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Building financial fortitude: tax and insurance opportunities for high-net-worth investors.

Speaker Participants

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Presentation

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Welcome and thank you for taking this time to join us for this quarter's Manulife Private Wealth webinar, Building financial fortitude, tax and insurance opportunities for high-net-worth investors. Before we begin, as an FYI, this seminar will be recorded.

My name is Hemal Balsara and I'm head of Tax, Retirement and Estate Planning Services at Manulife. Today, I'll be moderating a session and discussion with my friends Dan O'Shaughnessy and James Ward, Partners at O'Shaughnessy Financial, or OSF.

Dan started his career with Goldman Sachs and worked with some of the world's largest companies, as well as helping businesses raise equity on the Toronto Stock Exchange, during his time at Bank of America Merrill Lynch. James brings a work history that includes successes at Deloitte, time as a senior accountant, a senior hedge fund analyst at Goldman Sachs, and seven years delivering boutique insurance advice before becoming an OSF partner. In this seminar, Dan and James will present scenarios where high-net-worth investors may benefit from life insurance and tax opportunities from doing so.

Some important topics that we're going to cover include life insurance as a complement to an investment portfolio, how corporate-owned life insurance policies can provide tax advantages and optimize business structure, and ways to help create easy distribution of the estate. As always, this webinar is solely for your information. For those of you who are interested in a replay, we're recording this segment and we'll be posting the recording

on manulifeprivatewealth.ca and LinkedIn at Manulife Private Wealth. Additionally, for the advisors on the line, Dan and James are pleased to team with you when working on life insurance scenarios.

We'll have time for questions at the end of the session. Please submit any questions through the button at the bottom, the Q&A button at the bottom. And if you wish to remain anonymous, you can choose to do so before submitting. With that, let's begin. Dan and James, the field is yours.

Daniel O'Shaughnessy
Partner
O'Shaughnessy Financial (OSF)

Right, thank you so much, Hemal, for the introduction, it's a real pleasure to be here today.

I'm just going to share a screen with everyone and we're going to get going. So, today we're talking about what happens if you've got excess corporate assets and you're looking for diversification, and we're going to talk about estate tax liability and what to think about when you've got multiple next-generation shareholders. So, we sort of came up with a sample client type here, and we always say when you've seen one family, you've really just seen one family.

So, a lot of our work is understanding the landscape in a family dynamic, understanding, you know, how close the relationship is between the parents and the kids, and how well they all work together and what their objectives and goals are. So, in this case, what we've decided to work on is a male female joint last-to-die insurance strategy.

They're both 55 years old. They've been married for 30 years and they've got a great relationship and joint last-to-die if the relationship lacks a little trust or isn't perfect can be harder and will go on single life, but in this case, we've said this is a reasonably happy family. And they have three children, and you know, at their kids' ages, who knows what's going to happen, but planning for the future to make sure anything they want to happen is really important. This family owns a private business, it generates cash flow above and beyond the operating expenses, and because of that, they have a holding company and they're investing in that holding company in a diversified pool of assets. And really what we're looking at here is over time, the holding company has managed to retain 90 million in cash, investments and other assets.

So, we've got a corporate structure here. For those of you on the call who are real tax planning experts, you'll recognize that this can be a gross simplification of what a normal corporate structure looks like. But at the end of the day, we spend a lot of time on corporate structures. And with James' expertise, we really boil down complex

corporate structures into what matters for this insurance conversation.

And oftentimes it boils down to Opco/holdco and which holdco is going to be the owner of the insurance? And there's times where we even create an independent company to hold the insurance if that fits the fact pattern. And that's where the account wants to take it. So, that's sort of a landscape we're working with here. And then we look at when we talk to clients, and oftentimes, you know, we're not saying this is the perfect asset mix, but when we get a sense of what clients are invested in, we'll oftentimes spend, we will put that into a visual for our clients. So these clients have a big pool of public equities. They've got some private equity. We often find private business owners end up being invested in all sorts of things for friends and family, but not always tracked perfectly well,

and values aren't always fully understood, but they're always there. You know, there's always a chunk of personal real estate investment, real estate and fixed income. Now fixed income is typically cash or near cash. So, assets, it may in fact be in cash. It may be in fixed income. But what we look at is how do we view this chart and where does insurance fit into it?

So, we're often concentrating in this bucket. So, if you're going to have liquid assets, what if we split that up? What if we said have a portion of fixed income? And what if we said have a portion of life insurance? Typically, a lot of our clients don't need life insurance. They're in great shape anyways. And when they spend a bit of time with their insurance adviser or with us, they start to understand that if we put enough of this into life insurance, we can actually use the life insurance proceeds to pay the entire estate tax liability on all the other asset classes.

