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WINTER 2000
$4.95

Investment.com Magazine

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Canada's Last Bastion of Tax-Free Money

John Eitel

Lorna Fadden

How To Read Financial Statements

Richard Czerlau

Retiring To An Exotic Country – Testing The Financial Waters

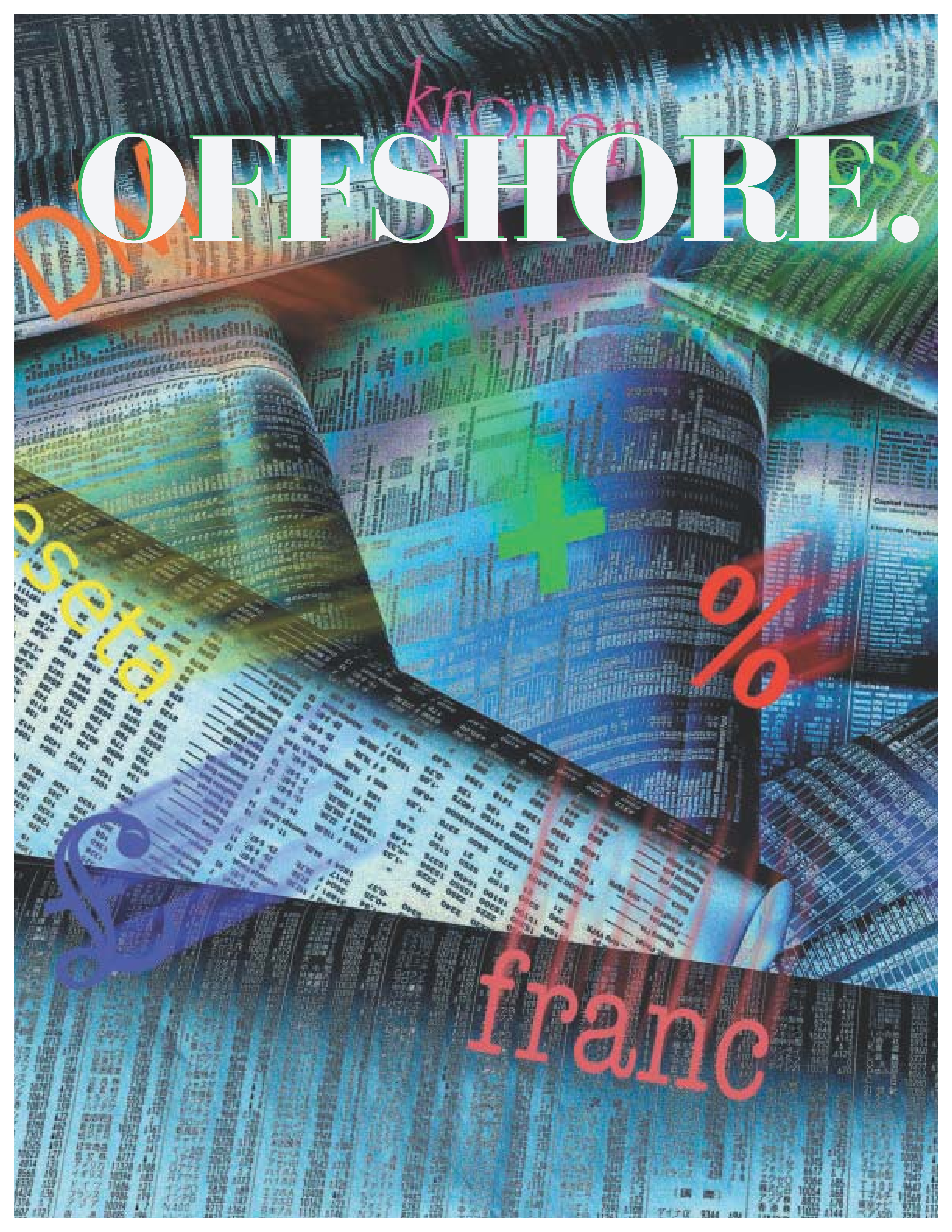
Joanne Thomas Yaccato

Through The Din Of Swirling Controversy... 100% RRSP Eligible Funds

Geof Wheelwright

Day Trading: Do You Have What It Takes?

