Tax Planning in the Era of Trudeau II

Canadian Institute of Financial Planners

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  - Osgoode Hall Law School. Master of Laws, Taxation
  - Ontario Bar 1996
  - Queen’s University Faculty of Law, Bachelor of Laws
  - University of Toronto. Master of Arts, History
  - Trinity College (U of T), Bachelor of Arts.

- Professional Experience
  - National Sales Director. GBL. 2002-2014. Over 2000 IPPs implemented and 500 RCAs.
  - Financial Consultant. CIBC Wood Gundy. 1996-2002

- Publications and Media:
  - BNN, CALU Report, InfoExchange, Morningstar, Investment Executive, Financial Independence Hub, Financial Planning Magazine, Financial Post, The Bottom Line, T.A.S.K, Essential IPP Guide, etc.

Agenda

- Part I The Tax Policy Environment
- Part II Corporate Planning Issues and Strategies
- Part III Enhanced Retirement Planning

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Pillars of Tax Planning Approach

- To defer and, where possible, reduce taxation
- To ensure all planning hews to the risk parameters of each client
- To assure complete due diligence and strategic understanding
- To marshal top talent in the strategy and planning process
- To work with existing advisory group
- Ideological devotion to tax planning

PART I

THE TAX POLICY ENVIRONMENT

First, a little sanity.

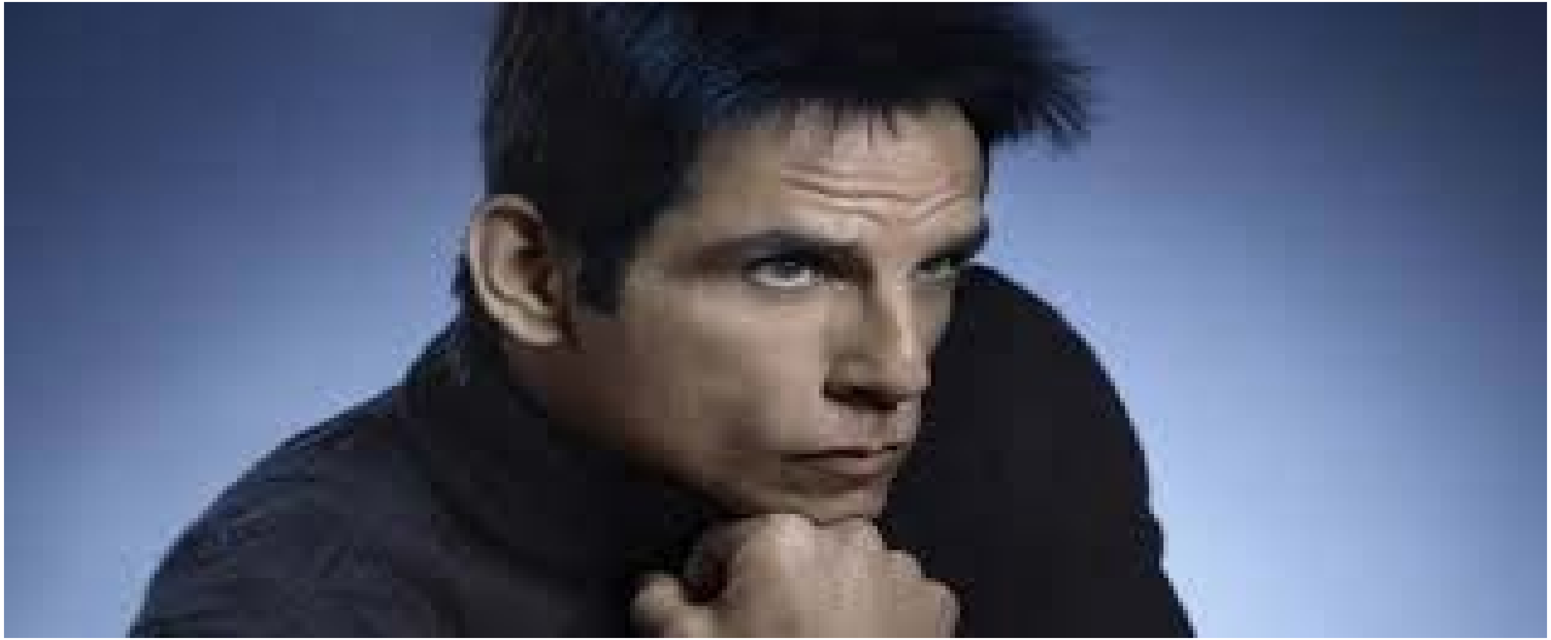
- "I contend that for a nation to try tax itself into prosperity is like a man standing in a bucket trying to lift himself up by the handle." Sir Winston Churchill.

A new tax era?

Several studies have shown that more than half of small business owners are “high net worth individuals who incorporate . . . to avoid paying as high taxes as they otherwise would”

—Campaign 2016

Doppelganger?



The Policy Landscape

- Corporate tax policy of the Mulroney, Chretien, Martin and Harper governments: promote economic growth through reduced corporate taxation. SBD and GRIP rates
  - Significant advantage to defer taxation inside a corporation and pay it out later
- New high taxes on passive income and investment income challenge that
  - Targeting of deferral-based investment products
- Section 55(2) creates further headaches when trying to structure inter-corporate dividends
  - Elimination of the “related party” exemption means you must focus on safe income calculations.
- New reality: a return to the Liberal Party of the 1970’s
  - PM is of and advised by left-wing policy advocates

The CANADIAN income tax system

- Carter Commission (1966) introduces & underpins the modern income tax system
- Creates the concept of integration as a central pillar:
  - The concept of integration is that the taxpayer should not be advantaged by the nature of their remuneration, i.e. dividends or income
  - Gross-up and Dividend Tax Credit system created to assure that the net tax paid on income or dividends is the same
  - Martin government, followed by Harper government, to stop the mass conversion to Income Trusts introduces the Eligible and Non-Eligible dividend regime. Important to know SBD and GRIP taxation
  - Theory and practice often diverge. Until recently there was an advantage for the Owner/Manager to take dividends instead of income.

