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Corporate estate transfer with cash withdrawal

A tax-advantaged strategy for withdrawing cash from your company and transferring assets to your estate.



How much of your corporation's growth is lost to tax?

It's a question facing every business owner. To get a general idea of the potential size of the problem over the long term, let's look at an example.

Corporate estate transfer with cash value

An alternative strategy using tax-advantaged life insurance

What if John redirects some of the excess cash flow to a corporately owned, permanent life insurance policy?

First of all, assuming there is a life insurance need, the life insurance policy provides an immediate estate enhancement. In addition, it has tax advantages, which can make a huge difference for John.

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- Growth inside the policy, within prescribed limits, is not subject to income tax.
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- At death, the policy's death benefit is paid tax free to John's company, as the named beneficiary.
-
- The company can distribute the proceeds of the death benefit as tax-free dividends to shareholders, including John's estate. Proceeds are net of the policy's remaining adjusted cost basis, if any. Dividends are tax free up to the balance in the company's capital dividend account.
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Taken together, these tax advantages can help John preserve more of his company's assets to transfer to his heirs and successors.

CASE STUDY

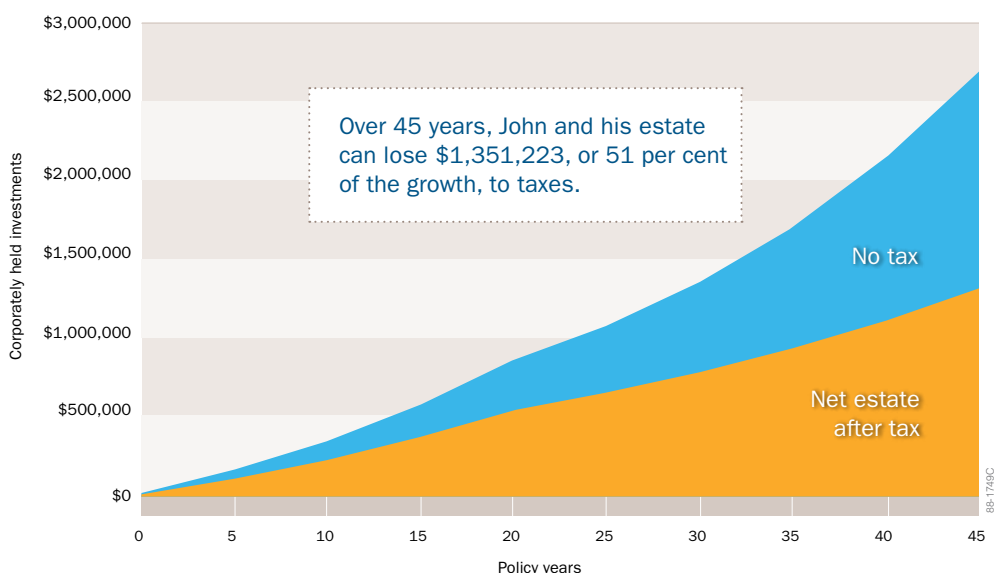
John is 40 and owns a successful private corporation. It generates \$25,000 a year in excess cash flow, beyond what it needs for day-to-day operations.

The company invests the cash in traditional investments (50 per cent interest, 30 per cent dividends and 20 per cent capital gains). He plans to deposit \$25,000 a year for 20 years into the portfolio of investments within his corporation.

John wants to know how these investments will grow over time, and how much they will contribute to his estate.

- If the investments' growth was not taxed, they would grow faster, year after year. (Historically the company's investments have grown at four per cent for interest, five per cent for dividends and six per cent for capital gains.) If John died at 85, the estate benefit would be \$2,643,638.
- In reality, however, the growth of these passive investments is taxed at the highest corporate rates. (For John's Ontario corporation, these are 46.17 per cent for interest, 33.33 per cent for dividends, 23.09 per cent for capital gains.) Year after year, these taxes erode the growth of the assets in John's corporation.
- What's more, when John's estate receives assets from the corporation, distributed as dividends, the estate has to pay an additional 32.57 per cent tax. This means the net estate benefit, after taxes, is only \$1,292,415.

Preserve more of your company's assets for your retirement and estate



All examples are based on the assumptions specified on the last page.

Which strategy can help you transfer more cash from your business?

Let's compare John's current investment strategy against a strategy using a Canada Life participating life insurance policy.

The policy insures John, who is a healthy non-smoker. The company owns the policy and is its named beneficiary. The premiums use the same cash flow as the investments.

As the following table shows, life insurance can help provide more cash to John and his estate over the long term. This can make a huge difference to John's estate.

