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"The Premium is not the Problem, the Premium is the Solution"

While we may not necessarily enjoy thinking about our insurance needs, most people know someone who has benefited from life coverage. Insurance is used to protect People, Plans and Incomes against death, disability, critical illness and tax loss. Insurance is a defensive strategy which coordinates with your offensive investment strategies to preserve and transfer your wealth to the next generation, thereby leaving a legacy while you enjoy the fruits of your labour.

The following article focuses on life insurance and some of the areas where it benefits your personal and business planning. The different types of life insurance will also be reviewed.

How Can You Use Life Insurance?

An interesting characteristic of life insurance, making it a useful tax and estate planning tool, is that the benefits are paid out completely tax free to the beneficiaries and can be paid outside of the will avoiding probate fees. Most financial, tax and estate planners agree that insurance is a necessary and reasonably priced solution to the risk management issues involved in preserving an estate and/or business.

Family protection is what usually comes to mind when people think about insurance. Paying off the mortgage, replacing a spouse's income and making certain there is enough capital to provide for the survivor are the most common reasons why people arrange for life insurance. Educational funding can also be guaranteed through insurance as well as providing cash to pay for outstanding debts, credit card balances, legal and accounting fees, executor fees and probate fees. In other words, insurance can be used to guarantee all that was planned for even in the event an individual dies too soon.

Insurance can also be used as an estate and wealth preservation tool. Capital gains taxes can significantly reduce an estate and are payable when an individual or both spouses have passed away. Capital gains on an investment portfolio, an increase in the value of a vacation property or the sale of a business are all events that trigger a tax bill from CRA at death. Paying these taxes using life insurance proceeds is like paying taxes with pennies on the dollar. You are eliminating your taxes at a significant discount. Clearly, not everybody has the desire or in some cases the obligation to maintain an estate and do everything possible to prevent it from being broken up, but for those who want to pass the baton to the next generation, insurance provides and excellent solution.

Equalization of an estate among beneficiaries is another issue many people face. In some cases, if one child is involved in the business while the other is not, and if a business makes up a large portion of the estate, problems can arise. Insurance helps parents treat their children equally in estate distributions, particularly when it is not in the best interest to split up a large family asset or business.

Charitable bequests can be greatly enhanced by applying the annual charitable donation to an insurance policy premium with the charity being either the owner or beneficiary. Tax benefits depend on how it is set up with either the premiums being considered the charitable contribution or the amount the charity receives at death being considered the charitable contribution.

Income drawn from investment portfolios can also be enhanced with life insurance. If you are drawing more from an account than it is growing, the depleted capital can be replaced for your survivors using life insurance.

Businesses can also benefit from life insurance. If a partner, major shareholder or key person within a business dies and there is no business continuation plan in place, the result for the survivors (and the business) can be disastrous. Life insurance can ensure the business maintains financial stability and

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continues operations. It can provide funding for shareholder agreements. Business stability can be maintained if the key person dies by paying off debts of the business. Insurance protects against financial hardships for all parties involved.

If a corporation is a beneficiary of a life insurance policy, a portion (often between 90% – 100%) of the benefit paid out on death will be credited to the company "Capital Dividend Account" (CDA). Amounts in the CDA can be paid out as tax free dividends to surviving shareholders of the company.

Types of Life Insurance:

Broadly speaking there are two types of life insurance you can arrange: Temporary or Permanent Coverage. It is important to establish how long you need the coverage for. Another consideration is what the premium for the ideal solution will be.

In estate planning situations, where the insurance proceeds are not needed until both spouses have passed away, a Joint and Last Insurance policy is most suitable. The premium is lower than a policy placed on a single life.

Temporary Life Insurance is more commonly known as Term Insurance. This is life insurance that has a premium that lasts for a specific term (5, 10 or 20 year terms) which is typically renewable at guaranteed premiums right to age 80 or 85. With term insurance, you are buying straight insurance and nothing more. There is no cash value or cash equity built up within the policy. While the initial premium is quite small, it increases significantly every time a term renews. Once the premium is no longer paid the coverage expires. Most term insurance plans are convertible to permanent insurance up to age 65 or 70.

Permanent insurance does not terminate at age 80 or 85; it lasts as long as you do provided you have paid your premiums. A premium for permanent insurance is significantly higher in the early years than term insurance but becomes the economically wise choice for those with longer term needs.

There are three types of Permanent Insurance. The first is Term to 100. Here you have arranged for permanent coverage but no additional cash value or cash equity is building up within the policy. At age 100, you can stop paying the premiums but the coverage will remain.

The other two types of permanent insurance are Whole Life and Universal Life. You can accumulate investments inside these policies (within certain limits) and they can grow on a tax sheltered basis. When you pass away, these investments could be added to the face value of the policy and all be paid out on a tax free basis to your beneficiaries.

With both Whole Life and Universal Life, it is possible to have a limited premium payment period. This, of course, depends on the financial results of the investments inside the policies. These limited pay premium periods are a projection and not guaranteed.

Whole Life plans have the insurance company do the investment management within the policy for you. Universal Life plans let you be in charge of what form those investments take. You have a broad range of equity, bond and balanced funds as well as term deposit investment choices.

Tax sheltered growth of these investments can be very attractive, particularly when large investment capital gains within the policy go tax free to beneficiaries. With some insurance companies, a portion of the investment within the policy can possibly be paid out tax free before death if the insured suffers a critical illness. However, the investment management fees on the funds that these policies hold could be significantly higher than investing directly with your investment management company.

You should buy the amount of coverage you will need not just for today but for tomorrow, and the type of coverage that lasts as long as the need exists at a manageable premium. When properly arranged, the premium is not the problem, the premium is the solution.

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