Being the White Knight: Tax Planning for the 1%...and those who want to be in it.

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The Foes

Objectives

To identify **opportunities** with entrepreneurs and incorporated professionals.

To understand where planning might be “aggressive”.

To increase revenue by “fencing in” your clients .

To protect yourself from unintentional errors in planning and implementation.

To engineer epiphanies.

Agenda

I. Why Tax Planning?
II. The Canadian Tax Landscape
III. Foundational concepts
IV. Deductible Tax Relief
V. Retained Earnings Strategies

I. Why Tax Planning

Demographics:

- We are now in the midst of two tremendous demographic events:
  - The transfer of wealth from the "Greatest Generation"
  - The retirement of the Baby Boomers.

Changing Retirement expectations.

- The traditional company pension plan has either been substantially changed or eliminated
- Lifespan is considerably longer making the job of the financial planner/advisor more difficult.

Why?

Changing nature of our industry and service offering.

- Client demands must be conditioned and tempered by objective review
- Competition has evolved. You are not just up against DS. Technology must be harnessed or it will be your adversary (robo-advisory)
- You must be a “River to your People”.
- Financial Planning isn’t a service it is the cornerstone to your future prosperity.

Why?

Government and Taxation

- Personal responsibility is under assault.
- Entrepreneurs and professionals are now treated as a “class enemy” by some governments.
- Demand for more government services (with someone else paying for them) is a constant theme.
- Taxing the 1% is smart politics.

A note on Cross-Border

American citizenship creates planning challenges:

- Transition Tax
- Global Intangible Low Taxed Income (GILTI)
- Insurance issues

Build it into your planning checklist

Get to know an expert….they don't come cheap.

Opportunity: Be the White Knight!

Tax planning is at the forefront of any successful individual's goals. Given the high level of investment knowledge and access to world markets the greatest threat to wealth is punitive taxation.

Centers of Influence (Accounting and Legal) realize that asset management is largely commoditized and understanding the key concepts in tax planning differentiates you from other advisors.

Capital preservation = Tax planning

Avoid aggressive planning "Pigs get fat, hogs get slaughtered"

Protect yourself

Tax Relief: Choices

Deductible tax relief:

- Individual Pension Plans (IPPs)
- Retirement Compensation Arrangements (RCAs)

Retained Earnings strategies (non-deductible)

- Permanent Life insurance based strategies
- Shared Ownership Critical Illness

Outside the box planning:

- International tax planning may be something you should be aware of.
- Viable if properly and prudently executed.

II. The Canadian Tax Landscape

Canadian Income Tax system created through thorough consultative process and introduced in the early 1970's.

Has become overly complex and imbedded with inherently political policy underpinning.

CRA is very much a silent partner in any enterprise.

Many planning strategies have been accepted for decades.

Current Tax Planning

2017 Morneau proposals concerning the taxation of Canadian Controlled Private Corporations (CCPC) very much a substantive tax reform proposal.

Considered by most to be a substantial derivation from traditional tax policy.

Most sweeping changes were withdrawn in the face of overwhelming resistance.

- End to pipeline planning
- End of LCGE multiplication through trusts
- Worsening of 84.1 non-arm's length sales
- Omnibus remedies more sweeping than GAAR.

Budget 2018: What did they introduce

Taxation of Split Income (TOSI)

Passive Income rules

RDTOH changes

The intention behind the policy is to discourage deferral, eliminate income splitting and force compensation to be paid as T4 and tax it.

Budget 2019

- No changes to life insurance
- Elimination of CV transfers to IPPs
  - Unfortunate as legal measures existed to prevent abuse
  - Aggressive planning by a few lead to this legislative result
- Stock Option plans targeted.
  - Consider a RCA for DSU programs
- Perhaps 84.1 gets fixed....one day
- Pixie dust

TOSI

Targets dividends paid to family members.

Subject to top marginal rates of tax unless “excluded shares.

