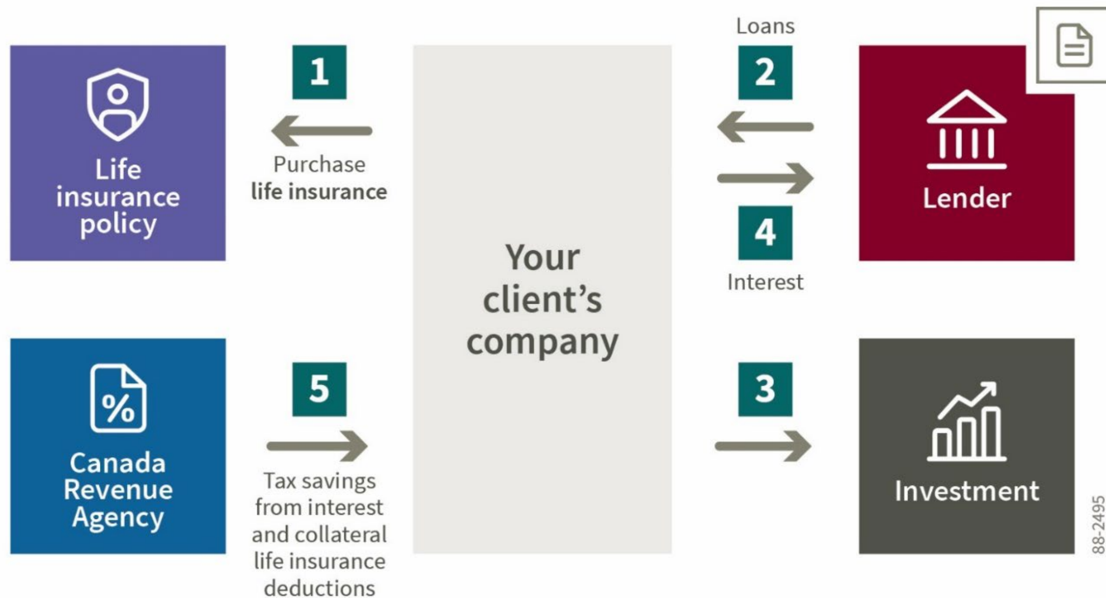
Immediate financing arrangement

Use the immediate financing arrangement strategy with your business owner clients to keep their company's capital invested while also getting life insurance coverage.



How does it work?

1. Your client's company diverts its cash flow or redirects investment dollars to pay premiums for a life insurance policy.
2. Each year that the company pays insurance premiums, it obtains a loan from a third-party lender (bank or credit union) to replace the funds that were used for this purpose. The life insurance policy's cash value, and potentially other assets, are used as collateral (movable hypothec in Quebec) for the loan and the policy is assigned to the lender.
3. The company uses the loan in its business or to purchase investments.
4. The company pays the loan interest to the lender.
5. If this arrangement is structured properly, the company may obtain two tax deductions relating to the interest payments and the collateral life insurance deduction.

On death

If the business owner dies, the insurance death benefit would be used to pay off the loan and any amount left over is paid to their company as the beneficiary of the life insurance policy. Generally, the life insurance death benefit less the policy's adjusted cost basis can credit the company's capital dividend account.

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Considerations

This material is for information purposes only and should not be construed as providing legal or tax advice. Reasonable efforts have been made to ensure its accuracy, but errors and omissions are possible. All comments related to taxation are general in nature and are based on current Canadian tax legislation and interpretations for Canadian residents, which is subject to change. For individual circumstances, consult with your legal or tax professional.

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 or future availability of collateral loans cannot be guaranteed. The loan or line of credit must be negotiated between the policyowner and the lender. It is subject to the lender's financial underwriting and other requirements. The policyowner should have enough income and capital to cover the interest and loan repayment, as well as the insurance premium, as a lender could call in the loan at any time depending on the terms.

Interest deductibility cannot be guaranteed. For Quebec income tax purposes investment expenses (which includes interest on loans that were used to purchase non-registered investments) are only deductible up to the actual amount of taxable investment income earned during a particular year. Investment expenses greater than the taxable investment income in a year may be carried back three years or carried forward indefinitely to offset taxable investment income.

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