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IS YOUR PLANNING
ABOVE OR BELOW
THE HORIZON?

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Real Case! Real Solutions!

A case study with clients who sold their business.

Amir Pourzakikhani, BCom, MTax

Wealth & Tax Planning Consultant

Emilio DeLuca, FMA, CFP, CLU, CHS

Advanced Case Consultant

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Considerations

- The information provided is based on current tax legislation and interpretations for Canadian residents and is accurate to the best of our knowledge as of the date of publication. Future changes to tax legislation and interpretations may affect this information. This information is general in nature and is not intended to be legal or tax advice. For specific situations, you should consult the appropriate legal, accounting or tax advisor.
- This information is provided by Canada Life and is current as of January 2021.
- Examples are for illustrative purposes only. Situations will vary according to specific circumstances.
- This presentation contains values taken from one or more corresponding illustrations that accompany it. To fully understand how some of the values shown in this presentation may vary, it is necessary to read the presentation together with the illustration(s). This presentation is incomplete without the corresponding illustration(s).
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Outline

- Jeff and Kim
- Life insurance
- Life insurance and post-mortem planning

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Jeff and Kim

Facts and estate planning goals

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Meet Jeff and Kim

- Jeff and Kim are both 62
- They recently sold their business, prior to which they each owned 50% of the:
  - Preference "freeze" shares of a holding company (“CanHoldco”) with an aggregate redemption value of $10,000,000
  - Common shares of another holding company ("USHoldco")
- CanHoldco and USHoldco each own:
  - An operating company (CanOpco / USOpco)
  - Cash and marketable investments
- A family trust owns all the common shares of CanHoldco
- Jeff and Kim have a daughter, Kelsey, who's gainfully employed, married and has a 6 year old son, Steven
- Jeff and Kim have significant cash and personal investment assets resulting from the sale and significant registered assets from years of routine RRSP contributions

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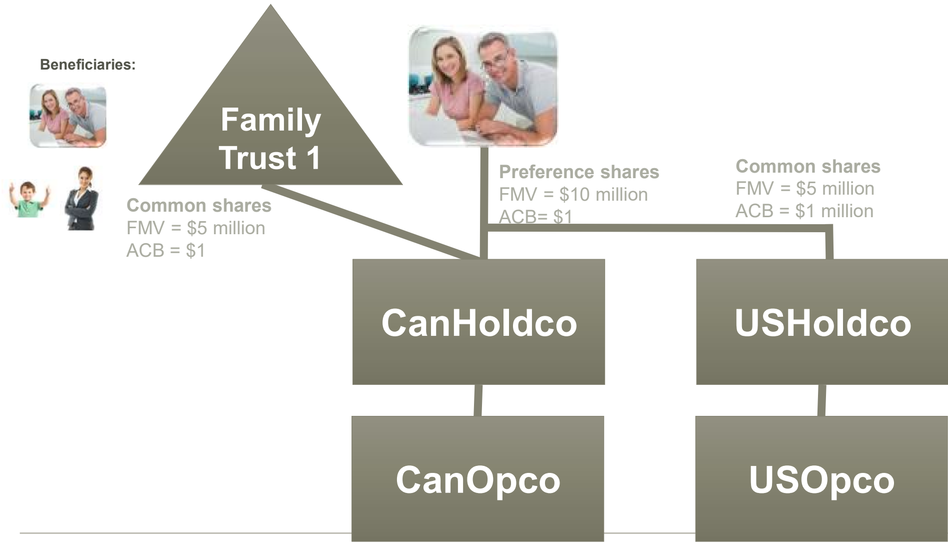
Pre-sale corporate structure



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Pre-sale planning

- Jeff and Kim now own Investco
- Investco's assets are derived from the proceeds of the recent sale of its subsidiaries' retail medical equipment business that operated in Canada and the US
- To form Investco:
  - USHoldco sold USOpco
    - Holds cash as after-tax sale proceeds ($4M)
  - CanHoldco purified its passive assets using a Newco ($6M)
  - CanHoldco is sold
  - Newco and USHoldco amalgamate to form Investco
  - The common shares of Investco are frozen in favour of a trust (#2)
- As a result of the sale, the family trust (#1), themselves personally and Investco collectively own significant amounts of cash and investments