Plus Planning for Profits Portfolio: Investment Opportunity Showcase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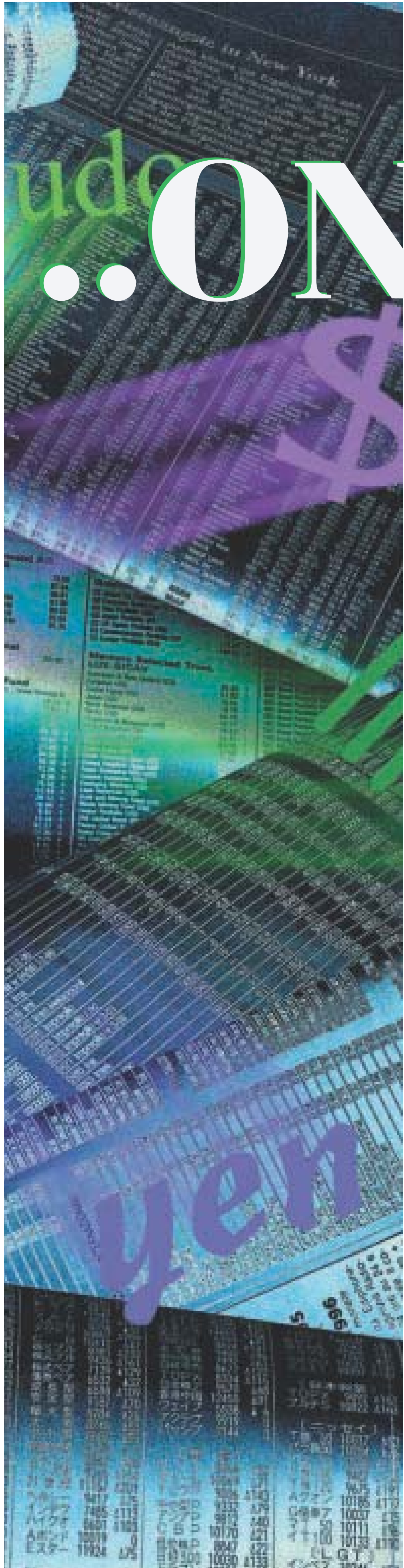

..ONSHORE

BY JOHN EITEL

At the end of the day we are all in this together - life, I mean. The goal is to get to the end (and there is an end) with some dignity, some money, and a legacy for those we love. In this installment we are going to examine the mechanism to accomplish this; we are going to view the latest international (made in Canada) stratagem, and exploit the last bastion of tax-free money left in Canada. Canada you say? You bet!

It has taken a long time for main stream Canadians to consider going offshore. We believed the promise of a Country that would take care of us from womb to tomb, cradle to grave. As such, we did not even mind the levels of taxation. This covenant has been broken. As recently as two years ago there were still people who felt guilty about cross border shopping. That demographic anomaly is now extinct.

It is interesting and a little frightening to note how few methods there are left to pass on family assets from this generation to the next. Over recent years, we have seen major changes to the Canadian family trust, attribution rules, and, of course, the final tax return. All this is in preparation for the enormous bulge of money that will emanate from boomers via RRSPs, real estate, stock & bond portfolios, boats, cars and planes, to their children. The government knows that at least one trillion dollars are going to change hands and they are perfectly positioned to have their share. We can rant and rave (for which I am King) about us being positioned for this event, but when all is said and done, it is what it is. The mature thing to do is to become as prepared and bullet proof as possible. I have to admit it is not as much fun as ranting and raving, but it is healthier. So, let's get healthy.

OFFSHORE

As you know, or have been told by offshore facilitators, Trusts are the vehicle to house your international wealth. That is no longer completely true for Canadians. Until the last budget, and in accordance with the original definition (876 a.d.), any money in a family trust was just that, money or tax paid capital. There is no capital tax in this country and only income is taxed (Capital Gains Tax is another movie). Revenue Canada's rules are now designed to ensure that money received in an Offshore Trust which has been derived from an International Business Corporation (IBC) is taxable Canadian income and is, therefore, deemed taxable to the Canadian settlor or beneficiary. Many of the existing structures that have been established in this manner simply no longer work.

