The Corporate Asset Transfer Plan

Someone is going to profit from your client's hard work.

Shouldn't it be their family?

BMO Insurance

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Introduction

The ideas presented in this Guide can be effective and have specific applications in the corporate insurance market. When combined with a BMO Insurance permanent life insurance policy, your clients can structure a solution that addresses their insurance needs as well as a strategy that helps them transfer their corporate assets to their heirs in a tax effective manner. Whether they choose a universal life or whole life insurance plan, they can have the confidence that their policy is backed by one of Canada's leading financial services organizations.

To help support your understanding of the mechanics of the Corporate Asset Transfer Plan, we encourage you to read this Guide and use the latest version of our Wave illustration software to help you prepare personalized proposals for your clients.

Note: The ideas presented in this guide should be reviewed for suitability to individual circumstances. The information contained in this guide is general in nature and should not be construed as legal or tax advice. You and your clients are encouraged to seek the advice of other professionals such as legal and tax experts to ensure that the ideas presented are appropriate for the circumstances of the individual(s) for whom this plan is being considered.

Overview of the Corporate Asset Transfer Plan

The Corporate Asset Transfer Plan from BMO Insurance is an effective life insurance strategy that facilitates a tax effective transfer of wealth from a business owner to their heirs.

The Opportunity

Many business owners of Canadian Controlled Private Corporations (CCPCs) have passive investment assets triggering a high annual tax bill for their corporation. When the business owner dies, these assets may be liquidated and the amounts transferred out of their businesses into the hands of their heirs.

The Corporate Asset Transfer Plan may be an ideal solution to accomplish that goal in a tax effective manner. The idea is simple: the Corporate Asset Transfer Plan allows business owners who hold passive investment assets in their businesses to transfer a portion of these assets into a tax-exempt life insurance policy to cover their insurance needs and to benefit from the tax-deferred growth within the policy. Then, upon death, the plan allows them to transfer these sums tax efficiently to their heirs. When compared to traditional taxable investment options, this approach can maximize the after-tax transfer of this wealth.

The Corporate Asset Transfer Plan

! A life insurance strategy for business owners designed to increase the after-tax transfer of their corporate assets to their heirs.

Target Market

The Corporate Asset Transfer Plan is targeted at business owners who have invested surplus assets in passive investments which they want to eventually liquidate and transfer to their heirs.

Typical Client Profile

- owner of a CCPC
- looking at wealth transfer strategies
- age 50-70 and require life insurance on their own lives
- are in good health and are able to qualify for life insurance
- intend to pass on wealth currently held in their businesses to their heirs
- have surplus assets and/or cash flow in their business (perhaps held in a holding company to house passive investments) that are not required for day-to-day business operations
- are interested in a tax-deferred financial instrument to house a portion of their corporate investment portfolio