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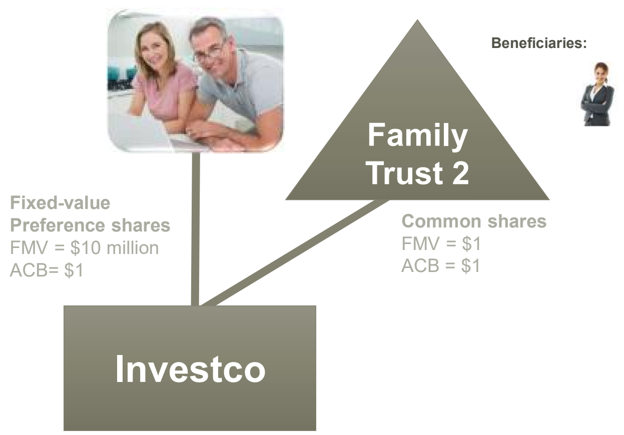
Post-sale (current) structure



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Estate plan and goals

- Kim and Jeff are interested in preserving and growing their estate without taking significant risks
- They live within their means but are still concerned about outliving their assets now that they no longer own a business
- They would like to leave a legacy for their daughter and grandkid(s)

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Estate plan and goals

- Jeff and Kim's estate plan is to the transfer his/her assets to the survivor upon death (no spousal trust)
- Upon the death of the survivor of Jeff and Kim, each Will states that Investco will be wound-up and their estate will be divided so that of the assets
  - 60% will be used to settle a testamentary trust for Kelsey
  - 40% will be used to settle a testamentary trust for grandkids

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The insurance discussion

Why life insurance? Selecting the right product. Other opportunities for insurance?

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Life insurance

There are two angles to an insurance discussion: needs and opportunities

Needs: insurance provides liquidity and financial protection

Opportunities: insurance acts as a tax-advantaged financial product that may enhance the life insured's estate

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Insurance needs

- Future financial security for family
- Income replacement
- Estate protection
- Final expenses
- Taxes on death
- Other taxes (registered, US)
- Probate fees
- Retiring personal debt

- Estate equalization
- Matrimonial obligations
- Retiring commercial debt
- Funding buyout arrangements
- Key person

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Insurance opportunities

Potentially grow and enhance your client's estate using life insurance

1. Unique asset class
2. Tax-advantaged growth
3. Capital dividend account

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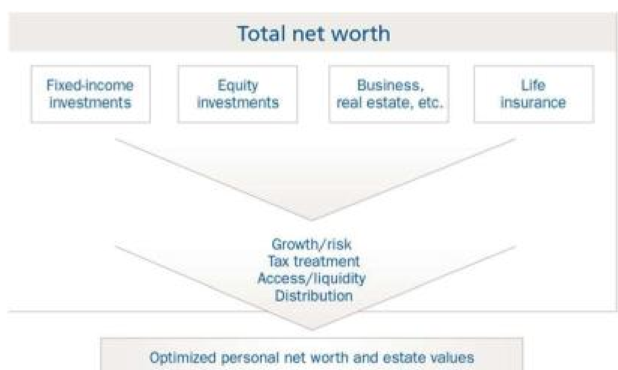
Life insurance is part of a strategically diversified portfolio

- Investors with cash face equity markets at all-time highs
- Part of the popularity of equities is described in the media by using the acronym "TINA" – There is no Alternative:
  - Low or negative bond yields
  - Low interest rates on cash savings
- There's an alternative with life insurance



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Tax-advantaged growth

- Cash values within a life insurance policy grow tax-advantaged, whereas income from corporate investments is taxed at the highest corporate rate
  - See table
  - Growth in policy values won't affect the corporation's small business deduction (SBD)
- Intra-policy transactions typically don't produce taxable outcomes, for example where a policy dividend purchases a paid-up addition
- The death benefit is received tax-free

Type of passive income	Tax Rate	Addition to RDTOH
Interest	50.17%	30.67%
Foreign portfolio dividends	50.17%	30.67%
Canadian portfolio dividends	38.33%	38.33%
Capital gains	25.09%	15.33%

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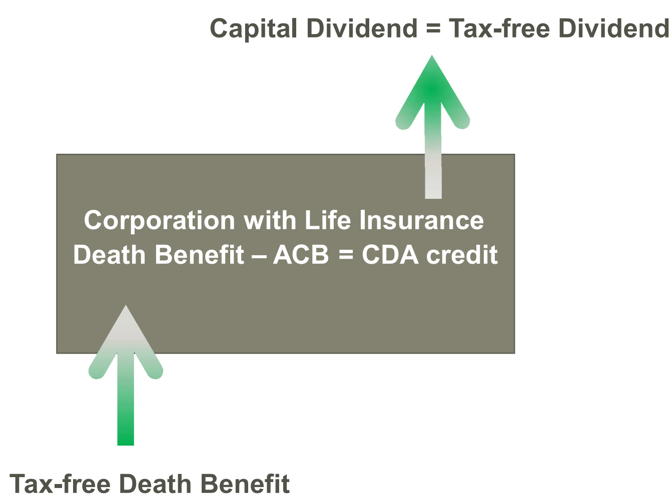
Capital Dividends from Life Insurance



Intended for conceptual purposes only.

