ADVISOR USE ONLY

LIFE INSURANCE

Investment Strategy Advisor Guide

For Individuals And Corporations

A STRATEGY USING TAX-EXEMPT LIFE INSURANCE

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We help. You grow.

Important information about this guide

This guide for advisors explains how life insurance can be useful as an investment strategy. For individuals or owners of a private corporation, life insurance provides a unique way for wealth accumulation within a corporation and the transfer of that wealth to surviving shareholders. The Corporate Investment Strategy uses life insurance to provide a combination of tax-preferred growth, tax-free death benefit and resulting credit to the corporation's capital dividend account (CDA) that can help protect and significantly increase the value of an estate. The guide will focus on how the strategy works, Client profiles and benefits.

This guide includes information on the Investment Strategy using tax-exempt life insurance as of January 1, 2017. The information in this guide has been prepared for advisor use only.

This guide doesn't provide tax, legal, accounting or other professional advice. We suggest that you advise Clients to seek the advice of a tax professional when making decisions. It's the Client's responsibility to determine the tax consequences under the relevant tax legislation. Any tax information provided in this advisor guide is based on the provisions of the Income Tax Act (Canada) and the regulations as of the date of this guide. In addition, these are subject to Sun Life's current understanding and interpretation of the rules and the administrative practices of the Canada Revenue Agency (CRA) in effect.

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Overview

What is the investment strategy?

The Investment Strategy benefits Clients because it addresses a variety of tax challenges, both while living and at death. Income earned by Clients on investments outside of a registered plan – such as interest, dividends or capital gains – may be subject to tax. Paying these annual taxes reduces the overall net return and can substantially slow the accumulation of Clients' assets and estate values over time. Having too much investment income may also result in other unintended consequences. For corporations, it may limit the advantages that the small business deduction can provide. The Investment Strategy compares the net estate value of a tax-exempt life insurance policy against a taxable investment.

How it works

The following table compares how the Investment Strategy addresses a variety of tax challenges, both while living and at death and the advantages of insurance over taxable investments.

Challenges that can exist with taxable investments	How the Investment Strategy addresses these issues
• Income earned on non-registered investments is subject to tax during the Client's lifetime. • Annual taxes paid reduce the overall net return and can substantially slow the growth of Clients' assets and estate value over time. • When an individual dies, their assets are deemed to be disposed of at fair market value. There may be rollover opportunities available for the first death of a married or common-law partner, but taxes are triggered upon the second death, reducing the estate value. • When an asset is disposed of for more than the adjusted cost base, a capital gain is incurred. Currently, 50% of the capital gain is subject to income taxes, which can significantly reduce the final estate value. • Probate, executor and legal fees may also apply, further reducing the amount available to beneficiaries.	• A life insurance policy's cash value grows tax-preferred, within legislative limits. • This cash value may be accessed in a number of ways, helping to satisfy the Clients' liquidity concerns. • Transferring funds from taxable investments to an exempt life insurance policy can help reduce overall taxable income. • The tax-free death benefit is paid directly to the named beneficiary, avoiding probate, executor and legal fees, addressing the common tax challenges often faced at death for individual Clients.
Corporate Clients • Passive investment income within the corporation, including interest, dividends and half of realized capital gains, is taxed at the high corporate investment income tax rates. • Depending on the province, taxable income within the corporation is subject to a tax rate near 50%. • When the assets are liquidated and distributed from the corporation following the shareholder's death, any deferred capital gains are realized. Half of any realized capital gains are included in the corporation's taxable income. • The after-tax value of these assets in the company need to be paid out as a taxable dividend to the estate or new shareholders, resulting in an additional layer of taxation.	**Corporate Clients** • The tax-free death benefit is paid to the corporate beneficiary. • The death benefit, minus the policy's adjusted cost basis (ACB) just before death can be posted to the corporation's capital dividend account (CDA). Since the ACB of a policy decreases as the insured person nears life expectancy, in some circumstances the full death benefit could be credited to the CDA. • The CDA can then be used to pay tax-free capital dividends out of the corporation. Any remaining portion of the death benefit that didn't provide a CDA credit, representing the ACB of the policy, can be paid as a taxable dividend.