So, it's a really efficient tool. And we'll walk through why it can be really efficient both personally and corporately as we work through this presentation. So, these are the bookends of insurance. So, term insurance and permanent insurance, I'm sure people, you know a lot of our younger clients put significant term insurance in place. And a lot of our younger clients and our older clients start putting permanent insurance in place.

But the way that we look at these is term insurance as a tool. What is it good for? It's great when you're young and this is the premium that would go into a term insurance policy. So, you can see how efficient those premiums are in the early years. You get a level death benefit over time and you can see over time it starts becoming hard to keep.

And in fact, it doesn't stay in place past the age of 80. So, if you live to 84 and you had a term insurance policy, there will be no death benefit. But when you're young and you've got a lot of liabilities, you've got young kids, you've

got a mortgage, you've got all the things that young people have, it can be a great tool.

What we're going to talk about today is permanent insurance. So, this is the premium for permanent insurance. So, it's obviously more upfront deposit into the plan. But what it does is it gives you a death benefit that's going to grow over time. So, it's more capital in, but it's more capital out as well. So, it continues to grow throughout your lifetime.

It never expires. Once it's funded, it will payout on death. It's an amazing product once it's fully understood. And again I go back to a lot of our clients show up and they don't need to do this but when they spend the time understanding the attributes of permanent insurance, a lot of clients choose to do it.

This is an example and you'll see as we go through this presentation why we picked this example. So, there's lots of different designs. What we've chosen to show here is a 20-pay strategy and there's ways for us to pay this up in 10 years. There's lots of different ways to do this. We picked a product for this presentation, but really the client is signing up to transfer over a 20-year period 4.16 million into an insurance shell.

And what does that come with? So, you get an initial insurance death benefit of around \$5 million. But during the funding period, you'll see that the benefit continues to grow and then it continues to grow throughout your lifetime, even when you're done funding it. Death benefit IRR. We always tell our clients the best IRR is term insurance if you're going to use it in the first couple of years.

But the IRR on permanent insurance is pretty high in those early years. So, this is the true IRR. This is what's happening and it's obviously really high in the beginning, stays really high for quite a long time and then narrows out to a pretty competitive long-term investment number. And then we put in a pretax equivalent here so that insurance death benefit is not taxed.

So, what would you have to do in the open market to get the same benefit over time? So, you can see how we explain to a lot of our clients that the return you get on your insurance, it most likely won't beat your best investment, but it is certainly going to beat your worst investments. And I know we don't talk about our worst investments very often, but these are designed to be very steady and simple, and they really do an amazing thing over a long period of time. Cash surrender value for a lot of our entrepreneurial and business-owning clients is a really important tool that we really try to spend a lot of time helping people understand. So, you're investing in an insurance strategy in this example. So, this cash surrender value, you get this outsized death benefit for your deposit, but you also get this cash value which sits on your corporate or personal balance sheet. And that cash surrender value is going to grow over time. And it

gets to a pretty significant number considering what you deposited into the plan.

Capital Dividend Account is applicable. We're going to show personally held and corporately held. The Capital Dividend Account is the tool. You know, anybody who understands corporate structures knows that CDA is sort of the golden goose of planning. If you have CDA or you can create CDA, it's the way you get capital out of your corporation that's non-taxable.

So, in this case, as you track this death benefit growth over time, it always comes with a corresponding Capital Dividend Account and at age 100, in this example, the full death benefit can come out without tax. There are no other assets that can just do that in the Canadian planning space. If you're buying and selling companies, you can create CDA.

There's ways of creating it, but not as efficiently as life insurance. Dan, I just want to interject really quickly and just clarify a point with you. With that IRR number, the death benefit IRR. If we did this in a corporation, does that include the benefit of the CDA? We've seen illustrations where people will actually use the CDA benefit as well in the IRR. In this case, this is pure death benefit IRR in the corporate structure. So, when we add that CDA, if we're looking at the estate, it would actually be a higher IRR and we just don't illustrate it that way. Yeah. Perfect. Perfect. And just for the benefit of the audience, one of the other things I'm just going to come back on the CDA on this is, as Dan and James described it, it's really the golden goose or I like to call it like the Holy Grail of all tax attributes because it's, if we think about what we're doing with corporate-owned life insurance and life insurance premiums is we're using tax-deferred retained earnings to fund this money. So, effectively, we're using after-tax corporate dollars to fund this. And then what happens is, we get that tax-sheltered growth and then when the death benefit ultimately pays in, we get that tax free and we get the CDA creation. So, effectively, what we're able to do by using corporate-owned life insurance is turn taxable retained earnings that would have been taxed as eligible or non-eligible dividends into tax-free capital dividends.