Excluded includes:

- Over age 18 if working 20 hours per week in current year or in 5 previous years.
- Spouse over age 65.
- Excluded Shares – Horribly complex
- Revenue testing +10% of ABI not from provision of services.
- Targets professional corporations
- More flexibility with investment holding companies

TOSI: Conclusions and Opportunities

The implied intention behind these rules is to discourage the payment of dividends.

T4 is still acceptable and subject to “reasonableness” s. 67

Clients are looking for tax relief.

- Defer and wait it out?
- Cease to be a CCPC?
- Find acceptable income splitting - IPP

Passive Income

Deferral is still an achievable goal with a corporation…..although discouraged.

Rates of taxation on passive income remains unchanged (effectively the same as individual rates).

Where a corporation earns in excess of $50,000 in passive income annually they will see their access to the Small Business Deduction (SBD) reduced.

For each dollar in excess of $50k the SBD is reduced by $3.

At $150,000 of passive income the SBD is eliminated and the company pays General Rate on all Active Business Income (ABI).

Ontario rates: $62,500 tax increase!

Passive Income

Related and Associated companies must share SBD. Using a Holding Company or Trust does not exempt you.

For entrepreneurs and professionals who utilized their “retained earnings” for future retirement, rainy day fund, potential expansion they are in jeopardy.

Passive Income: Strategy and Opportunity

Where a deduction is sought to reduce overall profit utilize an IPP or RCA.

Life Insurance grows tax exempt and is not considered “passive income”.

- It is considered a passive asset…more to follow.

Innovative generation of MTAR room can accelerate the ability of the client to shield assets from this new rule.

Access to working capital is critical and is a strategic reason to explore the use of leverage.

Opportunity continued

If retirement funding is a key goal the CIRP has added luster.

Effective arbitrage strategy possible with Shared Ownership Critical Illness

Ascertain real client tolerance and understanding of the risk associated with leverage.

Stress testing and nuclear options.

Refundable Dividend Tax on Hand changes

RDTOH

Eligible vs. Non-Eligible Dividends

Deferral opportunity

New rule creates two RDTOH pools

Non-Eligible must be paid out first

Reduces or eliminates deferral

Overly complex and onerous for the accountant to manage

The effect is to discourage the holding of portfolio investments in a corporation and to pay dividends from the company.

Tax Policy Conclusions

Entrepreneurs and Incorporated Professionals are being targeted.

Government is actively trying to discourage deferral, income splitting and encourage payment of T4

Complexity is intentional

Tax Policy Opportunity

Complexity and punitive taxation are the hallmark of Trudeau/Morneau tax policy.

Deferral is still possible.

Using the company as the retirement vehicle is still possible.

Clients (and accountants) are looking for a White Knight.

III. Foundational Concepts

I. Corporate taxation
   I. Integration

II. Insurance Concepts
   I. Valuation issues and challenges and opportunities. s. 148(7)

Key Concepts: Corporate Taxation

Integration

- Cornerstone of fairness in the tax system.
- Attempts to level the playing field with regards to how funds are distributed.
- Shareholder can pay corporate tax and receive dividends while and employee only receives T4 earned income from salary and bonus.

Integration Mechanisms

For Active Business Income (ABI) which is taxed corporately at SBD or GRIP income to the shareholder is “integrated” through the gross up and tax credit mechanism.

For Passive Income (investments, dividends, rents, etc.) the corporation pays a high rate of taxation but credits the Refundable Dividend Tax on Hand (RDTOH) account (Part IV Tax 38.33%). RDTOH credit is paid back to the corporation when dividends declared.

Withholding tax on dividends paid to non-residents triggers tax credit. Not integrated but does provide some relief.

Integration Snapshot 2018

Province	SBD	GRIP	Top Personal Rate	Non-Eligible Dividend Rate	Eligible Dividend Rate	Flow Through Rate
B.C	12%	27%	49.80%	43.73%	34.20%	51.97%
Alberta	12%	27%	48%	41.64%	31.71%	50.15%
Sask.	12%	27%	47.50%	39.76%	29.64%	48.64%
ON	13.50%	26.50%	53.53%	46.84%	39.34%	55.41%
Quebec	18%	26.70%	53.31%	43.94%	39.83%	55.90%
NS	13%	31%	54%	47.34%	41.58%	59.69%

Integration Conclusions and Opportunities

Ability to understand why an accountant is recommending a particular compensation strategy.