The Permanent Life Insurance Solution

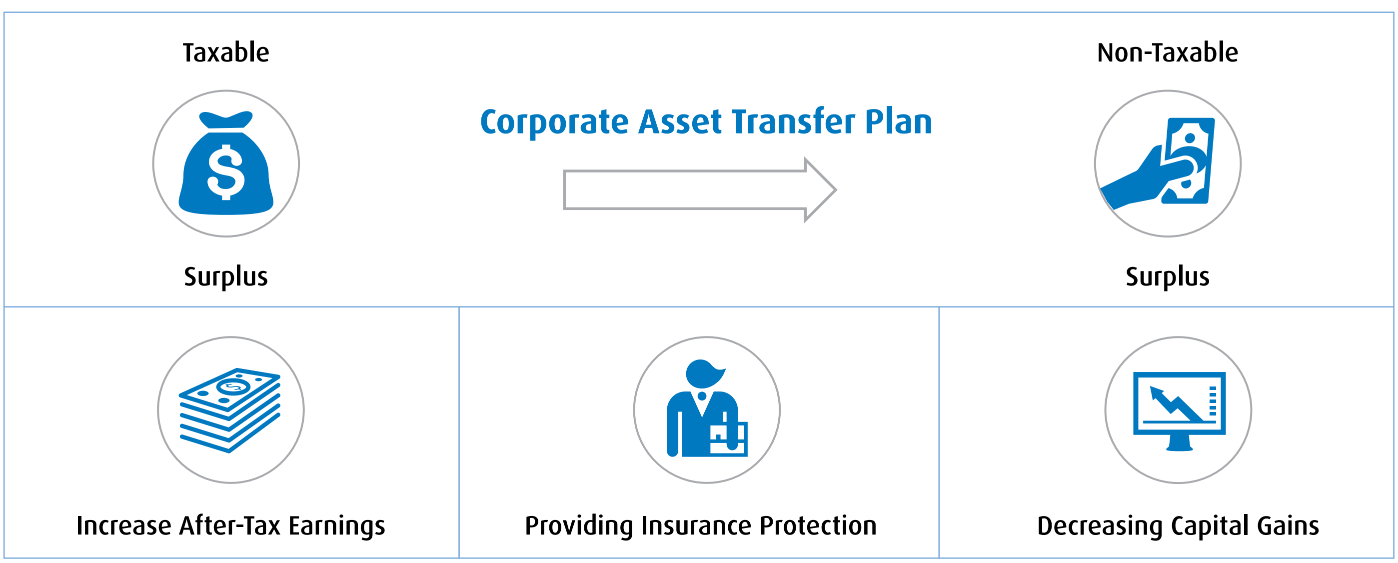
To implement the Corporate Asset Transfer Plan, use the following as a guideline:

Step	Corporate Asset Transfer Plan
1	Determine the amount of permanent life insurance your client needs for their business.
2	Select whether a universal life or whole life insurance policy from BMO Insurance suits their needs.
3	Work with your client to determine how quickly and what portion of their surplus corporate investment portfolio they would like transferred into the policy.
4	Select an appropriate premium schedule.
5	If they select universal life, have them choose an investment mix from the list of available options[1] that's aligned with their long-term financial objectives and risk tolerance.
6	Have them apply for the insurance with their corporation as the owner and beneficiary of the policy.

The Results

By using the Corporate Asset Transfer Plan from BMO Insurance, your clients will benefit from the following:[2]

- An increase in the size of the shareholder's estate value.
- A reduction in the corporation's future taxable income, since assets are transferred into a life insurance vehicle with tax-deferred accumulation.
- Upon death of the insured, the life insurance benefit is paid to the corporation tax-free. With this approach, a significant portion or all of the proceeds can subsequently be paid as a tax-free dividend to the shareholder's estate (see Tax Considerations below).
- A possible reduction in the ultimate capital gain on the company shares due to the unique valuation rules for life insurance.



The Permanent Life Insurance Solution

Is the Corporate Asset Transfer Plan Right for Your Clients?

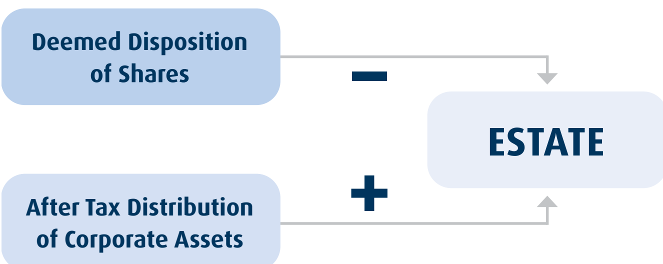
When considering the Corporate Asset Transfer Plan for any of your clients, you may want to run through the following checklist to determine if the plan is appropriate for their specific needs:

Checklist for the Corporate Asset Transfer Plan
Are my clients business owners thinking about wealth transfer strategies?
Do they require life insurance to protect their business (e.g. key person insurance, offset estate taxes, etc.)?
Do they want to leave funds for their heirs?
Do they want to simplify the transfer of their estate to these heirs?
Do they want to reduce corporate taxes on their investment income?
Do they want to minimize the capital gains tax due upon the deemed disposition of shares upon their death?
Do they want to minimize the tax payable upon the transfer of funds from the company?

