working with experienced, knowledgeable people.

Our advisors across the country are available to help you – on the phone, Skype or through Zoom.

Do not hesitate to contact us for a no-obligation consultation.

Stay safe. ❑

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

He guides successful business owners, professionals, and affluent families through the complex process of ensuring the people and organizations they care about are taken care of. If you are like his other clients, you are looking to reduce your tax obligations, preserve your wealth and leave a legacy.

Mark collaborates with your professional advisory team to achieve your desired outcomes. His simple approach makes sure what is important to you gets done. He will suggest appropriate strategies to get your financial affairs meticulously organized, help you take action, and simplify the complicated so you and your family can rest easy.

Mark can be reached at 416-364-2929, toll-free at 1-866-566-2001 or Mark@WEALTHinsurance.com

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