The only catch is obviously the insured has to pass away, so you can't have it all, but it ends up being a very, very tax-efficient result. So, I just wanted to add that on. I'm sorry to interrupt, Dan. That's perfect, we appreciate that. So, and we often from time to time will do personally own insurance policies. And we're working on a couple of cases right now where a business has been sold.

The client, the end client, wanted to own all their assets personally, did not want to keep capital in a deferred holding company without an operating business. So oftentimes we'll meet clients like that. And what we're comparing here is the same insurance policy we looked at on the previous page, \$208,000 of premium over 20 years. And then we're going to look at an investment

return on something that gets you 4.75% after tax annually.

So, obviously it's a higher pre-tax number, but we've just kept it simple and set after tax. So, if we look at that 20-year funding of either or and pretty basic, we're going to fund something for 20 years. And if we look at that, that the investment we've chosen to make, it's going to grow to obviously a substantial number and time and compound interest is an incredible thing.

And when we look at insurance, insurance death benefit, there'll be a spread on your investment balance almost the whole way through. And where it breaks even is at age 100. So, if you're planning on living to 110, your investments will win. If you're not sure when you're going to live to, insurance should win. And we often show clients that even held personally, these are really great plans and if something happened to happen in the early years, it's really hard to beat insurance on a yield perspective. If both of these plans grow to \$22 million personally and both are good. Insurance has its advantages and so, and what we really look at is when we've got a client with a big diversified asset pool, which we looked at previously, we're just taking the fixed income assets.

So, getting 4.75% after tax annually in fixed income is very difficult. In equities, it's probably not a big deal. But if you're going to have a portion of your portfolio in fixed income, insurance is obviously and often the most efficient way to do that. So, who would do something like this? It's typically, you know, high net worth is the clients that we work with,

but for a lot of people in general, this is a really good way of growing their net worth. So, there's really no scale to these. If you wanted to do a smaller plan, you could, and if you want to do a really big plan, you can. And that after-tax yield is something that really people really like about life insurance.

Next up, we're going to look at corporately owned life insurance and how that works. So, we're going to take the same assumptions from the previous example, and we're going to layer a corporate structure in. So, we have the same deposits over 20 years. We have that growing investment account, we have a growing insurance death benefit over time. And in the corporation, we're going to hit that same tied

mark. So, we're getting to 22 million. There's no difference. You know, the difference is these are more efficient dollars and they're tax-deferred dollars. And so they get to be the same point within the corporation. But what's really interesting here is with the 22 million of death benefit, we're going to create anywhere from 6 to 10 million of Capital Dividend Account room for the next generation.

So, really simply, your estate tax is not, it's not a cheque you write directly from your corporate structure, although the cash is oftentimes coming from the corporate structure. So, with life insurance, it comes out through that CDA account. And with your investments, we have to incur dividend tax to get it out and into your estate. So, that's where, when Hemal asked the question, is the IRR on that previous page including these numbers?

The answer is no. And if we did, it would be a much higher number. Yup. So, and this next page should explain how that works pretty simply. So, we oftentimes have corporate clients, even when they feel tax paid in the corporate structure, they're often not tax paid inter-generationally because the corporation has to distribute capital into the estate to pay the estate tax.

I'm sure a lot of clients on here have dealt with that. And dividend distributions are painful for a lot of us. But what we're doing here is we're saying back to that same deposit amount over 20 years, we're going to invest in something. So the first thing we're going to look at is fixed income. What if we put up strategy at play in the corporate structure over time to handle our eventual estate tax. So, that fixed income at 4.75% after tax is going to grow to 22.4 million.

What we're going to face is dividend extraction tax. So, we pick the 40% number, it's sort of a round number. If you do no planning, it's more like 47%. And if you do really aggressive planning, which exists today, we can probably get it as low as 27%. Whether those rules exist in the future, it's hard for anybody to say.

But at 40%, we're taking our 22.4, distributing it out of the corporation. We're going to send 8.9 to the CRA on dividend distribution and have 13.5 in the estate to pay estate tax. So, it works. You just bleed tax. So, in the insurance strategy example, we're essentially depositing the same amount of money. We get a small win, 22.6 of net death benefit at age 100.

And remember, this is the last death because it's a joint last-to-die. So both clients don't have to live to 100, just one. And we get the full CDA at that stage. So, we're taking 22.6 million, we're skipping this whole layer of tax through the Capital Dividend Account and we've got 22.6 million in the estate to pay estate tax.

