

# ADVANCING *Issues*

Spring/Summer 2002 • Published quarterly by Corporate Planning Associates • Vol. 9, No. 1

## Success On And Off The Ice

By R. Stewart Gavin, Senior Vice President, Corporate Planning Associates

Five years ago, I joined Corporate Planning Associates. As a former professional athlete, I recognized CPA's services could greatly benefit the lives of professional athletes. Professional athletes possess certain qualities: dedication, perseverance, commitment and passion. In order to overcome adversity, fierce competition, the endless challenges and attain one's dream, these characteristics are essential to achieving success.

CPA offers a comprehensive program that allows players to focus on hockey, maximize financial opportunities and build financial independence. A professional athlete's life is very structured and the ability to plan every detail is a key component. By applying this same discipline to one's financial situation, the results can be remarkable. With a limited time to establish financial independence, it is essential for players to maximize each opportunity. The same dedication, perseverance, commitment and passion an athlete undertakes towards being successful on the ice should be conferred on their finances. This commitment will be rewarded.

While CPA works with players at many different stages of their career, we encourage clients to plan for financial success as early as when they are drafted by an NHL team. This preparation opens the opportunity to incorporate tax-planning strategies into the initial NHL contract. Seeking to find the best plan for a young client, CPA encourages parents or family members to participate in strategy planning sessions. A parent can provide valuable guidance to assist their loved one in making an informed decision. Players and their families are often surprised by the lifestyle expense of a young NHL player. It is critical that discipline is established early for an effective financial plan. It is far too easy to be lured into a lifestyle of spending and awake one day, out of the game, with little to show for their efforts.

Born and raised in Ottawa, I learned to play hockey at the age of 7. I enjoyed skating, the thrill of scoring and spending time with my teammates. Although Ottawa did not have an NHL team at the time, I remember fondly Saturday

evenings when I was allowed to stay up later than usual to watch Hockey Night in Canada. My favorite team was the Chicago Black Hawks and Bobby Hull was my favorite player. By the age of 10, I proclaimed to many people that I would play in the NHL. I left home at 17 to play Major A junior hockey for the Toronto Marlboros and in 1980 my dream was realized when I played for the Toronto Maple Leafs.

When I think back, I recall one defining moment in the pursuit of my dream. During my second season with the Marlboros I broke my wrist. After being fitted with a cast, I left for practice. While waiting on the subway platform, I witnessed a person take their life. I was overwhelmed and in shock.

I arrived late and my coach would not allow me to join the team practice. Overcome by emotion, questioning my priorities and missing family and friends, my first reaction was to forget my dream. As I walked towards the exit, my former coach, George "The Chief" Armstrong entered. He could see my frustration and encouraged me to

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# Viatical Settlements – Investing in Death

By David Vicic, ASA, Senior Vice President, Corporate Planning Associates

You may be asking yourself “What exactly is a viatical settlement?”. The word viatical comes from the Latin word *viaticum* and there are two definitions that will help describe what a viatical settlement is:

*Viaticum* –

- 1) *An allowance for travelling expenses made to those who were sent to the Roman provinces to exercise any office or perform any service*
- 2) *According to the rites of the Roman Catholic Church, the communion given to persons in danger of death.*

In today’s world, a viatical settlement is an arrangement whereby an insured person sells their life insurance policy to a third party. The insured typically will have a shortened life expectancy due to a physical condition or a terminal illness. In return for the policy, the insured receives a lump sum cash settlement (30¢ to 90¢ per dollar of face amount) to do with as they see fit. The third party then becomes the owner of the policy and is responsible for the continued payment of the premiums due. In addition, the third party is made beneficiary of the policy and receives the full face amount of the insurance policy on the death of the insured.

Currently, the only provinces in Canada where these settlements are legal are Quebec, Saskatchewan, New Brunswick and Nova Scotia. With the passing of the *Red Tape Reduction Act, Bill 119* in 2000, viatical settlements are close to

becoming legal in Ontario. The provision in Bill 119 that would make viatical settlements legal has not yet been proclaimed and will not be proclaimed until an appropriate regulatory system has been developed and approved by the government.

Viatical settlements have been around in the United States since the late 1980s, where they were used to provide early access to life insurance proceeds for AIDS patients. According to various sources, there are anywhere from 50 to 70 viatical service providers in the U.S., buying an estimated \$500 million to \$1 billion in face value of insurance per year.

From the numbers just quoted, it would appear that these settlements are quite prevalent in the United States. Why do people choose to *sell* their life insurance policy in advance of their death? Frankly, they need the money. With the ability to work taken away, any savings that they may have are rapidly exhausted. The life insurance policy may be the only “asset” that they have left. The money received when the policy is sold can be used to fund health care costs, improve the quality of life and allow them to live the remainder of their life with dignity.

Looking at it from the other side, why would anyone want to *buy* a viatical settlement? The biggest single reason is the possibility of earning a high rate of return. To illustrate, let’s assume that a terminally ill individual with a life expectancy of 3 years owns a \$300,000 life insurance policy with a premium of \$1,000 per

year. He sells his policy for \$200,000. The buyer becomes the owner of the policy and is responsible for the payment of premiums. The following table illustrates the expected rates of return depending on the date of death of the insured:

Death at End of Year	Annualized Rate of Return
1	49.42%
2	21.95%
3	13.89%
5	7.99%
10	3.70%

As the table shows, realized rates of return can be very high. However, if the insured beats the odds and lives longer than expected, the investor could realize a rate of return that is **not** commensurate with the risk involved. Needless to say, an investor looking to get involved in these “investments” must have a high risk tolerance and must be comfortable with the moral and ethical issues that arise.