Integration with Teeth (Data provided by MNP)

Province	GRIP Rate	Flow Through Rate	Top Personal Rate	Tax Deferral	Savings/(Cost)
BC	26.00%	49.16%	47.70%	21.70%	(1.46%)
Alberta	27.00%	50.15%	48%	21%	(2.15%)
Sask.	27.00%	49.14%	48.00%	21%	(1.14%)
Manitoba	27.00%	54.58%	50.40%	23.40%	(4.18%)
Ontario	26.50%	55.42%	53.53%	27.03%	(1.89%)
Quebec	26.90%	56.02%	53.31%	26.41%	(2.71%)
Nova Scotia	31.00%	59.69%	54.00%	23.00%	(5.69%)

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Tax Measures: Budget 2016

- Termination of “switch” funds (Corporate Class)
- Reduction in TFSA contribution limits
- End of s. 148(7) transfers
- Goodwill sales (hybrids) gone at end of 2016
- Increased taxation of Personal Services Businesses
- End of CDA manipulation

Tax law and insurance

Bill C-43 replaces the rules on Exempt Life Insurance:

- Takes into account longer life expectancy
- Some changes to the ability to shelter CV, particularly in later years of the policy
- Primary effect is on corporate-owned life insurance.
- Capital Dividend Account = the Death Benefit – Adjusted Cost Base (ACB)
- ACB is a complex calculation that utilizes the Net Cost of Pure Insurance (NCPI)
- New rules dramatically reduce NCPI
- ACB grind-down in a corporate setting will take significantly longer to get to Zero (may never get to Zero in certain instances)
- **Corporate-owned insurance STILL makes overwhelming sense**
- UL still works! Not as attractive but where flexibility is required it should be on the table.

Federal budget 2016: insurance issues

- CDA will now be tracked across the corporate group. This will end the strategy of magnifying the CDA credit through split ownership
  - Holdco would own and OPCO would be the beneficiary, thus CDA unimpaired to OPCO.
  - No surprises in its termination. CALU had advised of this for a couple of years in advance

- Fair Market Value transfers are also curtailed.
  - Pre-Budget transfers would allow policies to be transferred and the amount that the FMV exceeds CSV ("the benefit amount") would be paid out tax free
  - In the case of term insurance the entire FMV would be paid out tax free
  - Post-Budget eliminates the ability to withdraw the benefit amount tax free.

Make Canada Great Again?

- Trump tax reform promises a top U.S personal tax rate of 33% and a corporate rate of 20%
- Massive repatriation of profits and elimination of inventive transfer pricing schemes likely
- Canadian punitive taxation policy will hasten a flight of talent and capital southwards. Capital is agnostic.

Budget 2017

- Could be characterized as a punt.
- Likely to see an Economic Statement in the fall
- Full of Liberal gobbledegook, terms like "innovation budget, etc."
- However the Budget indicated where they want to go:
  - Attack family income splitting and dividend sprinkling strategies
  - Attack corporately held taxable investment portfolios
  - Character conversion transactions

What is next

- More government interference in business. Expanded attribution rules.
- Attack on Small Business and Professional Corporations. Tying the SBD to number of full time employees (Je me souviens).
- Tax on employer funded benefit programs
- Increased inclusion rate on capital gains.
  - 75% inclusion means about a 40% tax on capital gains.

Tax Policy: Conclusions

- The Integration Funnel: Liberals want the compensation result to be T4
- Deferral very much alive in theory:
  - However deferral product is being targeted.
- Permanent Life Insurance (despite “exempt-test” changes) is the last large-scale deferral vehicle available
- Under the Marxist fiction of “fairness” the Liberal government wants:
  - Reduce the ability of companies and individuals to save. Anti-TFSA.
  - Rely on government programs (Enhanced CPP)
  - Anyone making 200K + must be punished. Politics of envy.
  - **To From each according to his ability, to each according to his need**

Tax Policy: Conclusions

- 20 years ago, average dividend tax in Canada was under 25%

- Now it is over 40% in all provinces except one and over 44% in five.

- They have gone from being an incentive to do business to a punitive tax on the wealthy. This is not going to change.

- The lowest Top Marginal Tax Rate in Canada is now 47.7%

PART II

CORPORATE PLANNING ISSUES AND STRATEGIES

Redemption Method

- Most common method in Shareholder Agreements
- Corporation must purchase shares from deceased's estate
- Corporation is owner and beneficiary
- CDA available
- BE AWARE of MTAR changes on CDA.
- Factor in likely inclusion rate increase.
- Deceased is deemed to sell before death = Capital gains (use LCGE)
- Estate acquires shares at FMV
- Company redeems from deceased estate = creating capital loss and receives deemed dividend

Redemption

- Corporation will declare a dividend to redeem shares
- Size of capital dividend may reduce or eliminate the ability to use capital loss realized by estate
- Estate would normally carry back the loss against the individual capital gain if done within first year of estate.
- S.164 Stop Loss rules
- Consider the 50% solution: Only 50% of the deemed dividend will be declared as a capital dividend and the other as a taxable dividend
- Eligible or non-eligible depends on GRIP balance
- 50% solution will allow for carry-back of capital loss
- Leaves 50% of the CDA balance in the corporation, which is favourable to the surviving shareholders . . . they can take capital dividends during their lifetime
- Might be ideal for some family businesses

Redemption: roll and redeem

- Spouse receives shares on rollover basis from deceased
- Corporation redeems share from surviving spouse
- Modified Stop Loss occurs as redemption from spouse occurs with much reduced capital loss
- Put –Call option. Directs redemption from spouse not deceased. Must indefeasibly vest with spouse. Potentially no Stop Loss at all. This is becoming quite common in buy sell drafting.
- Agreements and Insurance issued prior to 1995 are grandfathered against Stop Loss.

