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Top 10 ways wealthy Canadians use insurance

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Investor's Digest readers are painfully aware that taxes are a necessity, but you shouldn't pay a penny more than what's legally required.

Successful and high-income Canadians need to know that many taxes and related expenses - whether on investment income, capital gains, or on death - can be legally minimized or eliminated entirely with proper planning.

Insurance can be the most versatile and reliable financial product in your entire portfolio, but many readers don't know how to use it to preserve their hard-earned money and achieve desirable tax outcomes. Nor do they know that it's available to everyone.

Life Insurance, which enjoys special treatment under our Income Tax Act, can be used to reduce or eliminate your taxes and leave more tax-free funds to your family and the causes you care about.

Health and disability insurance will protect your earnings if you get sick and provide access to the finest medical care in the world, while property and casualty insurance products protect your business, home and tangible assets.

Here are 10 ways to use insurance products to your benefit:

1. Life insurance as an alternative investment

If you are like every person we meet, you want to leave as much as possible to your family (and hopefully your favourite charities) and as little as possible - ideally nothing – to the government. Canadians who die without a spouse or financially dependent child or grandchild, unwittingly leave the government up to 54 per cent (in Ontario) of the value of their registered retirement savings plans and registered retirement income funds.

A further tax of 26 per cent is levied on the growth of your non-registered holdings like stock portfolios, investment real estate and private business equity. And there are still estate costs that must be paid.

Life insurance can mitigate those losses and preserve your estate for your beneficiaries.

2. Estate preservation

The main goal of estate preservation is to minimize the tax burden at death.

To do this properly, you need to develop a robust financial plan with an experienced financial advisor who will ask you, among other things, what you want to do in retirement and where you want your money to go after you die. Now that people are living longer, you may be retired for several decades.

If you own shares in a private holding company or investment corporation, proper planning now can reduce or eliminate the double taxation that will result from the deemed disposition of the shares at death and the tax liability on the final distribution of the assets out of the corporation.

3. Wealth transfer

While many people believe they can only buy life insurance for themselves or as part of a joint last-to-die policy, it's also possible to transfer wealth by buying a life insurance policy on a child or grandchild.

As the owner of the policy, you pay the premiums and create a tax-exempt cash value within the policy. When the policy is transferred to the child in the future, there's no taxable disposition, as it will qualify as a tax-free rollover, and the child will have access to the cash value.

If you transfer the policy to the child once he or she is 18 and there is a policy gain, that income is attributed to the child, not you. The "wealth cascade" strategy is particularly appropriate for grandparents.

4. Immediate financing arrangements (IFA)

A leveraging strategy can allow you to acquire the life insurance you need for estate planning and investment without tying up your own money to pay the premiums. You can enjoy all the tax benefits of ownership and vastly increase the value of your estate while your own money continues working for you in your investment portfolio, business, real estate, or elsewhere.

IFA policyholders pay only the interest cost on the borrowed premiums for a permanent or whole life insurance policy. The loan gets paid off from the ultimate death benefit payout.

Along the way, all the interest paid is tax-deductible and the tax savings can be used to reduce the outstanding balance on the line of credit. The after-tax interest cost on premiums for a $100,000 insurance policy is usually just a few thousand dollars in the current rate environment.

5. Skip probate costs

While insurance can preserve your estate, all will be for naught if you don't have a will. More than half of Canadians do not have an up-to-date will. Where do you fit?

Your will is the cornerstone of estate preservation, ensuring that your assets go to your heirs or other beneficiaries (like charities) according to your wishes.

Without a will, your estate will be administered by a government bureaucrat according to applicable provincial law. Most provinces grant a preferential share of the estate to the spouse and the rest gets split between the spouse and children.

Certain assets, like private company shares, don't have to go through probate and should be dealt with in a secondary will.

Life insurance with a proper beneficiary designation bypasses the estate, without paying any probate fees.

6. Disability insurance

Successful Canadians who check the fine print of their company benefits booklet are usually surprised to discover their long-term disability coverage is insufficient and may only pay out to a maximum of $10,000 a month, all of it fully taxable.

High-limit disability insurance is now available with coverage of up to $150,000 a month, all non-taxable.

7. Secure funds for long-term and critical illness care

The biggest and fastest-growing demographic in Canada – and most of the world – is seniors. Statistics Canada predicts there will be more than seven million seniors by 2021.

The cost of long-term care can easily exceed $10,000 a month and will rapidly deplete your retirement savings, putting a financial strain on your spouse or family.

Recognizing that the cost of long-term care or suffering a critical illness can be significant, wealthy people use it as a hedge. They buy policies that include a return of premium option, and if no claim is made, they get back all the premiums paid.

You can also purchase inexpensive joint and last-to-die life insurance that will enable you to enjoy your retirement years without worrying that you won't be able to leave something for children or a favourite charity.

8. Get health services fast through Best Doctors Insurance®

We live in a great country, with an over-stressed health-care system that provides universal coverage (and long wait times for treatment) paid for by our taxes. But all those taxes aren't enough to get you the specialized care you need as quickly as you want it.

Best Doctors Insurance® provides immediate access to the finest health care at Centres of Excellence around the world with a $5-million lifetime fund to pay treatment costs.

Service providers are paid directly (it's not a reimbursement plan) for tests, procedures, treatments and surgeries not available in Canada. I own a policy myself.

A "health-care concierge" helps you navigate the system, from diagnosis to treatment and recovery, and looks after everything from scheduling doctor's appointments to arranging travel and accommodation. No doctor's referral note is required.

9. Charitable planned giving

You probably have favourite charities near and dear to your heart, whether it's an organization devoted to an illness that afflicted a family member or a school that helped you get to where you are today.

As a parent, grandparent, or great-grandparent, you can use a strategy that will provide ongoing giving through an endowment in the form of an irrevocable gift to either a private foundation or a donor-advised fund (DAF) within a public foundation.

A DAF requires that a board of directors be set up to distribute the funds. Often, adult children or grandchildren join the board to keep the family name alive and aligned with a specific cause.

Funding a charity using life insurance is the most cost-effective and tax-effective way to give. Proceeds are usually many times greater than the premiums paid, and you will be remembered for leaving a large charitable gift, and not for leaving a pile of money for the tax department.

It's also a great way to instil a love of philanthropy in your family, especially by involving young family members in the process.

10. Property and Casualty Insurance

Above and beyond customary property and casualty insurance such as house and car coverage, other aspects of your life deserve appropriate protection.

Your office is your second home and should have coverage that includes potentially costly flood damage and business interruption insurance. The latter compensates for lost income resulting from catastrophes like a major weather event (ice or snow storm) preventing you and your staff from entering the office.

Directors and officers insurance protect you from lawsuits brought by investors, employees or customers. This insurance will pay for legal fees, settlements and other costs. Professionals like doctors, engineers and architects also need errors and omissions coverage in the event of a lawsuit related to professional mistakes or negligence.

Get professional help

Don't go it alone. Get the benefit of experience and knowledge from a team of seasoned insurance professionals who can assess your needs and suggest appropriate strategies.

Simply having insurance in place isn't enough – get the right types of insurance in the right amounts, with the help of professionals who will be there to advocate for you in the event that you make a claim.

Please be in touch for assistance with your estate planning and life insurance needs.

Our team of advisors across Canada would love to help.

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