Leveraging life insurance

Another potential source of retirement income

Life insurance is useful for more than providing an estate to your family when you die. It can be used to pay certain tax liabilities arising upon death. It can provide a sizeable gift to charity, providing your estate with a charitable tax credit. However, it can also be an integral part of achieving your retirement goals as a complementary tool, in addition to your Registered Retirement Savings Plan (RRSP) and other investments, as a source of retirement income.

Retirement funding with Life Insurance: stability and security

Under current tax law, the value of cash you put into your universal or permanent life insurance, beyond the cost of pure insurance, and up to the allowable maximum, can be permitted to *accumulate tax-deferred*. (Gains would be subject to tax if you disposed of or withdrew from the policy.) Further, once you maximize your RRSP, and TFSA contributions, a permanent life insurance policy with a cash value can be a tax-effective strategy for *sheltering non-registered cash*.

There are other benefits of individually owned policies. The accumulated cash value may be *protected from creditors* during your lifetime, and after your death. By naming a beneficiary you will be able to pass on the death benefit to your beneficiary outside of your estate. It won't be included in your Will (potentially a public document). Therefore, it will not be considered part of your estate, and not subject to estate administration tax (*probate fees*).

There are **four ways to use the cash value** inside an insurance policy:

- Make a withdrawal from your cash account (taxable)
- Direct dividend payments to be paid out (taxable)
- Take out a "policy loan" (taxable)
- Use the policy as collateral for a bank loan or line of credit (non-taxable)

If you use the policy as collateral for a loan, there will be a maximum amount you can leverage — somewhere between 50-90% of the policy cash value, as established by your lender. The amount will be based on your individual needs, as well as the state of the economy (*i.e.*, interest rate and dollar value) at the time.

You will likely be able to obtain a loan structured with interest payments only or interest and principal paid on a regular basis. Alternatively, the bank may agree to allow the policyholder to borrow the amount of loan interest and add it to the loan amount. As long as your loan remains in good standing, it could be paid off when you die with your policy's tax-free death benefit. If there is an amount left over, it can be distributed to your named beneficiaries.

Will funding your retirement with a life insurance policy meet your needs? Are any of the ways you might use the cash value within your policy appealing? To explore these possibilities, speak with your TD advisor and ask about consulting with a TD insurance specialist.

The Best Time to Purchase a Policy

The best time to invest in life insurance is when you are in the pre-retirement stage of your life. Generally, depending on the dividend performance within your policy, you'll need at least 20 years to enable you to accumulate enough cash within your policy to generate the income you need to meet your retirement goals.

You should keep in mind potential long-term changes to the interest rate, dollar value and your policy's dividend rate, which will affect the growth of assets that make up the cash value of your policy. If you change your country of residence, the ability to obtain a policy loan could be affected. Finally, changes may be made to the federal *Income Tax Act*, which may affect this retirement strategy.

Let's look at an example: Kate is a 38 year-old successful professional. She maximizes her RRSP, TFSA, and company pension plan contributions every year and has sufficient disposable income to fund a permanent life insurance policy. It will help safely increase her retirement income, when she and her partner, Kim, eventually move year-round to their winterized cottage.

Kate buys a $1,000,000 policy at age 40 that requires her to put $25,735 a year in premiums into it for 20 years. This is not just the cost of paying for the insurance. About half will be used to build up the cash value within the policy. She plans to retire at 65, when Kim will be 60. She plans to take out a bank loan when she retires to fund further renovations to their cottage, and construction of a new guest house. To facilitate the transaction, she will assign her policy to the bank as the primary creditor.

Based on the projected accumulated value in her policy, she will be able to receive a loan of $500,000 (67% of the cash value of her policy). If she passes away at 85, the outstanding loan balance will be $1,326,648, and paid off by the proceeds of her insurance policy. The following chart illustrates Kim's insurance strategy:

Kate's life insurance policy benefit at death	$2,395,290
Annual premium (includes amount required to fund the policy and the amount invested to build up the cash value) payable until age 60	$25,735
Projected cash value when Kate turns 65 (assuming 3% earned interest within the policy)	$750,951
Annual tax-free cash flow from age 65 to age 85	$40,121
Outstanding line of credit at death at age 85 (assuming a 5% loan interest rate)	$1,326,648
Life insurance proceeds available to Kim at Kate's death	**$1,068,642**

As a result of this retirement planning strategy Kate's line of credit will be paid off when she dies, and she will be able to leave Kim over $1M.

Consider funding a life insurance policy that could be leveraged to create a source of income when you retire. How will this fit into your overall financial plan and retirement goals? Speak with your TD advisor and request to be connected to TD insurance specialist.

Corporate clients

Let's look at this strategy with Kate as the owner of a corporation and Kim as the sole beneficiary of her estate. Here's how it would work.

Kate's company would buy the policy on her life, pay the premiums and name itself as the sole beneficiary. The ongoing premiums are paid by excess cash flow or the corporation's retained earnings. By purchasing the policy inside the corporation, Kate will be spending less pre-tax dollars (*i.e.*, it's typically cheaper than if she bought with her own pre-tax dollars due to the difference between the corporation's tax rate and her individual tax rate). The policy could also replace the fixed income component of her corporate assets, which will help avoid the relatively high tax on passive income.

When Kate retires, she can use the policy to secure a personal loan, outside the corporation, receiving the funds on a tax-free basis. When she dies, the insurer will pay the bank first as her primary creditor on the loan. The remainder will go to the corporation.

The ongoing premiums are paid by excess cash flow or the corporation's retained earnings.

Under current tax law, even though a proportion of the death benefit less Adjusted Cost Base of the policy (the actuarial costs of insuring Kate) was paid to the lender, the corporation can credit its Capital Dividend Account (CDA) for the entire amount of the death benefit less the ACB. The CDA balance can then be paid out as a tax-free capital dividend to the current shareholder, Kim.

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Addition to the CDA	$2,395,290
Life insurance proceeds available to Corporation	$1,068,642
Balance of CDA funds to be withdrawn from the corporation and paid to Kim as a tax-free capital dividend	**$1,326,648**

By having her company purchase an insurance policy on her life, the company will be able to pay the tax-free dividend of $1,326,648 to her surviving partner Kim.

To explore the opportunities presented by having your corporation purchase an insurance policy on your life, speak with your TD advisor about connecting you with a TD insurance specialist. This strategy may result in a taxable shareholder benefit based on the interest rate savings that the borrower obtains by having a corporate loan guarantee, or the equivalent to a guarantee fee. The risk may be reduced by having the borrower pay a guarantee fee to the corporation. You should consult with your tax advisor to ensure this strategy is tax-effective for you.

Now you are ready to:

- Talk with your TD advisor about the potential benefits of leveraging a permanent life insurance policy
- Review the benefits of this strategy — whether you will own the policy as an individual or through your corporation

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