Hybrid redemption method

- Preferable to Redemption but requiring more expertise in drafting
- Combines both the Redemption and Promissory Note method
- Allows the quantity of shares to be redeemed by the corporation or purchased by the surviving shareholder to be decided in accordance with tax situation of the deceased and surviving shareholders.
- 50% solution may also be used if capital loss exceeds the ACB of the shares. Where capital loss exists and Capital Dividend paid out the Stop Loss rules will reduce that Capital Loss by the amount of Capital Dividend. 164(6) ITA
- Estate will pay slightly higher taxes but 50% of the CDA is preserved inside the corporation and deceased's estate was able to utilize the capital loss carry-back

To Plan or Not to Plan?

Province	Estate Size	Worst Case	Best Case
British Columbia	$200,000	64.46%	11.93%
Alberta	$300,000	64.40%	12.00%
Saskatchewan	$200,000	64.06%	12.00%
Manitoba	$200,000	70.89%	12.60%
Ontario	$220,000	72.06%	13.38%
Quebec	$200,000	70.88%	13.33%
New Brunswick	$250,000	72.05%	14.68%
Nova Scotia	$200,000	73.97%	13.50%
P.E.I.	$200,000	69.55%	12.84%
Newfoundland	$200,000	63.55%	12.07%

The Result of Proper Planning

	NO PLAN	Redeem , No Insurance	Redeem, with Insurance	Redeem, 50% Solution
Tax on Final Return	$265,000	$0	$132,500	$0
Tax on Share Redemption	$450,000	$450,000	$0	$225,000
Total Tax Owing	$715,000	$450,000	$132,500	$225,000
Assumptions:	No Life Insurance	No Life Insurance	$1mm Life Insurance	$1mm Life Insurance
	No CDA	No CDA	$1mm CDA used	$500k CDA used, $500k left

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Growth period concerns: 55(2)

- Insurance is needed for tax considerations
- **Given high tax on investment income and elimination of “switch” funds it now takes on the added dimension of being the only large-scale deferral vehicle available**
- S 55(2) is now being enforced and creates a problem
- If an intercorporate dividend reduces the value of the corporation, it will be considered a taxable capital gain
- We used to be able to claim the related party exemption: that has been eliminated
- Now you can intercorporate dividend the “safe income” amount
- Accountant will be critical
- If the dividend paid exceeds the safe income amount then the entire dividend will be declared offside rather than simply the “error” amount

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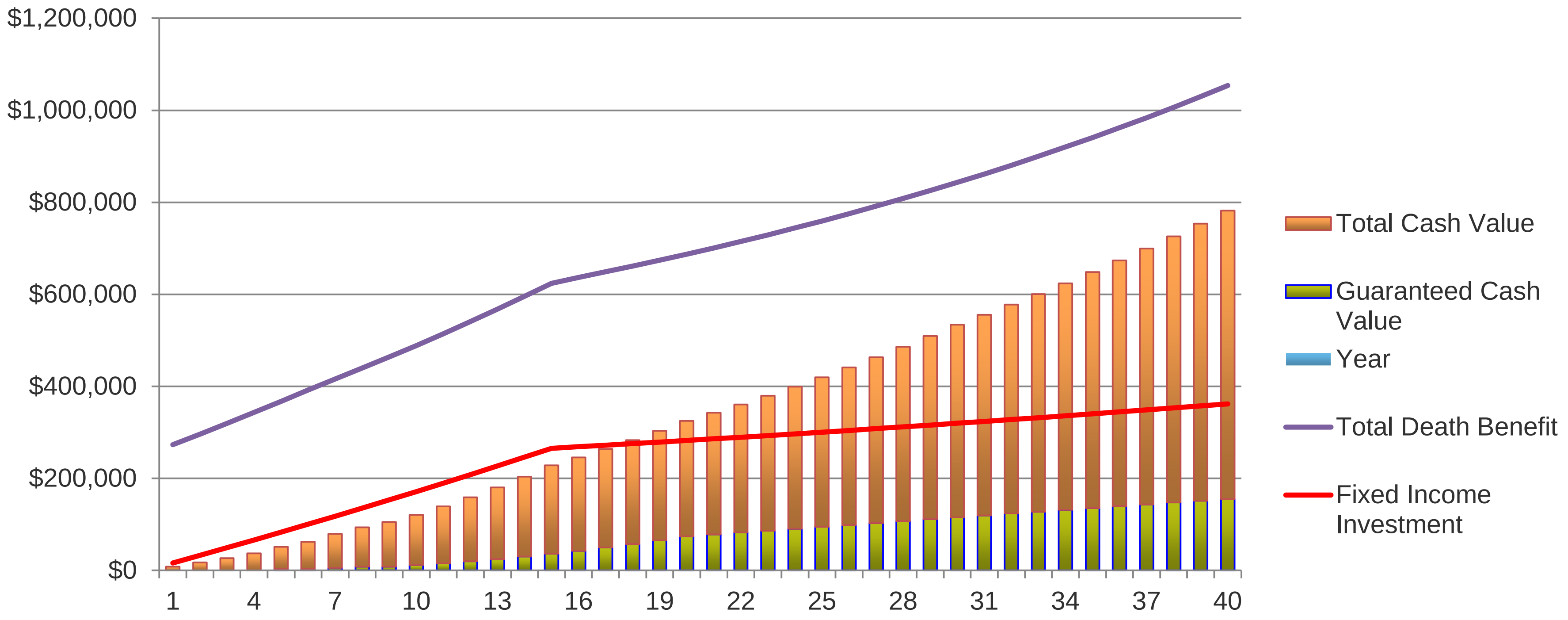
Powerful Planning – Only With Life Insurance

