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TAX**STRATEGY**

Reduce your tax bill, grow your estate and put money into your pocket with this...

Overlooked strategy

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Like most Canadians, you probably have some life insurance. This coverage may be owned and paid for by you, your company or a trust.

If the policy is owned by you or by a trust, tax benefits may be available now by transferring ownership of your personal policy to your company. At the same time, there is little or no reduction in the after-tax death benefits to your family.

If you own a corporation, whether a holding company or an operating company, this strategy deserves serious consideration.

A little background

There is a unique tax treatment surrounding the non-arm's length transfer of personally held life insurance policies into an individual's private corporation.

This strategy has been well known to industry insiders for several years now, and has become more mainstream since it was supported by a Canada Revenue Agency (CRA) roundtable discussion at a CALU (Conference for Advanced Underwriters) in Ottawa in 2002.

In its response to a sample transfer, the CRA noted that as long as the shareholder received fair market value for their interest in the life insurance policy, the payment received by the individual would not be taxable. The CRA also made the following comments:

"The result of this transaction is that the shareholder is effectively receiving a distribution from the corporation on a tax-free basis.

Notwithstanding that the corporation will have a reduced adjusted cost basis in the policy it is not clear that the above result is intended in terms of tax policy.

We previously brought this situation to the attention of the Department of Finance and have been advised that it will be given consideration in the course of their review of policyholder taxation."

How is fair market value calculated?

An actuary calculates the fair market value of the policy based on the current health of the insured(s) and the features of the policy.

The policy's death benefit, cash value and premiums required to maintain coverage are all taken into consideration.

The process is similar to how the premiums were determined in the first place, and also how commuted values of pension income are calculated.

Not all policies have a fair market value that exceeds the policy cash value. Term life insurance is a good example.

However, if an insured with term insurance would now be rated or declined for new insurance due to health problems, the term policy could have a significant value.

Term-to-100 policies or uni-

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versal life policies with level insurance costs will have a value which will be higher with older policies.

Regular term insurance does not have a value, unless the health of the insured has changed as described earlier.

Another important factor to consider with respect to permanent insurance is that rates from most national carriers have risen sharply since January 2011, with increases ranging from 10 per cent to 25 per cent.

Additional rate increases will soon follow. A few companies haven't announced their increases yet, so if you are considering converting existing term insurance or purchasing permanent insurance, there will never be a better time than right now.

Consider Universal Life Insurance for your overall Portfolio

✓ In the long run, universal life insurance is less expensive then term insurance.

At the end of the day, universal life insurance is less expensive then term insurance. While there is initially more cash flow up front, a universal life insurance plan is far less expensive in the long run – and it provides a guaranteed payout.

✓ Universal life insurance is an excellent estate investment asset.

A Universal life insurance plan offers a very good long term rate of return as an estate investment asset.

✓ Universal life insurance makes an excellent retirement income too.

At retirement you need guaranteed cash flow and little or no risk. Stocks are too volatile, bonds are inefficient, and GICs offer low interest rates and are also inefficient from a tax perspective. Life insurance companies offer tax-efficient, high-yielding annuities.

✓ You may need the life insurance for your estate tax.

Most believe mistakenly that as their children grow and they accumulate assets, they no longer need insurance.

A permanent life insurance policy will provides the necessary funds to your estate at the time of death to fund the tax bill.

✓ Things don't always work out as planned.

Insurance is purchased in case things don't work out as planned. Most people hope that by retirement their investments have performed as originally projected, and that they will continue to perform for the dependents when they are no longer here.

We have experienced stock market corrections and bond defaults. A permanent lifetime insurance policy provides you and your dependents peace of mind so that they don't have to "hope" things go according to plan.

– Mark Halpern

Who should consider the transfer?

Potential tax benefits exist for anyone who owns a private company and also owns an existing life insurance policy (or their trust, spouse, parent or child owns a policy).

A Recent Case

✎. A 61 year old business owner had a $5 million face amount permanent life insurance policy for more than 10 years, for which he was paying $15,000 annually. The policy was personally owned.

✎ An actuarial review determined that the fair market value was $1,520,000.

✎ This meant he could sell his policy to his holding company for $1,520,000.

✎. He received the funds from his corporation without tax because it is based on the fair market value for the life insurance.

✎. He saved $494,000 in income tax. This is the amount of tax he would have paid at the rate of 32.5 per cent on a taxable dividend of $1,520,000.

✎. The cost of future premium payments are effectively reduced by the differential in the corporate tax rate of 15.5 per cent compared to his personal tax rate of 46.5 per cent.

✎. The life insurance proceeds of $5 million are eligible for Capital Dividend Account treatment which means the proceeds can be distributed to his beneficiary's tax free.

Why are life insurance rates are on the rise ?

Today's low interest rate environment is the driver behind the increasing cost of life insurance

Most life insurance products were initially priced anticipating annual interest rates of 9 per cent to 10 per cent. Those levels are much higher than what is achievable today.

Why you should act now

The CRA will certainly make changes at some point, and this strategy may no longer be available in the future.

The role of your professional advisor

Your professional insurance advisor should obtain a preliminary estimate of the value of your current insurance policies, at no cost to you, and help you decide if there is a benefit in moving forward.

The advisor should also perform a comprehensive review of your current insurance policies for adequacy of coverage, ownership, rates, etc.

The next step is facilitating the independent actuarial report giving the fair market value of the life insurance policies.

The insurance advisor should coordinate the entire process and work closely with your accountant and tax advisors to consider the tax treatment and provide all the documentation necessary to complete the transfer.

The bottom line

In the right circumstances this strategy can be a win-win situation and put money in your pocket, while effectively reducing the cost of your life insurance policy and improving its performance. ❐

The information presented herein is believed to be accurate and reliable as of the date it is written. Tax laws are complex and are subject to frequent change. Professional advice should always be sought before implementing any tax planning arrangements. We cannot accept any liability for the tax consequences that may result from actions based on the contents thereof.

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