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ESTATEPLANNING

Permanent Tax-Exempt Insurance

Four Reasons To Buy Now

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Throughout my professional career of almost 30 years, many affluent people have said they don't need life insurance. And you know what? They are correct – they don't need insurance – at least not for many of the traditional reasons.

Most people buy life insurance because they don't want to leave loved ones with a mortgage and bills to pay, and children who need funds to attend university. That's about 80 per cent of the population.

But wealthy individuals buy – or should buy – permanent tax-exempt insurance for other important reasons:

1. Creates liquidity -- for pennies on the dollar -- to pay estate tax liabilities.

2. Insurance can help equalize assets after death

3. Permanent insurance can serve as a tax shelter

4. Permanent insurance can provide a substantial rate of return – certainly higher than bonds or GICs.

Helps pay tax liabilities

People want to preserve their hard-earned money for their family or favourite charities and do not like the idea of the government taking 27 per cent to more than 50 per cent of their assets when they die.

When a married person dies, he or she can take advantage of a spousal tax-free rollover and not be taxed on the assets. It's on the second to die of a husband and wife that taxes become due and payable.

But if you are single, widowed or divorced you don't get that benefit. All of your investments will be considered to be sold at current market values and taxed accordingly since there is no spouse.

In Ontario, for example, as much as 54 per cent of registered assets like RRSP's and RRIFs will go to the tax department. If a divorced person has $1m in a RRIF, their children will only get $460,000.

How do people fund the tax liability? You can use cash on hand -- but who has large sums of cash available? You can borrow to pay the taxes - but you must pay back the loan and the interest cost is not deductible. You may have to liquidate assets to create the cash for the tax bill --but it may not be the best time to sell and who wants to give a family asset such as a business, cottage or real estate investment? The least expensive strategy is to acquire permanent life insurance. In a family situation, joint and last-to-die coverage, which is about 40 per cent less expensive, pays out on the second to die of a husband and wife, when the taxes are due. Affluent families need to learn how they can create dollars for pennies, even using financing arrangements, to provide the financial wherewithal to pay estate taxes without having to sell any assets, such as part of a

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business, real estate or even worse, go into debt.

We recently had to inform an 80-year-old client that estate taxes would gobble up a big chunk of her investment portfolio at death. She had curated an impressive investment portfolio worth $10 million and wasn't happy to learn that only $6.5 million would remain in her estate after taxes.

An awareness of tax liabilities is essential to successful tax minimization and estate planning. It's the starting point that sets the direction of your planning to save enough money for a long and comfortable retirement, fund ultimate tax bills and still be generous to charity.

On an interesting note, we often have situations where adult children fund the insurance premiums on their parents. They know they will ultimately be the ones who will inherit the assets and would rather pay for small premiums today in order to retain valuable assets long term, and not have to deal with estate taxes that could seriously eat into their inheritances.

Permanent insurance can help equalize asset distribution

It's not uncommon in family businesses to have one adult child running a company with others looking in from the outside. But most parents want to be fair and equitable and realize that someday they will have to hand over the reins of the company to the child who knows what he or she is doing. If the parents divvy up the business equally, the daughter who has been running the business for years with the parents will become a minority shareholder in a business she has taken over as her own, with the remaining siblings beholden to her to find out when they will receive their dividend cheques.

This is a perfect situation in which insurance will equalize the inheritances to all the adult children. Using insurance, when the parents die they will leave the oldest daughter the business and her siblings will divvy up the insurance proceeds, making everyone "whole".

The same thing can happen when it comes to the family cottage: one child loves getting away, has great childhood memories and wants to bring up their family in the same loving venue.

But unlike a home, the family cottage is deemed an investment property and is subject to potentially hefty taxes. If you bought the cottage before February 1994 you were eligible for a $100,000 lifetime limit for tax-free capital gains. But that exemption is no longer available. Some Canadians who owned a cottage at that time filed an election with Canada Revenue Agency (CRA) to claim a deemed capital gain on the 1994 fair-market value of the cottage. This then became the new cost base for the purpose of calculating capital gains taxes.

