How can I transfer wealth built up in my company to my heirs tax effectively?

You have currently invested excess surplus in your company in a passive investment portfolio and wonder if there is a better option for you today *and for your heirs in the future.*

Earnings from passive investments in a Canadian Controlled Private Corporation (CCPC) are taxed at higher tax rates than business income. Plus, these funds are not removed from your company because they would incur additional tax if distributed to shareholders. So, your investments are effectively "trapped".

Furthermore, you realize that if you wanted to transfer the wealth accumulated in your company to your heirs, you would have to pay dividend tax on these amounts. In addition, capital gains tax may need to be paid on the full value of your company's assets (including the portfolio of passive investments) upon your death.

The Corporate Asset Transfer Plan

The Corporate Asset Transfer Plan allows you to transfer passive corporate investments into a tax-exempt life insurance policy to cover your life insurance needs and to benefit from the tax-deferred growth within the policy.[1] Then, upon death, the plan allows you to transfer these sums tax efficiently to your heirs. When compared to traditional taxable investment options, this approach can maximize the after-tax value they receive.

With the Corporate Asset Transfer Plan you get:

- An immediate increase in the after-tax value of your corporation at death which increases your estate value, through the preferential tax treatment of life insurance.
- A conversion of your company's taxable surplus into non-taxable surplus.
- Reductions in future taxable income since assets are transferred into a life insurance policy with tax-deferred accumulation.
- A potential reduction of the taxable value of your business for estate purposes.

Plus:

- You're able to access the Cash Value of the plan at any time through cash withdrawals or loans secured by the policy.
- You'll also be able to transfer the insurance proceeds to your heirs outside of your will – reducing charges that result from settling your estate.

It's a simple way to minimize current tax and maximize the value of the transfer of your "trapped" corporate surplus to your loved ones.

Note: Corporate tax planning can be complex. Before proceeding with this strategy, you should work with your team of financial planners to determine the full impact of this strategy for your specific situation.

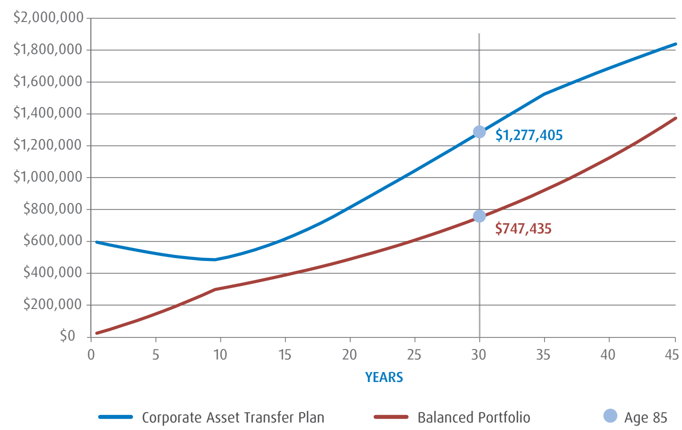
For example:

John is 55 years old and a very successful owner of a Canadian privately held corporation (JohnCorp). He set up a holding company (John Holdco) that houses $800,000 of corporate surplus that is currently invested in a balanced portfolio. John would like to eventually transfer at least half of this portfolio to his children, Steve and Sue, retaining the rest for potential reinvestment back into the business.

Currently, John Holdco owns 100% of the shares of JohnCorp. Last year, when he factored-in the tax he paid on the investment income (at a rate of 50%), a 6.00% net annual return translated into 3.00% net return after-tax.

John is looking for a better option and is considering the Corporate Asset Transfer Plan.

A Projection of Net After-Tax Estate Values[2]



This projection ignores the impact of the capital gain that arises when the corporate shares are deemed disposed upon death because the outcome varies depending on if post mortem tax planning is put in place or not. Life insurance cash value immediately before death would impact share valuation while the full Fair Market Value (FMV) of the Alternative Investment would impact the share value.

The results

- Over a 10 year period, $400,000 of corporate surplus will be reallocated to insurance (net of charges) and will accumulate on a tax-deferred basis in a whole life insurance policy, greatly reducing their corporate tax bill.
- At death, and after receipt of the life insurance benefit, the company can pay the proceeds less the Adjusted Cost Basis (ACB) of the policy to John's estate via tax-free capital dividends. Any amount of the remaining death benefit can be paid as a taxable dividend which benefits from favourable dividend tax rates. This process maximizes the amount that Steve and Sue will receive.
- Based on this projection, if John passed away by year 30 (when he reaches age 85), his heirs would receive 71% more value using the Corporate Asset Transfer Plan compared to investing the same amount in the balanced portfolio (i.e. $1,277,405 compared to $747,435).
- Using the insurance strategy, capital gains may be minimized and based on the cash value of the policy prior to the death benefit payout. Conversely, without the Corporate Asset Transfer Plan, capital gains tax would be payable on the entire amount of the fixed income portfolio.

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[1] Subject to certain maximum amounts. See your insurance advisor for more details.

[2] This example is a projection based on BMO Insurance Whole Life Estate Protector assuming a 4.75% Performance Bonus Rate, 10-Pay ($40,000 per year) and a face solve of $612,355. The Balanced Portfolio (50% interest, 30% dividends, 10% deferred capital gains, 10% realized capital gains) is projected at 6.0%, 0% probate fee and 45% individual dividend tax rate. Please contact your advisor for full detail. Source: The Wave 56.0.

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