TOMPKINSights

October 26, 2023

Looking back and looking forward

By: Florence Marino B.A., LL.B., TEP
Vice President, Tax & Estate Planning

Over the past 30 years the acceptance and deployment of life insurance within estate and business succession planning has blossomed. In large part, we attribute this increased utilization to a greater understanding of the unique tax and legal attributes of life insurance amongst tax and legal professionals who work with Canada's business families and entrepreneurs as well as their internal advisors.

Business valuations have increased substantially for many of Canada's leading private businesses and with that, so have their estate tax liabilities. During this period, corporate tax rates on active business income have decreased, while personal marginal tax rates have increased, which has meant after-tax profits have been reinvested inside their corporations. The unique tax attributes of life insurance have contributed to the uptake of corporately owned life insurance to fund tax liabilities on death, facilitate post-mortem planning and provide equitable distributions to beneficiaries.

With this greater use and acceptance, has come some aggressive products and strategies which have been the subject of specific tax measures. 10/8 plans, leveraged insured annuities, capital dividend account maximization through naming different corporate beneficiaries than the owner corporation, transfers of policies into a corporation for fair market value consideration have all been the subject of specific legislative changes to limit or eliminate them.

And these changes have not occurred in vacuum. Significant changes to private company taxation and the taxation of trusts have brought on levels of complexity that require multi-disciplinary approaches to planning.

The regime of taxation for exempt life insurance itself was modernized in this period to ensure that the significant tax benefits, such as tax-free death benefits and tax-exempt growth in values with taxation only on disposition, were maintained yet reflect current assumptions.

Life insurance has proven to provide tax efficient instant liquidity when businesses and families need it the most. The capital dividend account credit at time of death attributable to corporate owned life insurance allows funds to be paid out to the estate, preserving the tax-free character of life insurance proceeds.

Integrating insurance into business succession plans has become a crucial component of solving for the liquidity required to carry out some of the important goals and objectives of this complex planning. With complexity, sophisticated resources need to be brought to bear including specific knowledge and expertise surrounding the use and deployment of life insurance.

So that is where we are today - broad acceptance and use of life insurance in sophisticated estate and business planning. What do we see in the future?

We are at a turning point or maybe a tipping point. A whole new ballgame, brought on by increased resources for audit, collection and enforcement of tax for the Canada Revenue Agency, combined with newly enacted mandatory reporting for reportable and notifiable transactions and proposed amendments to strengthen the general anti-avoidance rule, will shift the balance.

To navigate this complexity and the overall shifting balance, clients require advisory firms with robust professional resources to understand and recommend options and solutions. These firms need to talk to each other, ideate and implement. You can count on TOMPKINSights to provide you with our views and guidance looking through a distinctly insurance focused lens at tax and estate planning issues and developments.

FOOTNOTE:

This publication is protected by copyright. Tompkins Insurance is not engaged in rendering tax or legal advice. TOMPKINSights contains a general discussion of certain tax and legal developments and should not be construed as tax or legal advice.

Should you wish to discuss this or any other TOMPKINSights article, please contact florence@tompkinsinsurance.com