PLAN WITH
CONFIDENCE.

Universal Life Insurance

A Tax Planning Tool and Estate Protection in One...
You're in Business.

Assumption Life
Life Insurance

LIVE WITH CONFIDENCE.

Reduced income tax, comfortable retirement, larger estate

As a business owner, you've already invested countless hours and substantial financial sums in the future of your business. Now that your company is successful, you'll want to find a strategy to save on income taxes. Life insurance could be the perfect tool for tax planning, and may be just what you need to protect your estate.

To better explain the role life insurance can play in this strategy, we'll use the following elements in our illustrations: a corporation (OPCO), a holding company (HOLDCO) and the business owner, an individual.

Why a Holding Company?

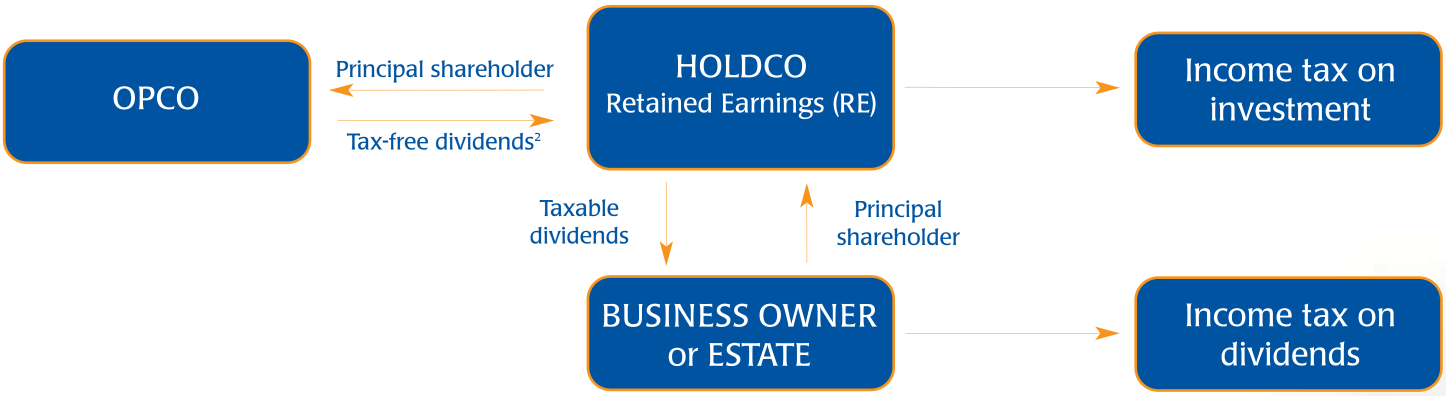
There are advantages in having corporate-owned life insurance. Since premiums are paid after income taxes, the income required before tax is often lower for a corporation, especially for a small business. For example, a small business with a 16% tax rate would have to generate an income of $1,191 before taxes to pay a premium of $1,000, whereas an individual with a marginal tax rate of 46% would have to earn $1,852 of income before taxes in order to pay that same premium. That's a difference of $661 before taxes!

Although there are advantages for a corporation to hold a life insurance policy, it may be preferable that the owner be a holding company, rather than the corporation itself. This way, the policy may be sheltered from the corporation's creditors. Moreover, holding a life insurance policy with a substantial value could make the corporation ineligible for the $500,000 capital gains exemption[1]. Finally, if the corporation is sold but you want to maintain the life insurance coverage, you will avoid certain fiscal consequences if the life insurance is owned by the holding company.

For these reasons, the case studies shown on the next pages include a holding company. Since every case is different and there are fiscal implications to every decision, **we recommend that you consult your tax specialist before choosing one of the strategies presented.**

Scenario 1

The OPCO corporation has as its principal shareholder a holding company, HOLDCO, which is owned by BUSINESS OWNER, an individual. OPCO pays out a portion of its earnings to HOLDCO in the form of tax-free dividends[2].



If these sums are invested within HOLDCO, income tax will have to be paid on the investment earnings. The amount of income tax will vary according to the type of income generated, but the rate could be similar to that of an individual's maximum rate[3]. If HOLDCO pays the retained earnings to the BUSINESS OWNER in the form of dividends, the dividends will be taxed at the BUSINESS OWNER's personal tax rate.

Similarly, upon the death of the BUSINESS OWNER, the estate that inherits the shares of HOLDCO will be subject to the same tax consequences.

Scenario 2

By using the retained earnings that are accumulating in HOLDCO as life insurance premiums, funds can accumulate on a tax sheltered basis[4]. Universal life insurance is ideal in this situation because of its flexibility and the investment options it offers. HOLDCO is the owner and the beneficiary of the life insurance, BUSINESS OWNER is the life insured. To reduce the cost of insurance, BUSINESS OWNER and his or her spouse can both be insured on a joint last-to-die policy.

OPCO → Tax-free dividends[2] → HOLDCO → Retained earnings → Universal life insurance policy on the life of BUSINESS OWNER and his or her spouse. Tax-sheltered investment (certain conditions apply)

Let's compare the funds accumulating within HOLDCO that are subject to investment income taxes, to the funds accumulating in a universal life insurance policy.