If your client answers “yes” to these questions, then the Corporate Asset Transfer Plan may be an ideal solution for them.

Tax Considerations

Upon the death of a shareholder (assuming that there are no rollover of shares), there are two taxable events that need to be considered. The first is the deemed disposition of the shareholder's interest in the company which typically results in a capital gain which reduces the funds available for their heirs. The second is the transfer of the net value from the corporation to the shareholder's heirs. With a life insurance policy from BMO Insurance, you may be able to design a solution that reduces the capital gains tax that will become payable while increasing the after-tax distribution of these assets from the corporation to the heirs.



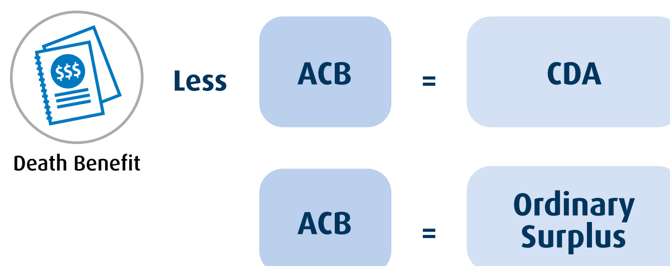
Deemed Disposition of Shares

The shares of the deceased will reflect the underlying value of the assets of the corporation. The valuation of life insurance is deemed to equal the cash surrender value immediately before death for policies insuring the life of the deceased or related individuals. This could mean that a significant portion of the death benefit paid to the company would be excluded from the calculation of the capital gains tax. Given the purpose of this strategy is to optimize the after-tax transfer of wealth, purchasing a policy that maximizes the death benefit while minimizing the cash value may reduce the capital gain exposure on the corporate shares when compared to an alternative taxable investment.

Corporate Distribution to Heirs

The Corporate Asset Transfer Plan results in insurance proceeds which flow to the corporation (the beneficiary of the policy) tax-free. Once the death benefit is paid, the next step will be to flow those proceeds out to the shareholder's heirs.

With the Corporate Asset Transfer Plan and as long as the owner and beneficiary of the policy is a corporation, the portion of the death benefit in excess of the Adjusted Cost Basis (ACB) of the policy will be credited to the company's Capital Dividend Account (CDA). The CDA is a division of the corporation's surplus for tax purposes that can be flowed to shareholders tax-free. Any excess amount forms part of the corporation's ordinary surplus for tax purposes and may be paid as a taxable dividend. This means that if the entire amount of the death benefit is paid to the shareholder's estate, only the portion of the death benefit equal to the ACB will be taxed using dividend tax rates in effect at that time. The ACB typically declines each year once premiums cease and may be negligible at the time of actual death which may allow a significant portion of the death benefit to flow out tax-free to the heirs.



To have a more complete understanding of the benefits and tax consequences of the Corporate Asset Transfer Plan, we encourage you to prepare a personalized projection for your clients using the most current version of the Wave illustration software. Also, we strongly advise that when you are working on structuring a Corporate Asset Transfer Plan and have tax and estate planning issues to resolve, you consult with legal, tax and accounting experts.

Case Study

Client Details

- Sam, male age 55 and Sally, female age 55
- both business owners of S&S Opco, a privately owned Canadian corporation
- Sam and Sally have created a holding company, S&S Holdco, to house surplus corporate investments
- S&S Holdco currently has $400,000 of assets invested in fixed income investments that is taxed at a rate of 50%
- Sam and Sally want to minimize their corporate tax bill and maximize the amount of assets available for transfer to their children, Bill and Betty, upon death