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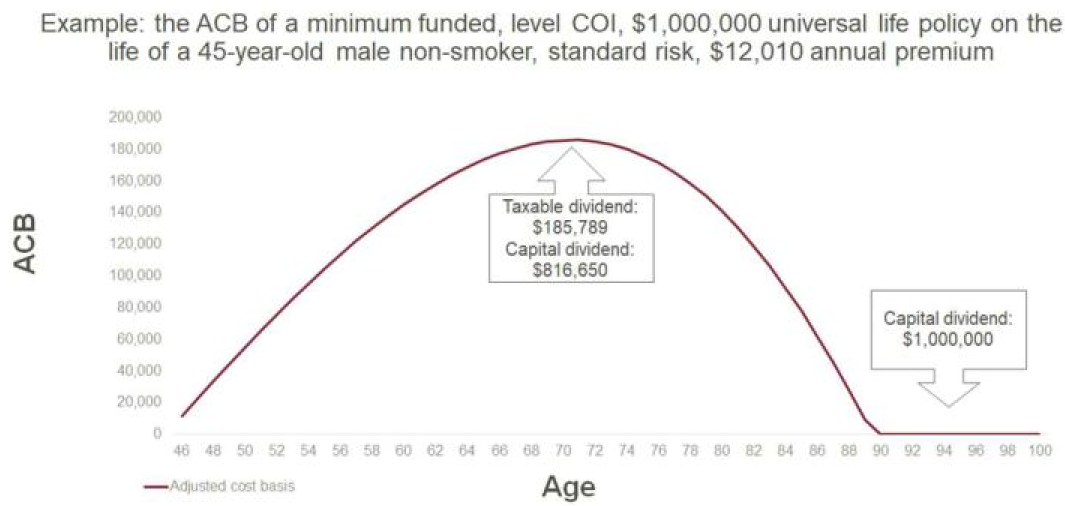
Capital dividend account



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Insurance planning

We know that without getting into the details of their post-mortem plan that:

- As a result of owning $10M of preference shares that they will have a tax bill on death of approximately $2.5M, and possibly more given their registered assets
- They could use life insurance to tax-efficiently grow their corporate wealth and transfer corporate wealth to their heir(s)
- They have sufficient personal and corporate assets such that a ***$200,000 annual premium*** paid corporately for 20 years purchases sufficient insurance amounts to cover their needs and makes sense within their personal and corporate portfolios, given their investment assumptions

Sources of growth within Investco's portfolio			
Asset	**% of portfolio**	**Annual growth rate**	**Corporate tax rate**
Fixed-income	50%	2%	50.17%
Dividend income	25%	4%	38.33%
Realized capital gains	25%	5%	25.09%
Total	100%	3.25%	

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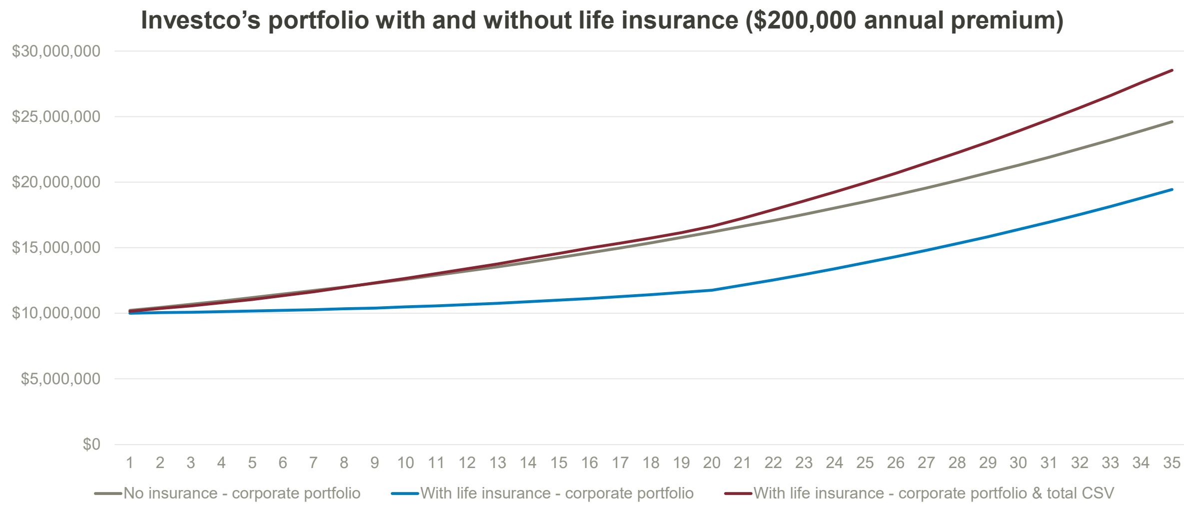
Asset values inside Investco



Based on Wealth Achiever Plus Max 20 PUA, JLTD.