If you are already offshore, some decisions must now be made. Repatriate the capital (if that is possible), do nothing (that is a decision, too), or sanitize. You are going to hear a lot about sanitizing structures in the near future. You may very well have completed the appropriate steps in your exit strategy, but now find yourself offside with the rule changes. No problem; remember, rules show us how to do it properly. Check with your facilitator to assess your exposure to the new rules. If your reasons for being offshore are still valid, then sanitize.

The sophisticated have gone to the learned who have developed a new (but old) vehicle that is a replacement for the former Trust structure. It is a Foundation.

One of the reasons that Trusts are under attack is that they find their roots in the bosom of Common Law. In common law Trusts, there are such things as settlors, protectors and beneficiaries. This falls very nicely into the realm of control, beneficially interested and possibly mind management. Remember, these are all reasons Revenue Canada gives for deeming the structure a Canadian entity and therefore subject to the Canadian (resident) taxpayer's worldwide income.

Foundations are different. First, they are formed in Civil Code not Common Law. In Civil Code there is no argument about ownership. Assets in a Foundation are undeniably the sole property of the Foundation. There are no beneficiaries. There is no definition or nucleus of thought that it could be beneficially owned by someone else. This kind of language does not exist in Civil Code. Foundations can be established for a purpose that will allow certain established recipients to receive benefits from the Foundation. There are no beneficiaries as such; only the Foundation's purpose to be satisfied. A properly structured Foundation will offer all of the protection one would need to take care of the family legacy. International tax and estate planning are very personal events. Discretion about one's private and family planning is to be maintained, and remain, private. However, if Revenue Canada asks about your affairs, you cannot lie. The strategies are still available. We have the technology.

ONSHORE

This strategy will shock some of you – raise some eyebrows, even – but do hear me out. It is **INSURANCE**.

Insurance is the only tax-free money left in Canada other than the sale of your principal residence. If you take the morbidity, pain, suffering, shame, guilt and sadness out of the passing away of a loved one or business partner, you are left with the perfect investment vehicle. Let's examine the risk/reward facts and see where they lead.

"It is appointed unto all men once to die." Hebrews 10:27. That is not a business assumption or a "what if" scenario on my part. The power that speaks here is even higher than Alan Greenspan. This is a certainty. An unfortunate and unhappy certainty, but a certainty none the less. In the quest for investment quality, every Bay Street Analyst will tell you if they had this certainty in an investment it would bear no risk. Your reward is clear. What does it say on the policy? $50,000? $100,000? $2,000,000?

The question is when, and that does not really matter. The reason that it does not really matter is, in most cases, death is the catalyst that will trigger the need for money to pay taxes, or live without the main income earner, or buy a partner's spouse out. This vehicle offers tax-free money and the optimum answer to health, family, and business solutions.

If you want to play in the big leagues and manage the tax system, you have to think like a big leaguer. The wealthy use the insurance for retirement, tax and estate planning. Insurance companies have entire actuarial departments of brilliant mathematical and statistical minds with formulae that will approximate the death of everyone. For your part of the investment (annual premium) they will joint venture this arrangement with you. You pay them a fraction of what the final payout will be, and they sign on. They know they will have to pay-out a lot of money and they do not mind. Well... they do, but they have calculated the numbers and that is their problem. You definitely will get your money – tax-free. Canadian insurance companies are federally regulated, powerful financial institutions that are guaranteed and backed by the Government of Canada. They enjoy a privilege that even the banks do not have (no one has): you can piggyback this unique financial environment as long as you tell the truth on the application and the insured can pass the medical.

I am not done. Insurance monies are not only TAX FREE (I cannot stop saying it), but they have creditor protection similar to offshore. The money comes directly to the beneficiary: YOU. Nothing on earth can stop it. If someone is seeking you out for a past debt, insurance money can not be attached or attacked in any way. Once you receive it they can come, but at least you have the dough to pay or fight.

I am still not done. This is probate free. Properly set up, this money does not go into the estate but directly to you, no probate fee, no three to nine months (sometimes years) tied up in legal harangue, contests, etc..