So, we do this calculation all the time. And what would it take to beat the insurance or match it, and the IRRs are usually pretty high, especially when we consider that whatever other asset we use is going to face dividend extraction tax. And so this family, by choosing insurance instead of fixed income, has gained by \$9 million in their estate. So, very efficient way to fund future tax liability, to do equalization, to do whatever it is the family's looking to do. Insurance often can play a very big role in that. So, this one, obviously you've got to have a corporate structure to do it. And it is typically, you know, the

businesses are often generating cash, but there's oftentimes cash already invested in the holdco.

So, clients sometimes say, well, it's 20 years, that's a long time. What if there isn't, what if there isn't cash being generated in year 15? Well, there's already an investment portfolio there, so we can fund it off new cash and we can fund it off asset diversification over time. And it's really an optimization tool. So, you know, we go back to this point that a lot of our clients don't need to do this planning, but if they're truly focused on optimization, they often choose to do this planning. Dan, I'm just going to interject really quickly as well, because one of the other big benefits associated with doing this is really helping address the issue of double or triple taxation, because when a person who owns a holdco ultimately passes away and that holdco's an investment holding company, effectively there could be capital gains tax on the disposition of the shares, and in order to extract money from the corporation, there's going to be capital gains tax to sell the investments and then dividend tax to cycle out the money from the corporation.

So it's a big three layers of tax that could significantly erode the value of the estate. Estate practitioners have tools in their tool kit to address these double tax issues. One's called the redemption loss carryback. The other one's called the pipeline, often combined with the bump strategy. But really the essence of these transactions is you can do them,

but when we layer on CDA and cash from life insurance, the results significantly improve. So, this is one of the things I also want to highlight is, you know, for the clients on the line, you know, this is one of those things where it's not insurance or the accountant's solution or post mortem planning. I kind of call it the cake and icing because basically the accountant can bake the cake.

And when we have life insurance on that, the life insurance basically serves as icing for that proverbial cake and the results end up being sweeter for you, the client. So, at the end of the day, my point with this is one where it's complementary planning. It's not exclusive planning. So, it's actually a really, really positive result, you know, for you as well.

I agree wholeheartedly. So, this one, and this will make sense as to why we picked these numbers. You know, we're going back to this corp that's worth \$90 million and there's going to be a \$22 million estate tax on that corporate structure, on the second death in this example, at age 100. So, you'll see where these numbers came from.

We tried to get to the right number and, you know, if the company's frozen or not frozen, if it's not frozen, we try to typically over-insure a little bit to cover some of the future growth. And if it's frozen, it gives us a bit more certainty on the numbers we're aiming at. But the timing doesn't always make sense to freeze.

And but what we're really trying to do here is how do we use corporate cash as tax-efficiently as possible to pay estate tax liabilities? You know, a lot of times and we're shoving the estate tax on the corp, but there could be a whole bunch of personally owned assets outside the primary residence that also are going to face tax.

So, we'll often include those in the analysis and perhaps bump up the insurance policy a little bit inside the corp to cover that. So, this is the same, we're using the same numbers. We're putting 4.1 million into an insurance policy over 20 years to cover that personal estate tax liability. And we always remind our clients that when people come to see us, they, I always joke when I worked at Goldman Sachs, they always talked about managing expectations and exceeding.

So, going into the client, make promises that you can exceed. The insurance industry has often done that job for us. So, when we go see clients, they think we're going to be an insurance salesman. But really we're there to help educate and people understand. So, we do try to outline that insurance is not the only way you can pay the estate tax.

So, we've seen examples like this after the fact where family members inherit an estate and they have to sell a whole bunch of mom or dad's assets to pay the estate tax. When Hemal talks about double and triple taxation, selling assets when they're in a capital gain position is going to incur capital gains tax along with paying estate tax.

So, we've seen that. It's a way to do it. It can be a hard way to do it because you have family members inheriting an estate that they have to start pulling apart to keep. So, and it's often they're handed the keys to a fast-running car and they don't always know how it got there. And we often talk that a family could take on debt to do this,

there's no reason why they couldn't. And, you know, especially if they're not levered at a high rate. But imagine you had to do that in the last year when everyone's used to 2% interest rates and we're now dealing with 7% interest rates. So, it could be quite punitive on the family business and the entire structure if you're taking on massive amounts of debt. We've seen situations where the family has enough personal assets to pay the estate tax.

So they have an investment account, they have a cottage, they have all sorts of assets that they could easily sell. They would skip that dividend extraction tax. But it's often not the most efficient way to do it, although it's definitely an option. So, we'll spend a lot of time with clients understanding that insurance is an option. It's not the only option, but typically when we run the math and the numbers, it is the most efficient way to do it.

