Corporate insured retirement strategy

As the owner of a private business, a significant portion of your net worth is likely tied up in your company. Even though you may have maximized the tax sheltering opportunities provided by retirement savings plans and Tax-Free Savings Accounts (TFSAs), there are additional options that provide flexibility for accessing the funds accumulated in your company to help fund your retirement. As a result, the corporate insured retirement strategy may be the ideal solution for business owners who have a need for permanent life insurance protection, have maximized their conventional retirement savings options, and are looking for a financial planning strategy that may provide a tax-efficient way to save for their retirement.

How Does the Corporate Insured Retirement Strategy Work?

To implement the strategy, a permanent life insurance policy is purchased by your company based on the needs of you and your business. The premium payments will not be considered a taxable shareholder benefit if your company is both the owner and beneficiary of the life insurance policy. The premiums are structured to build a cash value within the life insurance policy. All investment earnings are tax deferred as long as they remain within the policy.

When you are ready to begin receiving retirement income, the life insurance policy is leveraged to access the cash value. Leveraging involves having your company arrange a loan (or line of credit) through a financial institution, using the accumulated cash value within the life insurance policy as collateral for the loan. The funds borrowed by your company are used to fund taxable dividend or bonus payments to you. The maximum amount that can be borrowed ranges from 50% to 90% of the cash value within the policy, depending on the specifics of the situation at the time.

The company will be charged interest on the loan; however, often an additional loan can be arranged to cover the interest payments. The accumulated loans must remain within the lending limits, based on the accumulated cash value within the policy, to prevent your policy from terminating.

Upon death, the business will use the life insurance proceeds to repay the outstanding loan(s), and the remaining funds will be distributed as tax-free capital dividends to your named beneficiaries.

The corporate insured retirement strategy uses a life insurance policy and leveraging to provide:

- Life insurance protection
- Tax-deferred growth of funds
- Tax-free access to those funds in the future
- A tax-free benefit to your estate

Issues to Consider

The corporate insured retirement strategy isn't suitable for everyone, as the strategy uses leveraging to access the cash value of the policy. It's important to have a long enough time horizon to accumulate a sufficient cash value in the life insurance policy to generate the income you require. Loan rates and cash values should be considered before deciding if the corporate insured retirement strategy is appropriate for your circumstances. Since the life insurance policy will be corporately owned, it is important to consider the implications if you decide to sell the company in the future. In addition, you should be aware that future Income Tax Act changes could potentially impact the practicality of this strategy.

Continued

Case study

Meet Peter and Carol

Peter is a 50 year old incorporated professional who maximizes his Individual Pension Plan (IPP) and TFSA contributions each year. Peter has additional disposable income inside his corporation and is looking for a tax-efficient way to use the money to fund he and his wife Carol's retirement, as well as provide life insurance protection for Carol if Peter should die.

To implement the corporate insured retirement strategy, Peter's corporation purchases a $1,000,000 permanent life insurance policy and plans to deposit $65,000 per year for 15 years (approximately $30,000 to prefund the life insurance coverage and approximately $35,000 to build the cash value of the policy). The corporation is named as the beneficiary of the policy.

At age 70, Peter determines he needs to supplement his retirement income, so the corporation arranges a loan with its banker. Based on the accumulated cash value within the life insurance policy, the corporation is eligible for an annual loan advance of up to $56,500 per year for 14 years (or 75% of the cash value in the policy), and uses the borrowed funds to pay annual taxable dividends to Peter and Carol. The annual loan advance assumes that any loan interest is tax deductible to the corporation. As well, the corporation borrows an amount equal to its after-tax cost of the annual interest payment so that the corporation does not need to draw on other resources to pay the loan interest.

If Peter were to pass away at age 85, the outstanding loan balance would be approximately $1,000,000. The proceeds of the life insurance policy ($2,300,000) would be used to repay the $1,000,000 outstanding loan balance, leaving approximately $1,300,000 be to paid to the corporation. In turn, the corporation would make ongoing tax-free capital dividend payments to Carol.

The corporate insured retirement strategy enables Peter to build a pool of non-registered assets in a tax-sheltered environment, while providing life insurance protection for his wife. At Peter's retirement, the corporation benefits from a tax-free cash flow by taking a loan out against the policy and then provides a regular stream of income to Peter and Carol through taxable dividend payments. Upon Peter's death, the outstanding loan is repaid and the remaining funds are available to the corporation for making payments to fund Carol's retirement.

The result

Life insurance policy benefit at death	$2,300,000
Annual premium Approximately $30,000 required to prefund the life insurance coverage and approximately $35,000 to build the cash value within the policy	$65,000
Projected cash value at age 65 (assuming the investments earn 3% within the policy)	$950,000
Annual tax-free cash flow to the corporation from age 70 to age 84	$56,500
Annual dividends paid to Peter and Carol (taxable to Peter and Carol)	$56,500
Outstanding loan value at death – Age 85 (assuming a 5% loan rate and a 45% tax rate)	$1,000,000
Life insurance proceeds available to Carol by way of capital dividends from the corporation	$1,300,000 ($2,300,000 minus outstanding loan)

Illustrated values based on BMO Life – Life Dimensions Universal Life, Single Life, Male, age 50 non-smoker, YRT85/20 COI, with the assumptions that are shown in the table. Based on the assumption that the insured is healthy. Illustration generated on October 26, 2015.

For more information, speak with your BMO financial professional who will refer you to an Estate & Insurance Advisor (Financial Security Advisor In Quebec) from BMO Estate Insurance Advisory Services.

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