Plan for trouble before it occurs

MERRICK WEALTH

By Peter Merrick

What Lao Tzu said 2,500 years ago still rings true: "When the student is ready, the teacher will appear."

For the last five years I have been teaching risk management solutions at the university level. During this time I have learned that to be a good teacher, one must also be a persistent researcher in search of better solutions for clients' most common needs.

I learned a lesson from a recent lunch with Andrew Rogerson, one of my teachers and a lawyer who has developed a specialty niche in Toronto that focuses on estate planning and asset protection. Our conversation was primarily focused on legal solutions a client may employ to avoid asset protection strategies being set aside by the courts.

Rogerson made the point that all credit protection strategies should be made at a time when the client is clearly not insolvent or on the eve of bankruptcy. He clarified this by stating: "Planning must be justifiable in terms of non asset-protection objectives."

He illustrated this concept by recounting the merits of the case of Ramgotra (1996) where the Supreme Court of Canada held that the funds transferred from non-exempt RRSPs into a RRIF managed by an insurance company should stay out of creditors' hands. The court's rationale was that the transaction was part of a legitimate retirement planning exercise. This was so, even though the end result was the transfer of funds out of the reach of Dr. Balvir Singh Ramgotra's creditors.

The exact process by which Ramgotra managed to keep his RRIF proceeds was that he transferred non-insurance managed RRSPs into an insurance administered RRIF in 1990. This was done in good faith at the suggestion of his certified financial planner. The disposition took place within five years of bankruptcy.

The court held, however, that although the assets vested in the trustee in bankruptcy, the trustee could not deal with them and had to return them to the bankrupt (Ramgotra) upon the bankrupt's discharge. This was because the Bankruptcy & Insolvency Act precludes the trustee from dealing with assets that are exempt from execution or seizure. The court held that there was no evidence of fraudulent intent. The transfer was done in good faith as part of normal prudent retirement planning.

As a general rule, all assets of an individual or entity are security for debts to a creditor. This applies whether or not the individual or entity is bankrupt. Traditionally, life insurance products have been given special protection against the claims of creditors under provincial legislation. The legislation, which is fairly consistent across Canada, is intended to protect the rights of the beneficiaries under the contracts. Thus products offered for sale by a life insurance company are generally creditor protected.

The definition of insurance products in all provinces includes annuity contracts. Most RRSPs and non-registered investments issued by insurance companies take the form of an undertaking to provide an annuity and, as such, fall under the definition of life insurance within provincial legislation. Many provinces do not provide creditor protection for non-insurance RRSPs and no province provides creditor protection for non-registered monies held in non-insurance investment vehicles.

Creditor protection during the lifetime of the owner can be achieved in two ways; by making an irrevocable beneficiary designation in a life insurance contract, or by designating as beneficiaries certain family members specified in provincial insurance legislation.

After the death of the life insured, where an appropriate beneficiary has been designated, the creditors of the deceased are prevented from seizing the policy. The death benefit of the policy is specifically excluded from the estate of the owner. This is because the proceeds flow directly to the beneficiary, and are exempt from the claims of creditors.

It should be noted that creditor protection only exists where the policy is owned by an individual. Policies owned by a corporation offer no direct creditor protection, however a properly implemented corporate structure can achieve creditor protection.

Where creditor protection is important, it is advisable to name alternative or contingent beneficiaries within the protected class, since the exemption from seizure can be lost if the designated beneficiary dies.

Insurance products fall into two categories; life insurance policies, and deferred annuity contracts. When hearing of a 'life insurance contract' most people think of a traditional life insurance policy, where one makes a regular stream of payments and a death benefit goes to a designated beneficiary, upon the insured's death.

However, accumulation and investment products sold by life insurance companies are 'deferred annuity contracts' and, as such, also qualify as insurance policies.

Cash can be accumulated within a traditional life insurance policy subject to certain maximums imposed by the Income Tax Act. Within these maximums the investment growth is not subject to accrual taxation. This is commonly referred to as an 'exempt policy.'

Furthermore, in most circumstances, the policy fund or cash value is paid out to the designated beneficiary as a tax free benefit, in addition to the face amount of the policy. This makes an exempt policy an attractive tax deferral and estate planning tool, particularly when combined with the added value of creditor protection.

These structures offer tax minimization solutions that cannot be obtained by run of the mill investments. For example there are specialized instruments governed under insurance legislation that provide benefits that create the following end results:

- All personal deposits can be structured to be deductible over time.
- Large annual deductions are provided each year against income.
- Money would be invested on a deductible basis, the money grows tax free. The individual retires tax free, dies tax free, and all the while has savings protected from creditors.

Rogerson said a true professional understands "when to seek out other professionals with complementary skills in areas of asset protection and insurance contracts. A dangerous professional is someone who does not know that they don't know but acts as if they do. The problem with this is clients don't know the difference until it's too late."

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