Assumptions

- Insureds: Sam and Sally on a Joint Last to Die Wealth Dimensions UL policy
- Owner of policy: S&S Holdco
- Beneficiary: S&S Holdco
- Death Benefit option: Sum Insured plus Fund Value
- Planned deposits: $20,000 for ten years (half of the surplus assets to address any liquidity concerns)
- Projected values illustrated at a 4% net return in a Guaranteed Market Index Account
- Projected Alternative investment values illustrated at a 5% net return (before-tax) in a fixed income portfolio
- Corporate tax rate (passive investments): 50%, personal non-eligible dividend tax rate: 45%, personal marginal tax rate: 50%

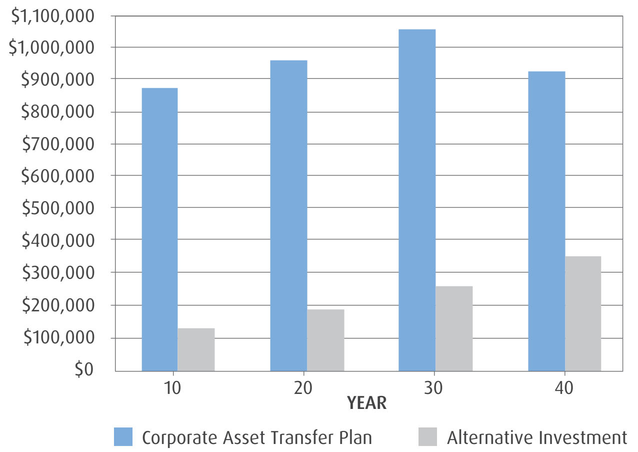
Comparison of Projected Values

The Corporate Asset Transfer Plan vs. the Alternative Investment

	Corporate Asset Transfer Plan using Wealth Dimension (projected at a 4% annual rate of return)						Alternative Investment (Fixed income portfolio projected at a 5% annual rate of return)	
Year	**Cash Value**	**Death Benefit**	**Adjusted Cost Basis**	**Net Estate Value**	**Capital Gains Tax[3]**	**Estate Value (net of taxes)**	**After-tax Account Value**	**Estate Value (net of taxes)[3]**
10	$222,511	$967,511	$189,504	$967,511	$(85,277)	$882,234	$229,669	$136,327
20	$291,889	$1,036,889	$149,712	$949,133	$(67,371)	$969,518	$293,996	$193,406
30	$338,434	$1,083,434	$36,108	$1,083,434	$(16,249)	$1,067,185	$376,340	$266,472
40	$189,112	$934,112	$0	$934,112	$0	$934,112	$481,747	$360,003

Case Study

A Projection of Net Estate Values (After-Tax)



Comparison of After-Tax Values

Year	Corporate Asset Transfer Plan	Alternative Investment	Corporate Asset Transfer Plan Advantage
10	$882,234	$136,327	$745,907
20	$969,518	$193,406	$776,112
30	$1,067,185	$266,472	$800,713
40	$934,112	$360,003	$574,109

The Result

- By using the Corporate Asset Transfer Plan, Sam and Sally will have significantly increased the value of their estate.
- Over a ten year period, $200,000 of their taxable corporate investment portfolio (net of charges) will grow tax-deferred within the UL policy, greatly reducing their corporate tax bill.
- Upon death, the life insurance proceeds less the Adjusted Cost Basis can be paid to Sam and Sally's heirs, via tax-free capital dividends from the company's Capital Dividend Account. Any excess is payable as a taxable dividend which benefits from favourable tax treatment.
- Using the Corporate Asset Transfer Plan, capital gains may be reduced as they would be based only on the cash value of the policy im-mediately prior to the death benefit payout. Conversely, without this Asset Transfer Plan, capital gains taxes would reflect the FMV of the entire fixed income portfolio.
- If they select a universal life policy from BMO Insurance, Sam and Sally also have access to valuable living benefits including the Joint Last to Die Special Death Benefit (Fund Value Payout on first death) and a Disability Benefit.[4]

Note: These examples are based on Wealth Dimensions (Wave version 56.0) policy and are merely a projection of future results, using a set of assumptions that will change over time. Actual results are not guaranteed and will vary.