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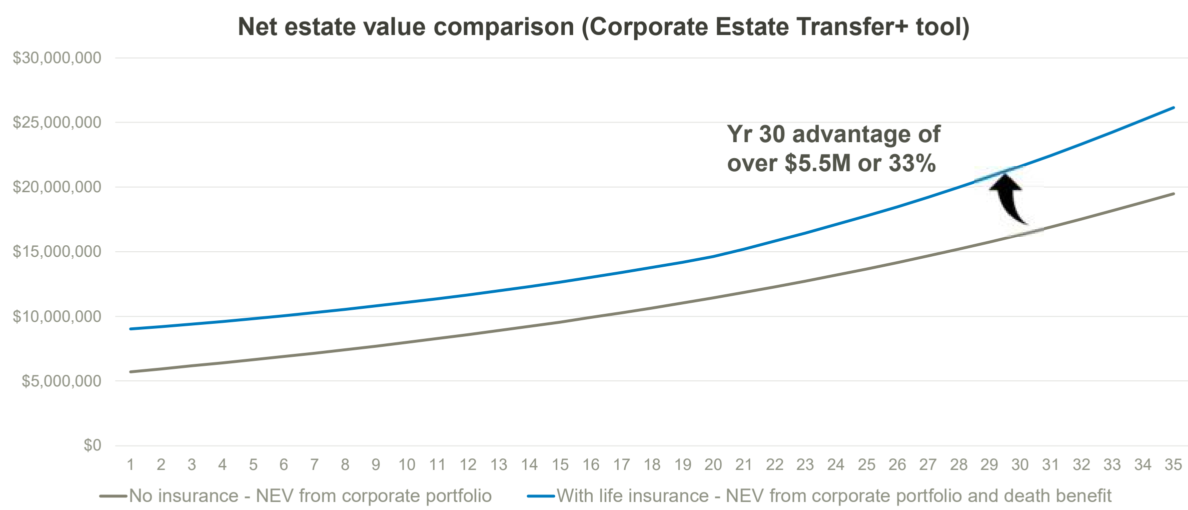
Net estate value comparison (Investco only)



Based on Wealth Achiever Plus Max 20 PUA, JLTD.

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Product selection

You show Jeff and Kim three options

	Wealth Achiever Plus Max 20 – JLTD	Estate Achiever Plus Max 20 – JLTD	UL 20 Pay COI JLTD
Total annual premium ($)	200,000	200,000	200,000
ADO / overfunding* ($)	50,000	50,000	0
Basic coverage ($)	3,368,514	4,046,397	7,805,655
Total premiums x 20 years ($)	4,000,000	4,000,000	4,000,000
Earliest possible offset year, 2020 div scale	11 (13 at current -1%)	12 (13 at current -1%)	n/a

* Minimum UL premium paid annually with & DIA at 0.0%

Performance data is provided for illustrative purposes only and represents past performance, which is not necessarily indicative of future performance.