Male Female Age 50 NS, Joint Last $250k Pmax Gold 15 Pay
$16,000 Annually for 15 Years



s. 55(2)

- Leveraged life insurance strategy (IFA) may be a viable remedy to 55(2)
- Work with accountant to stagger dividends
- Again, make sure you put the insurance in the right corporation!
- SAFECO vs. HOLDCO

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Transition: Corporate Freezes

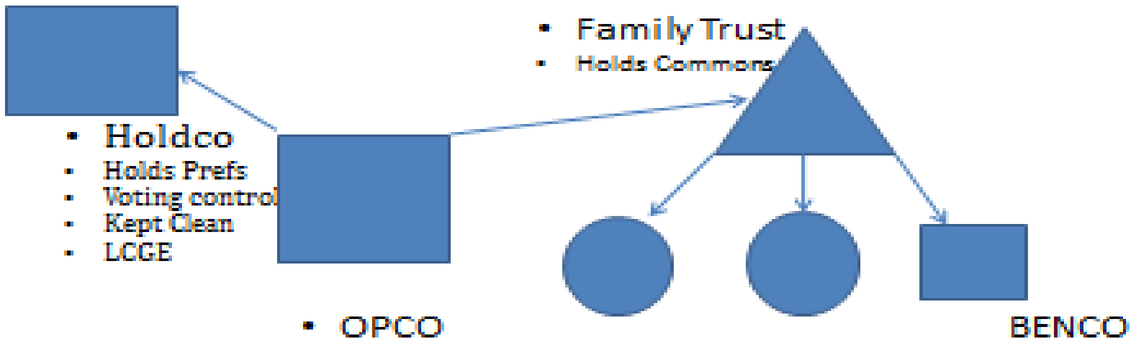
- Widely-accepted strategy for structuring transition. Not on chopping block?
- Company is reorganized with the older generation taking back fixed value/preference shares. Allowing them to crystalize LCGE if they chose. Important to have a solid price adjustment clause in Article of Amendment to guard against future CRA challenge.
- Floating value shares (common) transferred to a Family Trust to allow for:
  - Income splitting through dividends (beware of kiddie tax rules)
  - Magnification of the LCGE
  - Continued control by founder/parents
  - Discrimination allowed

Corporate Freezes—Challenges

- Traditionally freeze transactions are accompanied by an insurance strategy
- Insurance is purchased corporately to cover the cost of taxation on the preferred shares (sometimes commons)
- Traditionally the insurance was placed in a Holding Company
- Holdco creates a problem:
  - Section 55(2)
  - Sale. What if HOLDCO needs to be disposed of? S. 148(7) and 55(2) Freight Train
  - Shareholder Agreement calls for redemption of shares by company will create possible Stop Loss problem
  - Post 2017 corporately owned insurance takes considerably longer to “grind” down the ACB. CDA assumptions must be updated

Corporate Structuring

Preferred structure after "Freeze"



s.148(7) and Succession

- LCGE can only be claimed personally
- Holdco has to be sold as well. This will raise the spectre of “passive” asset problems.
- What happens to policies owned by Holdco?
  - s.148(7) disgorgement. FMV-ACB= Taxable inclusion.

s. 148(7) Solutions

- Implement reorganization before valuation issues associated with the policy become critical
- Create new corporation and transfer all assets other than insurance to that corporation under s. 85, then sell that corp. No LCGE!
- Where FMV is already profoundly in excess of ACB, consider share reorganization to issue “insurance” shares for consideration
- Insurance shares are tied to the value of the policy. Upon sale the vendor keeps insurance shares and purchase price is adjusted to fund future premiums. This gives access to CDA
- Exchange the shares for the policy in due course
- Transfer policy as an intercorporate dividend – s. 55(2) concerns!

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New s. 148(7) policy transfer rules

- Pre-2016 Budget policy transfers are caught by a charge against the CDA.
  - Benefit amount of transfer will be levied against CDA at death of insured.
  - **Solution: If still insurable consider cost of replacing against cost of paying out dividend of non-CDA death benefit.**
- Transfers are still possible up to the lesser of FMV or ACB.
- If transferring to a shareholder declare the transfer as a dividend in kind. Tax might be owed but you will avoid the 15(1) issue.
- Make sure you transfer to the right corporation.
  - LCGE issues
  - Stop Loss rules

The new “exempt” test: Dealing with ACB

- Where ACB remains significant at time of death, thus creating a large amount of death benefit not being treated as CDA:
  - Utilize family trust to create a dividend strategy for beneficiaries.
  - Consider a Philanthropic remedy:
    - Modify Shareholder Agreement and secondary Will to direct a charitable donation of shares at the time of death equivalent to the value of the ACB of the policy.
    - Create substantial personal tax relief through tax credit
    - Redeem the shares with the taxable portion of the death benefit. Neutralize tax and leave an enhanced legacy.