Underwriting and Administration Considerations

When proposing a Corporate Asset Transfer Plan, you should consider the following:

- Check to ensure that the amount of insurance you are proposing on any life is reasonable and justifiable; this amount will need to be approved by a BMO Insurance Underwriter.
- Refer to BMO Insurance's Underwriting Guidelines found under the Underwriting Guidelines menu of the Wave illustration software for details on age, amount and financial underwriting requirements.
- To ensure that the Underwriter reviewing the application for insurance understands the purpose of the insurance, include a covering letter with a summary of what is being proposed.
- Run a personalized illustration for your client, using the latest version of the Wave illustration software and include a signed copy with the application.
- When filling out the application for insurance, use the following as a guideline:

	Corporate Asset Transfer Plan
Life Insured	Key person or shareholder
Owner	Corporation
Beneficiary	Corporation

Frequently Asked Questions

Q 1

What is the typical profile for a client considering the Corporate Asset Transfer Plan?
This strategy is about maximizing the transfer of wealth from a corporation to a business owner's heirs. As such, potential clients should:

- be owners of a Canadian Controlled Private Corporation (CCPC)
- be between the ages of 50 and 70
- have a need and be able to qualify for permanent life insurance
- have accumulated surplus within a holding company in their corporation that's taxed as a passive investment (and which is subject to high tax rates)
- ideally have these assets invested in short-term or fixed interest investments that can be transferred to other investments with minimal (or no) tax consequences
- not require these assets to fund their business (or living) expenses

Q 2

What types of life insurance plans should be considered for the Corporate Asset Transfer Plan?
A key goal of this strategy is to transfer wealth at the time of death. So, a key consideration is the projected death benefit the plan has to offer rather than the cash value. The cash value may actually diminish the effectiveness of the strategy because of the negative impact of the corporate share valuation and deemed disposition of those shares could have upon death at Fair Market Value.

What's more, the cash value is also considered a passive asset which will impact the corporation's status when determining if it is a Qualified Small Business Corporation.

If structured appropriately, clients should plan to only contribute excess surplus earmarked for wealth transfer – so liquidity shouldn't be the focus.

Q 3

This strategy involves investing funds in a life insurance policy rather than alternative taxable investments. What should a potential client consider as far as investment choices of the life insurance solution?

The credited return on the policy's cash value is important since small variances in actual returns over an extended period can have a significant impact on the resulting death benefit and future premiums due.

- Selecting investment options that are aggressive set up false expectations which are unlikely to be realized.
- Being overly conservative may result in missed opportunities and a less than optimal amount being transferred to their heirs.

Therefore, a starting point should always be based on the client's investment risk tolerance.

For clients who want some flexibility, are looking for a choice of investment options and are comfortable with some investment risk, universal life insurance may be appropriate. With universal life insurance plans from BMO Insurance, they can choose from a wide range of investment options based on their tolerance to investment risk. Visit **bmoinvestpro.ca** for more details.

However, if they prefer not to do this, BMO Insurance Whole Life may be more appropriate for them.

Q 4

What are some of the key differences in the tax treatment of corporate owned life insurance vs. traditional investments?
Life insurance has a preferred tax treatment. An exempt life insurance policy is not taxed like a traditional investment which is either taxed annually or when sold. When held in a corporation, traditional investments including their earnings form part of the corporation's ordinary surplus; any dividends paid out of ordinary surplus are taxable.

A life insurance death benefit received by an individual beneficiary is not taxable in Canada and the credited return of an exempt life insurance policy is not taxed annually.[5] To provide a similar tax outcome for corporations, the death benefit less the ACB is credited to a Capital Dividend Account (CDA). The accumulated growth in the policy forms part of the death benefit. The CDA is a non-taxable part of the corporation's surplus and allows it to pay out dividends in the form of a capital dividend which is not taxable to Canadian residents.

So, by transferring their surplus investments into a life insurance policy, they can minimize (or eliminate) the annual tax that they pay on the returns in the policy and qualify to have the death benefit distributed to their heirs with minimal tax costs. This can result in an increase in their estate values when compared to the alternative investment options.

