PLANNING CONSIDERATIONS - LIFE AND DISABILITY INSURANCE

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Over the course of one's life, you will face many different compelling and valid reasons for needing insurance products. You may wish to protect your family in the event that you are unable to work due to disability or death, have bank requirements to secure business financing, or estate planning to cover terminal tax upon death and facilitate transfer of wealth to your beneficiaries in a tax efficient manner.

As an accounting firm that deals primarily with owner-managed businesses, we know that this is an area that can cause great confusion for business owners on which types of products are available and where they should be purchased – in the company or owned personally.

Life insurance

For those that have a corporation, there is a great advantage to owning the life insurance policy within the company. To illustrate the benefit, consider the following scenario where a business owner withdraws $150,000 of other than eligible dividends from his corporation and pays $1,000 of life insurance monthly. If the insurance policy is owned personally, the business owner must take an additional non-eligible dividend of $19,608 to fund the $12,000 annual life insurance policy after $7,608 of personal tax is paid.

Alternatively, by owning the insurance policy within the corporation, the $12,000 would be paid directly from retained earnings without the extra tax burden of paying personal tax. In the event that life insurance is a requirement of debt financing and assigned to the financial institution, the life insurance premium is deductible from income and further reduces the after tax cost of life insurance held within a corporation.

Our goal is to provide updates on topical accounting and tax issues. Information contained in this newsletter is not meant to be a comprehensive summary of the issues raised. Rather, we wish to bring what we believe to be important issues to the attention of our valued clients and readers. We would be pleased to discuss any questions that you, the reader, might

Upon death, life insurance proceeds are received by the corporation tax free and will then be paid to the shareholders of the corporation tax free through the capital dividend account. This strategy can be an efficient estate planning tool to reduce the retained earnings of your corporation and allow for a tax free transfer of wealth to your beneficiaries as opposed to the value of your company being taxed as a dividend upon your death, reduce.

Disability insurance – owned by individual

Many business owners wonder why a disability insurance policy may only pay 60% of the insured income level – how will only 60% satisfy their financial needs? The simple answer is that disability insurance is paid to the recipient tax-free, thus the benefit received will be approximately equal to your net pay after taxes. The downside is that the insurance premiums must be paid to the insurance company with after tax dollars from the individual. If your corporation has paid the disability insurance premium directly on your behalf, it must be treated as a taxable shareholder benefit and will generally not be deductible by the corporation. For an unincorporated sole proprietor, the premiums are not tax deductible because similarly the benefit is received tax free. However, the disability insurance premium can be deductible against self-employment income if the policy is designed to cover overhead expenses.

Disability insurance – owned by corporation

In certain circumstances, it may make business sense for the corporation to own a disability insurance policy on a key shareholder or employee. The advantage of the company owning the disability insurance policy rather than the individual shareholder is that the premiums will be paid with corporate funds not subjected to personal taxes. Situations where this strategy may be considered are:

Overhead protection – consider the example of a dental practice that relies upon the dentist to service their clients. If that dentist is disabled for a period of time, the business will still be responsible for paying wages, rent and other administrative expenses but will not have the revenue to cover those expenses. The insurance benefit would be received by the corporation tax free and in certain circumstances the premium could be tax deductible, if reasonable compared to the overhead expenses that the policy is intended to cover.

Debt held by corporation – if your company has debt that must be serviced, a policy that pays the disability insurance proceeds to the company directly is worthy of consideration so that the shareholder is not forced to use after tax personal funds to finance the corporate debt.

Large shareholder balance and payment of dividends – if your company has a large shareholder loan balance owing to you or if you income split with your low income spouse and adult children (over 18), there may not be a significant tax liability on withdrawing funds from your corporation. If the cost of withdrawing funds from the company is minimal, you may be needlessly paying for the disability premium with after tax personal dollars when you can achieve a similar result of tax free flow of money from the corporation through the repayment of your shareholder loan or income splitting.

There are many different Insurance products available with varying degrees of complexity to meet your needs. Professional advice from an insurance expert is highly recommended. If you have questions about how a well-planned insurance strategy can fit into your corporate structure in the most tax efficient manner, please do not hesitate to contact our office.

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