

Planning Matters

Insurance for Estate Planning

Rent an Estate Until You Own One

In our look at some of the uses of life insurance for estate planning, let's start with the simplest situation - using insurance to create an estate. Younger people who have started both their families and investment programs are looking forward to watching both grow, but they both take time. Until you have created an estate, you can rent one. Term life insurance is very inexpensive and will provide funds for your family if you are prematurely taken out of the picture.

The two most popular term insurance policies are 10-year and 20-year renewable. Each will renew at higher rates until age 75 or 80. For example, a 40 year old male will pay \$700 annually for 10 years for a \$1,000,000 policy. The second 10 years will cost \$4,800 annually. Renewal prices rise steeply as you age. This can be levelled by buying a 20-year term, which will cost \$1,300 per year for the full 20 years. Your intention will be to have sufficient investments after 20 years so that you will no longer need the insurance, but you can renew it at a higher premium if you wish.

Insurance is usually placed on the lives of both husband and wife. A 40 year old male and a 35 year old female can each be insured for 20 years for an additional \$500, or approximately \$1,800 annually for the 20 year policy. A 50 year old male and his 45 year old wife can buy a \$1,000,000 policy for \$4,570 for 20 years, or \$2,219 for 10, but with a renewal cost of \$15,700 in year 11. *Large amounts of inexpensive term insurance are recommended when your children are young and your assets are few.*

Is Insuring a RRIF Worthwhile?

Many retirees investigate the costs of insuring the tax liabilities on their RRIF's but often elect not to proceed once they have looked at the numbers. Insurance that is payable on the second death of a couple is far less expensive than insurance on one party only. Further, taxes on a RRIF can be deferred until the surviving spouse dies. The cost of a joint second-to-die life insurance policy for a 70 year old male and a 65 year old female is approximately 2% of the face amount or \$20,000 annually for a million dollar policy. Insurance premiums have to be paid with after-tax funds. Your RRIF withdrawals start at 5% taxable and increase slowly as time goes on. At a 35% average tax rate, your net 5% RRIF payment will be 3.25% after tax.

The entire RRIF balance becomes taxable on the second death of both spouses. This will likely draw the top marginal tax rate of 43.7%. If there is \$2,000,000 left in your RRIF, the tax will be \$874,000. Insurance at 2% will cost \$17,480 per year, or a little less than 1% of your total RRIF. Subtract that from your net income of 3.25% and you're left with a disposable income of 2.25%, which might be less than you would like.

The Family Cottage

Family Cottages are very special assets and pose very special problems. The important financial reality is that your estate will be taxed on the accrued capital gains that your cottage has accumulated since you acquired it. This can be deferred to the second death of spouses, and there are techniques to freeze the gains at today's value

to limit the future tax. Depending on your ages, the annual cost of insuring the tax will be roughly 2% of the amount of insurance you will need. *The most difficult planning issues usually relate to the use and management of the cottage by the next generation and require serious thought and discussion.*

Philanthropy Can Help You As Well As Others

Finally, we would like to briefly discuss the use of insured philanthropy in estate planning. For those who pay “too much tax”, either personally or in their companies, strategies are available that utilize dollars that would otherwise be paid in tax to buy life insurance for little or no outlay. *Insurance that is used for charitable donations will create tax credits that, in turn, can be used to pay estate taxes. Further, there are more complex strategies that create funds for immediate charitable purposes that will not reduce cash flow, assets, or estate values and can*

be implemented at no cost to the donor. For those who are unable to avail themselves of tax opportunities to create charitable gifts, but wish to be remembered through a Legacy Gift to their favourite charity, life insurance is usually the best option. If you prefer to enjoy current tax savings, donate a policy while you are alive and also donate the premium amounts annually. Each donation will generate tax credits. If your estate will require tax credits, then you will need to pay the premiums and have your estate make the donation. This donation has to be structured carefully to ensure that the estate receives the tax benefits.

Paying Estate Taxes

It usually makes more sense to buy insurance instead of using estate cash to pay estate taxes. When cash is sent to Ottawa, both the money and its future earnings are gone forever. If 2% of the earnings on that cash are used annually to “prepay” estate taxes with insurance, then the capital remains for your heirs and theirs, to invest and to perpetually generate income.

As in so many financial decisions, one should always “do the numbers”. Life insurance is an ingenious financial instrument that has immense value when used appropriately. There is no other way to create tax-free cash on death for a modest cost. Whether it should be used as part of your estate plan is a business decision that is best made after analyzing your alternatives.

Contributing Writer:
Doug de Savoye
Certified Financial Planner
L.D. de Savoye & Company Ltd.

Editor:
Andrew Hoffman, CFA
Vice President, Portfolio Manager

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1500—400 Burrard Street
Vancouver, BC V6C 3A6

Phone 604.683.3391
Toll-Free 1.888.292.1122

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LeithWheeler.com