CESTNICK

TAX MATTERS

# The top 10 creative uses of life insurance in financial planning

SPECIAL TO THE GLOBE AND MAIL
PUBLISHED AUGUST 11, 2022

An insurance adviser once shared with me a limerick: The cost of insurance was such, that its price I could sadly not touch, so I turned down the offers, then filled government coffers, and now it costs three times as much. I thought it was a valiant attempt to sell me a policy.

If you are going to invest in an insurance policy, you need to understand what you're accomplishing with the insurance. There may be more than one answer. Consider these top 10 uses of life insurance.

**1. Providing for dependants.** If you were gone tomorrow, would the loss of your income cause your dependants financial hardship? If so, life insurance can fill the gap by providing money to invest to generate income. This is particularly helpful if you're asset-rich, but those assets are illiquid (such as real estate or a business.) Unless those assets produce sufficient income or can be easily sold to free up cash, your dependants may otherwise struggle to make ends meet.

**2. Funding for specific purposes.** When insurance pays out, it can help to fund specific objectives, such as paying for a child's education, providing a fund to help the kids cover annual costs of maintaining the family cottage, providing for a pet or covering your funeral costs.

**3. Building retirement savings.** It's possible to accumulate investments inside an insurance policy on a tax-sheltered basis and to then access those funds in retirement or for other purposes, either by making withdrawals from the policy or borrowing against the policy as collateral. See my article last week for an example.

**4. Equalizing inheritances.** Suppose that you have specific assets you want to leave to specific children or heirs when you pass away. Maybe it's a cottage, business or valuable jewellery you want a particular person to have. If you'd like to leave an equivalent amount to each of your heirs, then leaving cash – perhaps insurance proceeds – to the other heirs can be a great way to equalize the inheritances.

**5. Paying off debts.** Ensuring that your personal or business debts are paid off when you die can be a huge help to your heirs or business partners. Insurance can provide the cash needed to pay off these debts. If you don't look after these debts, then creditors – including the Canada Revenue Agency in the case of tax debts – may have recourse to go after any assets that you leave to your heirs when you're gone. As an aside, mortgage insurance offered by your bank, to pay off your mortgage if you die, is very expensive insurance. As your mortgage balance declines, the cost of this insurance remains constant. Consider buying a term insurance policy to pay off your mortgage instead.

**6. Covering taxes owing.** Take the time to calculate the taxes that will be owing upon your death, and your spouse's death. How will those taxes be paid? Make sure you can answer that question. If you and your spouse are leaving assets to each other upon death, then taxes will be deferred until the second spouse dies. In this case, consider a joint, last-to-die policy on the lives of both spouses to cover the taxes. The insurance won't pay out until the second death, so the policy is cheaper than one on a single life.

**7. Eliminating taxes on death.** There are strategies using insurance that can eliminate taxes upon death. You could, for example, insure the lives of your children. This will allow you to accumulate investments in those policies. You can then transfer ownership of the policies to your adult children tax-free upon your death, or at any time, effectively transferring the investments in the policy to your children tax-free. That transfer might otherwise be taxable if the investments were outside of a policy.

**8. Donating to charity.** You can make a significant donation to your favourite charity when you die by having life insurance proceeds paid out to the charity. You could name a charity as the beneficiary of a policy, transfer ownership of a policy to a charity, have your estate donate the insurance proceeds or buy a policy for a charity. Each idea has different tax implications. See my article from Nov. 18, 2021, for more.

**9. Funding a buy-sell agreement.** If you own a business with partners, what will happen when one of you dies? Many shareholder agreements facilitate a surviving partner buying out the deceased partner's share upon death. Insurance can provide the cash to fund that purchase.

**10. Providing key-person protection.** If your business would be negatively impacted by the death of a key person in the business, consider buying life insurance on that individual. If they die, the business will receive the insurance proceeds which can help in a time of transition.

So, as it turns out, there may be more truth to that limerick after all.

*Tim Cestnick, FCPA, FCA, CPA(IL), CFP, TEP, is an author, and co-founder and CEO of Our Family Office Inc. He can be reached at tim@ourfamilyoffice.ca*