So, you know, we're really just trying to cover, sometimes it's for estate tax. Sometimes what we'll do is we'll have, you know, there's three kids in this example. Parents will say, you know, one of the kids is taking over the company and two of the kids we would like to try to equalize in a way. So, we can often use insurance and other assets to create an equalization strategy, so that house and that cottage can go to other kids and the business stays in one kid's hands or two kids' hands.

Like it, and sometimes it's all three kids. Sometimes the kids get along really well. But as I said earlier, when you've seen one family, you've seen one family. So, you really have to try to understand what's going on there. So, who's this applicable to when we're looking at paying estate tax? So, there's got to be a corporate structure, frozen or not frozen, we'll often not pause the insurance planning, but we'll bring in the appropriate tax advisors to look at freezing.

A lot of our entrepreneurial clients have not, they're so busy running their companies, they're so busy growing their companies that they forget to do appropriate tax planning. So, we will help them through that process with changes, tax planning, background. And although he is not an acting and practicing tax accountant anymore, he knows how it works. So he'll bring in advisors to help with that.

It's always great if the corporate assets are growing over time. And what's neat about that is in a frozen situation, we oftentimes have to start talking about the next generation as well. So, if you've frozen the company, the generation that's moving up is also incurring tax. So, how do we cover that off? It's just a lot easier with life insurance too.

So, when you're doing estate distribution, if you have cash on hand, that's not heavily taxed, it means that you can solve a lot of problems quickly and there isn't market timing risk. There's just a lot less risk to it. So if you're a large real estate family and you've got a bunch of assets in a capital gain position, what are you going to sell?

How are you going to sell it? What if we plan ahead and don't sell anything? And it's, it's really for those families that plan ahead. And it's our job sometimes to slow entrepreneurs down and sort of say like, listen, it's your job to run your company. And we get that it's going at a fast pace and it's going great.

But let us get a little involved. Let us carry the ball a little bit here for you. It's your goals and objectives that we're going to follow, but we're going to help you get this thing across the line. So it's not just insurance for us, it's insurance and everything else. And how do we get this appropriately set up?

So, in conclusion, it makes a ton of sense, both personally and corporately. Obviously, that CDA makes the corporate look more appealing. But as we showed, you know, up until age 100, the insurance will be a lot of assets over

the long term. And we always remind our clients, almost none of them need life insurance. But when we spend enough time with them and they understand the yield, the risk, the tax interplay, it switches to, I know I don't need this, but I might want this to help my family, simplify my estate and make things more efficient in general.

So, we have a lot of conversations where people are very skeptical coming in and leave pretty happy, and they feel like they've solved a big future problem that oftentimes they don't know how to communicate. They don't know how to say, you know, my one kid is definitely not inheriting the business and my other kid is, and that's fine.

So, how do we do that? How do we make sure that your kids still have Thanksgiving together in the future? So, that wraps up the presentation part. Perfect. Thanks, Dan and James. I just wanted to open it up to questions, so please put your questions in the Q&A. There's a question from Scott who's asking, do you have a breakdown of approximate tax based on planning options?

Loss carryback equals 25%, for example? Maybe what I'll do is I'll address that one, given it's tax rate related, and Dan and James, please add on. So, typically what happens is, is with a wind-up and loss carryback, it kind of comes back to the underlying mix of assets and also tax attributes. So, in the worst case scenario, assuming that we have a non-eligible dividend rate and no CDA, we're looking at about a 47.74% effective tax rate.

If we have full CDA and we do a redemption loss carryback and we have stop loss apply, we're looking at about 13.38%. And, effectively, if we have the 50% solution applied to avoid the stop loss rules and this preserves CDA for the next generation, we're looking at a tax rate of anywhere between 19.7% if you have an eligible dividend pool or GRIP pool, all the way up to, you know, 23.7% or 23.8%, sorry, where you have basically the 50% solution applied to non-eligible dividends.

So, anyway, my point with all of this is redemption loss carryback has a great range and it depends on the underlying tax attributes of the corporation. Let's look at the next one. What's the best way to... Yes, please do It's really helpful for us if we both understand what the client is trying to do and work with their advisors on what is happening and what exists currently.

Because if we can understand the whole landscape, we can make more appropriate advice. Perfect. I think that's the biggest thing with any of this stuff. This is it's really all of these things are solutions. Pipelines, redemption loss carrybacks, but at the end of the day, it comes back to the goals of the client and how we want the proceeds streamed out.