Ability to tailor strategy to fit that reality or knowledgably suggest modification.

Dividend rates have almost doubled since introduction of eligible and non-eligible rules.

Integration is rarely achieved and today favors T4 income over dividends.

Conclusions and Opportunities cont.

Dividends will likely still be paid to draw back RDTOH credits (although new RDTOH rules discourage that).

The “integration funnel” is real. If T4 is the logical conclusion then offering tax relief based on T4 makes sense.

- Individual Pension Plan
- Retirement Compensation Arrangement
- Shared Ownership CI (non-deductible arbitrage).

Exempt Test Changes

Most significant change is the calculation of Net Cost of Pure Insurance (NCPI). Modified to reflect more up to date actuarially determined mortality assumptions.

The result is NCPI is generally lower on post 2016 policies

This has a direct effect on the calculation of Adjusted Cost Base (ACB)

Valuation Issues

Budget 2016 introduced substantive changes to s. 148(7).

This was done to stop transfers done at Fair Market Value (FMV) from shareholders to their corporations.

FMV was being extracted often without tax.

Unforeseen consequence of long accepted definitions.

Policy Transfers: Pitfalls

New policy transfer rules now recognize FMV. Now for non-arm's length transfers which trigger 148(7) the transfer is said to occur at the higher of:

- ACB
- CSV
- Fair Market Value of Consideration paid.

Consider declaring a distribution of a policy as a dividend. Tax rules of 148(7) still apply but you will avoid 15(1)

When would I need to worry about this?

Business Reorganizations

- Insurance is not eligible property subject to s. 85 so it can’t be rolled over.
- This can mean that there are substantial tax results in the event of a non-arm’s length transfer

Sale of the Shares of a Business

- Most likely the purchaser will not want to own, or continue to pay for a policy on former shareholders
- Shareholders will likely want that policy

Example of a Potential 148(7) Train wreck

Client is selling shares of OPCO. 3 shareholders. All claiming the Lifetime Capital Gains Exemption (LCGE), $835,000 tax free amount each.

Advisor, acting in good conscience put a Level cost of insurance UL in place 10 years ago. ACB is 100k, CSV is 103k and death benefit is 1M.

Under the old rules the shareholder could have extracted the policy, paid tax on the ACB as a dividend in kind and the corporation would have be taxed on a $3k policy gain (CSV-ACB)

Train wreck continued

Level cost of insurance and less healthy insured results in FMV of $300k.

Now the proceeds of disposition on transfer is FMV- ACB = $200k

200k is deemed passive income. Under new Morneau rules they lose the SBD ($63,000 tax increase)

The passive income is in excess of 10% of total income in the two years previous to the sale. There they lose the LCGE

Opportunity

In our train wreck case you would replace the policy most likely. Client would pay tax on ACB amount paid as dividend.

You have the ability to present this to accountants. They all have this train wreck in their client base.

This is particularly germane with Dental Professional Corporations.

Huge opportunity to be the White Knight.

IV. Deductible Tax Relief

Individual Pension Plans

Retirement Compensation Arrangements

Individual Pension Plans

Registered Pension plan

Must have T4.

Tax relief is great but don't lose sight of other benefits:

- Predictability of retirement income
- Estate Planning friendly in the right context

Some Provinces better than others:

- BC, Alberta, Manitoba Quebec.
- Ontario quite likely to change rules but still has great flexibility Rule 48(1)
- Quite possible that Ontario will adopt similar rules. NO REQUIRRED FUNDING!

