



Financial Planning After Selling:

PART 2

In the June issue, we discussed the benefits of using whole life insurance in the context of a dentistry professional corporation (DPC) selling assets of a dental practice.

Here, we'll be discussing the benefits of a dentist owning whole life insurance personally (instead of through a DPC) when it comes time to sell the shares of the DPC.

Main Drawback

The main drawback of having the dentist own a whole life insurance policy personally is that they have to pay the premiums using their after-tax income. Since individuals get taxed at higher rates than their DPCs, the dentist is left with less after-tax money than their DPC to pay the premium. This can put pressure on the dentist to own a smaller or otherwise less beneficial policy than their DPC could afford to own.

So why wouldn't the dentist own the policy through their DPC? Because the buyer of their dental practice won't buy that policy when they buy the shares of the DPC from the selling dentist. So, the policy would need to be transferred out prior to completing the sale (or perhaps it's never owned by the DPC to begin with but personally by the dentist or through another corporation owned by the dentist). Transferring out a policy could also trigger taxes, so be mindful!

Regardless of the situation: the DPC doesn't own the policy at the time of sale and the dentist can hopefully qualify for the lifetime capital gains exemption (LCGE), which helps mitigate the main drawback.

Triggering the LCGE

Most dentists looking to sell their practice will want to sell the shares of their DPC to take advantage of the LCGE. After June 25, 2024, a dentist can sell those shares for up to \$1.250-million before paying ANY capital gains tax (assuming the dentist and their DPC qualifies) and they'll only pay roughly 33% capital gains tax on every dollar over and above that threshold; and these tax savings can be multiplied by having the dentist add their spouse, parents, and adult children as common shareholders to the DPC. Note: there are lots of tests that need to be met to qualify for the LCGE, so please speak with an accountant and lawyer years in advance of selling.

Financial Advantages

Did you know the Rockefeller family had a practice of buying whole life policies for every family member? The benefits weren't just to capitalize on someone's death. It has numerous financial and tax-benefits that can be capitalized during someone's death. Notably, it may be the only investment you make during your lifetime that is guaranteed to increase in value year-after-year and perhaps never produce a negative return!



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Tax-Efficient Retirement Income

The 2024 Federal Budget increased capital gains taxes from approximately 25% to 33% on capital gains over \$250k in a given year (excluding use of the LCGE). What does this mean for your retirement planning? Basically, you need assets that provide you with tax-efficient income without triggering these increased capital gains taxes. Whole life policies can provide you with tax-free and tax-efficient retirement income, complementing your other retirement investments and forming a holistic post-practice financial strategy. Few assets offer tax-efficient or tax-free income during retirement, making whole life insurance a conservative and valuable addition to your portfolio. Does this mean you put all your money into a whole life policy? No. But some? Probably.

Compound Growth and Tax Benefits

Section 148(3) of Canada's Income Tax Act states that assets that accumulate within a tax-exempt life insurance policy contract free of annual accrual taxation. What does that mean? Basically: the cash value (i.e. the real, tradable value of the policy) within a whole life policy is guaranteed to grow year-over-year without the burden of annual taxes. So, you won't be subject to the capital gains taxes or passive income taxes on annual growth!

This compounding interest, uninterrupted by taxes, allows you to accumulate significant funds within your whole life policy, which can be used tax-efficiently for your personal needs (e.g. you can borrow money against the cash value of the life insurance policy and use that to finance your lifestyle). As Albert Einstein once said: "Compound interest is the eighth wonder of the world. He who understands it, earns it ... he who doesn't ... pays it."

Estate Planning Benefits

Do you own a rental property? A cottage? Do you have an RRSP or non-registered stock portfolio? Do you plan on passing these properties and assets down to your children? You will most likely have a tax bill associated with assets when gifting them to your family. There are financial strategies to help minimize this estate tax bill, but estate taxes cannot always be completely eliminated.

The CRA doesn't care how you come up with the money to pay for the taxes in your estate (assuming it's in a legal manner), they just need the tax bill paid. Given the proposed increases in capital gains taxes outlined in the 2024 Federal Budget, your estate tax

bill may be a lot higher than you anticipate.

So how are you going to pay for the taxes on your assets when you pass away? There are very expensive ways of doing so and very efficient ways for someone to pay their estate taxes. Will your executor need to liquidate assets to pay off your estate debts, funeral expenses, and taxes? Will you require your beneficiaries to assume and pay off debts related to gifts you're leaving them (like a mortgage on real estate)?

Why not use the life insurance proceeds from the whole life policy to pay off your final debts and taxes? After all, when you buy life insurance, you are really buying a future amount of money you will need at a significant discount today.

On top of taxes, the tax-free death benefit can be strategically utilized to provide financial support to your family or contribute to charitable causes. This may align with your broader objective of legacy planning.

Conclusion

If you're thinking about selling shares of your DPC and want to take advantage of the LCGE, make sure your DPC doesn't own any whole life insurance policy at the time of sale (the buyer won't buy it and you'll likely want it as part of your retirement and estate planning). Talk to professionals about owning the policy personally, and not through your DPC, well in advance of selling. ✨

