The TaxLetter®
Vol. 34, No. 11 Your Guide to Tax-Saving Strategies November 2016

FINANCIALPLANNING

Problems Get Fixed

Recent Cases

Mark Halpern, CFP, TEP

Getting help from an auto mechanic usually begins with unexplained noises under the hood or flashing lights on your dashboard. That's when you get your car looked at and (hopefully) fixed. Similarly, a nagging toothache gets you into a dental office, and a leaky faucet gets your plumber involved. Unforeseen events, in each of those cases, are the catalysts to engaging a specialist, getting the right diagnosis and fixing your problem properly. But when it comes to insurance and estate planning, there are no warning lights, and nothing to make you aware of your problem in the first place.

Always work with experts

The law compels you to have automobile insurance to drive legally and your mortgage lender insists on home insurance, so you buy both protection products, perhaps grudgingly. Since no one in authority requires you to bulletproof your financial future, you need to take personal responsibility now, starting with a thorough review of your own situation. You may be paying too much income tax right now or in the future, and unless you work with an accredited financial and tax planning professional you surely won't know. With so many kinds of insurance products available, both business and personal, the key is to work with experts who can help you identify your needs, recommend the best solutions available, and advocate on your behalf in the event of a claim. Those products can help your family or business weather a death, get you the care you need through times of critical illness or disability and even leave a legacy to your favourite charities.

Bear in mind that unlike other financial instruments, the proceeds of life insurance always arrive tax-free to the beneficiary regardless of currency fluctuations, interest rates, or stock market uncertainty. Many people mistakenly consider life insurance a high-cost expense, but when used properly it is an unmatched financial asset and the most economical solution to solve expensive future problems with pennies on the dollar today.

Here are some examples of how we have helped our clients use insurance products to their advantage. These are true stories and real cases, with only subtle changes meant to protect client privacy and confidentiality.

Professionals with Holding Companies

Husband and wife lawyers sought our help after hearing about us on the radio. They had accumulated more than $3 million of assets in their professional corporation with substantial additional holdings outside the corporation. Both are 65 and continue to work. Their biggest concern was the huge tax bite that will occur on death of the second spouse. Those taxes on assets, shares and dividends could be as high as 40 per cent or more, taking down their original $3 million to $1.8 million.

So we repositioned their assets into a joint last-to-die insurance policy for $7.5 million that will provide $7.5 million tax free to their family to help

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.

pay off those taxes, pay off any debts, leave to family or go to charity. The insurance policy also contains a cash value that can be accessed if necessary.

Shareholder & Partnership Agreements

A banker asked us to help his clients in the real estate syndication business. We met the two partners, childhood friends now in their mid 50s, who had built up more than $50 million of equity. It was obvious from the beginning that they enjoyed a great business and personal relationship. Despite their fondness, if one of them dies unexpectedly, neither wants the surviving spouse to be their new business partner. Nor do they want their attention distracted and business assets depleted by a mountain of legal fees figuring out who gets what. When asked about a partnership agreement, they quickly produced the document, but on examination there wasn't a single mention of how that agreement would be funded.

A buy-sell provision is a must

We recommended funding their agreement with some buy-sell life insurance of $10 million on each of them, with the premiums paid by their company (a more tax-efficient arrangement than paying premiums personally), to ensure the widow adequate liquidity and a guaranteed buyer for her portion of company shares. Their case is far from isolated. Many business partners complete the process of negotiating, drafting and executing a 'comprehensive' shareholder agreement but fail to provide a funding mechanism in case of death or disability. An essential component of any good shareholder agreement is the buy-sell provision that sets out how shares get transferred on retirement, disability, death, bankruptcy or marriage breakdown. They have that peace of mind.

Immediate Financing Arrangements (IFA)

A couple in their 70s sought help for their tax problem. They had grown their profitable business to the point where the adult children will soon be taking over, and their accountant had informed the family of a looming tax bill of several million dollars upon the parents' death. The premiums to buy the required life insurance to cover those taxes amounted to several hundred thousand dollars annually. Despite that significant tax liability, they couldn't bring themselves to taking such large sums out of their finance business because the money in the company was producing enviable pre-tax returns of 22 per cent annually.

Problem solved

We structured a Joint last-to-die life insurance policy on the parents to cover the entire tax liability and arranged a leveraging strategy with a Canadian bank to cover payment of all the insurance premiums. The bank holds the new policy as collateral for a line of credit, enabling the business to 'pay' the premiums and immediately borrow back those funds from the bank. Every year, the tax-deductible interest on the line of credit gets paid by the business, and that interest expense is deducted from current income. The entire loan will ultimately be paid back through the death benefit. Their net cost for the insurance amounts to less than 4 percent of the true premium costs, a minor cost for a major gain.

Tax liability

Most Canadians don't begrudge the fact that some earnings go to taxes. After all, our taxes build roads and schools, support our health-care system and defend our country. But people who earn more than $220,000 a year currently lose up to 53.53 per cent to income taxes (in Ontario, it varies by province) and are subject to taxes again on investments like GICs, bonds and real estate income. Many people are unaware of what happens on the death of the both spouses: RRSP and RRIF savings will be taxed as income in the terminal return. That would typically bring them up to the top marginal rate of 53.53 per cent. Currently, the top rate of between 39.34 per cent (eligible) and 45.30 per cent (ineligible) of holding/operating company assets will go to taxes and about 23 per cent of accumulated capital gains from investments, real estate and business equity will be paid as taxes.

A low-cost solution

For clients in their mid-50s or older, I recommend buying inexpensive joint last-to-die insurance. It's a low-cost solution that usually doesn't impact lifestyle, and when the second spouse dies the family will not be forced to find the money to cover any tax liabilities.

Charity

I always ask clients where their savings should go when they die. Given 3 available choices (the tax department, family and charity) nobody picks door number one. A 70-year-old widow with 2 adult children asked for help with her $20 million estate comprised of real estate and other fixed income investments. She wanted to eliminate estate taxes of about $5 million as calculated by her accountant, and preferred to leave a charitable legacy instead.

We helped her create a $10 million gift to a private foundation using life insurance, so her family will no longer be required to sell assets in order to pay the $5 million tax bill when she dies. She will be remembered for leaving a $10 million gift to charity instead of a $5 million payment to Canada Revenue Agency.

A charity as a beneficiary

If you are charitable, and don't like paying taxes, consider buying a life insurance policy and naming the charity as beneficiary. The annual premiums qualify as a tax deduction on your income tax return. You can also buy a new policy and name either the charity or your estate as the beneficiary and include the charity as part of your will. You won't get a charitable donation credit for this second option, but the charity can issue a tax receipt for the proceeds it receives for your final tax return, potentially saving your estate quite a bit.

Start now

If you haven't done so already, seek the help of an experienced certified financial planner with trust and estate expertise to help you. Most will provide a personal and no-obligation consultation to uncover tax exposures and help you assess your planning needs. Proper planning is a process, not an event. Include your lawyer and accountant on your planning team and get the peace of mind that comes from knowing your family's financial future is secure in a tax-effective way. ❒

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, 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