Case Study # 1 – The Entrepreneur

Case Study # 1 - BUSINESS OWNER + SPOUSE

Member 1: Age 64, Service back to 1991, Maximum Earnings
Member 2: Age 62, Service back to 1991, $60,000 per annum wages

Total Assets in IPP						
Company Contributon						
(Maximum Assumed)	$	583,569	$	304,901	$	888,471
Transfer from RRSP		635,899		342,950		978,849
	$	1,219,468	$	647,851	$	1,867,320
Maximum Contribution for 2018						
Accrued Liability Jan. 1/2018	$	1,133,825	$	607,950	$	1,741,775
Less: Transfer from RRSP	-	635,899	-	342,950	-	978,849
Unfunded Liability Jan. 1, 2018	$	497,926	$	265,000	$	762,926
Interest Adjustment		42,518		22,798		65,317
2018 Current Service		43,125		17,103		60,228
	$	583,569	$	304,901	$	888,471

Case Study # 2 – The Incorporated Physician

Case Study # 2 - MEDICAL PROFESSIONAL + SPOUSE

Member 1: Age 50, Service back to 2005, Maximum Earnings
Member 2: Age 47, Service back to 2005, $30,000 per annum wages

Total Assets in IPP						
Company Contributon						
(Maximum Assumed)	$	139,913	$	49,491	$	189,404
Transfer from RRSP		328,699		54,400		383,099
	$	468,612	$	103,891	$	572,503
Maximum Contribution for 2018						
Accrued Liability	$	419,412	$	93,917	$	513,329
Less: Transfer from RRSP	-	328,699	-	54,400	-	383,099
Unfunded Liability	$	90,713	$	39,517	$	130,230
Interest Adjustment		15,728		3,522		19,250
2018 Current Service		33,472		6,452		39,924
	$	139,913	$	49,491	$	189,404

Case Study # 3 – The Farming Family

Case Study # 3 - MODEST EARNERS

Member 1: Age 54, Service back to 2001, $60,000 per annum wages
Member 2: Age 57, Service back to 2001, $60,000 per annum wages

Total Assets in IPP			
Company Contributon			
(Maximum Assumed)	$ 154,976	$ 173,494	$ 328,470
Transfer from RRSP	165,400	165,400	330,800
	$ 320,376	**$ 338,894**	**$ 659,270**
Accrued Liability	$ 294,613	$ 311,642	$ 606,255
Less: Transfer from RRSP	- 165,400	- 165,400	- 330,800
Unfunded Liability	$ 129,213	$ 146,242	$ 275,455
Interest Adjustment	11,048	11,687	22,735
2018 Current Service	14,715	15,565	30,280
Maximum Contribution	$ 154,976	$ 173,494	$ 328,470