So that's, that's really the macro of any of this stuff. There's a question from Jason. What's the best way to withdraw cash value from a corporate owned policy? Well, we didn't cover on that today, but for a lot of our

entrepreneurial clients, as I'm sure a bunch of people know, there's very aggressive strategies out there, which we do not participate in.

If a client has a cash surrender value and they have, we call it an opportunity fund. So if there is a, if they're going to buy a new business, if they're planning on investing in something and they have a cash surrender value inside their insurance policy, we can go to a bank, we can go to Manu Bank, we can go to the policy itself and borrow out of that policy.

So, what's nice about that in the Canadian system, even with interest rates high right now, whatever the interest rate you're paying, if you borrow to invest against the life insurance policy, it's tax deductible. So we have clients all the time, we don't have a ton of clients doing it up front, like a full leverage strategy. We do have some, but oftentimes they just know it's there.

So, if an opportunity is coming up, they want to use the insurance to make that opportunity a reality, it would be a banking conversation. If we've got to do it really fast, we go right to the insurance company and then we'll bring a bank in after that. So, the next one up is Josué, he's an advisor.

Where do you find these clients? What is your marketing strategy to attract such corporate life clients? I will say that when James first joined here, we have a lot of systems and processes we spend a lot of time on, on making sure that our company runs really well. And then James said, but how on earth are we going to find new clients?

And that's the part where I said, don't worry about that, I'll take care of it. And it's the hardest part for me to explain, I can just tell you that there's a lot of them, and I am constantly surprised with the success in Canada that I see because sometimes you hear a bit of a negative story about Canada and you start meeting these entrepreneurs.

There's a lot of them. And yeah, for us there is no active marketing strategy. And really what we do is, is we think we sell really well. We spend a lot of time with clients and because we sell so well, we feel really comfortable servicing. And what we've noticed is when we sell well and we service well, our clients send us new clients.

So, a lot of it is quite organic and just from a high level of service and high touch. And there's also, there's a randomness to it. Yeah. Like, you know, it took us a long time to create that magnetism of clients showing up, much longer than I originally anticipated. When I left banking, I thought this insurance thing looks really easy, you know, I sort of learned over time that it is not, there are businesses to grow.

But once you get that sort of market magnetism, they're really fun businesses. So, I know that's not a clear answer. And I'm sure James would love it if I had a better answer to that one, but it's not... I would have back

then...At this point I just accept it as true. Yeah, we have a lot of clients and we have a lot of other advisors we're working with who bring us, they bring us something, they want to work with the client,

they've got a great relationship with the client, but it gets a little confusing at times and we can come in and simplify everything. And so there's other advisors that bring us casework. We share that casework and there are there's an organic nature to it. It's sort of all of the above, but there's no real marketing strategy in the sense that we, you know, we don't post on LinkedIn and we don't brag about what we do, we just do what we do.

So, Kent has a question. Does this work for a professional that has a holdco with \$2 million invested in it, or is that too small for this type of solution? So, it goes back to there's, you can scale down these strategies. So the number we picked today may be big for some people, but, you know, if you look at that pie chart that we showed earlier, it's the same pie chart for \$2 million as for 90 million.

So, that client may have a harder time in accessing, really hard, you know, it's the same. It's the same end tax consequences, it's the same everything. It's just a different number that you'd recommend. It just comes down to objectives at the end of the day. If the objectives align with what the insurance is going to do in your portfolio, then it makes sense to do.

We've even worked with some professionals who are very late in their career. They have that \$2 million in their corp, but they also have like \$8 million personal. So they have their house paid, they have their cottage paid, they have an investment account. And there's been a couple of situations where we've actually recommended moving the entire corp into a life insurance policy.

That is not a common thing we've done. But there's a few clients. We had one client who had an enormous ranch property that was coming with a huge tax liability, but she happened to have this old professional corporation off to the side and we covered most of the tax through the professional corp. But she didn't have kids, so it wasn't going intergenerational without tax even though it was a ranch.

Perfect. This one: If parents purchase a par, Caleb has this question. So if parents purchase a par life policy on their children and are the policy owners, can the children's spouses claim the CSV upon marital breakdown? So do you want me to address this one? We're happy to do this one as well.

Okay. I'll address this one. So, in a nutshell, as long as the parents own that policy, the children, the ex-spouses of the children should not have a claim against it. The issue becomes one once the policy is transferred to the child. And really it's one where you have to look at, you know, the transfer itself. If it was a gift, which it normally

would be, it should be excluded for the purposes of the marriage breakdown.

