The TaxLetter®

Vol. 37, No. 7 | Your Guide to Tax-Saving Strategies | July 2019

ESTATEPLANNING

Life Insurance Options

Borrow, Rent or Buy

Mark Halpern, CFP, TEP

Life Insurance is the Rodney Dangerfield of financial services– it gets no respect.

It's the butt of many jokes, some very funny, including the hysterical depiction of a persistent life insurance salesman in the 1993 movie Groundhog Day

Jokes aside, much of that scorn and derision stems from lack of knowledge. No one has properly explained to most people exactly what this multi-function financial instrument can do for them.

And that's really a shame because life insurance is one of the most important, versatile, secure and tax-friendly financial investments you can find.

The importance of life insurance became apparent to my family in 1974, when my late father died of a massive heart attack at the age of 50. He was a busy engineer who didn't leave a will, let alone insurance. As a result, my late mother, who was 48 at the time, had to go back to work to support me and my three older brothers.

I used to think that wealthy people had it all together, assisted by the best accountants and smartest estate planning professionals who kept their financial affairs up to date and well-organized.

I was wrong. We frequently meet with very successful people who aren't properly organized. Despite a battalion of available financial advisors and resources, their wills are outdated or non-existent, their protection portfolios contain a mish mash of insurance policies, and their financial architecture has changed markedly over the years.

They've been so busy looking after everyone else (customers, shareholders, bankers, employees, etc.) that they haven't spent the time required to take care of what truly matters most – protecting their family and loved ones.

Our clients generally use life insurance to achieve one or more of the following objectives:

- Create liquidity at the time estate taxes are due to avoid the forced sale of assets.
- Fund specific inheritances for heirs or as charitable bequests.
- Protect a business against the sudden catastrophic loss of a key person.
- Secure maximum value of their business for succession planning, and pay minimum tax.

Establish a guaranteed, fixed-income investment within a family's intergenerational asset allocation.

Life insurance enjoys unique treatment under Canada's Income Tax Act. All benefits are paid to beneficiaries tax-free, independent of the will and bypassing probate.

According to the Canadian Life and Health Insurance Association, about 22 million Canadians (60 per cent of our population) owned $4.7 trillion in life

Mark Halpern is a Certified Financial Planner (CFP), Trust and Estate Practitioner (TEP) and one of Canada's top life insurance advisors. He is CEO of WEALTHinsurance.com® and illnessPROTECTION.com®, with special expertise for business owners, entrepreneurs, medical professionals and high-net worth individuals and their families. He can be reached at 416-364-2929, toll-free at 866-566-2001 or mark@WEALTHinsurance.com.

insurance coverage last year. That amount includes term, whole life and universal life plans. The remaining 40 per cent of Canadians had some insurance coverage through a group benefits plan at work, or no coverage at all.

Having group insurance is basically just “borrowing” life insurance, because when people leave their jobs - by their own choice or otherwise - that insurance is no longer available. In that case, who will pay the mortgage, credit card bills or lines of credit if they die? There are very few sure things in life, and nowadays when it comes to a job, there’s no assurance of a lifetime career topped off with a gold watch.

Term or permanent?

There are two types of individual life insurance policies, term or permanent. Getting term insurance is like “renting” it – it comes with specific terms that usually range from 10 to 20 years or even longer. Much like renting a house or apartment, when the lease period ends the renter leaves with no equity. Renewals come at a much higher cost and depending on the policy may not be available if the insured no longer qualifies due to poor health or other circumstances, like a bad driving record.

Many people tend to overlook the financial value of their existing insurance policies, including term. In fact, some $7 billion of life insurance falls off the books every year in Canada – from people who don’t renew their term insurance or let their policies lapse because they can’t afford it.

Those policies can have tremendous value to the policyholder. A reduced life expectancy caused by an illness such as cancer or heart disease adds to the value of these policies that can often be converted without no medical qualifications, valued by an actuary and then donated to charity.

We recently helped a woman in her sixties convert her term policy with no medical requirements and donate it to her alma mater. She received a $170,000 charitable receipt for her generosity and saved $85,000 of income taxes.

Then there’s permanent life insurance that you “own”. Similar to owning a home, you can take advantage of using the equity, or in this case – the cash value – of the policy in a tax-effective manner. If you decide to terminate your insurance contract, you can receive the cash surrender value (CSV) that has built up over time.

Permanent insurance is favoured by business owners who use the CSV in tax-effective strategies that allow them to protect and grow wealth while shielding it from taxes.

