

Tax Effective Transfer of Personal Insurance to Corporation

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There is considerable concern that Finance will seek to limit or close the tax benefits available to personal policyholders using the above strategy in a future budget, or perhaps even this summer when draft legislation affecting life insurance taxation is expected to be introduced.

As you may know, it is possible to recognize the dramatic increase in value that has occurred in many individual life policies, resulting from lower interest rates and increases in premium rates, by transferring a personally owned policy to a corporation. Policies may also have increased in value because of changes in the individual's health or insurability. The resulting gain is realized tax free in many cases, although tax will be payable if the policy's cash surrender value exceeds its adjusted cost basis. After the transfer, the corporation will pay premiums typically from dollars that have been taxed at a lower rate than that paid by the shareholder.

The increase in value can be substantial. In one case of which I am aware, a \$1MM policy bought in 1994 had a cash value of \$43K. There was no change in health but universal life rates had roughly doubled. The policy was valued by an independent professional actuary at \$353K. The shareholder transferred the policy to his corporation. Now the company pays the \$6K premium. On death, most or all of the proceeds will flow to the shareholder's family as a tax free capital dividend.

There are actuarial and administrative fees involved, and care must be taken to look at all aspects of the proposed transaction, as this strategy does not apply to every situation. This however could be an opportunity with a limited time to implement it.