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the abacus

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Preserve your wealth, create a charitable legacy

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 families with significant money. With proper planning, it's a tremendous opportunity to support wealth-building and manage risks that include over-taxation and future taxation increases.

Two basic types of life insurance

Term insurance	Permanent insurance
Covers you for a specific number of years	Includes universal life insurance and participating whole life insurance
At the end of the term, the policy has no value	Provides a lifetime of protection *plus* and investment component
	An asset with enduring value.

Federal budget and capital gains

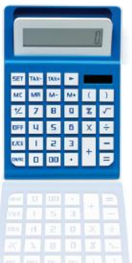
Some of the best news contained in the April 2022 federal budget and the November 2022 Economic Statement was what they did *not* mention. There was no increase in the capital gains exclusion rate of 50%, which keeps 50% capital gains tax-free. There was no introduction of a wealth tax, an inheritance tax or a principal residence tax (other than ensuring that sales within one year cannot normally claim principal-residence, which was already the case in more reported Court cases). 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.

One federal budget change removes a tax-planning opportunity for substantive Canadian-controlled private corporations (CCPCs). People were doing some planning involving entities established in other countries that allowed investment income to be taxed in their corporations at about 26% instead of about 50% (the exact rate varies by province). Basically, they got the general rate of tax rather than the investment income tax rate in a corporation. That was creating some deferral advantages. With the budget, this type of planning was shut down.

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.

SEE PRESERVE WEALTH P. 2

Here are three ways that affluent families can use tax-exempt permanent life insurance to preserve wealth, grow assets tax-exempt, and create enduring legacies – often by converting taxes into charitable giving.



1 Fund taxes due on death

WITHOUT ADVANCE planning, assets may be taxed on a deceased person's terminal return at a rate anywhere from 27-70%. The estate must pay that bill from cash on hand (which many 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 by selling 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 that is paid promptly and 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.

2 Avoid double or triple taxation

WHAT WE CALL "post-mortem planning" focuses on eliminating double or triple taxation that can be triggered when a shareholder in a private corporation dies. On death, there could be **capital gains tax** resulting from the deemed disposition of shares. There can be also **corporate tax** on the capital gains from selling the corporation's assets, and a **dividend tax** when the money is extracted from 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:

Redemption-loss carry-back	Pipeline
Eliminates the capital gains tax and must be completed within one taxation year of the shareholder's death	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 or capital dividend account balances. And often you do a pipeline when you're in a more favourable capital gains environment, like today.

Both strategies can use life insurance strategically to create a lower effective tax rate.

3 Accomplish strategic philanthropy

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% 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 a deceased person's terminal tax return. At that point, charitable donations can offset up to 100% of the taxes due for the year of death *and* for the preceding year.

So, if you're anticipating an income tax hit of $1 million in each of those two years on your death, you could create a tax-efficient $2 million life insurance gift. Instead of paying a lot of money to the CRA, you can provide a large donation to support the causes you believe in.

And consider using an IFA to achieve your philanthropic goals. For those who qualify, it's akin to having your cake and eating it too, which means you can do better 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.

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Partnership information returns

A partnership is not a taxpayer, and is not required to file a regular income tax return. Instead, the partners report their shares of the income or loss of the partnership on their income tax returns. However, in some cases the partnership must file an *information* return.

THE INCOME TAX REGULATIONS require a Canadian partnership (all partners resident in Canada) for a fiscal period, or a partnership that carries on business in Canada in a fiscal period, to file the prescribed information return for that fiscal period.

Fortunately, the Canada Revenue Agency (CRA) provides some **exemptions** from the filing requirement:

- Filing is **not required** by a farm partnership made up of only individual (non-corporate) partners. (This rule technically applies only to 2020 and earlier tax years, but the CRA has extended the rule by announcement every year and is expected to announce early in 2022 that the same rule applies to the 2021 tax year.)
- Filing is **not required** if all partners are Status Indians, and the partnership earns all its income at a permanent establishment on a reserve.

More generally, for other partnerships, filing is only **required** for a fiscal period where: at the end of the fiscal period, the partnership has an "absolute value" of revenues *plus* expenses of more than $2 million—**or**—has more than $5 million in assets, or if at any time during the fiscal period:

- the partnership is a tiered partnership (has another partnership as a partner or is itself a partner in another partnership); OR
- the partnership has a corporation or a trust as a partner; OR
- the partnership invested in flow-through shares of a principal-business corporation that incurred Canadian resource expenses and renounced those expenses to the partnership; OR
- the CRA requests in writing that the return is required.

Basically, this means that a partnership with only individual partners that does not exceed the absolute values described above does **not** have to file the information return (subject to the CRA requesting the return).

SEE **PARTNERSHIP INFO** P. 4

In terms of the absolute value requirement, the CRA notes:

"The **absolute value** of a number refers to the numerical value of the number without regard to its positive or negative sign. To determine if a partnership exceeds the $2 million threshold, add total worldwide expenses to total worldwide revenues rather than subtract expenses from revenues as you would to determine net income.

The **cost figure** of all assets worldwide, both tangible and intangible, without taking into account the depreciated amount should be used to determine whether a partnership meets the criterion of more than $5 million in assets."

It is therefore important to remember that the absolute value calculation means **adding** the revenues and the losses for the fiscal period – **not** taking the revenues net of the expenses. For example, if a partnership has $1.2 million in revenues and $900,000 in expenses, then absolute value is $2.1 million and the partnership will be required to file the return.

Partnership information required

If the partnership is required to file the return for a fiscal period, the reported information includes:

- ☐ The income or loss of the partnership for the fiscal period
- ☐ Each partner's name, address, business number, social insurance number or trust account number, as the case may be
- ☐ Each partner's share of the income or loss of the partnership for the fiscal period
- ☐ Each partner's share of a deduction, credit or other amount in respect of the partnership that is relevant in determining the partner's income, taxable income, tax payable or other amount under the Income Tax Act
- ☐ Certain prescribed information if the partnership has made an expenditure in respect of scientific research and experimental development in the fiscal period.

Who needs to file the partnership information return

Although each partner is responsible for the filing, **any one partner can file** the return on behalf of all the partners. As the CRA notes, "Once a partner files a return, we consider all partners to have filed it."

When to file your partnership information return

Partnership	When return is due
All partners are corporations	Within five months after the end of the fiscal period
All partners are individuals *(includes trusts)*	By March 31 of the calendar year following the calendar year in which the fiscal period ends
Any other case *(e.g., some partners are individuals, and some are corporations)*	By the earlier of five months after the end of the fiscal period and March 31 of the calendar year following the calendar year in which the fiscal period ends

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List partners
(optional)

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