The individual investment strategy (IIS)

Implementing this strategy for individual Clients involves the following steps:

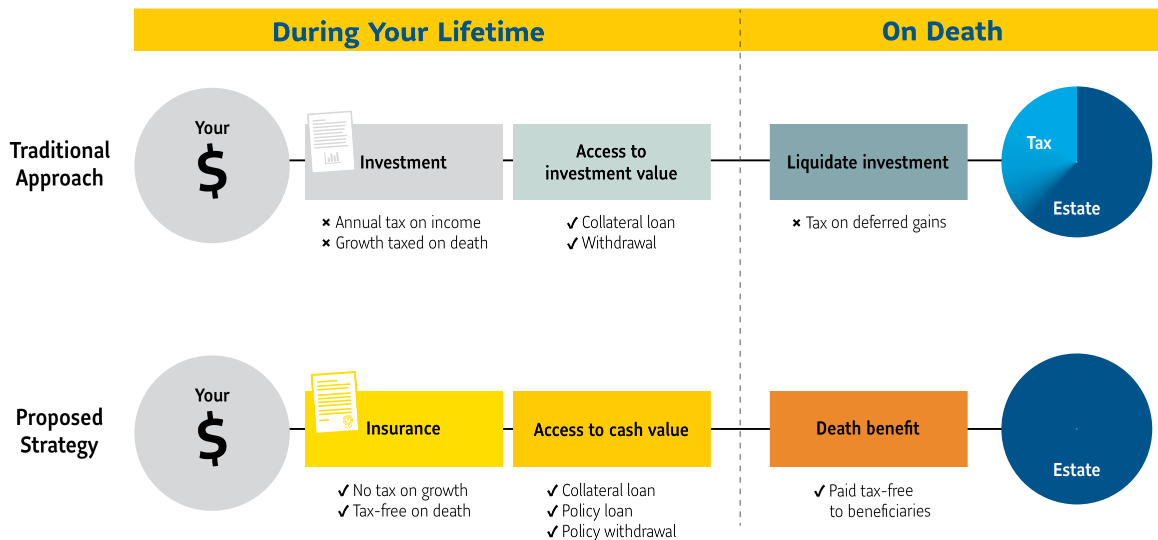
1. An individual or a couple purchases a participating or universal life insurance policy. For couples, the effectiveness of the IIS may be improved by illustrating a joint-last-to-die policy, compared to a single life contract.

2. Premiums for the policy are paid by either:
   - Using excess income not needed for other purposes; or,
   - Transferring a portion of the Client's assets from their non-registered investment portfolio to the life insurance policy.

3. The cash value accumulates within the life insurance policy on a tax-preferred basis. Depending on the policy type, the death benefit may also grow over time. By moving excess income or transferring funds from taxable non-registered investments to a life insurance policy, an individual can reduce their annual taxable income, potentially resulting in greater asset growth.

4. If Clients require access to the cash value in the policy, they may be able to take a policy loan, make a withdrawal from the policy, or collaterally assign the policy to a lending institution for a loan.*

5. When the insured person, or the second spouse for a joint last-to-die plan dies, the life insurance tax-free death benefit is paid directly to the named beneficiaries.



*In Quebec, using a life insurance policy as collateral involves the use of a movable hypothec. Like a collateral assignment, the movable hypothec doesn't involve the transfer of policy ownership. It provides security for the loan by giving the lender rights in the policy to the extent of the loan balance.

The corporate investment strategy (CIS)

The CIS has similar considerations to that of the IIS, but there are additional elements involved. The main differences are how the death benefit process works and flows to the estate. Implementing this strategy for corporate Clients involves the following steps:

1. A corporation purchases a participating or universal life insurance policy on the life of a shareholder. The corporation owns the policy, pays the premiums, and names itself as the beneficiary.

2. Premiums for the policy are paid by either:

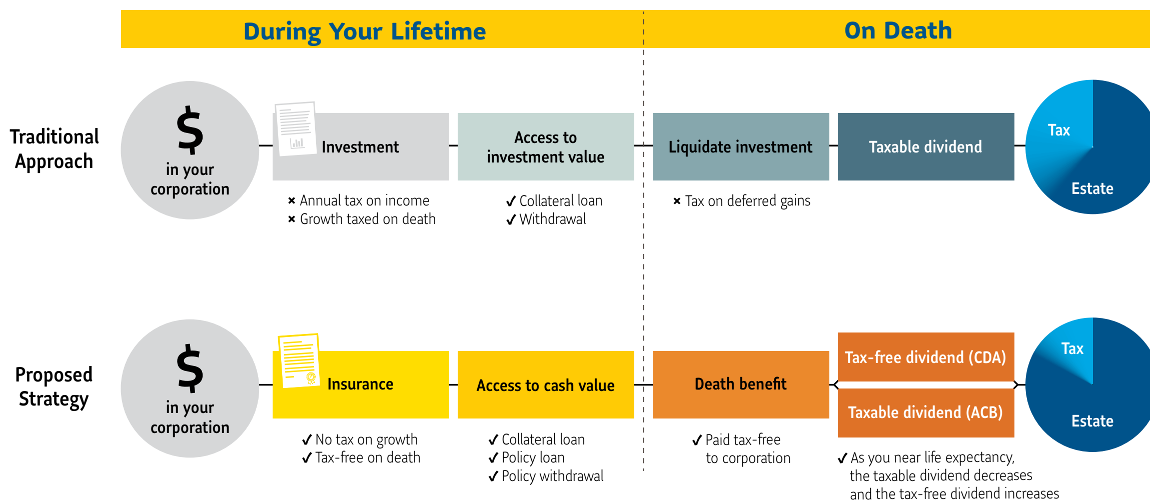
   - Using excess cash flow not needed for business operations; or,
   - Transferring assets from the corporation's investment portfolio to the insurance policy.

