Corporate estate transfer with collateral loan strategy:

A tax-efficient source of retirement income

This strategy uses a corporate-owned permanent life insurance policy to:

- Provide insurance protection
- Provide retirement income
- Facilitate a tax-efficient transfer of corporate wealth upon the death of the life insured

For retirement income, the corporate policyowner assigns the policy to a lender as collateral for a loan and pays the loan proceeds as a dividend to the shareholder. The below diagram compares the differences between using traditional corporate investments for income and using corporate-owned life insurance for income by accessing its cash value through a collateral loan.

Accessing cash using investments

Corporation invests cash

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Investment ··· **Annual tax on realized capital gains and investment income including interest, dividends, foreign income, etc.**

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Shareholder accesses the cash ··· **Shareholder pays tax on dividends**

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At death ··· **Shareholder pays tax on dividends**

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Shareholder gets the remaining funds

[1] The policy's cash value grows tax-free while inside the policy, subject to legislative limits.

[2] Need to be underwritten by the lender to qualify. Policyowner may need to make immediate repayment if lender calls in repayment of the loan.

[3] At death, the insurance proceeds are paid to the corporation on a tax-free basis. The capital dividend account of the private corporation typically receives a credit equal to the full death benefit less the adjusted cost basis of the policy. The capital dividend account credit typically allows the corporation to pay a tax-free dividend to the Canadian resident shareholders.

Accessing cash using a collateral loan

Corporation makes a premium payment

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Life insurance policy ··· **No tax on growth**[1]

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Corporation requests a loan ⇄ **Lending institution** advances a loan[2] ··· **Loan is tax-free**

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Corporation pays a salary or dividend ··· **Shareholder receives cash and pays tax**

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At death ··· Death benefit payout is first used to repay loan ··· **Corporation receives:**[3]
- Any excess death benefit payout
- Credit to capital dividend account

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Shareholder gets excess death benefit payout as dividends ··· **No personal tax on capital dividends**

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Accessing cash using corporate-owned portfolio investments

High tax rates on investment growth

Interest, portfolio dividends and taxable capital gains from corporately held investments are taxed at the highest corporate tax rate. They generally don't qualify for the small business deduction. This high tax rate erodes the growth potential of your corporation's portfolio.

Taxes when corporate assets sold for liquidity

When funds are required from the portfolio investments, the corporation can directly withdraw from the portfolio. This withdrawal may trigger unrealized capital gains and taxation.

The corporation could then use these funds for its own purposes or distribute them to the shareholder for income. The distribution to the shareholder would generally be subject to tax.

Taxes at death

Upon your death, your surviving spouse and/or heirs may want to access the corporation's assets. When these assets are distributed to either your estate or to your family members (whoever is the shareholder after death), they're subject to tax again at the recipient's personal marginal tax rate (for example, your estate, spouse, kids).

The tax on investment income within your corporation and the tax on the assets when distributed from your corporation (while living or after death) can have a significant impact on the after-tax value of your estate.

Corporate estate transfer with collateral loan strategy

Tax-advantaged growth

Permanent life insurance allows your corporation to accumulate cash value growth within the policy tax-free, subject to legislative limits, unless the cash value is withdrawn from the policy during your lifetime. Your corporation is the owner and beneficiary of a permanent life insurance policy on your life.

Tax-efficient access to the policy's cash value

When funds are required from the policy, the corporation can collaterally assign the policy to a third-party lending institution as security for a loan or line of credit. The loan is received tax-free and a collateral assignment is not a disposition of the policy for tax purposes.

Once the corporate policyowner has the loan proceeds, it can either use the cash for its own purposes or distribute the funds to the shareholder for income. The distribution to the shareholder would generally be subject to tax.

Tax-efficient transfer of corporate wealth at death

Upon your death, your corporation receives the death benefit. This credits its capital dividend account (CDA) by an amount that's generally equal to the death benefit less the adjusted cost basis of the insurance policy. If the policy is used to secure the indebtedness of the corporation, the corporation receives a credit to its CDA on the same basis, even when the death benefit is paid directly to the creditor.

The CDA can be used to distribute the insurance proceeds (net of the loan repayment) on a tax-free basis to the successor shareholder of your corporation (for example, your estate, spouse, kids).

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Collateral loans involve risk. They should only be considered by sophisticated investors with high risk tolerance and access to professional advice from a lawyer and accountant. The terms and future availability of collateral loans can't be guaranteed. The loan or line of credit must be negotiated between the policyowner and the lender. It's subject to the lender's financial underwriting and other requirements. The policyowners should have enough income and capital to cover the interest and loan repayment, as well as the insurance premium.

The information provided is based on current laws, regulations and other rules applicable to Canadian residents. It's accurate to the best of our knowledge as of the date of publication (May 2023). Rules and their interpretation may change, affecting the accuracy of information. The information provided is general in nature, and should not be relied upon as a substitute for advice in any specific situation. For specific situations, advice should be obtained from the appropriate legal, accounting, tax or other professional advisors.

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