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Professional Corporations

- Each professional association, in each Province determines the rules concerning corporate structure.
- Most professional corporations cannot be owned by a Holding Company
  - Dentists do it anyways . . . Midnight Holdco.
- Use of trusts limited to minor beneficiaries. Potential to use them nonetheless. Ideal for dental corporations where share sale likely
  - Alternative is to utilize non-voting insurance/skinny shares for insurance assets.
- Physicians can issue non-voting shares to others, spouse, parents, adult children
  - Dividend sprinkling
  - Non-Arm's-length loans

Professional corporations

- Almost every doctor and dentist is, or should be incorporated
- Useful for savings….or future savings….IPP (Doctors)
- Be aware of exit strategies:
  - Doctors don’t sell
  - Dentists sell . . . Purification issues
- Understand creditor protection issues. Don’t over emphasize them. Professionals all carry E&O
- Budget 2016 eliminated the ability to magnify the SBD. Affects lawyers and accountants as now they share the SBD. Not a big issue

Immediate Financing Arrangements

- Very popular with lending institutions
- Businesses who identify need for insurance but want to avoid tying up cash flow
  - Additional collateral requirements are critical
  - ADO a must in most cases
  - Consider introducing IFA in Year 5 and onwards
- Potential aggressive use
  - "Golini:" Use of corporation by shareholder as a clear benefit.
  - Corp owns policy. Shareholder receives loan pursuant to guarantee fee. Shareholder contributes loan proceeds into corp, credits shareholder loan account. Enhanced tax free payouts in the future.
  - This screams GAAR!

