THE STAN CLARK FINANCIAL TEAM'S

PERSPECTIVES

An Excerpt from Volume 13 | Issue 4 **June 2022**

Financial & Estate Planning

SAFEGUARDING YOUR ESTATE: THE ROLE LIFE INSURANCE CAN PLAY

By Sylvia Ellis, Senior Estate Planning Advisor

Life insurance has several uses: estate preservation; income replacement; business planning; an investment alternative; and charity, among others. For this article, we'll focus on the first use.

Estate preservation deals with liabilities that result from death: capital gains tax, probate fees and other estate costs. You calculate the liabilities and determine the total funds that will be required to cover them. You then compare different funding methods, taking into account the time value of money.

Under normal circumstances, when one spouse dies, the deceased spouse's assets can be transferred tax-free to the other spouse. But when someone dies without a spouse, as would be the case with the surviving spouse, this triggers a tax liability.

Canadian residents without a spouse are deemed to have disposed of their property for fair market value immediately before death. Assets such as stocks, company shares or recreational property are subject to taxation on the increase in value above the initial cost base. Assets such as Registered Retirement Savings Plans (RRSPs) and Registered Retirement Income Funds (RRIFs) are collapsed and fully taxed as income.

	Principal residence	Summer home	Investment portfolio	RRSP
Current value	$1,500,000	$750,000	$1,000,000	$500,000
Adjusted cost base	$ 750,000	$250,000	$ 750,000	Fully taxed as income
Capital Gain	$ 750,000	$500,000	$ 250,000	
Taxable capital gain (50%)	0	$250,000	$ 125,000	
Tax payable (50%)	<0>	<$125,000>	<$62,500>	<$250,000>

The table to the right illustrates a basic scenario and anticipated taxes at death.

The total tax payable, not including probate fees, is $437,500. (The tax could actually be higher today, given the top bracket of 53.5% in BC, but for simplicity I have used 50%.) Consider your own situation. What are your options for paying these taxes, and which option would be the most cost-effective?

You or your estate could:

- **Establish an investment account** in which you set aside money over a number of years, with the goal of having enough to pay taxes due at death. The problem is that there is no way of knowing how long you have to save. Furthermore, income earned on these savings is taxable.
- **Your executor could sell assets.** For liquid assets, this is not an issue. For non-liquid assets, such as real estate or company shares, the problem is that they may potentially have to be sold below market value. In addition, it is important to remember that a liquidated asset can no longer generate income or appreciate in value.
- **Your executor could borrow the funds needed.** However, there are several disadvantages. Will a bank lend the money? What collateral will the bank require? And, will the revenue generated from the remaining assets be sufficient to repay the loan and the non-deductible interest?
- **Purchase life insurance.** Where health is not an issue, life insurance could be purchased to offset the potential tax liability. The incident that creates the tax liability (i.e., the death of the last spouse) can also be the incident that creates the cash to fund the tax liability.

When we do a comparative analysis, life insurance often comes out as the most cost-effective and tax-efficient option. Viewing life insurance as another asset class in your investment portfolio, you may see, as others have, that it can be a good way of funding the tax liability at a reasonable cost.

Life insurance premiums may also be guaranteed. And, most importantly, the death benefit is paid tax-free to your beneficiaries or estate.

Regardless of your intentions, when it comes to passing on assets to your heirs, proper planning is imperative. If you are concerned about preserving the value of your estate and want to ensure your heirs receive it in the most tax-efficient and timely manner, please do not hesitate to contact us. We'd be more than happy to do a review and provide you with options for consideration.

CIBC WOOD GUNDY | The Stan Clark Financial Team
Where planning, investing and behavioral finance meet

Phone: 604 641-4361 | Toll-free: 1 800 661-9442 | Fax: 604 608-5211 | Email: stanclarkfinancialteam@cibc.ca | www.stanclark.ca