Wealth Strategies Group
Qualified Financial's
Strategies
www.wsgcanada.com
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# Overcoming the "Losing Pocket" Syndrome

The majority of people today focus on the accumulation of wealth and choose investments based on their rates of return. Unfortunately, all too often investors are afflicted with what is termed "losing pocket" syndrome, i.e., they lose more from one "pocket" than they earn from another. "Losing pocket" syndrome results in the unnecessary loss of money unbeknownst to the investor. Transfers, such as these, include expenses, such as taxes, interest on credit card and other debt, insurance premiums, and so forth. The accumulation of the wealth that is transferred from a "losing pocket" during one's lifetime, may add up to a very large sum.

Consider an additional factor, that of "lost opportunity cost". If, for example, you have spent a dollar you were required to spend, not only have you lost that dollar, you have also lost the opportunity to benefit from its growth during your lifetime. Combine your original "losing pocket" wealth transfer with potential "lost opportunity costs", and your negative investment may reach millions of dollars.

However, greater control over your finances is possible, and you can transform your losses into profits. Addressing the "losing pocket" syndrome may significantly enhance your wealth building, without additional risk or sacrifice to your lifestyle.

***The following are proven examples of how your wealth may be adversely affected and strategies to prevent such loss:***

**1. Compounding interest.** Many taxable investments result in the erosion of wealth due to the amount of taxable interest most people pay from their lifestyle pocket.

**2. Term insurance.** The cost of term insurance involves not only the value of insurance premiums, but also the time value of the money invested in the premium, i.e., its worth had you invested the money conservatively elsewhere. This is not to suggest that you forgo owning insurance, but rather that you be aware of the true cost of term insurance. The cost of term insurance can only be calculated when the time of death is known. However, subtracting the premiums paid and the related "lost opportunity cost" (e.g., interest from the expected return on an investment or from the cash value of permanent insurance) can provide a clear assessment of the actual cost of owning term insurance. This calculation can be easily performed by obtaining your company group term rates or individual term rates. A review of the total cost of your term insurance is likely to reveal that owning permanent life insurance and investing your term insurance premiums is a sensible option.

**3. Permanent insurance.** Permanent insurance is attractive, however the premiums may seem prohibitive. People whose money is tied up in investments often do not want to alter their principal investments. At the same time, they may consider assigning a portion of the interest earned to insurance. This is particularly relevant to taxable investment accounts, as compounding one's money in such accounts increases tax fees. Simply redirecting interest-only to acquire permanent insurance can often help to diversify your investment risks and minimize taxes, while maintaining your principal investments.

**4. Mortgage on investment property.** People are taken aback when they learn that there are more tax benefits in the first 15 years of a 30-year mortgage, than in a 15-year mortgage. In general, it is better to secure a 30-year mortgage, save and invest the difference, and finally repay the mortgage in the 15th year in one payment. You will have accumulated sufficient funds from the money you saved and invested during that time period. This option offers the greatest tax benefits while carrying a mortgage, and allows for its continuation if there is a rise in market interest rates during this time period. Furthermore, it is most beneficial if you are able to earn more on your savings and investments than the costs of the mortgage itself. It is important to remember that a 30-year mortgage offers control. It provides the option of repaying your mortgage early if you wish, and further options that are not available in a 15-year loan.

Some of the strategies outlined above may have challenged your current investment beliefs. Qualified Financial's Wealth Strategies Group offers valuable and practical strategies to protect your investments and maximize your wealth. We can prevent the unnecessary and adverse effects of "losing pocket" syndrome, and transform your losses into profits.

*John R. Ardill, CFP, CLU, CH.F.C.,*
*Senior Partner, Wealth Strategies Group*

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*Qualified Financial's Wealth Strategies Group consists of a network of financial advisors, lawyers, accountants, and other professionals in the areas of strategic financial planning, tax minimization, wealth creation and estate preservation. We specialize in practical strategies that maximize wealth and minimize taxation.*

*To gain a better understanding of our unique approach, please visit www.wsgcanada.com or contact one of our advisors.*

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# Choosing A Tax-Planning Strategy For Investment Holding Companies