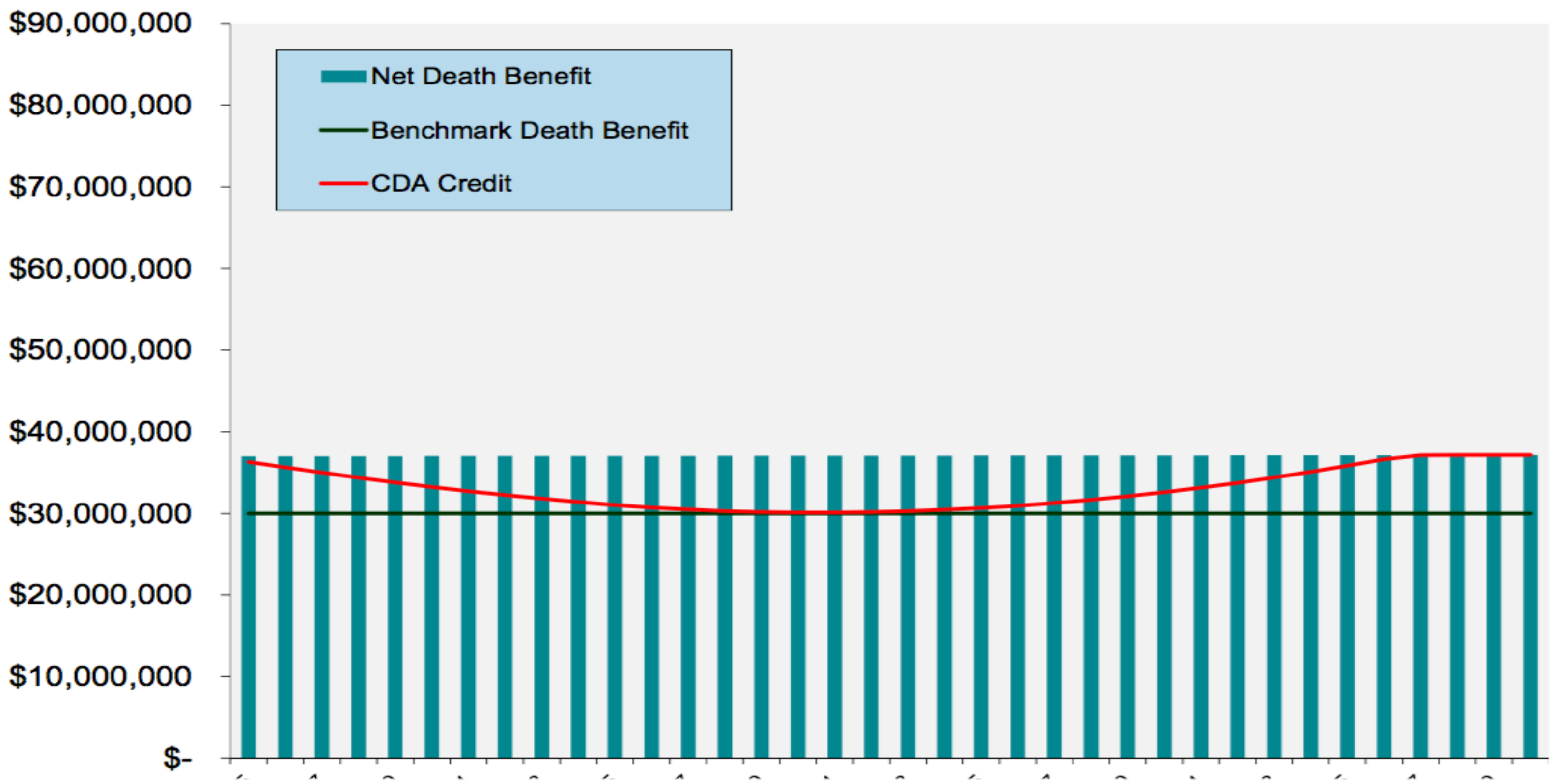
Immediate Financing Arrangement

- Real Case Study

- Male 55 NS, 150% Rating, needs $30mm of coverage

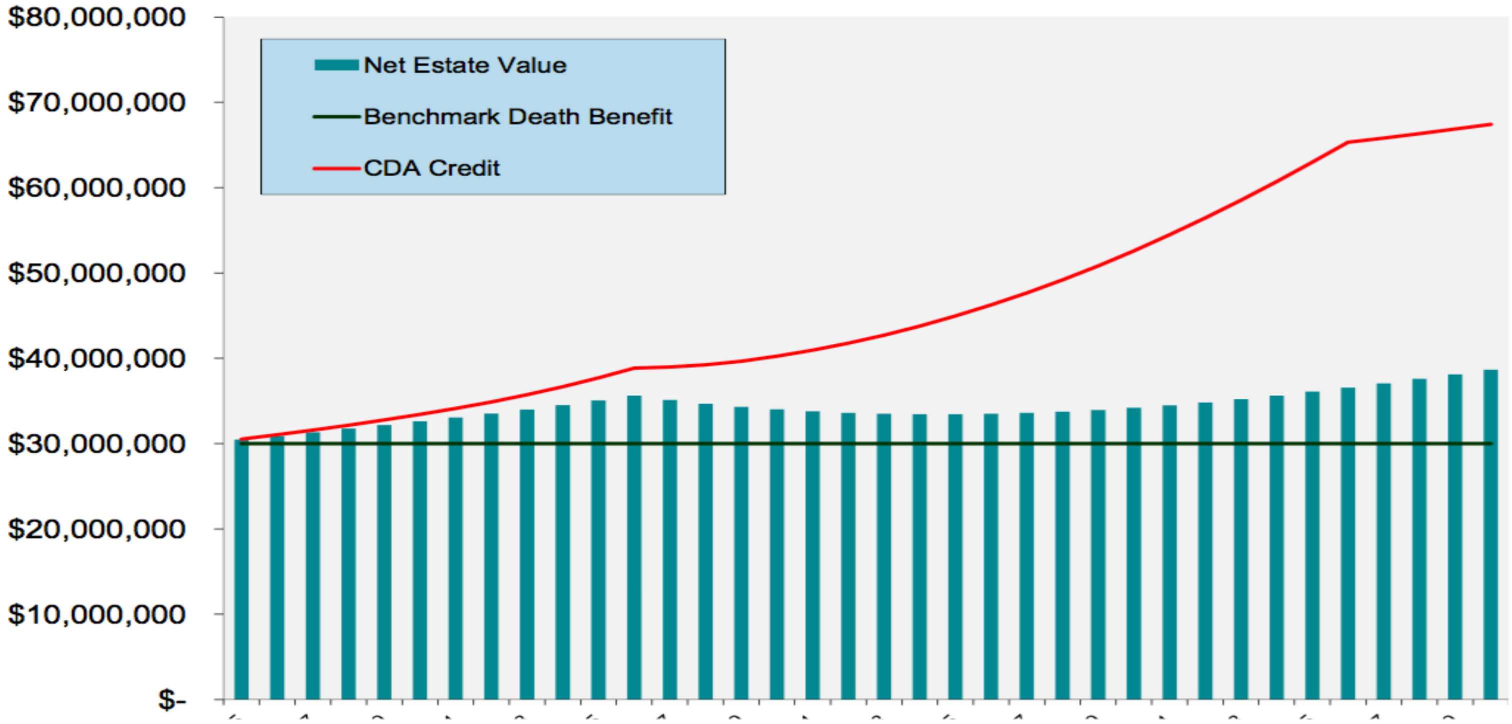
- Min Premium UL = $768,000

Guaranteed Life Pay



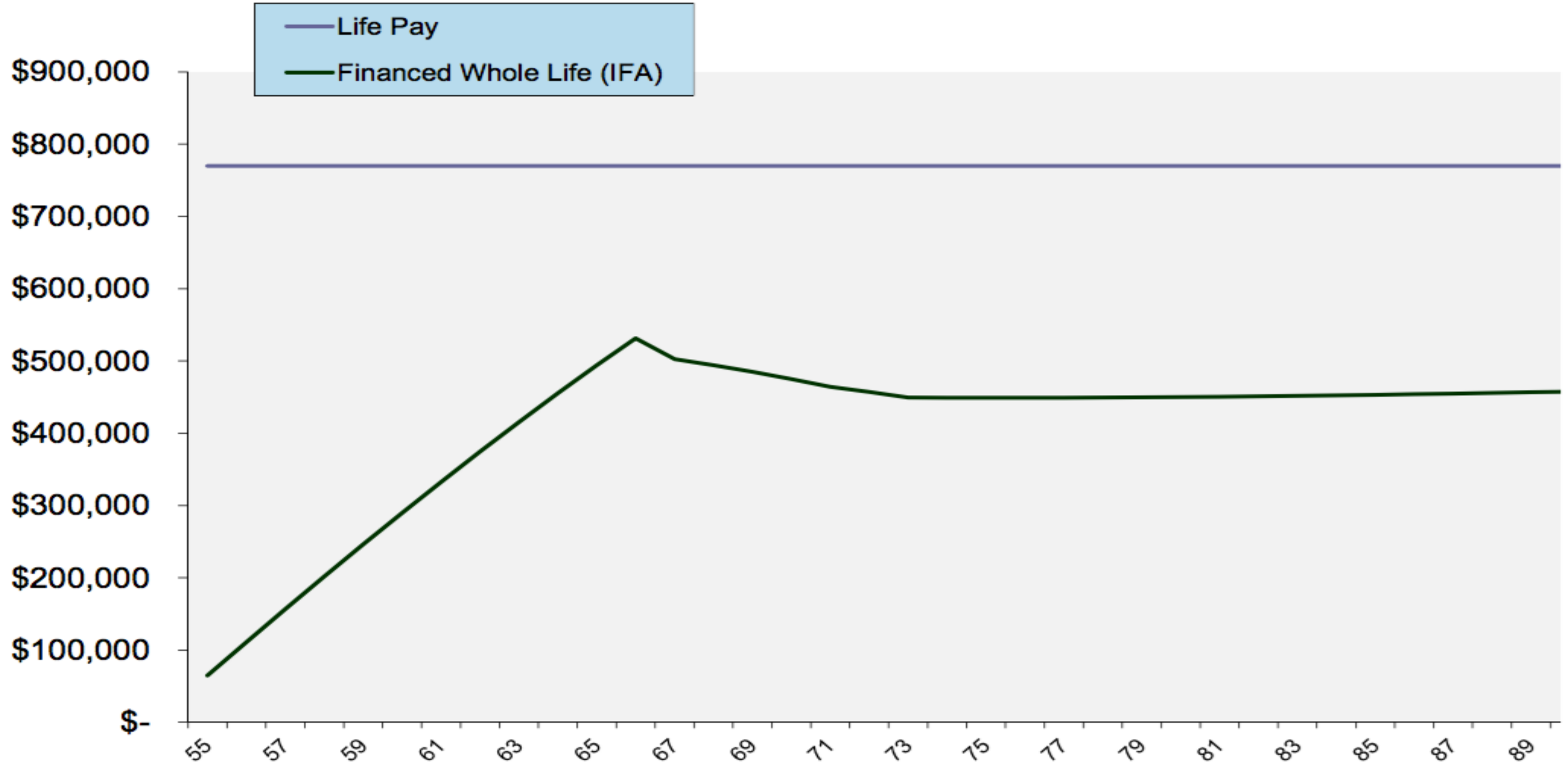
The Effect of Using Finance

Fully Financed - Interest Paid - Current Dividend -1% - 26.5% Active Business Income, 2.70% Loan



Comparison of Annual Cash Flow

Fully Financed - Interest Paid - Current Dividend -1% - 26.5% Active Business Income, 2.70% Loan



Strategic Philanthropy

- Charitable giving represents the last great bulwark against Government.
- Corporate donations are deductions
- Personal donations create tax credits.
- Inter vivos gift of a policy at FMV will create a deduction or tax credit equivalent to the FMV of the policy.
  - Useful for a corporation with considerable tax bill.
  - Often a good tax strategy for individuals where spouse unexpectedly pre-deceases.
  - You need an actuary.

Using Philanthropy in the new “exempt” test environment

- Consider amending the business will and Shareholder’s Agreement to allow for a charitable donation of shares of the corporation to a registered charity or charitable foundations.
- Amount of shares should be equivalent to the value of the remaining ACB of the policy at death.
- Gift of shares creates a tax credit.
- Redeem with insurance proceeds that would have otherwise been a taxable dividend.

Insured Gift of Shares

Value at Life Expectancy	No Gift	Insured Gift
Amount to Heirs	$7,350,000	$10,000,000
Amount to Charity	$0	$5,000,000
Amount to CRA	$2,650,000	($662,500)
Total Paid for Life Insurance		$2,323,000

Male 70 Female 70
$5mm face
$116k annual
$10mm estate

PART III

ENHANCED RETIREMENT PLANNING

Enhanced Retirement planning

- Unfortunately the Liberals are not idiots. They understand the "secrets of the Temple," have enforced integration so the "dividend-only" compensation strategy has lost most of its lustre.
- If T4 is a considerable part of compensation then income based deductions are needed.
- Certainly look to insurance-based solutions for retirement, however:
  - IRP is a nice concept. Interest-rate risk is rarely discussed.
  - How will an 80-year-old sleep at night with a huge loan on the books?
- Insurance remains the only large-scale deferral strategy available, *even with MTAR changes*

Individual Pension Plans (IPPs)

- Introduced in 1991 as “Designated Plans” coming out of pension reform legislation
