Insured Retirement Plan

A tax planning strategy

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Retirement savings plans (RSPs) are arguably the most popular way to save for retirement. But RSPs aren't the only way. To enhance your retirement strategy, consider the Insured Retirement Plan (IRP). The IRP is a tax planning strategy that uses a flexible investment vehicle—tax-exempt life insurance—to build your wealth and provide the following:

- A solution to current and future insurance needs
- An opportunity to take advantage of tax-deferred growth
- An innovative way to supplement your financial needs in retirement

The IRP can help you achieve the retirement lifestyle you've always imagined by complementing your RSP savings. With the IRP, the accumulated value of a tax-exempt life insurance policy can be used to provide you with future cash flow that will supplement your retirement income.

The IRP has three primary components:

Life Insurance

Life insurance offers you the protection you need and the peace of mind that comes with knowing loved ones or business interests will be looked after once you pass on. The IRP is based on permanent coverage, which has two components: insurance coverage and cash value.

Accumulation

Similar to an RSP, the investments within the cash value part of a tax-exempt life insurance policy are allowed to accumulate on a tax-deferred basis, with some limitations. In other words, depending on the amount of insurance you purchase, you have the potential to build a great deal of equity within the policy.

Income

The accumulated value in your tax-exempt life insurance policy is a potential source of income. Its assets can be accessed at any time in one of three ways: withdrawing money, obtaining a policy loan from the insurance company or using the cash value as collateral to obtain a loan from a bank or trust company.

Getting started with a tax-exempt policy

Before you apply for the purchase of a life insurance policy, consider your overall financial situation and your future insurance needs. We[†] can help you through this assessment.

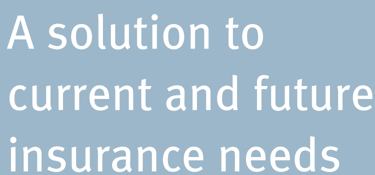
Once you have mapped out your needs and confirmed that a tax-exempt life insurance policy will enhance your financial strategy, consider the life insurance plan that will maximize the growth of your assets. With our guidance, you can select the plan that best meets your needs and the payment schedule that reflects your personal circumstances and preferences.

Remember that you are applying for an insurance policy, so you must be insurable in order to take advantage of this strategy.

Tax-exempt growth

Your policy will be tax-exempt under current tax laws. This means that any growth that remains in the plan will not be subject to accrual taxation. It works like a second RSP, except you don't receive a tax deduction for your deposits. What's more, you are free to contribute as much as you want, based on the amount of insurance coverage you purchase.

Once your policy has been left to grow for a significant period of time—at least 10 years—you can consider accessing funds for income. There are three ways to do this, as discussed on page three. However, using the cash value as collateral for a loan is usually the best option since the payments are not taxable,* whereas withdrawals and policy loans could be.



How the loan works

The loan can be structured such that the interest payable on the outstanding amount is capitalized, which means it is only payable upon death. However, you can choose to make regular interest payments in order to minimize the size of the loan.

At death, the tax-free benefit of the life insurance policy will pay off the loan—principal and interest—with any excess proceeds payable to your beneficiaries.

On the other hand, if you choose to surrender the policy prior to your death, a taxable disposition may occur. In this case, the bank will receive its portion of the cash values, but you will have to claim that money as your own income and pay tax on it.

To fully benefit from this strategy, consider making it a part of your overall estate plan.

Loan rules

The maximum amount the financial institution will lend will be based on a percentage of the cash value of the policy, which will range from 50% to 90%. This will depend on the investment mix and the issuer. Since the loan rate will not be guaranteed or linked to the growth within the policy, the lending institution will regularly monitor the ratio of the loan to the cash value. To secure your income stream, the financial institution will ensure this ratio remains within its particular threshold.

The loan advances generate a tax-free cash flow, which may be used in a number of different ways. For instance, you can draw a supplemental retirement income, make a large purchase or use the money for investment purposes. Depending on your personal situation, the interest on the loan may be tax-deductible, thereby increasing your after-tax wealth even further. Speak with your tax advisor to find out how you can take advantage of this benefit.

* This is based on current tax rules. To qualify for a loan or line of credit, you must satisfy credit criteria.

Corporate Insured Retirement Plan

This tax planning strategy also works well for small corporations that have excess capital to invest. The same three components make up the corporate IRP which has similar benefits to the personal IRP.

Income

Once the policy has accumulated a considerable cash value, your company can use those assets to obtain a loan from a financial institution. The loan can, for instance, be used to fund a new business venture or to buy out a retiring partner. You can also receive the income as a dividend for personal use. If you own a holding company, this is the approach to consider.

Accumulation

As mentioned, assets within a tax-exempt policy grow on a tax-deferred basis and are only taxed upon withdrawal. Your company can allocate excess earnings or current investments to a tax-exempt policy to maximize the growth of those assets. Combined with the insurance benefit, the overall value of the policy can surpass what would otherwise be earned in taxable investments.

Life Insurance

Many companies require insurance coverage to protect themselves from the loss of key employees or to fund a buy-sell arrangement between partners. By using tax-exempt life insurance, you can protect your company as well as create tax-deferred investment opportunities.

Additional Benefits

Again, the outstanding loan accumulates and is repaid upon the death of the insured using the proceeds of the policy, with the remaining benefit payable to the corporation. In addition, the benefit paid to the corporation creates a credit in its Capital Dividend Account (CDA), which allows the company to pay tax-free dividends to any shareholder up to the amount of that credit.

Since the CDA credit is based on the initial death benefit—before the loan is repaid—the corporation can use the credit to distribute the insurance proceeds as well as transfer other assets to shareholders tax-free (except in Quebec, where the CDA credit is equal to the death benefit less the outstanding loan).

Enhancing your tax planning strategy

The IRP is an effective way to get the most out of your retirement plan. A small company with capital to invest can also benefit from this strategy, as it is one way to create additional income for either corporate or personal spending. What's more, it can significantly reduce the tax liability incurred upon death as a result of transferring assets to remaining shareholders.

Call us† today to find out if this strategy is right for you.

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