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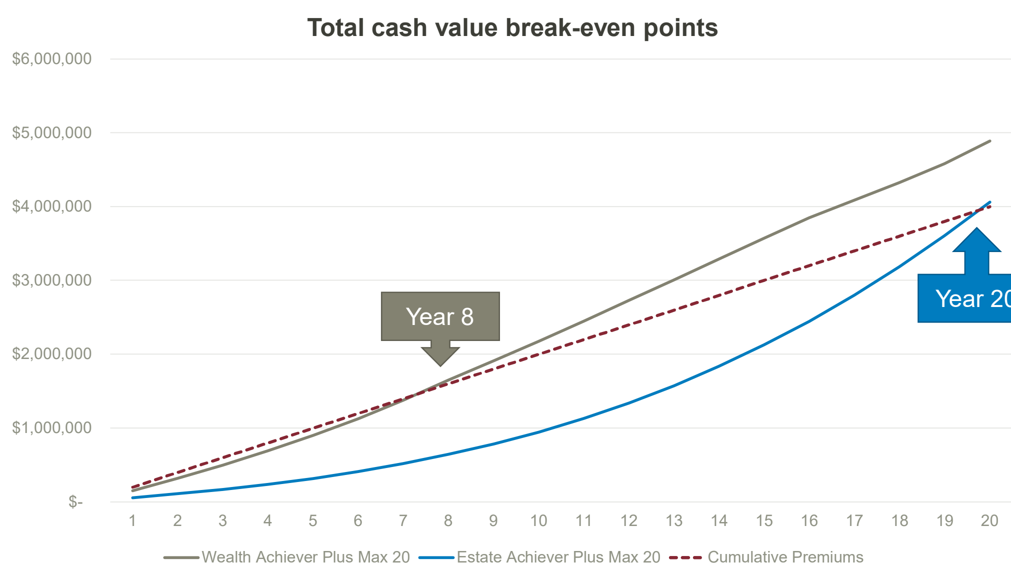
Compare par insurance plans



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Compare insurance plans

Jeff and Kim
62 male non-smoker
62 female non-smoker

	1		2		3	
	Wealth Achiever Plus Max 20		Estate Achiever Plus Max 20		Limited 20 Pay UL	
	5.10% DSIR Canada Life		5.10% DSIR Canada Life		5.10% DSIR Canada Life	
Notes:						
ADO/overfunding	50,000		50,000		62,286	
Total annual premium	200,000		200,000		200,000	
# of premium payments illustrated	20		20		20	
Total cumulative premium payments	3,999,999		3,999,999		4,000,000	
Cash values						
Year 1	152,204		54,845		0	
Year 2	318,233		109,120		0	
Year 3	495,302		167,177		0	
Year 4	689,841		238,123		0	
Year 5	898,618		315,133		288,341	
		IRR		IRR		IRR
Year 5						
Total death benefit	4,190,302	52.30 %	4,713,971	57.09 %	7,805,655	78.61 %
Total cash value	898,618	-3.54 %	315,133	-36.21 %	288,341	-38.80 %
Cumulative premium	1,000,000		1,000,000		1,000,000	
Year 10						
Total death benefit	5,147,142	16.69 %	5,520,161	17.90 %	7,805,656	23.91 %
Total cash value	2,174,740	1.52 %	945,485	-14.24 %	759,101	-18.72 %
Cumulative premium	1,999,999		1,999,999		2,000,000	
Year 30						
Total death benefit	9,389,323	4.11 %	10,411,394	4.61 %	7,805,657	3.23 %
Total cash value	7,520,126	3.05 %	8,347,985	3.55 %	4,060,192	0.07 %
Cumulative premium	3,999,999		3,999,999		4,000,000	

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Compare insurance plans

Jeff and Kim
62 male non-smoker
62 female non-smoker

	1		2		3	
	Wealth Achiever Plus Max 20		Estate Achiever Plus Max 20		Limited 20 Pay UL	
	5.10% DSIR Canada Life		5.10% DSIR Canada Life		5.10% DSIR Canada Life	
Notes:						
ADO/overfunding	50,000		50,000		62,286	
Total annual premium	200,000		200,000		200,000	
# of premium payments illustrated	20		20		20	
Total cumulative premium payments	3,999,999		3,999,999		4,000,000	
Cash values						
Year 1	152,204		54,845		0	
Year 2	318,233		109,120		0	
Year 3	495,302		167,177		0	
Year 4	689,841		238,123		0	
Year 5	898,618		315,133		288,341	
		Equivalent ROR		Equivalent ROR		Equivalent ROR
Year 5						
After-tax net to estate	3,763,278	111.20 %	4,289,091	121.11 %	7,398,056	165.57 %
Total cash value	898,618		315,133		288,341	
Cumulative premium	1,000,000		1,000,000		1,000,000	
Year 10						
After-tax net to estate	4,312,173	35.89 %	4,691,075	38.42 %	7,027,945	50.93 %
Total cash value	2,174,740		945,485		759,101	
Cumulative premium	1,999,999		1,999,999		2,000,000	
Year 30						
After-tax net to estate	8,301,393	9.48 %	9,386,161	10.49 %	6,895,009	7.98 %
Total cash value	7,520,126		8,347,985		4,060,192	
Cumulative premium	3,999,999		3,999,999		4,000,000	