3. The cash value accumulates within the life insurance policy on a tax-preferred basis. Depending on the policy type, the death benefit may also grow over time. By transferring funds from taxable corporate investments to a tax-exempt life insurance policy, the corporation can reduce its annual taxable income, potentially resulting in greater asset growth.

4. If the corporation requires access to the cash value in the policy, it may be able to take a policy loan, make a withdrawal from the policy, or collaterally assign the policy to a lending institution for a loan.

5. When the insured person dies, the tax-free life insurance death benefit proceeds are paid to the corporation as the beneficiary. The death benefit, less the adjusted cost basis (ACB) of the policy at the time of death, can create a credit to the corporation's capital dividend account (CDA).

6. Working with its tax advisors, the corporation can use the CDA credit created by the life insurance policy death benefit to pay tax-free capital dividends out of the corporation. Any additional money can be paid out as a taxable dividend.



Client profiles

The Investment Strategy may be most suitable for individual or corporate Clients with significant excess income, or substantial assets in taxable non-registered investments. Their immediate and long-term financial planning objectives may be similar, including minimizing taxes, and ensuring future generations are financially secure when they're gone. Unfortunately, tax on investment income can work against Clients' goals and objectives. The Investment Strategy demonstrates how a permanent life insurance policy can help reduce the overall tax bill and provide a larger estate than taxable investments alone.

These strategies should be used with individuals or corporations that have either excess income or assets they don't require to fund lifestyle needs or company operations. For individual Clients, it should only be used after maximizing other tax-preferred registered savings, i.e. registered retirement savings plans (RRSP) and tax-free savings accounts (TFSA). This strategy may not be suitable for Clients with variable income or fewer assets.

Examples of Clients may include those who are high-income earners, have saved diligently, inherited a large sum of money, sold their business, or may accumulate significant wealth that they don't intend to spend in their lifetime. A Client who is a shareholder of a Canadian-controlled private corporation (CCPC) may have operated a successful business which led to a large amount of assets in their holding company.

The Investment Strategy uses life insurance, so Clients must be reasonably healthy and able to qualify for coverage to take advantage of the benefits this strategy offers. The Investment Strategy is intended to be in place for the life of the insured person. A long-term view is essential to maximizing the benefits of this strategy.

Whether the strategy is implemented on an individual or a corporate basis, the individual or corporation must have an underlying life insurance need, and ultimately have a desire to maximize the value of their estate. Ensure that maximizing the value of assets passed on after death is consistent with the Client's goals.

Individual Clients	Corporate Clients
• Individuals in good health • Have a large permanent life insurance need • Have a regular, high income stream that exceeds their lifestyle needs • High net worth with a secure financial future • Have a significant taxable, non-registered, investment portfolio that isn't intended to be fully used • Have already maximized RRSP and TFSA contributions • Want to maximize their estate value for their beneficiaries • Want to minimize the tax burden associated with their taxable investments	• Shareholder of a Canadian-controlled private corporation (CCPC) and in good health • Corporation has a large permanent life insurance need • Have a successful business with stable cash flow and a sound future outlook • Significant investment portfolio or excess cash flow not required to fund business operations • Want to maximize the value of their business at death • Interested in reducing tax on corporate investment income

Benefits of the investment strategy

Here's a summary of the benefits life insurance can provide individual and corporate owners:

- **Tax-preferred cash accumulation** – The policy's cash value grows tax-free, as long as it remains within the policy.
- **Tax-free death benefit** – The named beneficiary receives the tax-free death benefit, avoiding probate and estate settlement costs for individuals. For corporate Clients, the CDA credit provides a tax-efficient way of moving the proceeds out of the corporation. This allows a larger amount to be passed directly to beneficiaries compared to taxable investments.
- **Liquidity** – If the policy owner requires access to the accumulated funds within their policy, they may take a policy loan, withdraw cash value, or collaterally assign the policy in exchange for a loan from a third party financial institution. Many Clients appreciate the comfort that comes from knowing they can access the cash value of their life insurance policy at any time.
- **Potential creditor protection** – For personally owned policies, the accumulated cash value of the policy may be protected from the claims of the policy owner's creditors during the policy owner's life and after their death. Policies owned by holding companies may offer some degree of protection against creditors of a related operating company.
- **Protection of privacy** – By naming a beneficiary, life insurance proceeds don't pass through the policy owner's estate but go directly to the person or organization named. The tax-free death benefit isn't part of the probate process and doesn't become a matter of public record. This helps Clients keep their final wishes and the distribution of their assets private.

FAQs

What if Clients want access to money?

Individuals or corporations may be able to access money by taking a policy loan, making a withdrawal, or collaterally assigning the policy in exchange for a bank loan or line of credit. There may be tax consequences to some of these options. If Clients choose to access money from the policy, the net estate value of the strategy will be reduced.

While accessing cash from a life insurance policy is straightforward, it may be less desirable than using taxable investments. Tax may be payable on policy loans or withdrawals. In addition, no capital dividend account (CDA) credit will result from a withdrawal, policy loan or surrender for corporate Clients. Policy loans and collateral assignments come with their own associated risks. Clients should consult their tax advisor for complete details.

How are the net estate values of the strategy using life insurance able to outperform an alternate taxable investment?

Traditional investment portfolios are subject to annual taxation of earned interest, dividends received, and realized capital gains. When these assets are liquidated, it also triggers taxation of half of the asset's deferred capital gains. For corporations, money is typically moved to the estate or new shareholders by payment of a taxable dividend.

A life insurance policy's cash value grows tax-preferred. Transferring funds from taxable investments to an exempt life insurance policy can help to reduce overall taxable income. The death benefit is paid tax-free to the beneficiary, bypassing probate, executor and legal fees, addressing the common tax challenges often faced at death for individual Clients. For corporate beneficiaries, the capital dividend account provides a tax-efficient method of moving money out of the corporation to the estate or new shareholders.

These factors will often allow the strategy to outperform an alternate taxable investment, in particular when the policy is held until the death of the life insured.

What additional benefits can the strategy offer, besides higher estate values?

Life insurance may also offer an element of creditor protection when properly structured. If the beneficiary of an insurance policy is irrevocable or a member of a specified family class, the cash value of the policy and the death benefit may be protected against creditors of the individual policy owner. Policies owned by holding companies may offer some degree of protection against creditors of a related operating company. In any situation though, creditor protection can never be guaranteed.

By designating a beneficiary, the death benefit can flow directly to them, bypassing the estate, resulting in reduced probate fees and other costs. This allows for an efficient transfer of assets to the named beneficiaries of the policy upon death of the insured person. This can lead to a significantly faster settlement process, and increased privacy when compared to probating an estate.

When the insured person dies, how does the estate access the death benefit with the corporate investment strategy?

The capital dividend account (CDA) is part of the system of integration in the Income Tax Act (ITA). The ITA attempts to ensure that income is subject to the same total tax burden, regardless of whether it is earned directly by an individual or through a corporation and then distributed to an individual.

With the Corporate Investment Strategy, the tax-free death benefit is paid to the corporate beneficiary. The death benefit, less the policy's adjusted cost basis, can be credited to the corporation's CDA.

To flow money out of the corporation, a capital dividend must be declared by the directors of the corporation and be made payable to the shareholders. A resolution of the directors declaring the dividend is recorded in the minutes of the corporation. An election must also be filed with the Canada Revenue Agency. Given the complexity of this process, Clients should work with their legal and tax advisor to ensure it's properly completed.

Any portion of the death benefit that exceeds the CDA credit can be paid out of the corporation as a taxable dividend.

Why would a Client choose corporate ownership of the policy over individual?

Many factors need to be considered when a Client is choosing between individual versus corporate ownership of a policy. At the top of the list is choosing an ownership option that properly reflects the insurance need. The following are a few additional considerations, although there may be more. Clients should work with their advisor, their estate planning specialists, and their tax and legal advisors to determine the best ownership structure. They'll want to avoid the need for a transfer of ownership at some point in the future, since this could trigger taxable gains and taxable shareholder benefits, depending on the situation.

