The TaxLetter®

Vol. 39, No. 9 | Your Guide to Tax-Saving Strategies | September 2021

ESTATEPLANNING

The Accidental Philanthropists™

Five Useful Examples

Mark Halpern, CFP, TEP, MFA-P

When our clients learn that they can choose two out of three possible beneficiaries of their estate when they die, many of them become "accidental philanthropists™". The three possible beneficiaries are family, charity, or the Canada Revenue Agency (CRA).

In this issue of the TaxLetter®, I want to share five recent examples, possibly similar to circumstances in your own lives, where clients became philanthropists when given the opportunity to leave more money to charity and their family instead of the tax department.

To begin with, cash, checks and credit cards are the least cost-effective and least tax-efficient ways of giving. We have identified more than 20 ways to make a more effective donation, plus 15 key life insurance strategies you can use to create transformational gifts to the causes you care about.

Contact us to obtain a copy of the lists.

Our Clients: Accidental philanthropists™

One client faced more than a $1-million tax bill on his retirement savings. We mitigated the tax bill by using a Donor Advised Fund (DAF) and a joint-last-to-die Life Insurance policy to create a $4.5-million gift to charity instead. Others find themselves collecting Canada Pension Plan (CPP) benefits without any real need for the monthly payments. (There are a number of strategies we can employ when this is the case – I will tell you about three of them below). Finally, we also have clients who've had a liquidity event – sold real estate or the family business, or who have private company shares they could donate. In each of these cases, Life Insurance can be used in conjunction with philanthropy to facilitate the donations and to make client estates whole in the face of biting tax penalties.

1. One million dollars of tax liability.

This client was a 65-year-old married business owner with $2 million in his Registered Retirement Savings Plan (RRSP).

Like many successful people we meet, he didn't know that more than half of those hard-earned savings will go to the tax department when he dies. For those in the highest tax bracket, RRSP and Registered Retirement Income Fund (RRIF), assets get taxed at 53.5 per cent in Ontario at death.

He learned that his RRSP would be worth $920,000 to his heirs. (In a marriage where the first spouse dies, all of the assets flow to the surviving spouse tax-free. The CRA must wait for the second death to collect $1,080,000 in tax). The spousal rollover is not available to unmarried, widowed, or divorced

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.

people. Wealthy clients with large sums in registered accounts, usually don't need that money for paying bills. Instead of paying more than $1 million in taxes, this client opted to donate the entire $2 million RRSP to a Donor Advised Fund (DAF), a charitable-giving vehicle where funds grow tax-free. A DAF is often established at a Community Foundation and it enables donors to make a charitable contribution without specifying the charities that will ultimately benefit from their gift. A DAF can be established in 1 day. The donor receives an immediate donation receipt and can recommend grants (gifts) from the fund over time. We also structured a joint and last-to-die (JLTD), 10-pay Life Insurance policy, owned and paid for by the DAF. The death benefit earmarked to the charity at the client's life expectancy, age 85, is $3.5 million. Assuming the donor has been distributing 5 per cent of the charitable assets each year during their lifetime, the donor-advised funds would have created a charitable family legacy of $4.5 million – instead of a more than $1 million payout to the CRA.

2. CPP Philanthropy™

Next, we have a husband and wife, both 65, each receiving $1,100 monthly in Canada Pension Plan (CPP) benefits for a total of about $26,000 a year.

That money only gets taxed, re-invested and then taxed again. The CPP Philanthropy™ strategy uses CPP benefits to fund a permanent Life Insurance policy, creating a substantial windfall for your family and the causes you care about. Because they don't require the CPP funds to pay bills or support their lifestyle, several strategies are available for mitigating taxes now and when death occurs.

Option A – *Life Insurance owned personally – ultimately a $700,000 Tax Savings.*

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 estate taxes . Note that a charitable receipt can offset up to 75 per cent of annual taxes, and any residual amount can be carried forward to up to five years. On death, charitable donations can be used to offset up to 100 per cent of the estate tax, including going back to the tax year before death.

Option B – *Immediate tax savings by having a Life Insurance Policy Owned by a Charity.*

As in the example above, create a charitable gift of $1.4 million using joint-and-last-to-die Life Insurance, this time with the charity as the 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 legacy gift.

Option C – *Donate RRSP/RRIF By Will or Beneficiary Designation*

Our couple with $1 million of RRSP savings could name the charity as the beneficiary, thus mitigating any taxes owing when they die. To replace the $460,000 that would have gone to the family (remember, a $1 million RRSP or RRIF will only be worth about $460,000 to the family after taxes), CPP benefits can then be used to fund a $1.4-million joint-last-to-die insurance policy with the family or their estate as the beneficiary. When the second spouse dies, the Life Insurance policy pays this amount out to the family, tax free. This represents an additional $940,000 for the family, over and above the $460,000 they would have received, all in addition to the initial large gift made to charity.

3. Private company share-donation strategy

If you own shares in a private company, several benefits unavailable to other taxpayers are open to you. If you are philanthropic, this strategy can allow you to donate private company shares to a charity, reduce your estate taxes, create a substantial charitable legacy and get money out of your company on a tax-free basis for your children and grandchildren.

For the client with private corporation shares, we first set up a donation of some shares to a charity in the client's will. At the same time, the company acquired a permanent cash value Life Insurance policy on the client's life, designating itself as the beneficiary. The company pays all premiums on the policy. When the client dies, the private corporation immediately uses some of the proceeds of the Life Insurance policy to buy back shares from the charity. This relatively simple approach lets clients make a significant gift to meaningful causes without reducing or depleting family inheritances. While the client is alive, the investment component of their permanent policy continues to grow tax-free. Upon the client's death, all insurance proceeds are then distributed to the beneficiaries tax free.

4. Real Estate Sold: How a $20-million tax liability became a $40-million charitable gift.

In this case, the patriarch of a third-generation farming family recently sold the real estate portfolio for $120 million, creating a tax liability of $20 million. After donating $40 million to a donor advised fund, thus completely offsetting the $20-million tax liability, we structured a $40-million Life Insurance policy on a joint-last-to-die basis to restore the donated funds to the family – when both parents die, the family will receive the $40-million death benefit, tax free.

We can also make use of what is called an Intermediate Financing Arrangement, or IFA, under which a financial institution will finance all of the premiums, so the client's money can continue to be used for investing instead. The client pays the IFA loan interest only, which is fully tax-deductible, and the IFA loan gets repaid with the Life Insurance proceeds when both parents die.

5. Business Sold: How a $10-million tax liability turned into a $20-million charitable gift.

In this case, a multi-generation family business was sold for more than $60 million, creating a tax liability of $10 million. Our objective? Mitigate the tax liability using philanthropy and Life Insurance.

We created a donor advised fund with a community foundation and had the client deposit $20 million, immediately generating a charitable receipt which offset the entire $10 million liability. We then structured a $20 million Life Insurance policy on a joint-last-to-die basis, to restore the donated funds to the family. Using an IFA strategy again, a financial institution financed the premiums so the client's money could continue to be used for investment purposes. The client pays the IFA loan interest only, which is fully tax-deductible. When both parents die, the family will receive the $20 million death benefit tax-free and the IFA borrowings will be repaid.

As you can see, there are several ways to give generously while preserving your hard-earned money and enjoying tax savings. Aside from producing compelling financial metrics, you will demonstrate and teach by example the importance of charitable giving. That's real legacy planning for your children and future generations. Please contact us for a no-obligation socially distanced consultation. We look forward to helping you. ❑

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