- Allowed the owner-manager to participate in a company pension plan
- All contributions, set up and administration costs and portfolio management costs are deductible
- Contributions are not subject to provincial payroll taxes, i.e. Ontario EHT, Manitoba, Quebec, Newfoundland, Nova Scotia
- Must have T4 income (employee) to be eligible for pension contributions
- Pension contributions will create a Pension Adjustment (PA) which will reduce RRSP contribution room to as low as $600 per year
- 2011 Budget changes define IPP as a particular type of pension in the ITA
- Past service contribution rules were amended to limit contributions based on RRSP asset size

IPP Advantages

- Creates significant tax relief for the company. Past Service funding can be quite large. Annual contributions are larger than RRSP contributions
- Can create a predictable stream of income
- Some Provinces better than others. Quebec is the best, B.C and Alberta are good, Ontario depends on your provider, Atlantic Canada is a regulatory minefield
- RRSP rollover required. AVCs should be considered
- Creditor protected
- Intergenerational rollovers possible in family businesses. Survivorship benefit is reduced to maximize plan surplus. No deemed disposition as long a plan member remains alive
- Tax rules and interest rate environment starting to suggest that purchasing an annuity is good planning.

IPP contribution and past service contributions

IPP Contribution for 2016			
Age	Percentage	Maximum	Past Service Maximum
40	18.20%	$26,300	$67,400
45	20.00%	$28,900	$121,800
50	22.00%	$31,800	$190,300
55	24.15%	$34,900	$265,500
60	26.50%	$38,300	$348,100
65	28.72%	$41,500	$438,900
71	25.19%	$36,400	$724,700

Maximum company contributions based on T4 of $144,500 for 2016

Maximum company contributions for past service based on employment to 1991, RRSPs of $573,810

IPP disadvantages and challenges

- IPPs are perceived (rightly so depending on service provider) as *cumbersome*, *paper-heavy* and *overly regulated*.
  - As mentioned, not all provinces are the same
- Strictly speaking you should avoid leaving plan deficiencies un-funded; in reality it is possible to terminate plans with deficiencies
- Accountants (for the most part) hate IPPs.
  - Often they are concerned with reporting requirements on the annual financial statements
- Market confusion as to what is an IPP and what is a PPP. The latter is a hybrid (DB / DC) plan