In general, life insurance premiums are paid for with after-tax dollars. A corporation that's a Canadian controlled private corporation (CCPC) is generally eligible for the small business tax deduction, and may pay tax at a lower rate than the insured shareholder. If so, the corporation won't need to earn as much money as the insured to pay the premiums.

Shareholders of qualifying small business corporations benefit from the lifetime capital gains exemption. However, qualifying the company for the exemption is very important. One of the requirements is that at the time the gain is realized, 90% of the fair market value (FMV) of the corporation's assets must be used in an active business carried on in Canada. Life insurance policy cash values are passive assets, and do not count towards this requirement. The CRA uses the policy's cash surrender value to measure the value of a life insurance policy when determining eligibility for the capital gains exemption. It may be useful to have the policy owned by a holding company rather than own policies in an operating company to avoid jeopardizing the operating company's status as a qualifying small business corporation.

While corporate-owned life insurance can increase the after-tax value to the estate, it may also increase the tax liability on the shareholder's terminal tax return. Shares of a closely-held corporation are deemed to be disposed of at death for their FMV immediately before death. The value of all the assets, including the cash value of any life insurance policies the corporation owns, helps determine the FMV of the corporation's shares. The significant cash value growth of the insurance policy may exceed what would otherwise have accumulated in the taxable investment. This may increase the tax liability on the terminal return and reduce the advantage of the corporate-owned insurance. Careful planning should be done with the Client's tax advisor to minimize this risk.

What's the best way to fund the life insurance premiums?

The decision to fund premium payments from cash flow or from an existing investment portfolio depends on the unique needs of each Client. Transferring funds from individually or corporate-owned investments such as stocks or mutual funds to a life insurance policy may trigger realization of capital gains, which could result in taxes owing. Clients should consult their tax advisor to ensure a tax-efficient transfer can be made where possible.

What if the Client changes their mind?

The Investment Strategy assumes Clients will take a long-term planning perspective, and that the policy won't be cancelled before the insured person's death. If a policy owner surrenders their policy during the insured person's lifetime, the policy owner receives the policy's cash surrender value. If the policy's cash surrender value exceeded its adjusted cost basis, the policy owner has to report the difference between these two amounts, known as the taxable gain, as income and pay tax on it.

Depending on the policy type chosen, there may be additional options for reducing or stopping premium payments for the insurance policy. Advisors and Clients should refer to specific product information for more details.

What types of life insurance policies are typically used with the strategy?

The Investment Strategy can be illustrated using any permanent life insurance product. The type of policy that's best for each Client depends on their specific needs.

Participating life insurance may offer Clients the opportunity to have their policy credited with policy owner dividends. It allows Clients to benefit from the stability offered from a diversified mix of bonds, real estate, equities, private fixed income and mortgages through the Sun Life participating account.

Universal life insurance provides Clients with access to a number of customizable investment options, allowing them to build their own portfolio, and may be more suitable for Clients who prefer a high degree of control over their investment decisions.

Sun Permanent Life provides clients with absolute guarantees. Premiums are paid when due and there are no investment options.

For couples, the effectiveness of the Investment Strategy may be improved by illustrating a joint-last-to-die policy, compared to a single life contract.

What impact does a change in assumptions have on the strategy?

There are a number of factors to be considered before implementing the Investment Strategy. Clients must understand there are many variables that contribute to the projection of any values in the report. Even a small change in the assumptions used in the strategy can have a significant impact on its effectiveness. Advisors should illustrate the strategy using a number of different assumptions, so Clients can fully understand the impact that changes can have on the results.

When comparing the growth of a life insurance policy to a taxable investment, policy performance is an important consideration.

- When using participating whole life insurance policies, illustrate at alternate dividend scales to help Clients understand the impact of a reduction in dividend scale on the cash values and death benefit of their life insurance plan.
- When illustrating using universal life insurance plans, be sure to show the impact of alternate rates of return.

What if tax rules change?

The Investment Strategy is based upon current tax rules, which are subject to change. It's possible that legislative changes could affect this strategy in the future. The tax rules surrounding these strategies can be complicated. Clients should work with their tax advisor to ensure this strategy is right for them.

Where to go for more information

The Investment Strategy is an excellent way to demonstrate how life insurance can help individuals and corporations increase the after-tax estate value of their excess income or assets compared to using taxable investments. For additional information, contact your Sun Life Sales Director.

Why choose Sun Life?

Sun Life is a leading international financial services organization. In Canada, we started selling life insurance in 1871. Since then, our commitment to helping people achieve lifetime financial security through market leading products, expert advice and innovative solutions has made us a household name – a name that people trust.

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