At the same time, if John wants additional income, the company can surrender part of the death benefit and withdraw accumulated cash value from the policy. This can help protect John's retirement plan.

Comparison assuming death at age 85	Taxable investments	Tax-advantaged life insurance
Cumulative cash invested or premiums paid (\$25,000/year for 20 years)	\$500,000	\$500,000
Results if cash is accessed		
Cumulative net cash flow to shareholder (Withdrawals or partial surrenders from age 66 to age 85)	\$735,599	\$735,599
Net benefit to corporation at death	\$95,730	\$929,132
Credit to capital dividend account	\$89,829	\$929,132
Net benefit to shareholder's estate	\$93,808	\$929,132
Internal rate of return	1.97%	4.02%
Results if cash is not accessed		
Net benefit to shareholder's estate	\$1,292,415	\$3,390,686

Internal rate of return is based on after tax cash flows and net estate benefit. All examples are based on the assumptions specified on the last page.

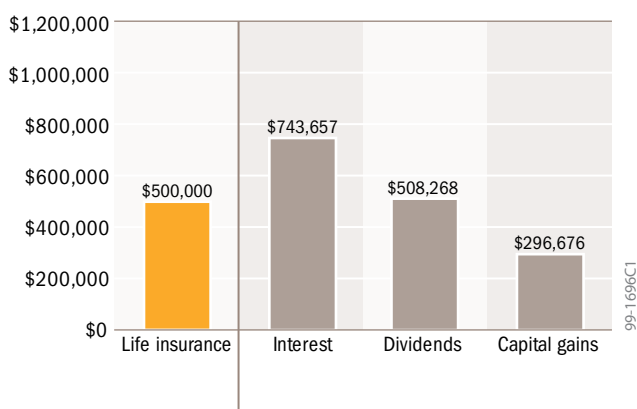
Which assets help you achieve your goals most efficiently?

As these charts show, if the comparison investment is entirely interest or entirely dividends, these asset classes may require more capital to give John the same net cash flow and estate benefit as life insurance.

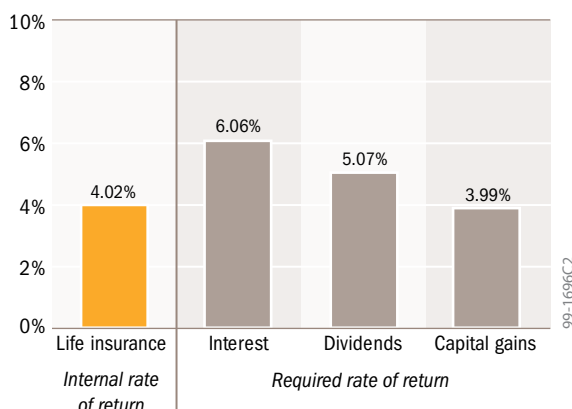
Or they may require higher rates of return, which may involve more risk. The primary reason for this difference is the huge long-term impact of life insurance's tax advantages.

Participating life insurance is often considered a fixed-income alternative and part of a long-term strategy. For this reason, John may wish to transfer a portion of his corporation's interest-bearing assets into participating life insurance. The Canada Life participating account investment mix offers a suitable risk/return mix for clients like John who are looking to reduce their exposure to risk. For clients with significant exposure to common stock markets and higher risk investments, Canada Life participating life insurance can provide good diversification.

Given the growth rates assumed, to provide the same cash flow and net estate benefit as life insurance, other asset classes may require more capital



Or, given the same capital, other asset classes may require higher rates of return



Comparison on death at age 85. All examples are based on the assumptions specified on the last page.