Frequently Asked Questions (cont'd)

Q 5

How is a life insurance policy recorded in the company records?
Life insurance is a valuable asset that needs to be reflected in the CCPC's financial records.

During the lifetime of the insured, there are three elements of a policy that need to be recorded (excluding special transactions such as a transfer of the policy's ownership or cash withdrawals):

- the cash value (on the Balance Sheet)
- premiums paid (on the Income Statement)
- change in the cash value (on the Income Statement)

In addition, the notes to the financial statements should disclose other information that may be relevant including:

- any encumbrance against the life insurance policy such as collateral assignments
- the amount of the death benefit
- any other special policy features or options

Q 6

How does the tax impact on the deemed disposition of shares differ if my clients invest in alternative investments versus life insurance?
Upon death (or second death where couples are jointly insured and a rollover applies), the shares of the CCPC will be deemed disposed of at their Fair Market Value (FMV). FMV reflects the value of the underlying assets in the corporation. Alternative investments will be reflected in share valuation based on their Fair Market Value immediately before death. The value of corporate owned life insurance on the life of the shareholder will be deemed to equal the cash surrender value immediately prior to death, not the death benefit. Acquiring a life insurance policy which maximizes the death benefit and minimizes the cash surrender value may reduce the valuation of the CCPC shares and thereby reduce the tax consequences on death even though the death benefit creates a larger amount that's available for distribution to heirs. In the example below, you can see how a $100,000 GIC may create a greater tax cost upon death than a $1,000,000 death benefit.

- Shareholder has ACB in the shares of $1
- Company holds only one asset

GIC = $100,001	Insurance policy = $1,000,000 CSV = $1
Capital Gain = $100,000	Capital Gain = $0

Tax saving at 50% = $25,000

Q 7

Are there ways to mitigate some of the adverse tax on the CCPC's shares if they invest in alternative investments?
Post mortem tax planning may reduce the impact of the capital gain realized on shares that reflect the FMV of alternative investments or life insurance cash values. Techniques like pipeline planning or loss carry back strategies can be invoked but they come at a cost and with additional tax risks. The best solution may be to avoid the problem and utilize an insurance solution with a product that maximizes the death benefit and minimizes the cash values instead of having to pay to deal with the challenges presented by higher than necessary FMV's post mortem.

Q 8

Are there limits as to how much insurance my clients can buy for the Corporate Asset Transfer Plan?
Life insurance is acquired to cover an insurable risk. The value associated with that risk limits the amount of life insurance coverage that can be acquired. Unlike traditional investments, you can't simply buy as much as you can afford; there needs to be an insurance justification for the amount applied for. In addition, health buys life insurance, money only pays for it. If clients are not healthy they will be precluded from utilizing this estate planning solution. Most clients that fit the ideal profile have significant tax liabilities upon death. Those liabilities form an insurable risk and can be used to justify the insurance amount applied for.

Therefore, when submitting an application for insurance for the Corporate Asset Transfer Plan, it is a good idea to include a covering letter to describe the intent of the insurance as well as a signed illustration.

Let's connect

To find out more about BMO Insurance products, please call your MGA, contact the BMO Insurance regional sales office in your area or call 1-877-742-5244.

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1-800-608-7303

Quebec – Atlantic Region
1-866-217-0514

Western Region
1-877-877-1272

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[1] Visit bmoinvestpro.ca for details.

[2] Based on Rules and Regulations in effect at the time of writing this Guide.

[3] These projections include the impact of capital gains on the deemed disposition of shares at death which may be reduced through post-mortem tax planning but would require the use of tax professionals and result in additional fees and tax risks being incurred. The capital gain impact for the Corporate Asset Transfer Plan reflects the insurance policy's cash value immediately before death which can be minimized based on product selection and design.

[4] Refer to the Wealth Dimensions Product Guide (709E) for more details.

[5] Subject to certain limits.

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