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THE ACCIDENTAL PHILANTHROPIST
MARK HALPERN

Is Strategic Philanthropy Part of Your Major Donors' Estate Planning?

Five ways affluent families use Life Insurance to preserve wealth and create enduring charitable legacies

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BY MARK HALPERN, CFP, TEP, MFA-P

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 today, to achieve their long-term estate, tax and philanthropic goals.

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.

This federal budget didn't touch the capital gains exclusion rate, but will the next one?

Some of the best news contained in the recent federal budget was what was not included. There was no increase to the capital gains exclusion rate of 50 percent, which keeps 50 percent 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 percent as opposed to 50.17 percent. Basically, they got the general rate of tax rather than the investment income tax rate in a corporation, and that was creating some deferral advantages. With the budget, this type of planning was shut down."

Many wealthy families think of life insurance as a grudge purchase.

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.

Here are the 5 ways affluent families use tax-exempt permanent Life Insurance for wealth preservation, growing assets tax-exempt and creating enduring legacies, often by converting taxes into charitable giving.

Fund taxes due on death — GOAL 1

Without advance planning, assets may be taxed on the terminal return at a rate anywhere from 27 percent to 70 percent. 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, paid promptly, that 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.

Avoid double or triple taxation — GOAL 2

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 corporate tax on the investment income, and 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 — 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.

Make fair bequests — GOAL 3

"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.

Diversify fixed-income investments
GOAL 4

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.

Permanent Life Insurance policies are very predictable and boring, and they can provide long-term pre-tax returns equivalent to 9 percent or more. In addition, in a corporate setting, you can pay for these policies 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. It exists. And this is how permanent Life Insurance is used by affluent families in Canada.

Accomplish Strategic Philanthropy
GOAL 5

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 percent 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 percent of the taxes due in the year of death and up to 100 percent 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 even more good 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.

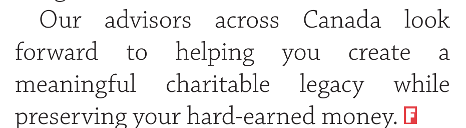
As a company, we've set an ambitious charitable goal: to create $100 million a year in new charitable donations by partnering with clients, charities, and allied professionals.

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 make 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.



MARK HALPERN is a well-known CFP, TEP, MFA-P (Certified Financial Planner, Trust & Estate Practitioner, Master Financial Advisor – Philanthropy). He was honoured to speak in the Disruptors Category at Moses Znaimer's most recent ideacity conference. His talk generated high interest and comments. Watch "The New Philanthropy" at bit.ly/MarkHalpernTalk. Learn more at www.wealthinsurance.com. He writes this column exclusively for each issue of *Foundation Magazine.*

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.