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*ESTATE*PLANNING

Preserve your wealth

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I recently moderated a panel discussion about insurance strategies at the 3rd annual Northwind Institute High Net Worth forum at beautiful Langdon Hall.

The expert panel was comprised of a tax expert, an actuary, a planner, a banker, and me (the insurance advisor):

Hemal Balsara, Assistant Vice President, Regional Tax, Retirement & Estate Planning, Individual Insurance, Manulife; Helen Chow, Assistant Vice President, Business Development & Marketing Actuary, Sun Life; Brent Swatuk, Advanced Case Consultant, Equitable Life of Canada; and Randy Cutting, Vice President, Sales, Specialized Lending, DUCA Financial.

We examined how affluent families use tax-exempt permanent Life Insurance to achieve their long-term estate, tax and philanthropic goals. See my TaxLetter article of June 2022 "Cash-Value Life Insurance. What's In It For You?"

In 30 years of professional practice, I've seen over and over that many wealthy families think of Life Insurance as a grudge purchase, much as they think of their car or house insurance. They don't realize that Life Insurance is about much more than replacing income to support families left behind after a death – a financial challenge seldom faced by monied families. With proper planning, it's a tremendous opportunity to support wealth-building and manage risks that include over-taxation and future taxation increases.

The federal budget and capital gains

Some of the best news contained in the recent federal budget was what it did not mention. There was no increase in the capital gains exclusion rate of 50 per cent, which keeps 50 per cent of capital gains tax-free. There was no introduction of a wealth tax, an inheritance tax or a principal residence tax. Looking ahead, there's no guarantee that any of those opportunities to build and pass along wealth in a tax-favoured way will remain in place.

My colleague Hemal Balsara discussed one federal budget change that removes a tax- planning opportunity for substantive Canadian-controlled private corporations (CCPCs). He describes it this way: "People were doing some planning involving entities established in non-treaty jurisdictions [that allowed] investment income to be taxed in their corporations at 26.5 per cent as opposed to 50.17 per cent. Basically, they got the general rate of tax rather than the investment income tax rate in a corporation. That was creating some deferral advantages. With the budget, this type of planning was shut down."

This change has the effect of making Life Insurance much more attractive compared to other investments within these CCPCs. Life Insurance now easily outperforms many of the alternatives because it provides tax-exempt growth and creates the opportunity to recharacterize retained earnings into tax-free capital dividends.

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Here are the 5 ways that affluent families use tax-exempt permanent Life Insurance to preserve wealth, grow assets tax-exempt and create enduring legacies, often by converting taxes into charitable giving.

Goal #1: Fund taxes due on death

Without advance planning, assets may be taxed on the terminal return at a rate anywhere from 27 per cent to 70 per cent. The estate must pay that bill from cash on hand (which most successful people don't have because their cash is effectively deployed), borrowed funds (not attractive because the interest rate adds insult to injury and is not deductible) or sell assets (a sale should never happen under pressure, and it eliminates future growth potential from those assets).

The better option? Life Insurance. For pennies on the dollar, you can create a tax-free lump sum that is paid promptly and can cover the terminal tax bill. And for those comfortable with borrowing to invest, using an Immediate Financing Arrangement (IFA) can create a cash flow neutral structure, allowing continued investment in private equity, real estate and securities, rather than tying up funds in insurance premiums.

Goal #2: Avoid double or triple taxation

What we call "post-mortem planning" focuses on eliminating double or triple taxation when a shareholder in a private corporation dies. On death, there could be capital gains tax resulting from the deemed disposition of shares. There is also a corporate tax on the investment income, and a dividend tax to cycle the money out of the corporation and into the hands of heirs.

Those three layers of tax can significantly erode the value of an estate, but two strategies, used individually or together, can help:

1. Redemption loss carry back – eliminates the capital gains tax and is completed within one taxation year of the shareholder's death
2. Pipeline – eliminates the dividend tax and can be completed within three to five years of the shareholder's death

Usually, you will do the redemption-loss carry back when you have favourable tax attributes such as refundable dividend tax on hand, capital dividend account balances – or things like that. And often you do the pipeline when you're in a more favourable capital gains environment, like today.

Both strategies use Life Insurance strategically to create a lower effective tax rate.