Bankers prefer lending against CSV over other assets like stocks, bonds, mortgages, real estate, precious metals, etc. when it comes to serving as security for loans.

The Immediate Financing Arrangement (IFA) strategy allows you to use your insurance policy as collateral for a line of credit with a Canadian chartered bank. The money from this loan can then be invested back into your business, property or investment portfolio to produce income.

With an IFA, you pay interest on the line of credit every year and use the collateral insurance deduction and the interest expense as tax deductions.

As you pay the ongoing premiums for the life insurance policy, you are eligible to borrow back as much as 100 per cent of the CSV. The loan is typically paid off at death with the life Insurance proceeds. The balance goes to family and charity, tax-effectively.

A 65-year-old business owner needed permanent life insurance but wasn’t prepared to pay the premiums. He was earning over 20 per cent annually on business investments and reluctant to reduce his returns to buy Life Insurance.

We structured an IFA to recover 100 per cent of his insurance premiums. He continues to invest his money in his business.

The IFA can be an ideal solution, but it needs to be developed ahead of time by experienced professionals who can help determine which financial institution is best for you. Some lenders have set minimum loan amounts, while others may have stipulations on how the IFA proceeds should be invested.

Corporate Annuity

Business owners over the age of 60 should consider a corporate-insured annuity, a strategy aimed at reducing final taxes. The annuity is ideal for those who are major shareholders of a private corporation with surplus capital not required to operate the business.

In the right situation, it will maximize your after-tax retirement income on a guaranteed basis and enhance your estate value in favour of your heirs.

This strategy has two steps: buying a corporate-owned life insurance policy and buying a corporate-owned life annuity. With this plan, a minimum-funded universal life policy will list you as the life insured and the corporation as the beneficiary. The corporation then liquidates interest-earning investments to buy the life annuity contract.

The cash flow from the annuity pays the life insurance premiums and the tax payable on the annuity income. Any remaining funds can help supplement your income on a higher, guaranteed, after-tax basis as opposed to a traditional investment.

On death, your company receives the death benefit from the life insurance policy. The excess of the death benefit over the adjusted cost base of the policy will then be credited to the corporation's capital dividend account.

The proceeds are then used by your corporation to pay a dividend to your estate, which can then gift the funds as directed in your will to your heirs or charities.

The result is that your corporation will enjoy substantial tax savings.

Life insurance can also earn much respect in your community and family if you buy, say, a $1 million life insurance policy with the policy owned by a charitable foundation. The annual premiums will be considered a charitable donation and reduce a person's current taxes. That person will also be recognized for his generosity by each charity now, while the person is alive, if they so wish.

There are many ways to fund this, especially for affluent Canadians, who can use their monthly CPP benefits to pay for the insurance with their favourite charity named as beneficiary. The CPP Philanthropy™ strategy was the subject of my Oct 2017 TaxLetter article.

People often have a high regard for teachers, physicians and successful entrepreneurs, not only for their achievements but for the inspiration they provide to others.

Taking advantage of the benefits of life insurance, whether for the short or long term, can well bring you too into that special circle and ensure, that unlike Rodney Dangerfield, you will get all the respect you can handle.

Don't do it yourself. Seek professional help. The best way to get financial peace of mind starts with advice from an impartial and experienced team that includes your accountant, lawyer and a Certified Financial Planner or Trust & Estate Practitioner.

Our team of experienced advisors is available to help you across the country. Contact us for your no-obligation consultation. ❑

Mark Halpern is one of Canada's top life insurance advisors, a Certified Financial Planner (CFP), Trust and Estate Practitioner (TEP) and CEO of WEALTHinsurance.com®.
He guides successful business owners, who are already challenged for time, through the complex process of ensuring the people and organizations they care about are taken care of.
If you are like his other successful business owner clients, you are looking to reduce your tax obligations, preserve your wealth and leave a legacy. Incompletions rob us of energy. Mark collaborates with your professional advisory team to achieve your desired outcomes. His approach is simple. He makes sure what is important to you gets done. He gets you organized, provides a big picture view of your financial affairs, determines your strategy and helps you take action. He will simplify the complicated, so you and your family can rest easy. He can be reached at 416-364-2929, toll-free at 1-866-566-2001 or Mark@WEALTHinsurance.com.
Visit WEALTHinsurance.com
Get your FREE Estate Planning Toolkit at WEALTHinsurance.com/toolkits.html
The 2019 Toolkit now includes:
Estate Directory
Estate Planning Checklist
Executor Duties Checklist
Business Owners Planning Guide
Visit MarkHalpernBlog.com and sign up for free updates