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*ESTATE*PLANNING

Wealth & Philanthropy

Missed Opportunities

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I recently met with a successful family in the process of developing a succession plan to transition wealth to the second and third generations. Three potential scenarios were presented to them:

1. Do an estate freeze and use cash on hand to pay tax bill on death
2. Use Life Insurance to fund taxes
3. Donate frozen Private Company shares on death and use Life Insurance to fund a generous donation to turn taxes into charity.

The numbers were crystal clear:

> **Please Note**
>
> This is a very large case and will not apply to everyone.
>
> The numbers presented are scalable for anyone who has done an estate freeze.

"Using cash and no Life Insurance resulted in a 27 percent estate erosion. Using Life Insurance resulted in $12 million more for the family at less cost. Using Life Insurance and donating shares resulted in a $33 million family foundation and 16 percent more money for the family versus the "do nothing plan".

Despite that, the family decided to stay the course and use cash to pay taxes. And try as we might, they missed out on an opportunity to expand their legacy by creating a transformational gift to a family foundation. Why, you may wonder?

For many, Life Insurance comes with "BAGGAGE"

This affluent family isn't the only one to resist using Life Insurance strategically to achieve their goals. I've thought a lot about what holds such people back and believe that in most cases it's because they're carrying baggage.

Many people view Life Insurance as a "grudge purchase," only needed while they're building wealth and need to pay off their family home mortgage, replace income to support day-to-day expenses and provide for kids' education funding. They often put Life Insurance in the same category as home insurance and car insurance – necessary but resented expenses.

Others had a negative experience with an advisor or a different type of insurance that was not guaranteed, or know someone who made a travel, property or auto claim that an insurance company denied. They may not realize Life Insurance is much more clear-cut than other types of insurance. It's hard to argue with a death certificate and built in guarantees.

Whatever the reason, it's important for affluent families to drop the baggage they are carrying and consider the 6 reasons why HNW/UHNW use Life Insurance:

1. Estate Tax Funding
2. Estate Equalization/Blended Families
3. Shareholder Agreement Funding
4. Key Person Coverage
5. Asset Diversification Strategy using Tax-Exempt Corporate Owned Insurance and the CDA (Capital Dividend Account)
6. Philanthropy

This list differs from the "grudge purchase baggage". Life Insurance can be a powerful way to optimize and preserve family wealth at a low cost with high tax-efficiency to become a multiplier of wealth and philanthropy.

Think of it as switching out your putter for a driver to amplify the effect of your golf swing and make your ball go the distance.

Illustrating the multiplier effect

Let's use the Cooper family (name changed) as an example. They live in Ontario and have already executed an estate freeze, which froze the value of the parents' preferred shares in their business at $62,400,000. Half that amount will be taxed as a capital gain on death. At a tax rate of 53.5%, this will result in a tax bill of $16,692,000.

There are three ways to handle the tax liability:

1. They can pay the tax bill in cash saved up for this purpose – a significant sum to tie up for an uncertain number of years. This is the "no planning" scenario. **Heirs will receive $45,708,000**.

2. They can buy just enough Life Insurance to cover the tax bill. For illustration purposes, a joint last-to-die level-premium universal life policy with a death benefit of $16,692,000 will cost them $509,974 annually. Assuming the second spouse dies 21 years from now, at age 90, the cost of insurance will amount to $10,709,454. With this option, their estate will pay the same amount of tax to the government, but the cost to the family is about $6 million less. And – the icing on the cake – they'll create a $12,665,521 capital dividend account (CDA) credit that the next generation can use to withdraw cash from the company tax-free. That's a $6 million tax savings for the next generation by using the insurance CDA credit (assuming a 47.74% tax rate), **heirs will receive $57,737,074**.

3. Most people know about donating non-registered appreciated public securities like stock, ETF's, mutual funds and seg funds and paying no capital gains tax when donated in-kind. But fewer people know that you can donate private company shares too. This family can donate their private company shares on death to charity and use Life Insurance of $33 million as a donation to charity and redeem the shares for the family, turning the tax that was going to be paid to the government into charity. This still leaves their heirs better off than the first scenario. In getting twice the amount of insurance needed with a $33,384,00 death benefit, the premium cost would be $1,019,948 annually. Assuming again that the second spouse dies in 21 years, the cost of insurance will total $21,415,682. However, the result will be a $33,384,000 donation to charity and redemption of the private share back to the family--the charity would prefer money to shares and the family would like to keep the

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.

	Scenario 1	Scenario 2	Scenario 3
	No Planning	Life Insurance to pay tax bill	Shares donated, Life Insurance proceeds used to buy them back
Total value of preferred shares	$62,400,000	$62,400,000	$62,400,000
Paid in taxes	**$16,692,000**	**$16,692,000**	**$ Ø**
Donated to charity	**$ Ø**	**$ Ø**	**$33,384,000**
Net to family	**$45,708,000**	**$57,737,074**	**$53,084,486**

shares in the family. The icing on the cake is the resulting CDA credit of $25,345,974. Including the tax savings resulting from the CDA credit (assuming a 47.74% tax rate), **heirs will receive $53,084,486**.

It's important to note that scenario 2 requires post-mortem planning, such as a pipeline transaction used to extract Life Insurance proceeds from the corporation. Bear in mind that people who are comfortable with leverage (such as real estate investors) can add an Immediate Financing Arrangement (IFA) to scenario 3 and complete the acquisition of the Life Insurance on a cash flow neutral basis and over a shorter period of time. In other words, they get all of the Life Insurance they need without tying up their money paying premiums.

Family, charity or tax department?

This case clearly illustrates that when we die, our money will go to some combination of family, charity, and the tax department. Appropriate planning can direct more towards family and/or charity – and even, as in scenario 3, take the tax department out of the equation.

The Life Insurance in these scenarios – a joint last-to-die level-premium universal life policy – guarantees a level cost of insurance, with no market risk and no interest rate risk. The only risk is longevity – that one or both insureds will live longer than the planning assumes. In that case, the annual cost of insurance will continue until the second spouse dies. However, as the example illustrates, there's a huge net benefit in both scenario 2 and 3. In all other cases, the family is better off than if they did no planning. This planning can also be structured with a fully guaranteed 10, 15 or 20 pay structure or by using permanent whole Life Insurance.

This type of planning can easily be scaled up or down, so it applies to high net worth and ultra high net worth families alike. Moving the baggage aside is critical to take an objective look at the numbers – because they speak for themselves.

Affluent families can benefit tremendously by remaining open-minded about how Life Insurance can enhance their legacy. Meanwhile, their teams of professional advisors – lawyers, accountants, investment advisors and insurance advisors – can present Life Insurance in a new and more strategic light, and partner with experts to implement customized strategies that meet each family's specific goals. Working together, we can ensure that our clients don't miss valuable opportunities to use a versatile multiplier tool – Life Insurance – to achieve wealth transfer and philanthropic objectives.

Reach out anytime to discuss these types of strategies. We love chatting about this because it can be transformational for charities, as well as affluent families, and we're on a mission to amplify philanthropy in Canada. Let's do good and do well at the same time! ❑

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

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The 2023 Toolkit now includes:

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-Estate Planning Checklist

-Executor Duties Checklist

-Business Owners Planning Guide

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Our Mission

1. Transform Canadian Philanthropy by inspiring advisors, charities, and donors to incorporate Strategic Philanthropy and Life Insurance into thier estate planning.
2. A Canada in which people not only understand what insurance is, but also what it actually does.
3. Create a national community of 100 allied professionals and charities committed to raising $1 Billion of new charity annually.

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