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Compare insurance plans

Jeff and Kim

62 male non-smoker
62 female non-smoker

	1		2		3	
	Wealth Achiever Plus Max 20		Estate Achiever Plus Max 20		Limited 20 Pay UL	
	Reduced		Reduced		0.00%	
	Canada Life		Canada Life		Canada Life	
Notes:						
ADO/overfunding	50,000		50,000		62,286	
Total annual premium	200,000		200,000		200,000	
# of premium payments illustrated	20		20		20	
Total cumulative premium payments	3,999,999		3,999,999		4,000,000	
Cash values						
Year 1	151,747		54,388		0	
Year 2	316,730		107,687		0	
Year 3	491,812		163,685		0	
Year 4	682,457		230,582		0	
Year 5	885,253		301,348		288,341	
		Equivalent ROR		**Equivalent ROR**		**Equivalent ROR**
Year 5						
After-tax net to estate	3,732,988	110.60 %	4,257,852	120.55 %	7,398,056	165.57 %
Total cash value	885,253		301,348		288,341	
Cumulative premium	1,000,000		1,000,000		1,000,000	
Year 10						
After-tax net to estate	4,155,007	34.78 %	4,525,443	37.34 %	7,027,945	50.93 %
Total cash value	2,094,476		860,896		759,101	
Cumulative premium	1,999,999		1,999,999		2,000,000	
Year 30						
After-tax net to estate	6,549,806	7.58 %	7,436,441	8.59 %	6,895,009	7.98 %
Total cash value	6,197,898		6,875,691		4,060,192	
Cumulative premium	3,999,999		3,999,999		4,000,000	

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Value Discussion?

$7,805,655 Face Amount, Annual Premium, MNS62 & FNS62, JLTD

Rank	Company	Policy	Premium
1	Canada Life	Universal Life [SumIns+Fund, 20 Pay]	200,000.00
2	Sun Life	SunUniversalLife II [SI+Fund, 20-Pay]	215,054.00
3	IA Financial	Genesis 9 (Std) [SI+Fund, 20-Pay, NB]	222,284.84
4	Manulife	Manulife UL Leve CIS (HS3) [20-Pay]	280,038.12

Source: *LifeGuide® Version 2021.02, February 16, 2021*

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Post-mortem planning and life insurance

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Abbreviations

FMV	Fair market value
ACB	Adjusted Cost Basis
PUC	Paid up Capital
POD	Proceeds of Disposition
CG	Capital Gain
DB	Death Benefit
CDA	Capital Dividend account
CL	Capital Loss

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Assumed tax rates

Regular Income	50%
Taxable Capital Gains	25%
Eligible Dividends	35%
Non-Eligible Dividends	44%

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Some concepts to understand (1/2)

1. Capital Dividend Account (CDA), discussed above

2. Deemed disposition at death
   - taxpayer's capital property is deemed disposed of, for its FMV, immediately before death
   - deemed sale triggers realization of any accrued CG
   - estate or any person who acquired the property as a result of taxpayer's death, is deemed to do so at the FMV at time of death
   - private company shares are one type of capital property

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Some concepts to understand (2/2)

3. Redemption of shares
   - Company buys back shares from shareholders
   - For tax purposes, two things happen:
     1. Deemed dividend
        - Equal to redemption proceeds less PUC
        - Dividend may be taxable or capital (tax free) dividend
     2. Share disposition
        - Could give rise to CL/CG
        - Equal to proceeds less ACB
          - Proceeds must be adjusted downward by the amount of deemed dividend

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Post-mortem planning – why do we care?

Three incidences of tax may arise when a deceased individual owns shares of a private corporation on death:

1. On deemed disposition at death
   - to the deceased shareholder
2. On disposition/deemed disposition of underlying corporate assets
   - to the corporation
3. On distribution of corporate assets to estate/beneficiaries
   - to the estate/beneficiaries

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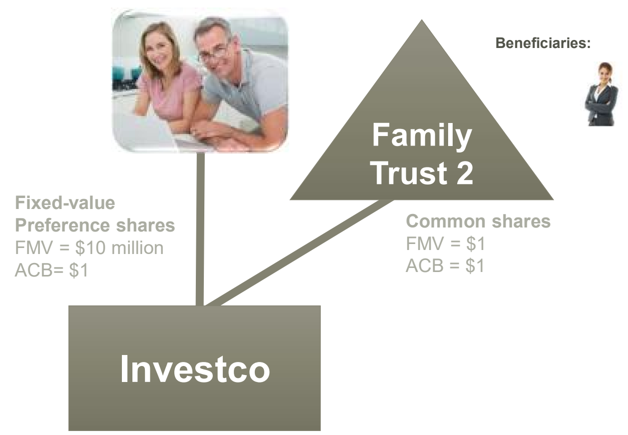
Current structure – Jeff and Kim



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30 Years later....