**Private corporations owning passive investments present an opportunity and a challenge when developing life insurance solutions. The opportunity is the need for life insurance and the ability to pay the premiums. The challenge is determining which life insurance strategy should be presented and understanding how the insurance planning integrates with the client's overall tax, succession and estate plan.**

*This article outlines a typical tax planning strategy for investment holding companies and demonstrates how life insurance can be used to facilitate and enhance the overall plan. Clients should review their personal situations with their own professional advisors before deciding on a course of action.*

### Death of a taxpayer and share transfers

Under Canadian tax law, private corporation shares (and other capital property) held by a deceased taxpayer are deemed to be disposed of immediately before death for proceeds equal to fair market value. This results in a capital gain reported on the deceased's final tax return to the extent the fair market value of the shares exceeds their tax cost that could result in a tax liability. There's a rollover provision permitting the shares to be transferred tax deferred to a surviving spouse (or to a spousal trust). This results in a deferral of the capital gains tax liability until the death of the surviving spouse, an important planning consideration.

### Estate freeze to limit the capital gains tax on death

The capital gains tax on death is based on the fair market value of the deceased's shares immediately before death. Investments owned in an investment holding company will presumably continue to grow in value over the years. Assuming clients own the common shares of the investment holding company, the capital gains tax liability on the death of the surviving spouse will also continue to grow over time, resulting in an increasing financial risk to the family's succession and estate plans.

One solution to this problem is to implement an estate freeze under which client's common shares are exchanged for fixed - price preferred shares that are redeemable and retractable at an amount equal to the current value of the common shares. New common shares can then be issued by the corporation for nominal consideration to clients' children directly, or indirectly through a trust.

The benefit is that preferred shares don't increase in value as the value of the corporation increases, so the accrued capital gain on the preferred shares is effectively frozen at the redemption value of the shares. Future increases in the value of the corporation accrue to the common shareholders, which could result in a significant tax-deferral opportunity.

### Taxation of investment income in a corporation

The tax rules for investment holding companies can be complex. Passive investment income earned in a private corporation is taxed at rates similar to or exceeding the top marginal tax rates for individuals. However, under the corporate tax rules, the nontaxable portion of capital gains are credited to the capital dividend account of the corporation and may be paid out as tax-free capital dividends to the shareholders. Also, a portion of the corporate tax on passive investment income is refundable to the corporation as taxable dividends are distributed to the shareholders.

To minimize the value of the client's shares in the corporation and to recoup refundable taxes, tax advisors may recommend the corporation distribute its after-tax investment income each year as dividends, tax-free capital dividends to the extent of any balance in the capital dividend account of the corporation, and taxable dividends to the extent required to fully recoup refundable taxes. This can also provide clients with a potential source of retirement income.

Alternatively, tax advisors may recommend a partial redemption of the preferred shares of the corporation each year. The tax consequences of a share redemption are exactly the same as for dividends distributed by the corporation. The benefit of this tax planning is the reduction in value of the preferred shares over time, which also reduces the capital gains tax liability on the preferred shares on death.

### Strategies to contemplate

Canada Life has several life insurance planning strategies you can consider when you're planning for investment holding companies. *These include using life insurance to:*

- Fund the capital gains tax on death (Preserve your wealth)
- Enhance net estate values (Corporate estate transfer or Insured inheritance)
- Generate supplemental retirement income (Corporate collateral loan or Corporate insured annuity)

The Corporate estate transfer strategy can be particularly attractive when combined with a share redemption strategy. The corporation purchases a life insurance policy on the client (or the client and the client's spouse on a joint last-to-die basis) sufficient to fund a redemption (or partial redemption) of the preferred shares following death. The corporation owns the policy and funds the policy premiums, and is the beneficiary under the policy. Upon death, the life insurance is paid tax-free to the corporation and can be used by the corporation to fund a redemption of the preferred shares. Depending on the circumstances, the deemed dividend (or a portion of the deemed dividend) arising on the redemption of the preferred shares and the distribution of the excess life insurance proceeds to the common shareholders can be elected to be a tax-free capital dividend to the extent of the balance in the capital dividend account of the corporation generated from the receipt of the life insurance proceeds.

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*Content provided courtesy of Canada Life.*

# Are You Sure Your Family Cottage Will Stay In Your Family?

When you die, your assets can be transferred tax free to your spouse. But, when your spouse dies and the assets are passed on to your children or other heirs, this transfer may result in a significant tax bill. And this tax is paid before your heirs get anything.

