

Lock in stability with key person coverage



**MERRICK
WEALTH**

**By
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When a senior partner in his early 50s at a mid-size accounting firm was killed in a car crash, his firm could have been badly damaged financially. Instead, his practice transitioned smoothly, and his spouse was paid handsomely for her husband's interest in the practice.

The best way to protect your firm from financial hardships and to meet its obligations is through proper planning with the right people. Having key person insurance will guarantee your firm's survival, and help each partner meet his or her financial and estate planning needs.

How did this accounting firm manage to stay financially healthy after one of its senior people died suddenly? A year earlier all the

partners had purchased key person life, disability, and critical illness insurance policies to insure two years of profits in the event any of them became critically ill, was disabled or killed. The result? The practice continues to flourish while having provided for the deceased partner's family.

It should be mandatory for every accounting firm in Canada to have key person insurance, but it is not.

Key person coverage can provide enough cash to replace lost revenue due to the death of an accountant, repay business loans and train a replacement accountant.

It can also improve your firm's chances for loan approval. Lenders look favourably on a firm with key person insurance, since it shows responsible planning and makes it more likely creditors will be repaid.

How much coverage should you buy? That depends on the impact the key person's death would have on the practice.

Although this may be difficult to determine, aspects to consider include the person's salary, industry knowledge, how much goodwill the person generated, the cost of hiring a replacement and the firm's outstanding loan balance. One rule of thumb is to buy

five to 10 times the key person's salary. Another is to purchase two years worth of net earnings that the firm produces.

Imagine a two-partner firm that has worked hard to establish a thriving accounting practice. Suddenly one partner dies of a massive heart attack. This could put the surviving partner into debt and force him to close the practice.

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However by having a buy-sell agreement that is funded through a key person insurance policy, the practice will continue almost uninterrupted.

The buy-sell agreement had established the value of the firm and the funds necessary for the surviving partner to buy out his deceased partner's interest. The practice survives, and the heirs of the deceased partner are paid in full for their interest in the firm.

If a firm is a partnership or closely held professional corpora-

tion, a properly funded buy-sell agreement is vital. When there is more than one partner, a buy-sell agreement allows the remaining partners to purchase the business interest of the deceased, retired, or permanently disabled owner.

A buy-sell agreement funded by a life, disability or critical illness insurance policy can accomplish the following:

- Help eliminate potential lawsuits stemming from the business valuation.
- Help assure the continuation of the business.
- Allow the surviving partners to maintain control of the firm by requiring the deceased partner's interest to be sold.
- Help assure that the deceased partner's heirs are quickly paid for their share of the firm, even if the surviving partners are not able to run it successfully.

You should consider purchasing key person insurance if any one of the following is true:

- Your firm is likely to falter if you are no longer there.
- Your firm is likely to falter if another accountant is no longer there.
- You do not have adequate funds to offset any losses until an appro-

priate replacement for the key person is found.

Whether your practice is considering key person coverage, a buy-sell agreement, or both, it is important that the documents and insurance policies be reviewed periodically to ensure that the valuation formula is current and that the plan is funded adequately. This should be done at least once every three years, or if there is a major change within your firm.

To receive the right advice and to be sold the right policy, you should consider your agent's experience and professional qualifications.

Certified Financial Planners (CFP) and Chartered Life Underwriters (CLU) are technically competent in the areas of life, disability, critical illness and long-term care insurance. They must continually meet education, examination, experience and ethical standards.

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Manitoba boosts dividend tax credit

By DEANA DRIVER
Winnipeg

Manitoba is increasing the tax credit to 11 per cent from five per cent on publicly-traded and private corporation dividends for income that exceeds the small business tax threshold.

The change, retroactive to January 1, will result in savings of \$7.5 million for Manitobans, Finance Minister Greg Selinger said. He also announced an increase in the purchase limit for shares of new labour funds to \$12,000 from \$5,000 per year.

The dividend tax credit enhancements will reduce the maximum effective tax rate on dividend income by one-quarter and "complement changes by the federal government," said Selinger.

In the May budget the federal government bumped the dividend tax credit to 19 per cent from 13.3 per cent.

The changes also reflect recommendations made by the Crocus Investment Fund Implementation Team, which not only investigated why that labour-sponsored fund had to go into receivership with a write-down of about \$60 million, but also consulted with industry stakeholders to make recommendations for the future of strong labour-sponsored funds in Manitoba.

The team, co-chaired by John MacDonald, retired senior partner of Deloitte and Touche, and Winston Hodgins, current president and CEO of Manitoba Lotteries, recommended the province consider an

increase in the annual individual purchase.

Richard Groen, assistant director of Manitoba's tax policy branch, said that with the federal government's changes to the dividend tax system, "provinces had to revisit their dividend tax credit system as well, because our system is tied to the federal system."

Manitoba has also announced the rate for taxable dividends distributed by Canadian-controlled private corporations with taxable income below the small business limit would be reduced from five per cent to 4.87 per cent in 2006 and 3.67 per cent in 2007.

"It's gone down from five per cent because we dropped our corporate income tax rate for small businesses," said Groen. "Before, we used to tie the dividend tax rate to the small business corporate income tax rate. The small business corporate income tax rate has dropped and we're making sure that overall, no more tax is paid whether income is paid strictly by an unincorporated business as personal income, or paid once at the corporate level and then distributed as dividends to the shareholder as personal income."

Craig Roskos, tax partner with Ernst & Young in Winnipeg and chair of the Manitoba CA Institute's tax committee, said he is not sure the change to the dividend tax rate will be as beneficial as the government may wish. "On the overall effect of tax rate, it does bring down the tax rate on eligible divi-

dends, ones that are not taxed at the small business rate," he said.

"The small business tax threshold in Manitoba was raised to \$400,000 while the federal rate is at \$300,000. So the effective tax rate on dividends is coming down in Manitoba at the highest rate from 35.08 per cent to 23.78 per cent. It may allude to people locating in Manitoba, but effectively all the provinces are going to follow suit with the feds."

The changes to an individual's annual purchase limit for shares of labour funds registered after July 1, to \$12,000 from \$5,000 make "labour fund investments more accessible to high net worth individuals," said Selinger.

That change came directly from recommendations of the Crocus Fund investigating team, said Groen. "One of the things that came out of those consultations is that investment dealers who provide people with advice were not prepared to deal with smaller amounts, so the government decided it would raise the contribution limit to accommodate and keep investment dealers interested in dealing with labour-sponsored funds."

"One of the other legislative changes we made is, before, people were able to sell labour-sponsored shares on the shop floor. That has now been prohibited. These kinds of acquisitions of labour-sponsored shares should be through the advice of a qualified investment dealer. The higher share purchase corresponds to that kind of view."

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