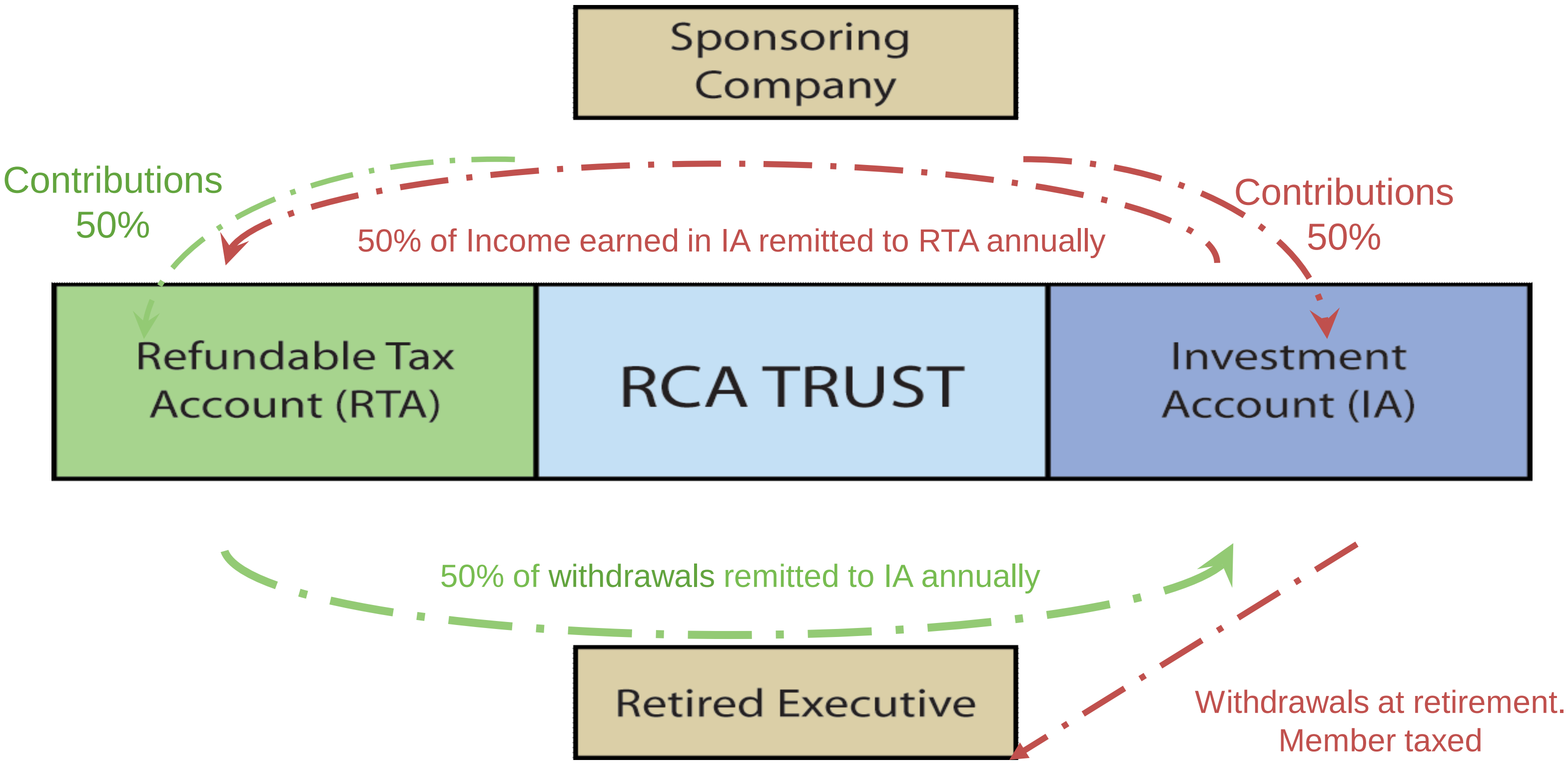
IPP: Model client

- Tax benefits do exist but quite frankly will not win the argument to implement.
- Most individuals considering the IPP from a tax perspective will be deducting at the SBD rate. With new punitive top rates they may be ahead using RRSP.
- Behaviour is the primary criteria for proposing the IPP.
  - Individual is over 45.
  - Stable business and history of strong and predictable income.
  - Dedicated to savings
  - Likes the security of a pension
  - Or, has trouble saving and needs to guarantee a result
- INCORPORATED DOCTORS AND DENTISTS ARE THE IDEAL IPP CANDIATE!!!!

Retirement Compensation Arrangements (RCAs)

- Introduced in 1986 as a punitive remedy under the act to combat "executive pension" plans. Often deferred annuities were used and deducted
- Used because rules associated with Employee Benefit Plans were inadequate
- Growing in popularity again given high tax rates on income
- CRA has conducted a national audit campaign in recent years imposing Salary Deferral Arrangement rulings on RCA
- While the plans can be set up as stand-alone structures with no funding guidance (other than requirement for Actuarial proof of "reasonableness") it is my preference to have the RCA governed by a benefit and funding document

RCA Structure



Funding the RCA

- Don’t let the tax tail wag the investment dog!
  - If your RCA plan member is leaving the country don’t worry about ongoing RTA remittances while you manage the portfolio
- Elimination of “corporate class” funds creates a challenge
- Letter of Credit must be matched with RTA contribution
- Is there a Supplemental Plan document governing the RCA? In some situations you want one

Insured RCAs

- Insured RCA's work
- CRA does not like large death benefits inside the RCA. This is puzzling in that it would enhance tax revenue.
- Split dollar Agreement is the best way to go, provided:
  - Company is prepared to pay mortality cost on a non-deductible basis
  - Time to fund is critical. Not practical for short term scenarios.
  - Insurability
  - Side Account issues
  - Par or UL work
  - Get the right actuary!

Living Benefits strategy

- Split dollar Critical Illness is an attractive strategy
  - can dramatically reduce taxation on removal of money from a corporation
- Likely CRA scrutiny due to aggressive use . Impoverishment of corporation.
- Consider personal ownership of policy and ROP and the company being designated beneficiary for the term of employment.
- Wise to have benefit period coincide with employment period.
- Actuarial valuation of taxable benefit and overall policy recommended to avoid Impoverishment finding by CRA.

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- Available for consultation and speaking engagements
- Nation-wide practice

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