An asset like your principal residence is exempt from this type of taxation. Generally, your cottage won't be exempt and it will be considered a capital asset. Consequently, it may trigger a capital gains tax liability at death.

With the recent real estate boom in Canada, cottages and other vacation properties have increased significantly in value. These properties are now worth substantially more than their purchase price. At death, 50% of this increased value is subject to taxation. Are you aware of the impact this capital gains tax liability could have on your estate? A lack of proper planning could mean that your family cottage won't stay in your family. Your estate might need to sell it to pay the tax.

It's a tax time bomb that most people are unaware of and don't plan for.

### What are your options?

A number of different options will provide the cash required to pay this tax liability at death. It's important to make the best choice for your situation.

### The alternatives:

- You or your family can start saving today,
- Your heirs can borrow the required funds from a bank,
- Your estate can sell the asset, or
- You can purchase life insurance to cover the growing tax liability.

### The best solution:

Life insurance is often the most cost-effective planning tool to cover the tax liability at death. Life insurance provides cash to pay the tax exactly when it's needed, helps ensure your heirs receive what you intend them to receive and puts your mind at rest because you know you've taken care of this important issue.

A little planning can ensure that your dream of passing the family cottage to your heirs will come true.

*Here's an example that shows the growing problem:*

**20 YEARS AFTER THE COTTAGE WAS PURCHASED**

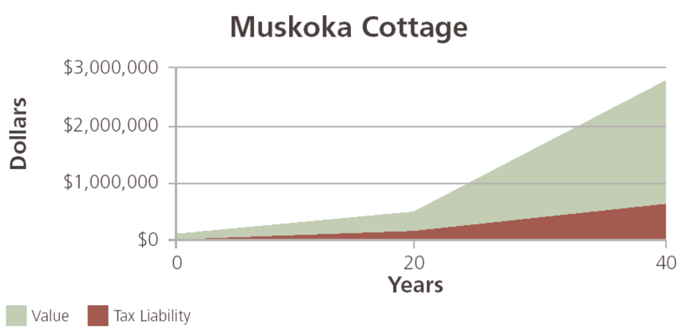
| Asset type | Market value | Original cost | Capital gain | Tax payable* |
|---|---|---|---|---|
| Cottage in the Muskokas | $ 600,000 | $ 100,000 | $ 500,000 | $ 112,500 |
| Cottage in PEI | $ 150,000 | $ 25,000 | $ 125,000 | $ 28,125 |

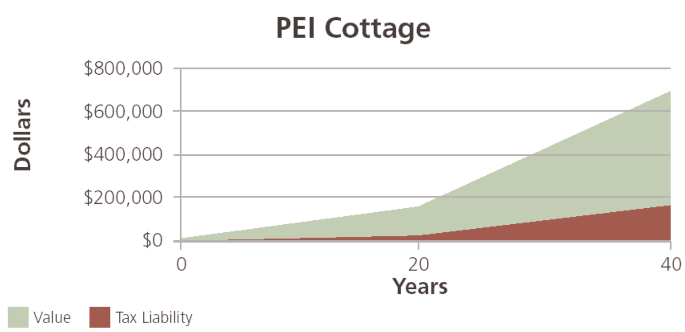
*Assumes 50% of Capital Gain is taxable at a personal rate of 45%.*

**40 YEARS AFTER THE COTTAGE WAS PURCHASED**

| Asset type | Growth rate | Future value | Original cost | Capital gain | Tax payable* |
|---|---|---|---|---|---|
| Cottage in the Muskokas | 8.00 % | $ 2,796,574 | $ 100,000 | $ 2,696,574 | $ 606,729 |
| Cottage in PEI | 8.00 % | $ 699,144 | $ 25,000 | $ 674,144 | $ 151,682 |

*Assumes 50% of Capital Gain is taxable at a personal rate of 45%.*




*Growing value means growing liability*

### Life insurance – the better choice!

- Life insurance allows you to custom design a solution to meet your specific needs
- It creates immediate estate liquidity to pay for the tax
- You can choose a death benefit that increases over time to match the growing tax liability
- You can customize the amount and number of deposits you make into the plan to suit your needs
- Certain insurance products offer a broad range of investment accounts, if you choose to invest money in your policy over and above the cost of the insurance it provides
- Your advisor can use the expertise of tax and estate planning professionals to help with complex situations

*Content provided courtesy of Manulife Financial.*

# Whole Life Insurance: 'The Investment Bomb Shelter for Scary Times'

WASHINGTON, Jan. 28/PRNewswire/

During one of the most unsettled periods in recent financial history, author and investment guru John E. Girouard (www.johngirouard.com) is warning people to think twice before moving their money into bank CDs and money market funds.

