



CESTNICK

TAX MATTERS

Life insurance can earn its keep in different situations of life

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Maybe you've heard the story of the executive who met with a life insurance adviser. "You should feel honoured that we're meeting" the executive said. "So far today, I've had my assistant turn away seven insurance people." "Yes, I know," replied the insurance adviser. "I'm all of them."

It's easy to poke fun at insurance advisers because they can be persistent – but I have to say that I've always been a big fan of life insurance. Why? Because of the ways it can mitigate risks, minimize taxes, provide in retirement, solve estate issues, help in a business, and enable greater charitable giving. Let me share a little more on these ideas today.

Your risks

If you're a breadwinner in the family and you're gone tomorrow, how would this affect your family's ability to make ends meet? What if your spouse could pay off the mortgage if you were gone? Life insurance can look after these needs if you die unexpectedly. And don't forget about providing funds for the education of your kids, or to pay off school, car, or

other loans. What's the value of your earning capacity? It's amazing how we'll insure a \$1-million home but not \$3-million of future earnings.

How will the life insurance on our corporation be distributed among our children?

Your taxes

Whole life and universal life are types of insurance that provide a benefit payable at death, but also operate as an investment account with a sort of wrapper around it. This insurance wrapper allows the investments in the policy to grow tax-sheltered – similar to those in an RRSP or TFSA – and for the death benefits to be paid tax-free when you're gone. Term insurance, which provides coverage for a set period only, can serve certain purposes (like paying off mortgages or term loans), but won't provide an investment component. Are you someone who owns high-value but illiquid assets like real estate or private company shares? Paying the taxes owing on these assets when you die can be tough for your estate. Life insurance can provide the liquidity needed to cover

those taxes. Finally, you can create tax-efficient cash flow in retirement using life insurance – which I’ll talk about now.

Your retirement

There are a few things to consider when it comes to using life insurance to help finance your retirement. First, you can accumulate tax-sheltered investments – that is, cash value – inside a life insurance policy, which you can tap into in retirement. You can make direct withdrawals from the policy (which can be taxable as regular income), or you can borrow from a bank to meet cash needs in retirement, using the cash value in the policy as collateral. The insurance can then pay off the bank loan when it pays out after you’ve died. Finally, the annual dividends paid on the accumulating investments inside a whole life insurance policy are very stable, so you’ll avoid the type of market volatility that can create stress when saving for retirement.

Your estate

If you’re leaving assets of different values to different heirs, life insurance can help to equalize the inheritances if that’s important to you. And I’ve already talked about using insurance to cover taxes when you die, making life easier for your heirs. As an aside, life insurance can also sidestep probate fees if they apply in your province or territory. Finally, if you have more than you’re going to spend in your lifetime, consider using whole or universal life insurance to replace part of the fixed income portion of your portfolio. Why? Because the policy will shelter the interest income from high taxes that may otherwise be owing on your portfolio.

Your business

One of the most common uses of insurance for business owners is to fund a buy-sell agreement if you have co-owners in the picture. Upon your death, life insurance proceeds (paid either to the corporation or directly to surviving co-owners) can help them buy your shares from your estate. Another benefit of this corporately-owned insurance is that the capital dividend account (CDA) of the company is increased when the company receives the death benefit, allowing tax-free dividends to your heirs after you’re gone. Insurance can also pay off corporate debts after you’re gone, improving the company’s balance sheet. Finally, consider insuring any key people whose death could negatively affect your business.

Your philanthropy

You might consider naming a charity as beneficiary of your policy. You won’t receive a donation credit for annual premiums, but your estate will receive a tax credit for the full death benefit which can be used on your final tax return, the prior year to death, or carried forward up to five years by your estate. Alternatively, you can name your estate as beneficiary and direct your executor in your will to donate the proceeds – although this could expose the funds to probate fees or challenges to your will. Finally, you can transfer an existing policy’s ownership directly to a charity; you’ll receive a donation credit for the policy’s fair market value. See my article from Nov. 18, 2021, for more.

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