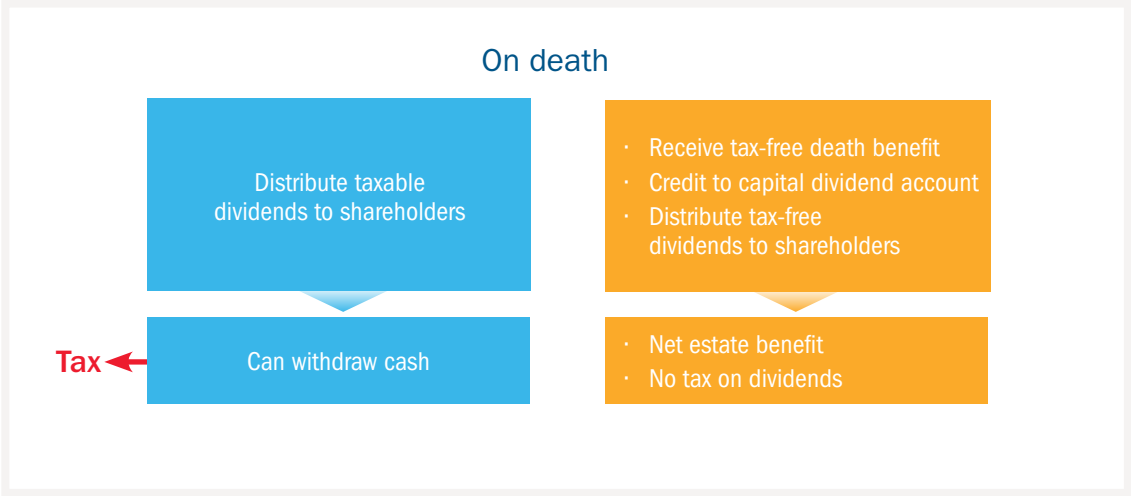
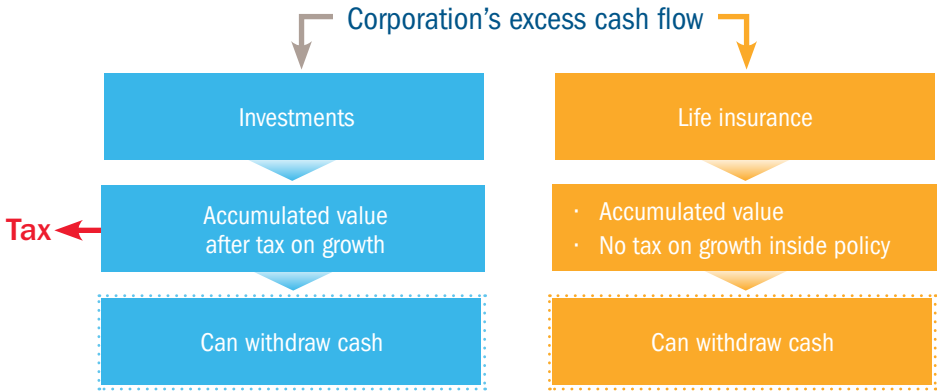
In John's example, a mixed portfolio of 50 per cent interest, 30 per cent dividends and 20 per cent capital gains (and given each component's respective growth rate), the Canada Life participating life insurance policy will require less capital and a lower tax-advantaged rate of return than compared with the taxable portfolio.

Generally, a higher growth rate required to reach goals means more risk and possibly more volatility. For John, the Canada Life participating life insurance policy could provide \$735,599 cumulative net after-tax cash flow in his pocket during retirement. In addition, the life insurance policy could provide \$929,132 net to his estate, whereas the portfolio of investment would only have enough assets remaining to provide \$93,808.

What if John's company wants to access the policy's cash value during John's lifetime? For example, John may want a stream of income in retirement.

In that case, the company can simply surrender some of the policy's death benefit and withdraw some of the accumulated cash value. The ability to withdraw accumulated cash value through partial surrenders is guaranteed in the life insurance contract.

What's the best way to use the company's excess cash flow?



Talk with your advisor

You may be able to dramatically increase the cash you transfer out of your business during your lifetime and ultimately to your estate.

Talk with your advisor about this strategy in relation to your specific situation. If appropriate, your advisor can prepare a personalized report for you, tailored to your company's cash flow and investments, and to your personal goals.



Assumptions for examples. Company: Canadian-controlled private corporation. Insured person: male, non-smoker, age 40, standard risk. Life insurance: Canada Life participating life insurance, *Estate Achiever*, max 20, \$929,103 initial death benefit, \$25,000/year basic premium for 20 years, paid-up additions, based on Canada Life's dividend scale and premium rates as at May 2013. Investment mix: 50 per cent interest (four per cent growth rate, 46.17 per cent tax rate), 30 per cent taxable dividends (five per cent growth, 33.33 per cent tax), 20 per cent realized capital gains (six per cent growth, 23.09 per cent tax). Invest \$25,000/year for 20 years. Withdrawals and partial surrenders: from age 66 (policy year 26) to age 85 (policy year 45). 32.57 per cent tax on dividends to shareholder and shareholder's estate. Comparison at death at age 85 (policy year 45). Figures not adjusted for time value of money. Required rate of return on investments illustrates pre-tax return required to achieve the same tax-advantaged internal rate of return as life insurance. This example is not complete without a complete Canada Life life insurance illustration, including cover page, reduced example and product features page, all having the same date. Read each page carefully, as they all contain important information.

This information is based on current tax legislation and interpretations for Canadian residents. It is accurate to the best of our knowledge at the date of publication. Future changes to tax legislation and interpretations may affect this information. This information is general in nature. It is not intended to be legal, accounting or tax advice. For specific situations, you should consult the appropriate legal, accounting or tax advisor.

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