The Role of Insurance in Tax Planning

Insurance has typically been used to protect against the risk of future financial loss. However, more and more, innovative insurance solutions are being used to safeguard the value of investors' assets in a tax-efficient manner.

Key Tax-Related Insurance Benefits
1. *Creating a tax-free wealth transfer* Insurance is transferred to beneficiaries outside of your client's estate and as such does not trigger taxes, probate fees, or legal costs.
2. *Preserving assets against taxation* Insurance can be designed to provide beneficiaries with a lump sum of cash equal to the taxes owing on the deemed disposition value of your client's investments.
3. *Generating tax-preferred income* Insurance strategies can be used to create tax-preferred retirement income streams.
4. *Minimizing tax on corporate assets* Insurance can provide a means to move surplus assets out of the corporation on a tax-preferred basis while enhancing the value that will be passed to beneficiaries.
5. *Minimizing tax through charitable giving* Insurance will help increase the size of your client's gift and in most cases provide significant tax benefits.

Creating a Tax-Free Wealth Transfer

Once you have a financial plan that ensures your capital will generate sufficient income and address your needs, you may want to consider shifting a portion of your assets to a tax-exempt environment. With a tax-exempt insurance policy, you can maximize the value of your estate and the value of your assets at death since the assets accumulate within a contract, free of annual accrual taxation. Part of the policy premium will pay for the cost of the insurance and the rest will be invested, allowing the policy's ultimate benefit to grow through the years. Tax-exempt life insurance shares certain characteristics with other types of investments, however no other asset allows for all of the following:

- tax-deferred growth, much like within your registered pool of capital
- potential for tax-free income during retirement
- tax-free distribution on death

Protecting Assets Against Taxation

If you've worked hard to build your investment portfolio, it is worth protecting it from the eroding effects of taxation. This is especially critical for registered investments like RRSPs and RRIFs that become fully taxable on the death of a surviving spouse. Taxation concerns extend beyond your retirement assets to other investments or valuables such as the family cottage that may be subject to capital gains tax.

™ Trademark used under authorization and control of The Bank of Nova Scotia. ScotiaMcLeod is a division of Scotia Capital Inc., Member CIPF. All insurance products are sold through ScotiaMcLeod Financial Services Inc., the insurance subsidiary of Scotia Capital Inc., a member of the Scotiabank Group. When discussing life insurance products, ScotiaMcLeod Investment Executives are acting as Life Underwriters (Financial Security Advisors in Quebec) representing ScotiaMcLeod Financial Services Inc.

Generating Tax-Preferred Income

Creating an insured retirement strategy

An insured retirement strategy can help you meet the need for both supplemental retirement income and estate liquidity in a tax effective way. By allocating excess capital or income into a tax-exempt insurance structure a number of years ahead of retirement, you allow the investment component to grow over time into a large pool of capital, better known as the policy's cash value. At retirement, up to 90% of this cash value can be pledged to a bank in exchange for a series of loans. As loans, the corresponding retirement income created is not considered taxable income.

This approach is also a consideration for small corporations. Shareholders can use the tax-free loan proceeds against the cash value of a corporate-owned policy to supplement their retirement income.

Securing a guaranteed income stream

Life annuities can be very useful in providing a guaranteed, lifetime, tax-preferred income. An annuity is the opposite of life insurance: instead of paying an insurer small annual amounts in return for a large amount on death, you give the insurer a large amount up front and receive small annual amounts every year until death. Each payment is a blend of interest and a return of your original capital, of which only the interest portion is taxable.

If guaranteed income is a requirement as well as maintaining your estate, this can be accomplished by insuring your original annuity deposit. The net income from this strategy is often much higher than the net income from a GIC or bond, even with the cost of the insurance.

This strategy can be considered if you own shares in a small corporation.

The concept is the same: a higher net income for the shareholder than a traditional fixed income investment through the purchase of an annuity. However, an added benefit is derived from the corporation receiving the insurance proceeds at death, which allows for a greater amount of corporate wealth to be paid out of the corporation free of tax. Additionally, the corporation reduces the value of the shares, thereby reducing or potentially eliminating capital gains tax that might otherwise be owing on the value of the shares.