But if theoretically they start, the child started surrendering portions of the policy to fund family expenses, now this may become co-mingled with that family property. So, generally speaking, it should not be included while the parents own it. Once the child owns it should be excluded unless it's being co-mingled. So that's really how this works from a macro perspective.

The other thing is, if we take a step backwards, if marital breakdown is ever a concern prior to getting into a marriage, one of the things that we highly recommend is clients ultimately look at doing marriage contracts and this could minimize the risks associated with marital breakdown in terms of potential exposures. And as well, you know, usually one of the assets that's often used even as part of a divorce settlement, is a life insurance policy.

So, it's one of those things where this can actually present a good opportunity just to have life insurance either in place from the beginning or in the future in the event of a marital breakdown. I don't know if you guys have any other colour to add to that one, Dan, James? Okay, perfect. So quick answer live. Okay, So this is a follow-up question from Jason.

So, in terms of, so his first question was around the best way of like leveraging a policy or the best way to withdraw cash value from a corporate-owned policy. And the follow-up question is this: is the withdrawal taxed as a dividend? Is he talking about taking cap? So let's imagine this. We've got a corporately owned life insurance policy.

It sounds like what Jason is working toward is he wants the end client to have that capital, not the corporation. That's right. I think that that would be what he's looking at in terms of options. I mean, really, you know, if the corporation is the borrower and ultimately that money is allocated out to the shareholder, there is going to be a dividend tax treatment to the shareholder when they receive the proceeds associated with that.

But on the flip side, there is a way to also do this, which is what we call shareholder borrowing. I'm personally not a fan of it, although I know it does happen. It's really shareholder borrowing, is one where you're using the corporate asset, being the corporate-owned life insurance policy, as collateral security for a personal loan. And when we do this, what ends up happening is, you do get the cash in the form of a loan, tax free,

however, if you're using it for consumption, you lose out on interest deductibility. Where we use the borrowed funds to pay a dividend out of the corporation, we can actually get interest deductibility on that. The other piece of the puzzle with that is, is because we're using a corporate asset to the security for personal loans, now there's a potential shareholder benefit issue to consider from a tax perspective.

And I think this is where things get messy and historically that number's been 1 to 2%. But, you know, it's been one of those things where, generally speaking it's important that you structure this properly and you make the appropriate payments to the corporation for this. Otherwise there could be a shareholder benefit during your lifetime. And alternatively, when you ultimately pass away, there can also be shareholder benefits if you don't follow the appropriate tax cycle in terms of actually having the death benefit pay into the corporation and cycle out the monies from the corporation.

So there's a bunch of steps that you need to look at in order to be careful. And then the other the other problem with shareholder borrowing is at the tail end, you could potentially get hit with the higher capital gains exposure and you end up with a lower net CDA credit after the loan is repaid. So for all of those reasons, I'm personally not a fan of shareholder borrowing unless it's a very specific client scenario that points to the opposite.

I don't know, Dan and James, do you have any more colour to add just based on your experience with any of this stuff? I know those strategies are getting challenged, so there are strategies out there where that was happening at a scale unseen before in Canada, they're being challenged quite aggressively by the CRA. I personally wouldn't, back to your thing, if there is some situation where a client needs cash and they need it for a year or two, it might make sense.

But is it a permanent strategy? And it's gripping strategy? We wouldn't touch that. Perfect. And then there's another question. I think this is more tax related. I have two 75-year-olds with \$2.5 million in their former farm corporation. The accountant is telling them to do an inter-vivos pipeline. I could see no purpose for this.

Am I missing something? And the simple answer to that is for those of you who've been paying attention to the recent tax rules, there's a proposed new GAAR, general anti-avoidance rule, that's being introduced. And what's happening with the new GAAR is they're proposing to introduce an economic substance test. And in the explanatory notes to the economic substance test, they specifically identified an inter-vivos pipeline transaction as a GAAR-able transaction.

So one of the things that's been happening in the marketplace and we're probably going to see this between now and the end of December 31st, is tax practitioners are aggressively promoting surplus strip strategies for the money that, you know, it's basically they're aggressively promoting these strategies. And really the gist of it is one where they're trying to do this to get this under the old GAAR rules rather than the new GAAR rules.

So, effectively, there's a higher likelihood that this won't be challenged. So, my issue with this one is this a few different things. The first thing is this is from a tax act

perspective, the whole point of doing a pipeline is so you could pull out values like capital gains rates rather than dividend rates. So right now, if you were to do a pipeline, you're looking at 29% effective tax rate versus like 47%,

if you had it as a dividend coming out. So the issue here I have here is, is first off, if the client doesn't need the money, there's a better surplus strip available, and that's corporate-owned life insurance, like Dan and James talked about. And I think that's important to realize, why do this on an inter-vivos basis and prepay tax when you can ultimately benefit from the tax deferral on that \$2.5 million and ultimately get CDA treatment.

