Wealth
Management

Brad Weatherill, CIM
Insurance Representative
Tel: 403-341-8868
brad.weatherill@rbc.com

Weatherill Wealth
of RBC Dominion Securities
4900 - 50th Street, Suite 300
Red Deer, AB T4N 1X7
www.bradweatherill.ca

Understanding corporately owned life insurance

Life insurance solutions available for corporate business owners are 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.

How can a corporately owned policy help with business needs?

Before considering whether a corporately owned policy is necessary, you need to ask yourself what is the purpose of the life insurance. Corporately owned life insurance policies can be used for a number of strategic planning purposes, including:

- Key person insurance
- Business loan protection
- Funding buy-sell agreements
- Charitable giving
- Funding capital gains tax at death
- Executive compensation
- Retirement funding
- Estate tax and equalization
- Tax sheltered wealth accumulation

Funding a corporately owned policy

Generally life insurance premiums are not tax deductible as the premium payment is not considered an outlay for the purpose of gaining or producing income from a business or property. Therefore the premiums will be paid with after-tax dollars so a business owner may want to utilize dollars that generate the least amount of taxes payable.

There are three ways to fund a policy with corporate dollars:

1. The corporation pays a dividend to the business owner who then pays the premium and owns the policy personally.
2. The corporation pays an increased salary to the business owner who then pays the premium and owns the policy personally.
3. The corporation pays the premium directly and owns the policy.

From these three options usually the most tax-efficient strategy is to have the corporation pay the premiums directly and own it corporately. This is due to the fact that corporate tax rates are usually lower than individual tax rates. Furthermore this is a major factor in owning a life insurance policy corporately versus personally.

Tax-exempt growth

Corporately owned tax-exempt life insurance provides tax deferred growth, which is especially attractive for business owners who have maximized their total contribution room to their registered accounts. Specifically, the cash surrender value grows on a tax deferred basis in addition to a tax-free death benefit. This gives rise to a tax minimization strategy whereby a business owner reallocates funds, within the corporation, that would otherwise be subject to tax, into a corporately owned life insurance policy.

Cash value options

A corporately owned tax-exempt life insurance policy can provide more than a tax-free death benefit. In fact, during the life of the policy, the cash value can provide funds to the business owner for personal or business reasons. There are three options when accessing the cash surrender value:

1. Partial of full withdrawal of funds within the cash value account.
2. Obtain a policy loan against the cash value from the insurer.
3. Collaterally assign the policy to secure a loan.

With the first two strategies, there would be a deemed disposition that could result in a taxable policy gain. Collaterally assigning the policy to secure a bank loan is not considered a disposition and will not affect the policy's ability to grow on a tax deferred basis. The bank loan can be structured in different ways including no repayment until death enabling more possible solutions for the business owner. Even while the loan is outstanding, the policy continues to grow on a tax deferred basis which could produce a higher return than the interest rate on the loan. For these reasons the most efficient manner to access cash values usually is to collaterally assign the policy to secure a loan. A potential downfall of cash value within a corporately owned policy is that it may not be fully creditor proof.

Death benefit and beneficiary designation

A corporately owned policy should also have the corporation as the beneficiary. When a corporation receives the death benefit from a life insurance policy it will receive a credit to its capital dividend account (CDA) in the amount of the total proceeds of the policy less the adjusted cost basis. The CDA is a notional tax account that tracks tax-free surpluses accumulated inside the corporation. The corporation can then issue tax-free capital dividends to the intended shareholders.

Other corporate considerations

- The cash surrender value of the life insurance policy shows up on the balance sheet of the corporation and in turn affects the value of the corporation.
- It is possible to transfer a policy from your personal ownership into your corporation. Care should be taken to determine the effect of such a transaction, which is considered a disposition of the policy for tax purposes. A resulting gain in the transfer may create tax consequences.

Conclusion

Corporately owned tax-exempt insurance policies present a lot of tax efficient insurance planning opportunities for a business owner; however, it is always important to consider all advantages and disadvantages before implementing.

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