Goal #3: Make fair bequests

"Equal" isn't necessarily "fair." Say mom and dad start a business and they have three children. The daughter works in the business and will one day take over the corporation. The two sons work in other professions. It would be "equal" to split the business among the children with one-third going to each – but that wouldn't be "fair" to the daughter, who would suddenly become a minority shareholder with two-thirds of her success in running that business flowing out as dividends to her brothers. It would be fairer to leave the company to the daughter and provide other assets of equivalent value to the sons.

Estate equalization looks at the estate as a whole, rather than each piece, to ensure bequests are fair to all heirs. It's an essential consideration when there's a family business and can also be very useful for blended families. Life Insurance is a straightforward and cost-effective way to achieve estate equalization.

Goal #4: Diversify fixed-income investments

Permanent Life Insurance provides a unique tax-exempt investment opportunity that can contribute to the diversification of a portfolio of other assets. Specifically, high net worth families often reallocate some fixed-income investments into permanent Life Insurance to improve returns with the same or lower volatility.

(Read my TaxLetter article from Nov 2020 "Four Reasons to Consider Permanent Tax-Exempt Life Insurance").

Permanent Life Insurance policies are very predictable and boring, and they can provide long-term pre-tax returns equivalent of 9 per cent or more. In addition, in a corporate setting, you can pay for these policies

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.

with after-tax, corporate dollars, with the death benefit credited to the capital dividend account and then withdrawn from the company virtually tax-free. This is an extremely tax-efficient way to get money out of a corporation to benefit the next generation.

Here is the easiest way to see how this strategy could fit your planning. TFSA balances have now surpassed RRSPs in Canada. Imagine if you could have a NO Limit TFSA for yourself personally or for your corporation. Your money would grow tax-exempt, could be accessed tax-free and could be passed along virtually tax-free. Such a strategy exists. And this is how permanent Life Insurance is used by affluent families in Canada. (Read my Tax Letter from Feb 2020 "No-Limit TFSA")

Goal #5: Accomplish Strategic Philanthropy

A primary goal for many affluent families is to create a substantial charitable legacy. It's possible to create a significantly bigger legacy by converting taxes into philanthropy with permanent Life Insurance. There are many ways to do this, but here's one of the simplest.

Charitable donations can offset up to 75 per cent of net annual taxes payable in any year, and any additional amounts can carry forward for up to five years. But the rules are even more generous when it's time to file the terminal tax return. At that point, charitable donations can offset up to 100 per cent of the taxes due in the year of death and up to 100 per cent of the taxes due in the preceding year.

So, if you're anticipating a $5 million tax bill in each of those two returns, you could create a tax-efficient $10 million Life Insurance gift. Instead of paying a lot of money to the tax department, you can provide a large donation to support the causes you believe in.

And consider using an IFA to accomplish your philanthropic goals. For those who qualify, it's akin to having your cake and eating it too, which means you can do better for the charities and causes that you are passionate about. But all of this needs to be viewed as part of your overall estate planning.

If any of these goals resonate with you, reach out to us. We'd love to help you to accomplish your family's unique objectives as tax-efficiently as possible.

As a company, we've set an ambitious charitable goal -- to create $100 million a year in new charitable donations by partnering with clients, charities, and allied professionals.

At the same time, we are working to expand our charitable footprint beyond our firm by developing a network of 100 like-minded professionals and charities who want to set $10 million a year as a goal of their own. That's a $1 billion objective! Consider joining us. Please visit https://wealthinsurance.com/billion.php

In our capacity as legacy process consultants, we work with several charities and foundations across the country, helping their supporters and donors structure generous charitable gifts in the most cost-effective and tax-advantage manner.

Please contact us to arrange your no-obligation consultation.

Our advisors across Canada look forward to helping you create a meaningful charitable legacy while preserving your hard-earned money.

Insurance 101

There are two basic types of Life Insurance: term and permanent. Term insurance covers you for a specific number of years. At the end of the term, the policy has no value. Permanent insurance (which includes universal Life Insurance and participating whole Life Insurance) provides a lifetime of protection plus an investment component. It's an asset with enduring value. ❑

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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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The 2021 Toolkit now includes:

-Estate Directory

-Estate Planning Checklist

-Executor Duties Checklist

-Business Owners Planning Guide

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