Wealth Management

Preserve your estate with the "tax protector"

Life insurance is most commonly used to provide financial security to your family and other beneficiaries in the event of your death. However, life insurance can also be used to protect the full value of your estate from taxes. At death, your assets often trigger significant tax obligations, which are frequently met by liquidating the assets of your estate. A life insurance benefit can cover your tax obligations and leave your estate intact.

Protect the full value of your estate from taxes.

How can the tax protector help you?

The tax protector can help you:

- Leave a lasting legacy for your family
- Lessen the burden on loved ones during a difficult time
- Keep family heirlooms in the family
- Give more to your favourite charity

Planning for the tax bill on your registered assets

Are you aware that almost half of your retirement savings are payable to the government at death? Often, the top marginal tax rate is applied to all remaining funds in your Registered Retirement Savings Plan (RRSP) or Registered Retirement Income Fund (RRIF) when they are taken into income in your final T-1 tax return, or that of your surviving spouse. On a $300,000 RRIF account, up to $150,000 in taxes will be payable to Canada Revenue Agency, depending on which province you live in. Are you and your family members prepared for this tax liability?

Life insurance may be the least costly method of compensating for the taxes that are payable at that time. Even better, you can design your plan to specifically pay a benefit on the death of the last remaining spouse, which is when the taxes are due. This is called "joint last-to-die" insurance coverage and comes at a lower premium cost than the equivalent individual coverage.

Reducing your capital gains tax

At death, your assets may be transferred to your spouse without triggering any taxation. But on the death of your spouse, your assets are deemed to have been sold at current market value for tax purposes – even if they have not been sold. This can

If you own substantial assets that you want to protect from taxes, the tax protector can preserve the value for your beneficiaries.

This includes:

- Registered plans, such as an RRSP or RRIF
- Shares in private or publicly traded corporations
- Collectibles, such as art, jewelry and antiques
- Real estate

result in taxable capital gains. Under certain conditions your RRSP or RRIF may be rolled over to a child's (or grandchild's) RRSP on a tax-deferred basis if the child is dependent due to a mental or physical disability, regardless of the age of the child.

After the cost base has been subtracted from the current market value of these assets, 50% of the gain must be claimed as income in your or your spouse's final tax return. Often, these assets must be sold in order to create enough cash to pay the taxes.

The tax protector allows your heirs to retain these assets, since the proceeds of the life insurance policy will cover the tax liability. This can help avoid an untimely disposition.

U.S. estate taxes

The following discussion applies only to Canadian residents who are not U.S. citizens or U.S. green card holders.

If upon your death you own any assets considered to be U.S. situs property (shares of U.S. companies, U.S. real estate, etc.), your estate may be required to pay U.S. Estate Taxes to the Internal Revenue Service based on the fair market value of these holdings at your death.

For 2016, as much as 40% of the value of U.S. assets may be payable in taxes when you die. In addition, state taxes may also be payable. However, U.S. Estate Tax will not be payable if your worldwide assets at death are less than $5.45 million US.

If your U.S. situs assets are $60,000 US or less upon your death, then no U.S. estate tax is payable regardless of the value of your worldwide assets.

Individuals investing in the U.S. should note that life insurance proceeds generally factor into the calculation of worldwide assets. You may consider holding your insurance policy within an Irrevocable Life Insurance Trust (ILIT) to reduce your exposure.

The above information is subject to change. Talk to a Cross Border Tax Specialist on U.S. Estate Tax.

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Case scenario – tax liability projection at age 85 (rounded to the nearest $1,000)

In this example, a wife and husband are both 65 and have combined assets of $2,285,000. When they are 85, their assets will be worth $3,271,000, and they will owe $781,000 in taxes if the last spouse dies (assuming a 45% tax rate).

Assets

	Shares of a private company (purchased in 1980)	Cottage purchased in 1973)	Registered assets	Totals
Amount invested / purchase price	$ 100,000	$ 20,600		$ 120,600
Current value	$ 1,745,000	$ 240,000	$ 300,000	$ 2,285,000
Growth rate	2.0%	2.0%	6.0%	
Income	n/a	n/a	Minimum RRIF	
Future value	$ 2,593,000	$ 356,600	$ 321,127	$ 3,270,727
Amount taxable / gross capital gain	$ 1,246,500	$ 168,000	$ 321,127	$ 1,735,627
Tax payable at death	**$ 560,925**	**$ 75,600**	**$ 144,507**	**$ 781,032**

RRSP values and income

Age	Annual RRIF withdrawals (minimum)	Balance at year-end (6% growth)	Tax liability at death
65	$ –	$318,000	$146,280
70	$ –	$425,556	$195,756
72	$33,290	$444,864	$204,637
75	$33,254	$423,936	$195,011
80	$33,245	$379,887	$174,748
85	$33,192	$321,127	$147,718

Cash can be made available by selling the more liquid assets. However, that may not be a preferred choice as it can result in a “fire sale.”

How will your final taxes be paid?

Your executor will have several options to choose from:

Choice 1:

Your estate can pay the tax liability with cash. Cash must be readily available when the tax bill is due.

Choice 2:

Your estate can pay the tax liability from other liquid assets. Cash can be made available by selling the more liquid assets. However, that may not be a preferred choice as it can result in a “fire sale” (i.e., the sale of goods at extremely low prices) of your assets. You should also consider how quickly your assets can be sold, if you can get full value for them and if they would be enough to pay the bill.

Choice 3:

Your estate can borrow the funds to pay the taxes. With this option, you should consider whether credit would be readily available when the time comes, and if your estate would have adequate assets to provide the security required for both the loan and the interest that would have to be repaid.

All three of these options involve the erosion of the final value of your estate, as well as considerable expense and inconvenience for your heirs. The following option effectively eliminates these drawbacks and allows your assets to be transferred intact.

Choice 4:

Purchase life insurance now to pay your taxes later. Since the taxes are not payable until the death of the last remaining spouse. Joint last-to-die insurance coverage can be purchased in order to provide the appropriate amount of cash upon death of the last spouse. Often, the cost of such coverage is only 1% to 3% of the future liability, depending on your age. You can either pay those costs monthly, annually, or take advantage of tax-exempt coverage, such as universal life, to prepay your premiums over five or 10 years.

In the case study above, it would cost $1,223* monthly to buy enough insurance to cover the anticipated taxes, which is roughly 2.0% of the total liability.

Protect your estate from taxes. To find out how you can benefit from the tax protector, contact us today.

* Effective February 10, 2016, Canada Life Universal Life insurance rates based on insurance coverage of $800,000. These values are for illustration purposes only and are not guaranteed.

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