Some thoughts on hybrids

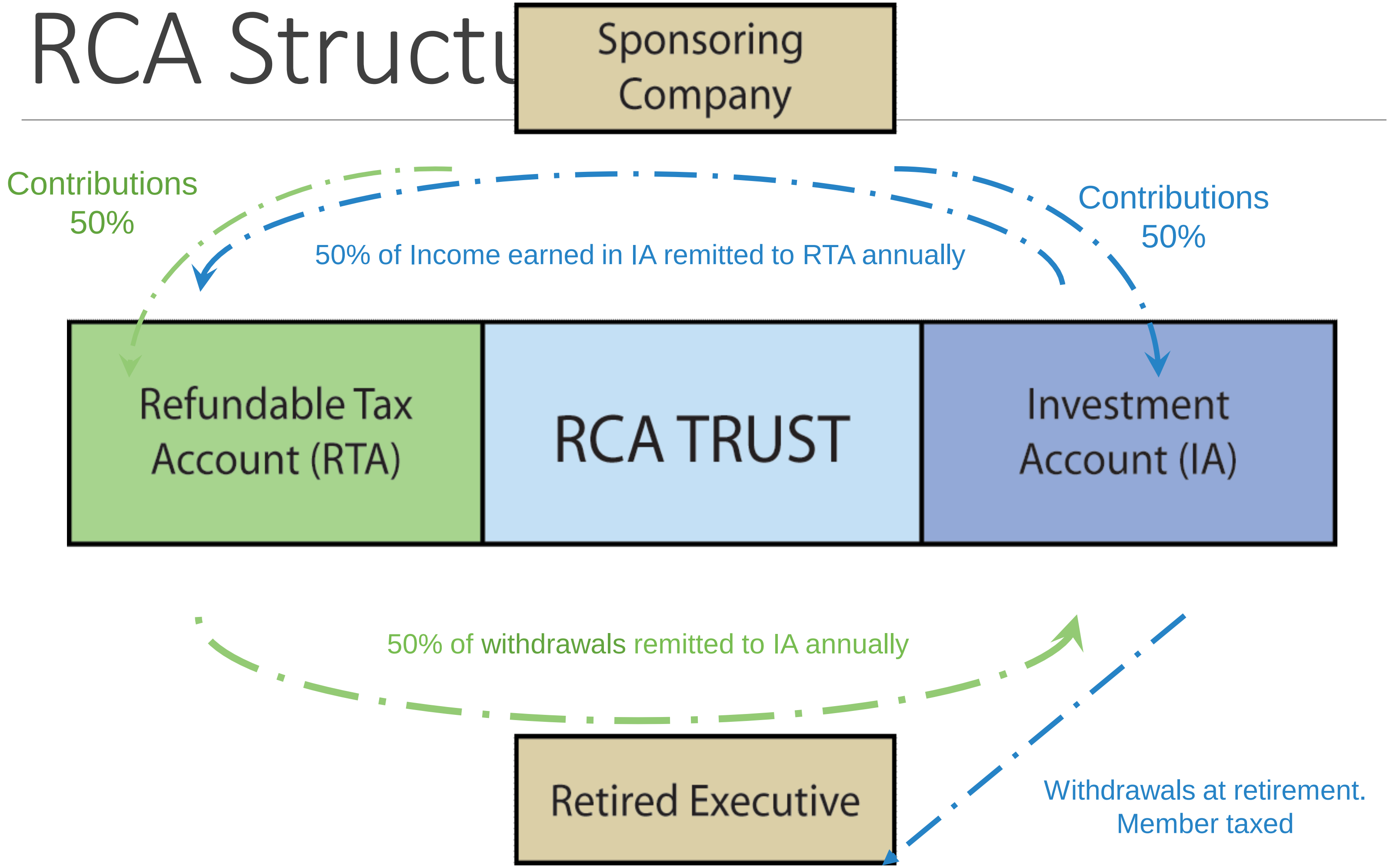
- A hybrid pension plan is a plan that has the ability to utilize Defined Contribution and/or Defined Contribution
- In certain cases it is marketed as something other than an IPP:
  - It is an IPP with lipstick
  - A solution looking for a problem
- Know Your Client:
  - Don’t set a pension plan for someone bordering on insolvency
  - Don’t set up a pension plan for someone under 40. You are paying a lot for the RRSP level of contribution
  - Don’t include family members unless they are really going to work at the company for a very long time. Think of the unwind
- Focus on service. Actuarial support. Ease of use. Support in the field.

Pension Remedies

- Rule 48 Ontario Pension Benefits Act.
  - A benefit formula can be substantially amended with a written application.
  - Safety valve

- Designated Plan Rules:
  - 7.5% return
  - 4% Inflation
  - 5.5% wage growth
- Legislative change?
- Suspend the plan
- Take dividends

RCA Structu



Sponsoring Company
Contributions 50%
50% of Income earned in IA remitted to RTA annually
Contributions 50%
Refundable Tax Account (RTA)
RCA TRUST
Investment Account (IA)
50% of withdrawals remitted to IA annually
Retired Executive
Withdrawals at retirement. Member taxed

RCA Uses

Leaving the country

Foreign executives

Executive severance

Executive Retirement

- Insured RCA?

Accounting strategies

- Offset recapture in an asset sale
- 84.1 mitigation

V. Retained Earnings Strategies

1. Some thoughts on Permanent Life Insurance Strategies
   i. Prudent use of leverage
   ii. Corporate insurance and Post Mortem planning issues

2. Shared Ownership Critical Illness

What does Insurance do?