People in Canada wonder about an inheritance tax. There is no need. We already have a defacto death tax. On the day one dies everything that he/she has is deemed disposed of (sold) and a tax return is necessary. Cash, assets, and real estate pass tax-free to the spouse if that is the arrangements of the Will. But that is the last free bump. When property passes from the parents to the children, we have deemed dispositions: income, with taxes due and payable. The only asset, other than insurance proceeds, that can pass to the children tax-free is the principal residence of the parents. That is it.

Every piece of real estate, stock portfolio, car, nick-knack and brica-brack, will be valued and taxes payable. Revenue Canada does not provide much in the way of condolences or time in these cases. For example, the family cottage on the lake, separate from the home in town, is income to the children. That $400,000 cottage has a $200,000 tax bill. Guess when it is due. If there is no insurance then the cottage must either be sold (not what the parents intended) or mortgaged (again a burden not intended). Solution: a life insurance policy that pays-out at the same time the tax bill arrives.

Who should pay for this policy? The children should pay when/if they are old enough to earn income. This is their tax bill that is coming; they can pay for it. It is simply the best investment they can make – better than the stock market. In the market there is a chance you will lose all or some of your money. If you are lucky and the E-commerce gods are smiling on you, you will still have to pay capital gains tax on the profit. This is both risky and tax vulnerable. Why be there?

This system can also be used to create new wealth where there is none or very little. Mom and Dad want to send the son/daughter to University. Why not put a policy on Grandma. Who should pay for this? Mom & Dad should pay for it. This is a solid investment. We hope Grandma is there at the University Graduation, and at the opening of the Dental Practice. The children will still have to borrow student loan money and wait on tables in the summer to earn their way, so nothing has changed. But when (not if) Grandma dies, this tax-free income will pay-off the loans and give these kids a start in a world of their own. Real Grandmas will be happy to have helped.

Business will use a multitude of insurance stratagem to retire partners in an orderly fashion so that the leaving, or the demise, of a partner does not destroy the company or force the smaller shareholders to lose their equity position in a forced sale. The company will survive. Insurance policies are used to fund huge taxes on unrealized capital gains on buildings, etc. These tax concerns are not going to disappear just because you did not want to deal with them. Would you pay premiums for ten years that cost you a fraction of your inevitable $2 million tax bill? The use of insurance policies, combined with annuities and a smart bank, can accomplish leveraged positions that use the money in a tax-free environment without anyone having yet died.

John Eitel

Think of using insurance products to guarantee the original investment in the equity market.

Partners will be able to utilize proper shareholder agreements funded by an Insurance Policy to take out the spouse of a partner at a fair market value. By funding this strategy we thereby are insuring a peaceful ongoing business and a fair and appropriate exit strategy for a partner’s family. Or would you rather have your deceased partner’s wife and her just-about-did-graduate brother in the office wanting to know, “How does this work?”

Remember, when a business passes on to the next generation one of three things will happen: Planned liquidation, forced liquidation, or planned retention. You choose!

Investors should be thinking of using Insurance products that guarantee the original investment in the equity (stock) market. This product is Segregated Funds. This strategy provides you with the ability to fully protect your original investment and freeze or crystallize any profits that you might make. Your initial investment is insured or guaranteed. This is great for people who are risk-adverse, long-term players; the ability to participate on the upside with no downside risk. Does it get any safer or smarter?

And, finally, a new product called Critical Illness. This one is close to my heart. My very brave wife is successfully fighting Cancer. This product covers Cancer, Heart Attack, Stroke, (accounts for 82% of illness deaths). This product was invented by Marius Baarnard brother of Christian Baarnard who performed the first heart transplant. In this format, if you are diagnosed with any of these diseases, 30 days later you are given a check for the full amount of your policy. From $50K - $2M, tax-free, lump sum, while you are alive and when you need it. Cash to go anywhere in the world for professional health care. I do not mind lining up for a hot dog or a hockey game, but I don t like lining up for a heart or kidney transplant. And we have long line-ups in this country as part of our Universal Health Care.

I also have no taste for moving in with my children or my parents to care for me when I am helplessly sick. This should not be their burden or illness. And here is a bonus: If you never use this benefit, either you or your beneficiary get back all of the premiums you paid in. So you either use it or you get all your money back. Sound too good to be true? I would never do that to you. This information was not available to me when I needed it, but now you have it for you and your family.

This is all about taking better care of yourself – and if not you, who? ■

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