Let's assume that:

- HOLDCO receives an annual dividend of $50,000 from OPCO at the beginning of the year.
- The annual return on the investment in HOLDCO and in the funds accumulated in the universal life insurance policy is 5%.
- HOLDCO's tax rate is 48.8% on investment income.[5]
- For the universal life insurance, the yearly renewable term (YRT) cost of insurance is used and the death benefit is increasing (face amount + accumulation fund).
- The universal life insurance policy is not rated.
- BUSINESS OWNER and his or her spouse are both insured on a joint last-to-die policy.

Investment in HOLDCO (interest income)			Odyssey universal life insurance – Male and female non-smoker, 65 years of age – Face amount of $1,200,000		
Year	Annual payments	Market value after taxes	Annual premium	Accumulation fund	Death benefit
5	$50,000	$269,868	$50,000	$247,728	$1,447,728
10	$50,000	$576,094	$50,000	$569,468	$1,769,468
15	$50,000	$923,575	$50,000	$965,770	$2,165,770

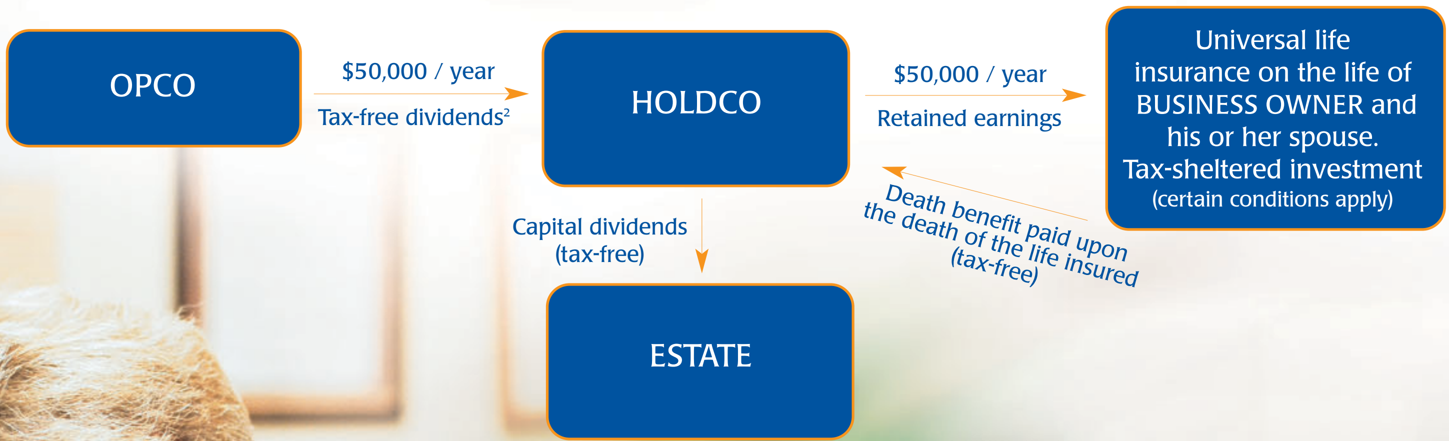
Approximate total amount of taxes paid:

By HOLDCO on income earned	With a Universal Life policy
Over 10 years - $72,528[5]	Over 10 years - $0
Over 15 years - $165,441[5]	Over 15 years - $0

In addition to the tax benefits available with a universal life policy, the value of your estate may be much greater. The cost of insurance for a joint last-to-die policy is lower than that of a single-life policy. Even if the full death benefit is only payable after the last death, with the Odyssey universal life insurance, 85% of the accumulation fund may be payable tax-free to the beneficiary upon the first death.

Upon the death of BUSINESS OWNER or his or her spouse

With the Odyssey joint last-to-die universal life insurance policy, 85% of the accumulation fund is payable as a death benefit to HOLDCO, the beneficiary, upon the first death. When the surviving life insured dies, the face amount plus the balance of the accumulation fund is paid in the same manner. A considerable portion of the death benefit will be used to create a capital dividend account[6]. HOLDCO will then distribute the capital dividends to the estate of the life insured, tax-free.

