TOOLBOX

STRATEGIES FOR ADVISORS FROM ADVISORS

REAL VALUE

A simple call about a critical illness policy kicked off a complex planning process.

BY **MARK HALPERN**, *CFP, founder of illnessPROTECTION.com. He's been an independent advisor since 1991, specializing in living benefits.*

HOW many of us can say we have truly done a complete job for our clients?

That question always comes to mind when I think about an experience I had with a client who came to me shortly after we started our radio marketing campaign about Critical Illness insurance. In March 2005, I received a call from a prospect—let's call him Mr. Howard. He was interested in spending a couple of thousand dollars a month for CI insurance and was particularly intrigued by the return-of-premium option. But my first meeting with him showed me he had a lot more to be concerned about.

I drove to the address he specified and found myself in a rather sketchy part of town. I was actually reluctant to get out of the car, but screwed up my courage to enter an old, rundown apartment building for the meeting. When I walked in the door, I saw a desk covered with files and behind it, a very conservatively dressed, soft-spoken 70-year-old man.

We started to talk about the contents of those files and it became clear to me the man owned a fortune in real estate. It was a true case of meeting a potential client about a fairly simple matter (his interest in some CI coverage) and winding up with a major financial planning project. After recognizing that virtually all of his net worth was tied up in real estate, I informed him matter-of-factly that if he would share all of the information I needed on his financial situation, I would deliver a comprehensive plan to save his heirs a lot of unnecessary taxes.

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The fact that real estate had been appreciating so rapidly in recent years meant his wife and children were in for some serious capital gains taxes after his death. I asked him to send a list outlining all of the real estate he owned and to detail when it was purchased, what he paid for it, and what it's worth today. In return, I received a fax listing a large number of full-sized apartment buildings, as well as a series of triplexes and six-plexes. The market value was close to $150 million!

The first question I asked was if he had a will. The answer was no, and to further complicate things, he had six children but no heir apparent for his business, no asset liquidity, and a number of citizenship issues with his wife (a U.S. citizen) and children who were resident in Canada, the U.S. and Europe. So he'd failed the first of what I call "crash tests" on his finances.

I probed further and found he had no powers of attorney, nor did he have an estate directory that would inform his family members on the whereabouts of important documents and provide a straightforward accounting and inventory of all his real estate assets.

No Simple Solution

Clearly, Mr. Howard needed an array of services, starting with will creation and proceeding to tax and estate planning.

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continued from page 17 First off, his 69-year-old wife was a Canadian permanent resident but still a U.S. citizen. In the event Mr. Howard died before his wife, she would be exposed to double taxation on any inheritance and that had huge implications for the value of the estate.

To try to plan around that problem, we went so far as to explore having her renounce her U.S. citizenship but decided that the complications—including potential difficulty for her to visit her children in the States—wasn't worth the savings. In the end, among other things, we bought an insurance policy that would cover off any U.S. tax liability.

To help me develop a solution, I worked with my friends at Manulife Financial's Tax & Estate Planning Advisory Group, which supports advisors who work in the high-net-worth market.

The team included Robin Goodman, LLB who oversaw the tax and estate planning, Catherine McRae, a regional actuary, and Paul Pickett, a regional underwriter. Robin's role was to propose the overall plan structure and to quantify the insurance requirement.

Catherine determined the best way to structure the insurance and which products to use. And Paul looked into what was feasible based on the couple's health issues—some of which were serious and needed to be addressed before other decisions could be made.

We then began to talk about different scenarios with the client.

We went through the implications of Mr. Howard dying intestate (without a will) and other financial planning areas and mapped out the impact on his taxes, probate, and how his wife's citizenship would affect his estate.

Then, we looked at what would happen if he had a will, and showed him the savings on probate and capital gains taxes alone were enormous.

In Trusts We Trust

We also looked at the options offered by spousal and family trust planning, and that's where we found some of the major savings.

Specifically, we used a spousal trust, which provides a tax deferral until the death of the second of two spouses, to let Mr. Howard maintain his tax deferral (through the trust) for his wife even after his death.

Using this vehicle allowed him to maintain some control of his assets and keep them out of the hands of the U.S. government, since they technically remained the property of a Canadian citizen—albeit in the form of a trust.

In this case, the spousal trust was set up only for her, so if she were to die first, Mr. Howard simply would have to write a new will to distribute his assets to his six children.

Another advantage to this type of trust is that separate tax-payer statuses can be established. Each of the Howards was collecting government benefits and there was a survivor benefit attached to Mr. Howard's pension.