We have noted that Ontario is preparing the way for the legalization of viatical settlements in that province. The Canadian Life and Health Insurance Association (CLHIA), the group that represents life and health insurance companies in Canada, opposes the proclamation of Bill 119. The industry is concerned that the introduction of viatical settlements will be accompanied by fraud and the abuse of policy sellers (known as viators) that has occurred in other jurisdictions including the United States. Types of fraud include:

**Clean-Sheeting** – A person with a life-threatening illness applies for new coverage but does not disclose the truth about their health.

**Dirty-Sheeting** – A healthy person sells a policy and provides false information, indicating that he/she has a life-threatening illness.

**Wet-Ink Policies** – Policies are sold immediately after they are issued. The insurance company believes that the policy was purchased for estate planning needs rather than for sale.

**Life Expectancy** – Viatical service provider advises investor that the insured's life expectancy is short but in reality, the data in the company's possession shows that life expectancy is 60 months or more.

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Since the viatical service provider must keep track of the viator's health status, there have been significant complaints about their insensitivity (e.g. calling to see if their health is deteriorating). This has led to the need to limit contact between the providers and the viators.

According to the CLHIA, viatical settlements are not necessary because many insurers already offer what they call "living benefits". These benefits may be included in the life insurance contract but more often than not, insurers will look at

individual cases and pay out a percentage of the face value less any outstanding policy loans to a terminally ill insured. One of the advantages of not selling the policy is that the balance of death benefit is payable to the beneficiaries of record.

There are a number of other questions for which there are currently no answers available.

*Who will protect the investor?*

This is not addressed in the law.

*What is the income tax treatment of these viatical settlements?*

At the time of writing, CCRA has yet to advise.

*Is a viatical arrangement an investment contract that falls under the Securities Act?*

This would require that they be sold under a prospectus and that the individual arranging the transaction would need to be registered to sell securities.

Individuals should be aware that in spite of the fact that Bill 119 has not been proclaimed, there are viatical service providers currently operating in Ontario. It is important to understand what these arrangements are and the risk associated with them.

In closing, another Latin phrase comes to mind – *Caveat emptor* – Let the buyer beware!

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look beyond the obstacles and to remain committed to my dream. I still remember his words "Stew, you will have many coaches, players or situations that will be obstacles, not barriers. When you look back, these instances will be little speed bumps on your highway to success." Looking back now on my 13-year NHL career, I can attribute my success to what I learned that day. Dedication, perseverance, commitment and passion in all aspects of one's life ultimately results in successfully achieving one's dreams.

At CPA, we have many success stories. Once such story is Jarome Iginla, a CPA client since 1997. We are delighted to see his efforts in the hockey and financial arenas pay solid dividends. As many will recall, Jarome had an outstanding 2001-2002 hockey season. He was instrumental during Canada's gold medal win over the United States at the 2002 Salt Lake City Olympics. Jarome is also the recipient of both the Art Ross and Rocket Richard trophies. It truly is remarkable the results that can be attained when

you commit to a plan and are passionate about your profession.

Although this article has been presented from the perspective of a professional athlete, the characteristics essential for success are universal. Dedication, perseverance, commitment and passion propel people to distinction and the financial rewards invariably follow.

# Income Splitting

By Alan J. Snowden, Senior Vice President, Corporate Planning Associates, Vancouver office

“**H**oney, do you have any money?” This request normally precedes an investment no larger than a café latte or perhaps a medium popcorn – no butter, of course! But, just maybe, married couples should be taking a closer look at the benefits of moving money from one spouse to another. For married couples, where one spouse has considerably higher income than the other, there are precious few ways of addressing the imbalance. As a result, the taxman tends to feed at the highest possible tax rate. Normal attempts to transfer income-generating assets from the high-income spouse into the hands of the lower income / lower tax bracket spouse are thwarted by the “attribution rules.”

This wide ranging legislation says, in a nutshell, that the income earned from any money or property that you give to your spouse or children under eighteen is “attributed” back to you and is taxable in your hands.

There is, however, one legal way of getting income into the hands of the lower tax bracket spouse – by way of a “bona fide” loan. As this is not at the top of the Canada Customs and Revenue Agency (formerly Revenue Canada) popularity charts, it is extremely important that one establish a clear and well-documented paper trail. The loan can be a demand note, but should be signed, dated and witnessed. Both the lender and the borrower must be residents of Canada. Most importantly the note must be interest bearing and the interest must be paid by the end of January each year. A cheque, of the same date as the loan, should be drawn from the lenders account and deposited in a separate account for the borrower.

Lest any good citizens become too creative with the rate of interest that they charge, the Minister of National Revenue is kind enough to “prescribe” the minimum interest rate that must be charged for a

spousal loan to be considered “bona fide”. This “prescribed rate” is set each calendar quarter, in advance. What makes this whole strategy so appealing at the moment, is the fact that the “prescribed rate” is set at 2% for the three month period from April to the end of June, 2002. This is the lowest it has ever been.

It is worth noting that although the “prescribed rate” may fluctuate each quarter, the rate used in the demand note remains constant for the life of the loan. If interest rates rise, as many economists expect, the locked in 2% rate may look very attractive.

The lender must declare the 2% interest they receive as income, but any return above that is taxed in the hands of the borrower. This can do very good things for the overall family after-tax income.

Although perfectly legal, this type of transaction really needs to be carefully documented. We are not talking decaf latte here, we are into double expresso.

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### Published by

Corporate Planning Associates  
Suite 1700, 320 Bay Street  
Toronto, Ontario, M5H 4A6

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*Subscription price: \$100 per year*

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