Competitors innovate to woo your clients

MERRICK WEALTH

By Peter Merrick

My father used to say that only a powerful person can admit he needs help, and only a wise one seeks that help.

In middle age, I find the truth of his words resonates more.

I recently had a conversation with Robert Martini, a tax partner at Wilson Vukelich LLP, in Markham, Ont. We have each witnessed how public accountants work hard for their clients. Every year they make sure clients' financial statements and tax returns are filed accurately and on time. They meet deadlines and honestly believe they are giving clients great service.

Martini said "unfortunately, much of the hard work that accountants and tax preparers do for their clients may go unnoticed. Clients may not appreciate the amount of detail and technical expertise that is required to complete what may be viewed as relatively routine compliance requirements."

The accountant in turn feels unappreciated and wonders why he works so hard for such people.

Clients in turn often question why they are paying substantial fees to an accountant who provides nothing more, in their minds, than the bare minimum.

Martini shared an example to illustrate what can happen when such client attitudes prevail.

A client is approached by another financial advisor – not even necessarily another public accountant. It may be a sales rep who works for a bank, or a life insurance agent who presents a planning opportunity. This person asks the client when the last time was that their accountant gave them a fresh and practical idea.

The client becomes interested in this free advice and even more frustrated with his existing accountant. Inevitably, the client wants to know more about any new approaches

Martini then offered a specific example of where accountants may be missing a tax planning opportunity, namely the prescribed rate loan strategy, and how another astute planner may fill the gap.

A banker notices that a client has $1 million in fixed income securities which earned four per cent, or $40,000, in interest the previous taxation year. He asks the client whether he has even considered prescribed rate loan planning, so that the client can split income with his three minor children. The client responds by saying his accountant told him there wasn't much income splitting you could do with minor children because of the 'kiddie tax.' The banker explains that there could be benefits, and shows the client how this could work.

Instead of the client investing his $1million portfolio personally, he can establish a children's trust for the benefit of his minor children. He can then make a loan of $1 million to the children's trust at an interest rate of one per cent per year. As long as the trust pays interest on a timely basis pursuant to the Income Tax Act and other technical tax details are dealt with, the client is only required to report the one per cent interest on his tax return. There is no attribution of other income earned by the trust to him.

The reason for the one per cent rate is that it is the current prescribed rate as of last April 1 under the Income Tax Act. This rate is at an all-time low, which presents greater tax planning opportunities, at least until the prescribed rate changes.

Assuming that the trust can earn four per cent in fixed income securities, it will generate $40,000 for the year but will have a $10,000 deduction for the interest paid to the client. The $30,000 net earnings of the trust can then be distributed or irrevocably allocated equally to the minor children. Assuming these minor children have no other sources of income, there would be virtually no tax on this net income earned by the trust, as each child would only report $10,000 in income for the year.

Assuming the client is already at the top marginal tax rate in Ontario, this results in a savings of approximately $14,000 in one year and a minimum of $140,000 for 10 years. These savings would be far in excess of the setup and maintenance costs of such a structure.

The client can't wait to put this plan in place with his newly found advisor.

"This sad little tale could have been easily avoided if the original accountant had advised the client of this and other money-saving opportunities, or referred the client to other experts who could have done so," Martini said.

He also noted that while the client would leave their original accountant in the scenario outlined above, that was hardly a worst-case situation. Martini said the worst-case scenario was that the client would have the means to sue their original accountant for not advising them on appropriate financial solutions.

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