1. Provides for a liquidity event at a discounted cost.
2. It is an accordion folder. It is an expanding asset that if properly structured grows without tax. That asset can be used for a variety of purposes.

Retained Earnings Strategies that work:

Corporate insured asset transfer

Post mortem strategy funding

Corporate Insured Retirement Plan

Immediate Finance Arrangement

Prudent use of Leverage

1. Can you clearly identify a need for permanent life insurance?
2. Can the client afford it?
3. Would the client rather use the retained earnings/cash flow for something other than insurance premiums?
4. What is the client's real gut sense of risk and the use of debt?
   i. "Pigs get fat and Hogs get slaughtered"
   ii. R v. Golini. What have we learned?

Some thoughts on Post Mortem planning

Shareholder’s Agreement and Organizational Chart are essential.

Plan for multiple strategies. Pipeline and Redemption

Be aware of critical rules:

- “Loss Carry back”
- “Stop Loss Rules”

Don’t go it alone.

Post mortem Planning

- The post mortem planning will be driven largely by the nature of the corporation and it's revenue. Active (QSBC) vs. Passive (Holdco).
- Pipeline is still popular.
  - Newco set up after death.
  - Estate subscribes for shares of Newco and exchanges a P Note
  - Oldco is amalgamated into Newco pushing up ACB of shares.
  - Debt instrument retired.
  - Newco wound up.
  - Tax on deemed disposition.
  - Life insurance can be used to pay capital gains tax on deemed disposition
  - Consider using insurance shares to reduce amount of deemed disposition

Redemption Strategies

- Cost analysis. Single life vs. JLTD will likely determine redemption strategy.
- Used to redeem freeze shares
- Spousal roll and redeem. Potential of zero tax on redemption.
- Loss carry back on second death. JLTD
  - Beware of Stop Loss rules
  - 50% solution

Shared Ownership Critical Illness

Critical Illness should be part of every risk mitigation strategy.

With the use of Return of Premium (ROPS) an effective tax arbitrage can be constructed.

Numbers are best under age 50.

A hybrid can be constructed if age is an issue.

Desjardins does this as a stand alone product

We have the ability to modify and construct the strategy with all providers.

Shared Ownership CI

Requirements:

1. Actuary – Ryan Wall CFA FCIA
2. Shared Ownership Agreement. Agreement between corporation and shareholder/employee.
3. Policy with ROPS added. Usually T75 level.
4. Report and certification of values.

How it works

- Company buys policy (or individual does and assigns it to their corporation) for CI coverage with ROPS (and ROPD).
- Company pays but does NOT deduct annual cost.
- Actuary determines what is the FMV of that benefit to the insured.
- That FMV is added to the insured's T4 annually and they pay tax on it.
- Avoids Impoverishment finding and 15(1) benefit.

Shared Ownership: What Happens

Scenario 1:

- Insured gets critically ill. Company receives benefit on a tax free basis (no CDA) and uses it for business related costs associated with the illness, paying excess medical costs through a PHSP or distributes as a taxable dividend.
- Good risk mitigation strategy as you used corporate dollars for both health and business costs.

What Happens

Scenario 2:

- After 15 years the insured triggers the ROPS.
- As they paid tax on the FMV of the benefit all along they ROPS proceeds are paid without further tax.
- You just engineered an arbitrage. They paid tax on the FMV and paid personal tax. The alternative was to pay tax on the accumulating asset under passive rates and the dividend rates on the distribution after 15 years.

Hybrid: Utilize money that would be allocated to ROPS into a Par policy owned corporately. With time you will have more money available than what ROPS provided. Mini CIRP.

Strategic Philanthropy

- You cannot displace Justin and Co. as your primary creditor with your children…..You can with a charity.
- Consider a gift of shares of a private corporation redeemed by the ACB portion of the death benefit. The effect is to eliminate the tax challenges created by the updated exempt test.
- Gifting a policy at death
- Inter vivos gift of a policy. Business opportunity.

Thank you

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