The TaxLetter®

Vol. 34, No. 5 Your Guide to Tax-Saving Strategies Single Copy: $10.00 May 2016

TAXMATTERS

Stay out of the papers

Panama Perils

Mark Halpern, CFP, TEP

If you thought investing in offshore tax havens like Panama was a good idea (as did Vladimir Putin, David Cameron and the recently departed prime minister of Iceland) now is the time to consider the myriad of avoidable perils, pitfalls and personal problems you may face as a Canadian.

I am of course referring to the notorious Panama Papers, a giant leak of more than 11.5 million pages of financial and legal records amassed by the huge Panama-based law firm, Mossack Fonseca.

Shrouded in secrecy until now, more than 200,000 secret accounts from tax-phobic clients in more than 200 countries were revealed. And while it may sound so far away, we Canadians aren't immune.

Our National Revenue Minister, Diane Lebouthillier, recently announced she would put more auditors to work tracking down offshore money owned by fellow taxpayers. The Royal Bank of Canada, our largest bank, was asked to provide sensitive information on clients with links to the law firm at the heart of this growing scandal.

Strategies Available in Canada

Generally unknown to tax-burdened Canadians is the existence of many smart and legal ways to get protection from too much taxation, right here in our own country.

Other than lottery winnings, your primary residence and Tax Free Savings Accounts (TFSAs), life insurance is an ideal tax-free vehicle still available to everyone.

Many of the strategies available domestically include the use of life insurance in unexpected ways: to wipe out a debit shareholder loan account, obtain tax-exempt funds from a corporation, fund retirement income and provide a death benefit at no cost to the shareholder. The funds can be from retained earnings, income or the amount left in the corporation from a capital gain.

Life Insurance: Canadian vs. Foreign Bought

Let's examine life insurance – what happens when you buy it in Canada and what happens when you buy it outside the country.

As a start, if you want to get life insurance outside the country, the application must be completed and signed outside Canada. If a company tells you it can be done here, buyer beware - it means the insurer is operating in Canada without a licence and the insurance broker is selling you a policy from an unlicensed insurer. If you have to complete any other documentation in the course of buying the insurance outside the country, you again have to do it all outside Canada -- even the policy itself must be delivered to the policy owner outside Canada.

So what's the advantage to all this secrecy? Nothing. A policy issued in Canada actually includes the benefit that with a preferred beneficiary, it's protected from creditors. If the policy is acquired outside Canada the cost of getting the policy is far greater than any savings in the cost of insurance.

Policies with a cash value have the same constraints as above – and some additional problems.

Tax Risks

Under the Income Tax Act, policies with a cash value – and issued in Canada – must comply with tax regulations and the maximum amount of cash that can build up tax free. If the policy exceeds that amount, it's no longer tax exempt and the cash buildup

Mark Halpern, Certified Financial Planner (CFP), Trust and Estate Practitioner (TEP) is the Founder and CEO of WEALTHinsurance.com. Mark is one of Canada's top life insurance advisors with special expertise for business owners, entrepreneurs, medical professionals and high-net worth individuals and families. He can be reached at 416-364-2929.

mark@WEALTHinsurance.com

in the policy becomes taxable.

Outside the country, an insurance company probably doesn't have the same restriction and that means that any increase in the policy value is taxable. When Canadians report their income tax, they have to report worldwide income, and that includes any increase in the policy value. In fact, tax has to be paid even if they don't receive any of the funds. If the policy value increase is not reported, it is considered tax evasion and runs the risk of penalties and even jail time.

Currency Risks

Since most offshore policies are issued in U.S. dollars, let's not forget the exposure to currency risk.

As we all know, the exchange rate between the loonie and the greenback has been subject to major fluctuations. The Canadian dollar dipped as low as US$0.62 back at the beginning of 2002 but was recently pegged at US$0.80. Even if you bought a policy today with the U.S. dollar, you would end up paying Cdn$1.25. Worse, if the dollar dipped back to the 2002 levels, you would have to pay Cdn$1.61. If the policy has a cash value, the same would apply to any taxes on the increase in the value of the policy. Keep in mind that in the case of a Canadian policy with a cash value, there no tax payable up to stipulated maximums.

Credit Risks

Let's not forget just how strictly regulated and creditworthy our insurance companies are here in Canada. It is a regulatory requirement that all insurance companies here be a member of Assuris, a not-for-profit organization that protects Canadian policyholders should their life insurance company fail. Specifically, it protects policyholders by minimizing the loss of benefits and ensuring a quick transfer of their policies to a solvent company where their protected benefits continue. If a life insurance company fails, Assuris guarantees that on transfer, policyholders will retain at least 85% of the promised insurance benefits. Insurance benefits include death, health expense, monthly Income and cash value. As a matter of fact, no one has ever lost money on a life insurance policy issued by a Canadian insurer.

If you decide to buy offshore, it's up to you to do the legwork on how financially viable the company is and determine whether it's worth your time, cost and aggravation to buy a life insurance policy outside of the country. Your due diligence should include examining how the prospective company stacks up with Standard & Poor's. Investigate whether the host country has an Assuris counterpart – chances are it doesn't.

Peace of Mind

Staying in Canada will give you peace of mind knowing that:

- Your money will stay in Canada, where you can see it, touch it, feel it and smell it
- Your policy will be Income Tax Act compliant
- Corporate deposits paid into the policy grow tax-free
- Large annual deductions are provided each year against income for the rest of your life
- With Canadian policies you know that your savings are protected from creditors
- With Canadian policies you know that when you die the insurance proceeds will go to your beneficiaries tax-free
- With either corporate or personal Canadian policies you will have a cash-on-cash return every year in a plan where tax will never be paid as you use the funds for either retirement or investing.

Keep your guard up if you are approached to buy your life insurance offshore. Be suspicious.

There are many safe and profitable home-grown insurance solutions that will easily solve many of the tax, estate and planning issues that previous generations sought to avoid by going offshore, but now only find themselves in an international quagmire of currency risk, negative stigma and the potential for committing tax evasion.

Access to Professionals

Another benefit of remaining in Canada is having ready access to many reputable and experienced professionals knowledgeable about life insurance and estate planning. Accredited professionals in Canada complete extensive training, belong to industry organizations with strict codes of conduct and take continuing education courses throughout their careers.

Proceed with caution. Proper estate planning and tax minimization is not a do-it-yourself project and requires professional help. Seek advice from an impartial and experienced team that includes your accountant, lawyer and a Certified Financial Planner or Trust & Estate Professional. ❒

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 1-866-566-2001 or *Mark@WEALTHinsurance.com*
Visit *WEALTHinsurance.com*
Get your FREE Estate Planning Toolkit at *www.WEALTHinsurance.com/toolkits.html*
The expanded toolkit now includes:
Estate Directory
Estate Planning Checklist
Executor Duties Checklist
Business Owners Planning Guide
Visit www.MarkHalpernBlog.com and sign up for free updates.