

# The Estate Reallocation Strategy

The key to effective estate planning is to minimize estate tax and maximize the amount of wealth that is transferred to the next generation. But how? Life insurance offers a unique strategy.

## Investments and Taxes

While registered assets, such as those within RRSPs, RRIFs, and pension plans allow for immediate tax deductions and tax-deferred savings for retirement, any withdrawals will be fully taxed as income at your marginal tax rate. Furthermore, any income or growth from most non-registered investments such as GICs, stocks, bonds, real estate, and cash will be taxable to some extent, either as it is earned or upon the sale of the asset. Even upon death, you are deemed to have sold all of your assets at their fair market value for tax purposes, which can result in some significant liabilities for your estate.

## Tax Minimization, Estate Maximization

Many individuals view life insurance as simply a necessary expense for managing risk. This is part of its purpose, but it can be much more than that. The Estate Reallocation strategy involves shifting a portion of your assets (say 5%) from fully taxable positions into a tax-exempt insurance policy, resulting in a significantly enhanced estate plan.

The investments you make in a Universal Life or Participating Whole Life policy are exempt from accrual taxation during your lifetime. With this permanent, tax-exempt insurance, you can pay a premium that is far in excess of what is necessary; the difference is invested on your behalf and the growth is tax-deferred, just like registered assets. This strategy also allows for the potential for tax-free retirement income.

Through the years, as your policy grows, your ultimate estate benefit builds as well. Eventually, the proceeds are distributed tax-free to your beneficiaries when you die, eliminating probate fees and delays.

### Comparing Two Estates

The following illustrates how an estate reallocation strategy can help maximize the value of an estate (reallocation of \$50,000 per year for a 10 year period).

	GIC at 4%	Estate Reallocation Strategy
Base Insurance Death Benefit	\$0	\$1,000,000
Estate Value* at age 85	\$917,542	\$2,153,043
Internal Rate of Return	2.40%	5.84%

\*Value payable at death. Assumes 55 year old couple, non-smoking at 40% tax rate. Rates and death benefit will vary based on personal situation.



## Universal Life (UL)

In a UL policy, the investments are tracked separately from your insurance coverage. You are in control of how your additional premiums are allocated (restricted only by the investment options available to you) and you have a great deal of flexibility with respect to when and how those premiums are paid. Investments typically “mirror” equity and bond indices, and sometimes even reflect the returns of certain mutual funds. Unlike the underlying positions, the UL investments are not taxable as they grow, however there is a management fee, much like most mutual funds. Upon death, both the investment value and the insurance coverage are paid out to the beneficiaries tax-free.

## Participating Whole Life (PAR)

PAR is a more inflexible product than UL, without as much transparency. The insurer itself invests your additional premiums – you have no control. The growth is achieved through the crediting of dividends, which strongly reflect the returns that the insurer achieves with your money, and which are used to buy additional amounts of permanent insurance coverage. The dividends have traditionally been quite stable, and cannot ever be negative. PAR policies fully guarantee the level of premiums you pay, the death benefit, and minimum level of cash value. The dividend scale in a PAR policy is the only feature that is not guaranteed.

### Which Product Suits You Best?

	Universal Life	Participating Whole Life
<i>Risk</i>	You are comfortable with normal investment risk	You are more risk adverse, preferring slow but stable returns
<i>Control</i>	You need to have control of the investment part of the policy	You are comfortable allowing the insurer to manage the investments
<i>Flexibility</i>	You value the ability to change your policy if you need to	You are comfortable that little or no change will be allowed
<i>Transparency</i>	You feel the need to regularly monitor your performance	You are comfortable with a long-term investment approach

## Summary

Tax-exempt life insurance allows individuals to maximize the estate value that they pass on to future generations. It allows for tax-sheltered growth and a tax-free payout at death that typically far outweighs achievable returns in a taxable investment account. Both UL and PAR policies are excellent products; whether you choose one or the other will be based mostly on your comfort level and investment style.

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