- Kim predeceases Jeff
  - Kim's assets (including fixed-value preference shares) transfer tax-free to Jeff under spousal rollover rules
- Jeff passes away at age 92
- Estate plan requires that Investco redeem fixed-value preference shares at death:
  - provides cash for tax liabilities
  - provides cash to make distributions from the estate
  - shares are not grandfathered
- For purposes of the following tax calculations, it is assumed that the ACB of the fixed-value preference shares is nil for simplicity
- Let's first look at tax results without life insurance

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Double tax … how?

Incidence of tax #1 - On Jeff's death

Deemed POD	$10,000,000
Less: ACB	$ 0
CG	$10,000,000
Tax @ 25%	$ 2,500,000

Estate receives shares with:

FMV = $10,000,000
ACB = $10,000,000

Incidence of tax #2 - Distribution to Estate

1. Deemed Dividend:	
Redemption proceeds	$10,000,000
Less: PUC	$ 0
Deemed Dividend	$10,000,000
Classified as Taxable Dividend	$10,000,000
Tax @ 44%	$ 4,400,000
2. Capital Loss:	
Total distributed	$10,000,000
Less: Deemed Dividend	$10,000,000
Adjusted POD	$ 0
Less: ACB	$10,000,000
CL (can't use CL to offset dividend)	$10,000,000

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Double tax … how?

Total Tax Burden:

On Jeff's Death	$2,500,000
+ On Distribution to Estate	$4,400,000
= Total Tax (69%)	$6,900,000

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Post-mortem planning

Two post-mortem transactions designed to address double taxation:

1. 164(6) Election planning

2. Pipeline planning

Post-mortem planning

164(6) Election Planning

- Use CL in estate to offset CG on death
- Goal is to eliminate or reduce personal CG tax on deemed disposition of shares at death

Pipeline Planning

- Create mechanism to extract corporate funds on a tax-free basis
- Goal is to ensure that tax is paid only once at CG rates on the death of the individual

164(6) Election planning

Incidence of tax #1 - On Jeff's death	
Deemed POD	$10,000,000
Less: ACB	$ 0
CG	$10,000,000
Less: Estate CL	$10,000,000
Net CG	$ 0
Tax @ 25%	$ 0

Estate receives shares with:

FMV = $10,000,000
ACB = $10,000,000

Incidence of tax #2 – Redemption & Distribution to Estate	
1. Deemed Dividend:	
Redemption proceeds	$10,000,000
Less: PUC	$ 0
Deemed Dividend	$10,000,000
Classified as Taxable Dividend	$10,000,000
Tax @ 44%	$ 4,400,000
2. Capital Loss:	
Total distributed	$10,000,000
Less: Deemed Dividend	$10,000,000
Adjusted POD	$ 0
Less: ACB	$10,000,000
CL (carry-back to Jeff's CG)	$10,000,000

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164(6) Election planning

Total Tax Burden:

On Jeff's Death ~~$2,50[illegible]000~~

\+ On Distribution to Estate $4,400,000

= Total Tax (44%) $4,400,000

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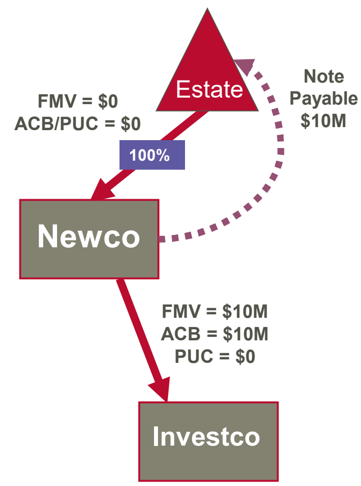
Pipeline planning

- Allows estate to extract assets from Investco without additional tax … How?
- Converts high ACB of shares into a promissory note
- In future estate extract assets equal to note instead of taxable dividend
- Note repaid tax-free over time



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Pipeline planning

Total Tax Burden:

On Jeff's Death $2,500,000

\+ On Distribution to Estate ~~$4,40 000~~

= Total Tax (25%) $2,500,000

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Pipeline planning - considerations

- Practitioners are using pipeline planning because of favourable tax rate on capital gains
- Canada Revenue Agency ("CRA") has been reviewing
- CRA past ruling requests have been favourable
  - Maintain business activity/investment strategy
  - Amalgamation/wind-up at least one year after shares transferred to Newco
  - Repayment of the note no earlier than one year after issuance
    - Repayment spread over several months
    - Exception – CRA has ruled to permit immediate receipt of cash to fund taxes
  - Company may be wound up thereafter

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Let's add life insurance

- Investco owns Wealth Achiever Plus Max 20 JLTD policy
- On Jeff's death life insurance proceeds of $9,389,323 are received by Investco
- Life insurance proceeds plus corporate funds are used to redeem preference shares

Recall … DB less ACB is credited to CDA

- Therefore, CDA credit on Jeff's death is $6,916,753

CDA may help improve tax outcome … How?

