Armstrong
Financial Services

Tax Liability, Life Insurance & Charitable Giving

Abe and Sarah, both 65, own 100% of the shares in Holdco, valued at $3M. Upon their deaths, they will gift all shares of Holdco to their son, Ben. Ben will immediately owe $1M in income tax. How can Ben finance this $1M tax liability using life insurance?

Scenario 1: Corporate life insurance with CDA

1. Holdco buys a $1M life insurance policy on Abe and Sarah for $15K annually.
2. On the deaths of Abe & Sarah, Holdco will receive $1M in tax-free policy proceeds and will add $1M to its Capital Dividend Account (CDA).
3. Ben will receive a $1M tax-free dividend from Holdco via the CDA, which he will use to pay the $1M tax liability.

Ben now owns 100% of Holdco, with no remaining $1M tax liability.

$1M of after-tax value has been generated from $300K ($15K x 20 years) using corporate funds, equating to a 22% tax-equivalent IRR in year 20

Scenario 2: Corporate life insurance with CDA + charitable giving

1. Holdco buys a $2M life insurance policy on Abe and Sarah for $30K annually.
2. On the deaths of Abe & Sarah, Holdco will receive $2M in tax-free policy proceeds and will add $2M to its Capital Dividend Account (CDA).
3. Ben donates $2M in Holdco shares to a charity and receives a $2M tax receipt, which offsets his $1M tax liability. Holdco then redeems the shares from the charity using the proceeds from the $2M life insurance policy.

Ben now owns 100% of Holdco, with no remaining $1M tax liability.
+ Ben retains access to $2M worth of unused CDA for tax-free distribution.
+ The charity receives a $2M gift timed with Abe and Sarah's passing.

$5M of after-tax value has been generated from $600K ($30K x 20 years) using corporate funds, equating to a 36% tax-equivalent IRR in year 20.