

## CORPORATE-OWNED LIFE INSURANCE

Do you own a professional corporation? Are you considering the purchase of an MD Life Plan, a universal life insurance policy from MD Life Insurance Company<sup>1</sup>? Are you wondering if you should own your life insurance policy personally or have your corporation own it? The following summary of the advantages and disadvantages of corporate ownership may help you make your decision.

If you decide to have your corporation own your life insurance policy, you should ensure that your corporation is the owner, premium payer and beneficiary in order to avoid shareholder benefit issues. The article assumes that the above structure has been implemented.

### Advantages of having your corporation own your life insurance policy

#### Reduced cost

You can save a great deal of money over the life of your policy if you have your corporation own it. It is generally much less expensive<sup>2</sup> to make deposits to your MD Life Plan from corporate funds rather than to pay to them personally. For example, the chart below shows how much you can save when you make a \$10,000 deposit to your life insurance policy if the policy is owned by your professional corporation and the deposit is made from income taxed at the small business rate rather than from income taxed at the highest personal tax rate. The pre-tax cost is the amount you would have to earn before tax to have \$10,000 after-tax to deposit to your policy.

	Tax Rate <sup>3</sup>	Pre-tax Cost
Personal funds	45%	\$18,200
Corporate funds	18%	\$12,200
<i>Annual savings</i>		\$ 6,000

#### Tax-free cash for your heirs<sup>4</sup>

Your corporation will receive the death benefit without tax and can pay most or all of it tax-free to your estate or heirs as surviving shareholders. This is not the case with most other corporate investments. For example, if your corporation owns a \$100,000 GIC, cashes it in and pays your estate a taxable dividend, your estate could receive as little as \$68,000 after-tax (based on an estate dividend tax rate of 32%).

The difference between the policy's death benefit and its adjusted cost basis (ACB) is added to your corporation's capital dividend account (CDA)<sup>5</sup>. The corporation can then declare a tax-free capital dividend for an amount up to the CDA balance, file the appropriate election with the Canadian Revenue Agency<sup>6</sup> and pay the funds to the surviving shareholders tax-free.

The CDA is a notional account that tracks tax-free money received by your corporation. Various items increase and decrease your corporation's CDA in addition to the death benefit of a life insurance policy in excess of its ACB. Examples include 50% of capital gains net of capital losses realized by the corporation from the sale of its investments and capital dividends received from other companies.

#### Tax-free growth

You can make deposits to your MD Life Plan in excess of the amounts necessary to keep the policy in-force within the "exempt policy" limits imposed by the Income Tax Act<sup>7</sup>. These additional deposits earn returns based on the investment allocations you choose<sup>8</sup>. These investment returns accumulate tax-free while the funds remain within your exempt policy<sup>9</sup> and will be paid out to your corporation as beneficiary without tax on your death. This can significantly increase the after-tax value of your estate.

### Disadvantages of having your corporation own your life insurance policy

#### Lack of creditor protection

The cash surrender value of your corporation's life insurance policy will be subject to the claims of your corporation's creditors. There is no creditor protection in a corporate environment. In contrast, your policy will receive the creditor protection afforded under the various provincial insurance acts if you own it personally and select a preferred "family member" beneficiary. *You can mitigate this disadvantage by carrying an appropriate amount of malpractice insurance.*

#### Potentially increased tax on death

You may increase the income tax liability on your final income tax return by owning your life insurance policy within your corporation. When you pass away, the cash surrender value of your corporation's life insurance policy on your life<sup>10</sup> is included in the fair market value of the

shares for purposes of the deemed disposition on death. The difference between the shares' value and their adjusted cost base is a capital gain, half of which will be taxed at your marginal tax rate on your final return. The fair market value of any other corporate-owned life insurance policies will also be included in your shares' value on your final return.

*This disadvantage becomes less important where the deposits into the life insurance policy would otherwise have been invested within your corporation. In that case, the fair market value of the investment would be included in the fair market value of your shares and will also increase your tax liability on your final return.*

### Potentially negative impact on the \$500,000 capital gains deduction

The cash surrender value<sup>11</sup> of your corporate-owned life insurance policy will be considered to be an inactive investment asset for purposes of determining if your shares qualify for the \$500,000 capital gains deduction.

