A Business Owner's Guide to Life Insurance Ownership

Earning success does not come without an understanding of how to properly manage risk

Life insurance for business owners is fundamental to protecting your family, business interest and continuity. Business owners have the option of owning life insurance policies personally or inside of their corporation. Corporate ownership has advantages and disadvantages, and deciding on where to own a life insurance policy involves serious consideration prior to making any decisions.

Corporately owned life insurance can be tailored to meet many different needs of a business owner. It can be used to protect your interests, ensure the continued operation of your business, provide security for creditors or provide funding from a share purchase agreement.

Funding Your Corporately Owned Life Insurance Policy

Life insurance premiums are not considered to be for the purpose of gaining or producing income from a business or property. As a result life insurance premiums are not typically eligible for a tax deduction and insurance premiums are normally paid for with after-tax dollars. Nonetheless, business owners often consider paying their insurance premiums from their corporation because it is the most desirable and least expensive way to fund the benefit.

Beneficiary Designation

Deciding on life insurance ownership status will determine who should be the beneficiary of that policy. If a policy is owned personally, any beneficiary can be named. This may be important if you wish to name charities, friends, religious organizations, family members or a combination of these options as the direct beneficiaries of your life insurance proceeds.

When a corporation owns an insurance policy the corporation should be the recipient of the proceeds. The life insurance death benefit less the policy adjusted cost basis (ACB) will be credited to the Capital Dividend Account (CDA), and can then be paid out to shareholders or the deceased's estate through a tax-free dividend.

The Capital Dividend Account is a notional tax account created in order to track the tax-free surpluses accumulated inside of a corporation including but not limited to life insurance proceeds. All private corporations in Canada, including those that are not Canadian-controlled qualify for a CDA. In funding the policy corporately and maximizing tax-free dividends through the CDA you can achieve the same benefit as you would with a personally owned insurance policy.

It is important to weigh the advantages and disadvantages of owning your life insurance policy inside of your corporation, and that you thoroughly understand all of the potential outcomes that may result, including the potential for creditors to access your CDA account. If creditor protection is a concern for you, then owning a policy inside of a holding company as opposed to an active operating corporation may provide protection against creditors. You should always seek independent legal advice if you are considering creditor protection of your assets.

The Pros and Cons

Prior to determining the ownership structure of your life insurance policy, you must first decide on the purpose of the life insurance, where the proceeds of the life insurance are most effectively received and where cash flow or assets are available to pay for premiums.

The following is a comparison of the advantages and disadvantages of corporately owned life insurance:

Advantages

- Lower after-tax premiums
- Under very specific circumstances premiums may be tax deductible[1]
- Tax free capital dividends can be paid from the insurance proceeds in excess of the policy ACB

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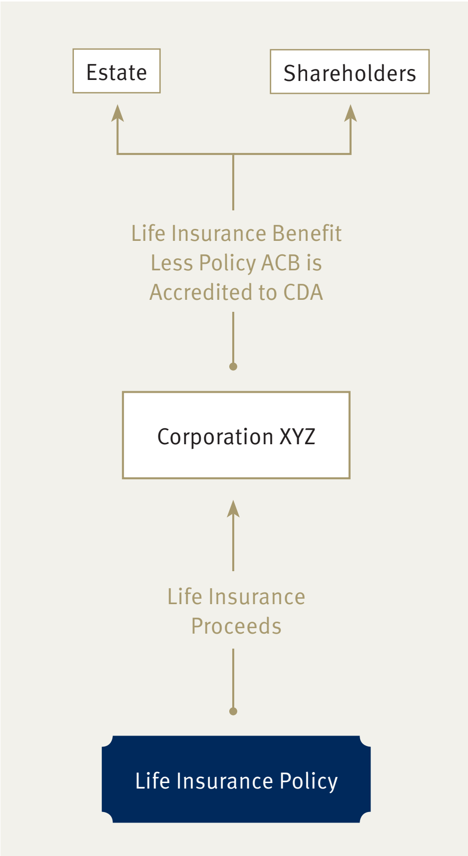

- Corporate owned insurance policy can be used for a number of strategic planning purposes, including:
  - Funding buy-sell agreement
  - Key person insurance
  - Business loan protection
  - Share redemption
  - Corporate tax shelter
  - Corporate wealth transfer
  - Corporate insured annuity

Disadvantages

- Lacks potential creditor protection
- If the corporation is sold or dissolved, and the policy is transferred to an individual or another corporation (i.e. a holding company), a disposition will occur. This risk may be reduced through initial ownership considerations such as owning your life insurance policy inside of a holding company.

If you already have a personally owned life insurance policy, there may be an opportunity to transfer your life insurance policy ownership into your corporation and benefit from:

- Allowing you to unlock tax-free retained earnings from inside your corporation;
- All future premiums being paid with after tax corporate dollars;

Prior to considering the transfer of a personally owned life insurance policy into a corporation, the Fair Market Value (FMV) of the policy must be determined, which can be provided at a cost by an actuarial firm. There are other considerations that you should review prior to transferring a personally owned life insurance policy into your corporation. For instance, this transfer may lead to an increase of your policy ACB. (The new policy ACB will be the higher of the current ACB or CSV (Cash Surrender Value).

Corporately owned life insurance may provide significant benefits to a business owner for strategic planning purposes, however just like any important consideration, you should not make your decision without thoroughly understanding and weighing all of the advantages and disadvantages.

To learn more about corporately owned life insurance, please contact us today.

[1] Under certain circumstances life insurance premiums may be tax-deductible inside of a corporation. For instance if a corporation has taken a loan from a financial institution, the interest on that loan is deductible if that financial institution requires the life insurance policy to be collaterally assigned for the loan. This is referred to as the 'collateral insurance deduction.' The second scenario in which life insurance premiums may be deductible by a corporation are if the premiums being paid are for a life insurance policy on an employee. In this case the corporation may deduct the premiums; however this potentially results in a taxable benefit to the employee.