He says the ultimate bomb shelter during scary financial times is your grandparents' life insurance, called participating or mutual whole life, which dominated the industry until falling out of favor in the late 1970s, but is now coming back into style.

"Few people know that the life insurance industry was one of the few economic sectors to survive the Great Depression intact. It was one investment that kept its promises," says Girouard.

Buying a policy from a mutually-owned company, you become an owner instead of a customer. "It's like becoming your own bank," notes Girouard. Mutual life premiums accumulate cash value that earns untaxed interest, and policyholders can borrow against it, no questions asked. Mutual whole life policies have recently been earning around 6 percent and carry ironclad guarantees: your cash value and the death benefit are secure. Some policies even include disability benefits.

Girouard observes that corporations for years have been buying mutual insurance policies on their employees' lives as a way of stashing corporate cash in an untaxed vehicle they can draw down on a moment's notice.

"My phone and those of America's nearly 300,000 investment advisors are ringing off the hook. The question on everyone's lips: 'Where do I stash my money when nothing looks good?'" Girouard says. Bank CDs help people sleep better, "but low interest rates, inflation and taxes steadily erode buying power so people actually lose money instead of protecting it."

"Investing is a three legged stool," Girouard says. "One leg is the money you need to live on, one leg is the money you invest for growth, and one leg is the bomb shelter you can retreat to when you can't sleep because the rest of the world seems to be falling apart."

He says most investment advisers don't understand how mutual whole life policies work, and don't offer them to clients "because they aren't sexy or new."

John E. Girouard is author of "The Ten Truths of Wealth Creation"and founder of the Institute for Financial Independence (www.independenceinstitute.com).

*Source: John E. Girouard*

*This article contains U.S. references, however the overall concept remains prudent in Canada.*

## UPCOMING EVENTS


Qualified Financial's Wealth Strategies Group will be volunteering at a wonderful event associated with Gilda's Club on June 10, 2008. The **"Cutler Classic"** is one of Toronto's premiere Golf Tournaments and Charity Auctions. Since 2000, this sell-out Golf Tournament has generated over $700,000 in support of Gilda's Club Greater Toronto. The tournament was founded in memory of Jimmy Cutler, a dear friend of Gilda Radner's and someone who was instrumental in bringing Gilda's Club to Toronto before he died of cancer in 1998.

*For more information about how you might support this organization and/or event, please visit:*

**www.gildasclubtoronto.org**


We are pleased to announce our **next Wealth Strategies Group Seminar** to be held on **July 9, 2008**. Please contact one of our advisors for further details.

### COMMENTS FROM OUR PREVIOUS WEALTH STRATEGIES GROUP SEMINAR:

*"My husband and I thought ourselves to be reasonably sophisticated in terms of managing our personal and financial affairs — but the subjects covered in the seminar proved us very wrong ! The issues presented such as establishing a proper Power of Attorney and the value of Critical Illness insurance are two examples of where our overall plan is completely awry and we intend to deal with them promptly. We appreciate Qualified Financial's Wealth Strategies Group providing us with such an informative and valuable session !"*

Julia Murphy

*Overall, a great evening. I came to the seminar with interest but no great expectations. I found all speakers to be exceptional, without exception. Even though I had a general understanding of each topic, I had a few "a-ha" moments when greater clarity was provided or misperceptions were cleared especially around the critical illness insurance. The rest was good for a refresher/reminder of the facts surrounding the issues. I am able to use the information taken away for the benefit of myself as well as, my clients. As an additional bonus, it was a great networking evening as I was introduced to an R&D tax consultant.*

Denise Jones, Chartered Accountant