I guess, Dan and James, 75-year-olds, how hard is it to get life insurance on 75-year-olds, and do you have any tips on that? It totally depends. You know, joint last-to-die is obviously easier than single life, but there's no guarantee. And I would wave every red flag on the way into that underwriting process saying we are going to give this a shot.

And getting life insurance is definitely an option. Finding out you have a health issue is also an option, which could be great. So think of this as a free Medcan service. And so we've taken a bunch of people that age through underwriting with some success and some failure. But what we do is explain that this may not work.

And with joint last-to-die, one of the things we always flag is if one of you is declined, that doesn't mean we can't do it, but you're going to get a decline letter from the life insurance company. So, I would just prepare people mentally for every outcome and then give it a shot. And it depends in that case, you know, if that corp is all of their future cash flow,

what we talked about earlier by putting it all into a life insurance policy doesn't make sense. If they have a significant, if they have an ability to get cash from elsewhere, you can go heavier on the insurance. If they don't, it's just a portion of that corp, not the whole corp. Absolutely. Perfect. Thanks. Caleb has a follow-up question.

If the holdco funds and owns the policy for the children, will the cash values always be protected upon marital breakdown, or no? So, this really comes back to the marital breakdown question and my answer in that situation is this. This is where you kind of have to look at the macro picture, at what the parents are ultimately trying to achieve, because, a few moving pieces here... if the parents own a policy on a child's life and that policy is subsequently transferred to the child, that's a tax deferred transfer.

So, there's a very favourable tax rule around ownership of child's policies or children's policies by the parents, on the kids' or the grandkids' lives. So, generally speaking, because of this rule, we would generally want to focus on personal ownership. However, in the context of a

corporation, it's now going to come back to, you know, what's

the story of this corporation? Are the kids already shareholders of this corporation, either directly or indirectly through a freeze? And when I say a freeze, there might be a family trust that owns common shares and the kids are the beneficiary of the family trust. But really the gist of this one is if, you know, if the holdco ultimately owns the policies,

now the question becomes is the freeze value of the shares included in the kids' net family property calculation? And the reality is where those kids own the common shares directly, the answer may be yes, right, depending on how the freeze is ultimately structured, but it's likely going to be yes, and if the shares are held through a family trust, and there was a case,

Siegel, maybe about ten years ago that effectively said, like, even if you have a discretionary family trust, what ends up happening is the beneficiary has to include their proportionate interest in the trust. So, if there's, like seven beneficiaries, one seventh of the value would be included in the value, for the purpose of the marriage breakdown. So, this is where I think, like, you know, the bigger nugget here is just get that marriage contract done right.

Because what happens is if you do that correctly, I think this will help minimize the risks associated with other aspects of this. So, there's a follow-up question from Sudhir. If the married child receives the death benefit, do spouses have rights? So, if the married child receives a death benefit, does the spouse have the right to the money?

Alright, so the simple answer to that one is, as long as that money is kept separate and not co-mingled, it should be fine. But the moment it is co-mingled with other family members' assets. So, let's just say, for example, you know, the child had a mortgage, they received a \$500,000 death benefit. Now they use that to repay the mortgage.

All of a sudden it forms part of the net family property. So, at the end of the day, the issue is one where, you know, what are we doing with this money? Are we keeping this as a separate pool, away, with any income being generated away from the rest of the family? Or are we co-mingling it? And if we're co-mingling it, all of a sudden we're in a situation where it may be included for the purpose of the net family property.

So, long story short, get a marriage contract. It helps minimize the risks around all of these issues. So, yeah, so I think that's the questions that we've got so far. Dan and James, do you have any final thoughts that you want to share with the audience before I wrap this up? I think this is just a perfect example.

You know, Hemal's a tax expert, we're insurance experts, Hemal's also an insurance expert, but he happens to be a tax expert at the same time. And when we planned this call, Hemal said, should I jump in whenever I feel like it? And the answer was absolutely yes. As a tax expert, you should jump in whenever you feel like it, because if we can work well with tax experts and they can work well with us, it just helps the clients

in the end. Absolutely. Well, with that, thank you, Dan and James, for joining us today at Manulife Private Wealth. We understand the importance of maximizing income and preserving wealth while minimizing the impact of taxes on your gains. In addition to investment management, Manulife Private Wealth also offers access to private assets at lower entry minimums, financial planning, tax and estate planning services, and comprehensive private banking.

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