The first \$500,000 of gain on the sale of qualifying small business shares<sup>12</sup> may be eligible for the capital gains deduction and will effectively be tax-free. The rules relating to the capital gains deduction are quite complex, but generally all or substantially all (i.e. 90%) of the corporation's assets at the time of sale must be used in an active business in Canada. The requirement falls to about 50% throughout the 24-month period prior to the sale. A large cash surrender value could disqualify your shares from this deduction which could potentially save up to \$113,000 in personal taxes.

*This impact of this disadvantage may not be as significant as it seems at first glance for three reasons:*

- 1. There may not be a market for the sale of your professional corporation, especially if you are a general practitioner, because of the current shortage of doctors and the ease of opening a competing practice;*
- 2. You may build up so much cash and investments within your professional corporation that the shares will not qualify for the exemption in any case; and/or*

- 3. If you would have bought other investment assets with the funds deposited into your MD Life Plan; these assets would be inactive assets as well.*

### Greater tax implications when accessing cash from the policy

Your corporation will pay tax on any policy gain if it takes a policy loan or a partial withdrawal of cash from the policy<sup>13</sup>. This level of taxation would also occur if you owned the policy personally. However, your corporation still has to pay the cash to you as salary, dividends or as the repayment of amounts it owes you. You will be taxed on salary or dividends you receive. Your corporation can deduct the amount of salary it pays to you, but cannot deduct dividend payments. Repayments of loans are tax-free.

If you add the disability benefit to your policy and you qualify for the benefit, your company will receive the funds tax-free, but will have to pay them to you as taxable salary or dividends unless you have loaned the company money.

You would receive the disability benefit tax-free if you owned your policy personally.

### Other tax implications for very large corporations

There can be other capital and income tax implications with corporate-owned life insurance policies depending on the corporation's asset base and province. Most professional corporations will not have to be concerned with these implications.

## In summary...

Your MD Life Plan can be a very tax efficient asset within your professional corporation reducing current taxation, enhancing asset growth and providing liquidity on death.

To learn more about the advantages and disadvantages of owning life insurance in your professional corporation please contact your MD Financial Consultant or Lancet Insurance Consultant or call 1-800-267-2332 and you will be put in touch with a consultant in your area.

<sup>1</sup> MD Life Plan is distributed through Lancet Insurance Agency Ltd. MD Life Plan is underwritten by MD Life Insurance Company. Both are subsidiaries of the Canadian Medical Association. All MD Management Financial Consultants and Lancet Insurance Consultants have life insurance licenses with Lancet Insurance Agency Ltd.

<sup>2</sup> MD Life Insurance Company does not intend to provide taxation, accounting, legal or similar professional advice to clients or potential clients. The information contained in this document is not intended to offer such advice, nor is it to replace the advice of independent tax, accounting or legal professionals.

<sup>3</sup> The actual income tax rate will vary according to your province of residence and your overall income level.

<sup>4</sup> The tax information included in this document is based on the most current Income Tax Act (Canada) rules available at the time of publication. The Income Tax Act (Canada) is hereinafter referred to as the Act. All statutory references in this article are to the Act.

<sup>5</sup> See the definition of capital dividend account in S. 89(1) of the Act.

<sup>6</sup> See S. 83(2) of the Act.

<sup>7</sup> See Regulations 306 and 307 of the Act.

<sup>8</sup> When you invest in a MD Life Plan, you do not acquire an interest in any mutual fund or index your account may be linked to, nor do you purchase any units or legal interest in any security.

<sup>9</sup> See S. 12.2(1) of the Act.

<sup>10</sup> See S. 70(5.3) of the Act.

<sup>11</sup> See S. 110.6(15) of the Act and technical interpretation 9310100.

<sup>12</sup> See S. 110.6 and S. 248(1) of the Act.

<sup>13</sup> See S. 148(1) of the Act.