CRA did announce a few years ago that it will allow the principal-residence exemption only if you report the sale and designation of principal residence in the capital gains section of your tax return. You also have to report when you bought the principal residence, a description and the proceeds of the sale.

But buying life insurance is the least costly way to deal with this or any tax liability. A joint and last-to-die policy can cost about 40 per cent less than insurance on an individual life. Each spouse leaves the cottage to the other either by will or by right of survivorship, if owned jointly. When the surviving spouse dies, the insurance benefit is paid to the beneficiary or the estate, providing all the cash required to pay the tax bill. If a cottage is involved, it is left to the children in the will.

As an aside, buying insurance will provide the funds to pay taxes on the appreciated value of the cottage when the child who inherits it decides to sell it.

Permanent insurance can act as a tax shelter

All my clients have a Tax-Free Savings Account (TFSA) because, as the name suggests, savings are sheltered from taxes. The only problem with this marvellous federal program is that it allows people to deposit only $6,000 a year.

But if it was possible to have an unlimited TFSA for your business or personally, would you be interested? Most people answer yes. After all, other than permanent life insurance, your principal residence and lottery winnings, a TFSA is one of the very few tax-free investments still available in Canada.

We recommend that investors first consider moving some of the taxable investments in their investment portfolio into tax-exempt life insurance. This way, the savings component of the policy, known as the cash surrender value (CSV), grows tax-exempt and accumulates funds that can be accessed during your lifetime for everything from emergencies, investment opportunities or to help fund your retirement. On top of that, the death benefit is also paid out tax-free if the policy is owned personally, or with little tax if owned corporately.

If you qualify, you can get permanent life insurance using an Immediate Financing Arrangement (IFA). With an IFA, your insurance policy CSV can serve as collateral to secure a line of credit with a Canadian chartered bank and use those borrowed funds for other investments. The loan balance is paid off at death from the insurance proceeds with the remaining going to family and charity.

If you are a business owner or incorporated professional, you can invest some retained profits in your business in a permanent life insurance policy and not be subject to the passive income tax of 50.17 per cent in Ontario. The savings component of the policy grows tax-exempt and the CSV can also be accessed tax effectively.

Permanent insurance can generate a substantial rate of return

With interest savings rates at most financial institutions near zero, you may want to consider permanent insurance with a much heftier rate of return for your estate.

A couple, both 65, own a holding company with $100,000 of after-tax income available to invest each year. The Smiths, as we will call them, use their holding company to deposit $100,000 annually for 10 years in a solid investment, which earns a four per cent rate of return. After 25 years, their beneficiaries receive net after-tax proceeds of about $990,000.

It's true that this is less than their original investment because the interest earned over those 25 years was all passive income and gets taxed every year at just over 50 per cent. Another dividend tax is levied when the money leaves the holding company and is distributed among the family.

However, their holding company could deposit the same $100,000 for 10 years into a joint last-to-die tax-exempt life insurance policy, and after 25 years their beneficiaries would receive proceeds of about $2.8 million.

That's right: $2.8 million with permanent life insurance vs $990,000 with investments.

With federal and provincial governments putting out billions of dollars in help to companies and individuals during the COVID-19 plague, there is a general consensus that current taxes will go up and new taxes on things like principal residences, and inheritances may be taxed for the first time. Other taxes that are likely to rise include capital gains, private equity and appreciated securities. While insurance companies have lowered qualifications for some life insurance policies (up to $2 million), at least one has raised its rates recently.

The entire COVID situation has crystallized the importance of resolving all your financial planning issues, like inheritances, personal taxes and wills. It is important that you talk to professionals to ensure this work is completed correctly.

There has never been a better to get your incompletions done. And there has never been a better time to consider permanent tax-exempt life insurance as part of your overall tax and estate planning. The only caveat is that we need to do this while the sun is still shining.

Please reach out to us or reach out to your professional advisors and get the process started.

Until then, please stay safe and stay well. ❑

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He guides successful business owners, who are already challenged for time, through the com plex 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.
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