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Tax Savings or Deferral

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One of the least understood benefits of life insurance, in our experience, is the way in which it actually reduces the tax otherwise payable on death.

Most advisors are quite familiar with funding aspects of a shareholders' agreements or estate planning (capital gains) for a family business. Insurance funding at an annual cost of 1% - 3%, typically will provide the necessary cash at precisely the moment it is needed to pay the tax. Liquidity shortage requiring bank loans, installments, liquidation of assets/shares can all be avoided if proper insurance funding is in place.

But life insurance proceeds, due to their inclusion in the capital dividend account while at the same time being excluded from the valuation of the business, can actually reduce the tax payable. A funded share redemption agreement effectively reduces the net capital gain taxed on death by creating a loss in the estate that can be used to offset (or eliminate) the capital gain on death.

There are stop loss rules in effect which may limit the reduction to 50% of the gain. If that is the case, the net tax will be reduced by almost 1/3 from 23/24% to 16/17%. However, where circumstances permit, it may be possible to have the shareholders' agreement operate between holdcos, in which case it may be possible to eliminate entirely the capital gain on death. As well, if the shares can be left to a spouse, you may wish to consider the "roll and redeem" strategy to eliminate the tax.

Of course, the tax will be paid by someone, someday. But for the first shareholder to die, the tax has been saved.

Clients who are serious about paying less tax appreciate knowing about the potential to reduce tax, as well as having liquid funds in the estate.