So, if he died first and there was no spousal trust set up, it would be very easy for his wife's earnings to exceed $100,000 annually, both pushing her into a higher tax bracket and creating a clawback opportunity for any pension issuers. With the trust in place, the surviving spouse would be able to take as much or as little income as required while remaining below the clawback radar.

Further, the family and spousal trusts would push off the tax liability by another generation. The trusts created a flow-through to the children to help avoid probate and put all future taxes in the children's hands.

As well, to the extent taxes remained payable on the assets within the trust, the insurance would pay the tax liability, and

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the trust would ensure the deferral of the U.S. taxes. The client now has multiple wills in place for probate and tax planning purposes for himself and his spouse. We placed all the capital property shares, land, and business assets into one will, and then the personal exemptions went into another will.

That, combined with the spousal trust saved the couple millions of dollars in potential tax liability.

A few years ago, it was in vogue to move assets offshore, at least on paper, as a way of avoiding taxes. These mechanisms can be problematic and very complex. A lot of people who used them are now in a different place in their lives and are finding the arrangements difficult and very expensive to unravel.

As an alternative, skillful use of trusts, combined with inexpensive joint-and-last to-die life insurance, offers many of the same advantages but without the potential headaches.

Insurance Matters

I was also concerned about the existing life policies the couple was carrying. Mr. Howard had purchased two $1 million joint-last-to-die insurance policies from two different advisors who had since left the business.

The policies weren't correctly structured and the client had bought term-to-100 life insurance. While those offer nice level premiums, **continued on page 20** continued from page 19 they're unforgiving if a client forgets a payment. Once the grace period passes, the policy lapses and there really is no safety net—and for an aging couple, forgetting a payment is a very common problem.

We solved that by going with an over-funded Universal Life policy paid for with retained earnings locked inside the corporation. We set things up to allow the holding company to be the policy owner and the beneficiary.

That allowed us to accomplish the following:

- Pay the premiums and the over-funding of the policy with pretax dollars;
- Take the insurance proceeds out through the holding company's capital dividend account on death; and
- Take out formerly taxable funds on a tax-free basis at death.

Mrs. Howard, meanwhile, had her own underwriting issues.

A heart problem required that she undergo some invasive testing during underwriting because her weight and arthritis precluded her from taking a standard treadmill stress test. The test results led to her having a substantial rating for insurance purposes. The good news was that the rating went on a well-priced joint-and-last-to-die policy so it still made financial sense to the client. She's since lost weight and we're working to get the rating reduced.

Generation Next

We've also delivered effective tax planning for each of the children. They now have wills, powers of attorney, life insurance and trusts in place. Mr. Howard moved a $2 million group registered pension plan and a sizable RRIF to our office, as well as a group benefits plan.

> We've put individual life insurance on each family breadwinner, as well as some joint-last-to-die insurance for future estate planning.

And, we've met with almost all of the six children. We've sat down with those in Canada, and my colleagues from the Million Dollar Round Table's "Top of the Table" are taking care of the non-Canadian residents. We've put individual life insurance on each family breadwinner, as well as some joint-last-to-die insurance for future estate planning. Mr. Howard is paying the premiums because the kids don't have the financial capacity to pay for what's been purchased.

Since we started working together, two of his children have joined him in the property management business. Naturally, some of the other kids will just want to liquidate the assets when their father dies. But the parents would prefer that the children take the income stream off the rents that flow in from the real estate, while keeping the property portfolio in the family.

The answer has been to arrange for some life insurance on Mr. Howard only, to ensure each child gets a lump sum that will satisfy the siblings but still keep the real estate assets intact to provide income in the future.

Lessons Learned

This started with a phone call response to my radio ad and led to my earning the respect of someone who had, up to that point, only dealt with other brokers who simply sold him insurance products and then moved on.

The following three principles helped me turn that phone call into a significant account:

- Never assume anything. I've learned that people with the most money, more often than not, don't have their financial affairs in order. Many of them are too busy looking after their business, their clients, and their families and haven't taken the time to look at their own financial pictures in a comprehensive way.
- Uncover information. I highly recommend a book by Harold A. Zlotnik called *The Broad Concept Approach*. This book teaches a simple interview style that helps advisors ask the difficult questions people need to explore. Once you have the answers, you can help your clients protect their areas of vulnerability.
- Build the big picture. Listen to a client's entire situation and then help him or her take a step back. Find out about current needs, and how they'll change in the future before you ever discuss solutions. In this case, as with others who have responded to my radio ads, the first contact generally involves CI coverage. Instead of just selling the products and being finished, I build an understanding of the entire financial picture and expand my role by providing a stable foundation for entire families now and into the future. AE

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