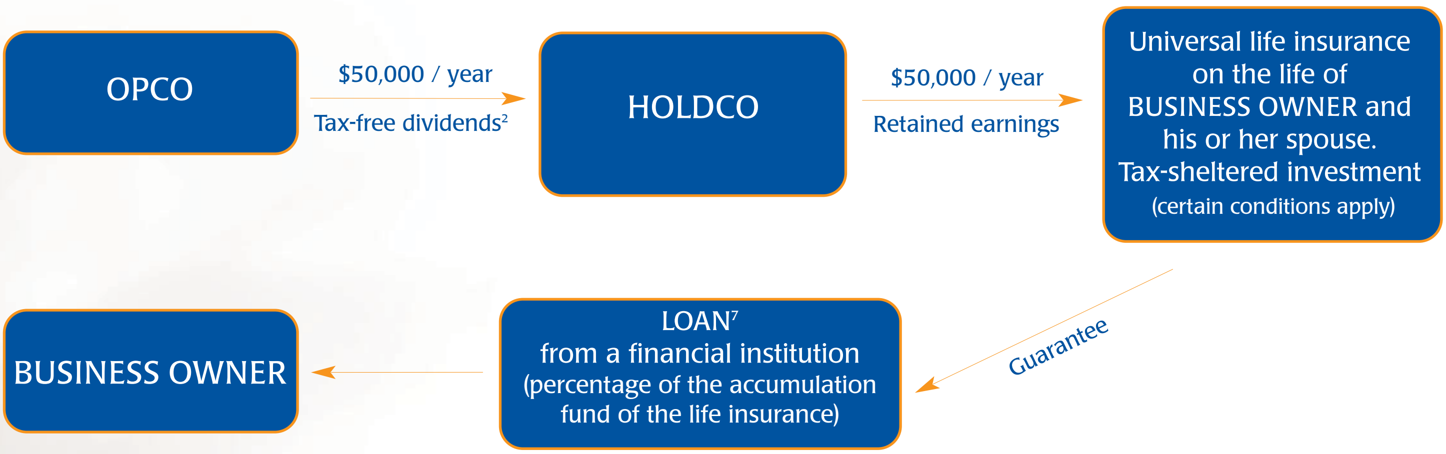


What if BUSINESS OWNER wants to withdraw funds while he or she is still alive?

With no life insurance in place, BUSINESS OWNER can receive dividends from HOLDCO, but he will have to pay personal income tax on these dividends. With life insurance, he or she can use the policy to guarantee a loan for himself or herself[7] on which no income tax is payable. This loan could be used as retirement income for BUSINESS OWNER. With the available guarantee, a lower interest rate is usually negotiable. Furthermore, since no money will be withdrawn from the accumulation fund in the universal life policy, its value will continue to grow.

Upon the last death, the death benefit will be used to reimburse the loan and the accrued interest, and the remainder of the death benefit will be paid tax-free to the beneficiary, HOLDCO[8], which in turn will be able to use this money to pay tax-free capital dividends to the estate[6].

The life insurance policy can also be used as a guarantee for a commercial loan that could finance the expansion of OPCO.



Do you already have funds accumulating in your operating company?

The retained earnings which have accumulated in your operating company (OPCO) can be transferred into your holding company (HOLDCO) tax-free[2]. This money can then be placed in a fixed annuity which will be paid into the universal life insurance policy to increase your tax-sheltered savings and the value of your estate. The interest income from the annuity is taxable but the total tax cost is usually lower than the tax cost of the annual investment earnings earned by the retained earnings in HOLDCO.

Odyssey
Assumption Life

The strategies presented above are definitely appealing. We remind you to consult your tax specialist in order to assess the benefits and to determine the best solution for your particular situation.

The fiscal strategies presented in this document are based on the provisions of the Income Tax Act on June 1, 2006. Any changes to the Act could have an impact on those same strategies.

[1] In very general terms, for a corporation's shares to be eligible for the $500,000 capital gains exemption:
- substantially all (considered by the CRA to mean 90% or more of the value) of the business' assets must be used for operating an active business in Canada or be shares and debt in other small business corporations (or any combination thereof);
- nobody but you or a person "related" to you can have owned the shares for the two years prior to you selling them; and
- throughout this two-year period, more than 50% of the corporation's assets must have been used primarily in an active business operated in Canada or invested in other small business corporations (or any combination thereof).

[2] Intercorporate dividends are tax-free as long as the payor and recipient corporations are "connected" within the meaning of Part IV of the Income Tax Act. Generally, this means that the recipient must hold shares representing more than 10% of the votes and more than 10% of the value of the payor.

[3] In New Brunswick, the tax rate for a holding company can run as high as 48.8%. A portion of this income tax is reimbursed when the holding company pays out a taxable dividend to its shareholders.

[4] Investment earnings are sheltered from income tax as long as the funds remain within the universal life insurance policy. In addition, the value of the accumulation fund cannot exceed the value of the maximum tax actuarial reserve (MTAR). If the accumulation fund exceeds the value of the MTAR, the amount in excess will be transferred to an account outside of the universal life insurance policy and investment earnings in this account will be taxable.

[5] A portion of this tax will be reimbursed when the holding company pays out a dividend to its shareholders. However, the shareholders are required to pay taxes on the dividends they receive.

[6] The amount eligible to create the capital dividend account is the total death benefit minus the adjusted cost base of the policy at the time of the insured's death.

[7] We cannot guarantee that the financial institution will approve a loan, nor can we guarantee the amount or the interest rate of the loan.

[8] Since the Odyssey universal life policy pays 85% of the accumulation fund upon the first death, it is quite possible that the lending financial institution will demand a full or partial reimbursement of the loan and accrued interest at that time.

Assumption Life

Assumption Mutual Life Insurance Company
PO Box 160 / 770 Main St., Moncton, NB E1C 8L1

Telephone: 506 853-6040 • Toll-free: 1 800 455-7337
Fax: 506 853-5428 • www.assumption.ca

LIVE WITH CONFIDENCE.