Minimizing Tax on Corporate Assets

A tax-exempt life insurance policy can be employed as a strategy to move surplus assets or retained earnings out of a corporation on a tax-preferred basis, significantly enhancing the value of corporate assets that are passed on to beneficiaries. This is well worth considering since annual growth on investment income inside a corporation is taxable at a higher rate than if owned personally. And when money is taken out of the corporation, it will be taxed again, most likely as a personal dividend, thereby creating double taxation.

The strategy involves shifting redundant corporate assets from a taxable portfolio to a tax-exempt life insurance policy. The proceeds of the combined death benefit and tax-deferred growth within the policy are paid to the corporation at death. This creates the ability to channel funds from the company to the

TM Trademark used under authorization and control of The Bank of Nova Scotia. ScotiaMcLeod is a division of Scotia Capital Inc., Member CIPF. All insurance products are sold through ScotiaMcLeod Financial Services Inc., the insurance subsidiary of Scotia Capital Inc., a member of the Scotiabank Group. When discussing life insurance products, ScotiaMcLeod Investment Executives are acting as Life Underwriters (Financial Security Advisors in Quebec) representing ScotiaMcLeod Financial Services Inc.

shareholder's estate without tax; an opportunity not readily available with taxable investments. The mechanism for this asset flow is an account that permits Canadian controlled private corporations to pay out tax-free capital dividends.

Minimizing Tax through Charitable Giving

The gift of life insurance can be effective in providing a practical and affordable way to make sizeable charitable gifts to your favorite charities or private foundation. Not only will life insurance help increase the size of your gift, in most cases it will provide significant tax benefits.

Four Ways To Leave A Legacy Through Life Insurance

1. Transfer ownership of a paid-up policy to a charity. This is equivalent to an outright gift of cash in the amount of the policy's cash surrender value. The charity can surrender the policy immediately or retain it until the insured individual dies and collect the death benefit then.
2. Transfer ownership of an existing policy in which the premiums are still being paid. A policy is gifted to a charity and the person receives charitable receipts for each subsequent premium. Tax savings are received during life from donating the policy itself and subsequent premiums. The charity will receive the death benefit but no further receipt will be issued.
3. Create a new policy and name the charity as owner and beneficiary. This is an effective way to donate to a charity you are currently supporting. You receive a tax receipt for annual premiums but not for the death benefit.
4. Designate the charity as the beneficiary of a new or existing policy so that the charity will receive the life insurance proceeds at death. This will not generate any tax credit during your lifetime however the amount of the death benefit will be paid out as if it was a bequest made in your Will. In the year of death, your estate will receive a charitable receipt for the face amount of death benefit that the charity receives.

This publication has been prepared by ScotiaMcLeod, a division of Scotia Capital Inc.(SCI), a member of CIPF. This publication is intended as a general source of information and should not be considered as personal investment, tax or pension advice. We are not tax advisors and we recommend that individuals consult with their professional tax advisor before taking any action based upon the information found in this publication. This publication and all the information, opinions and conclusions contained in it are protected by copyright. This report may not be reproduced in whole or in part, or referred to in any manner whatsoever, nor may the information, opinions, and conclusions contained in it be referred to without in each case the prior express consent of SCI. Scotiabank Group refers to The Bank of Nova Scotia and its domestic subsidiaries. ™ Trademarks of The Bank of Nova Scotia.

™ Trademark used under authorization and control of The Bank of Nova Scotia. ScotiaMcLeod is a division of Scotia Capital Inc., Member CIPF. All insurance products are sold through ScotiaMcLeod Financial Services Inc., the insurance subsidiary of Scotia Capital Inc., a member of the Scotiabank Group. When discussing life insurance products, ScotiaMcLeod Investment Executives are acting as Life Underwriters (Financial Security Advisors in Quebec) representing ScotiaMcLeod Financial Services Inc.