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164(6) Election planning – full CDA

Incidence of tax #1 - On Jeff's death

Deemed POD	$10,000,000
Less: ACB	$ 0
CG	$10,000,000
Less: Estate CL	$ 8,083,247
Net CG	$ 1,916,753
Tax @ 25%	$ 479,188

Estate receives shares with:

FMV = $10,000,000
ACB = $10,000,000

Incidence of tax #2 – Redemption & Distribution to Estate

1. Deemed Dividend:	
Redemption proceeds	$10,000,000
Less: PUC	$ 0
Deemed Dividend	$10,000,000
Classified as Taxable Dividend	$ 3,083,247
Classified as Capital Dividend	$ 6,916,753
Tax – Taxable Dividend @ 44%	$ 1,356,629
2. Capital Loss:	
Total distributed	$10,000,000
Less: Deemed Dividend	$10,000,000
Adjusted POD	$ 0
Less: ACB	$10,000,000
CL before stop loss	$10,000,000
Less: CL reduction - stop loss	$ 1,916,753
CL (carry-back to Jeff's CG)	$ 8,083,247

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164(6) Election planning – 50% solution

Incidence of tax #1 - On Jeff's death

Deemed POD	$10,000,000
Less: ACB	$ 0
CG	$10,000,000
Less: Estate CL	$10,000,000
Net CG	$ 0
Tax @ 25%	$ 0

Estate receives shares with:

FMV = $10,000,000
ACB = $10,000,000

Incidence of tax #2 – Redemption & Distribution to Estate

1. Deemed Dividend:	
Redemption proceeds	$10,000,000
Less: PUC	$ 0
Deemed Dividend	$10,000,000
Classified as Taxable Dividend	$ 5,000,000
Classified as Capital Dividend	$ 5,000,000
Tax – Taxable Dividend @ 44%	$ 2,200,000
CDA remaining	$ 1,916,753
2. Capital Loss:	
Total distributed	$10,000,000
Less: Deemed Dividend	$10,000,000
Adjusted POD	$ 0
Less: ACB	$10,000,000
CL (carry-back to Jeff's CG)	$10,000,000

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164(6) Post-mortem planning with CDA

	No Insurance	Full CDA	50% Solution
FMV of preferred shares	$ 10,000,000	$ 10,000,000	$ 10,000,000
Less: tax on capital gain	$ -	$ (479,188)	$ -
Less: dividend tax on redemption	$ (4,400,000)	$ (1,356,629)	$ (2,200,000)
Net funds to estate	$ 5,600,000	$ 8,164,183	$ 7,800,000
Effective tax rate	44.00%	18.36%	22.00%
CDA Remaining	$ -	$ -	$ 1,916,753
Value of CDA (44%)	$ -	$ -	$ 843,371

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Pipeline and life insurance

In our case study ….

- Pipeline planning with life insurance does not change overall tax result
  - Pipeline without life insurance = CG tax of 25%
  - Pipeline with life insurance (CDA) = CG tax of 25%
- What does life insurance do for us then?
  - Provides liquidity that can be used to repay promissory note (i.e., created with pipeline strategy)
  - Creates CDA available for use by children in the future
    - $6,916,753 CDA credit on Jeff's death

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Pipeline planning … some final thoughts

- Recall goal is to limit the tax on death to the personal tax arising from deemed disposition of shares on death
- Corporate-owned life insurance can be used in conjunction with pipeline planning
- Can sometimes be used in conjunction with 164(6) election planning – “hybrid” approach
- What does future of pipeline planning look like if CG inclusion rate increases?

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Conclusion

- Clients like Jeff and Kim can use life insurance for both financial protection and as a means of growing their wealth and enhancing their estate
- Corporate-owned life insurance is a unique financial product with specific tax treatment:
  - Tax-advantaged policy growth
  - CDA credit
- There’s lots of planning involved when corporate-owned life insurance is used in estate planning
- We have the resources to help!

canada life

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Haunn Landers & Co.
Experience. Trusted advisors to accomplished entrepreneurs.

Thanks for your time!

Feel free to contact us with any questions.

905-821-8224
service@haunnlanders.ca

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