Armstrong
Financial Services

Non-Correlated Legacy Planning Using GUL Life Insurance

Abe and Sarah, both aged 65, have frozen their shares in Holdco, valued at $3M. Upon their passing, these shares will be bequeathed to their Estate, triggering a $1M personal income tax liability. The challenge lies in mitigating this tax liability amid the uncertain timing of the transfer, high capital gains inclusion rates, and elevated tax rates on passive income.

Proposed Solution: Corporate Life Insurance with Capital Dividend Account (CDA)

To address this challenge, we propose that Holdco purchases a $1M joint last-to-die life insurance policy for Abe and Sarah. The details of this strategy are as follows:

1. Holdco purchases a $1M life insurance policy for an annual premium of $15K.
2. Upon the deaths of Abe and Sarah, Holdco will receive $1M in tax-free proceeds.
3. This $1 million will be added to Holdco's Capital Dividend Account (CDA).
4. The Estate will receive a $1 million tax-free dividend from Holdco via the CDA, which will be used to pay the personal income tax liability.

This approach generates $1M of after-tax value at life expectancy (age 88) from an annual investment of $15K, resulting in an 18% tax-equivalent Internal Rate of Return (IRR).

Key Advantages:

- **Liquidity:** Guaranteed funds free of timing risks related to life expectancy.
- **Performance:** Offers a high after-tax IRR free from market uncertainty.
- **Estate Hedge:** Protects against unwanted taxation of assets and asset liquidation.

Alternative: Passive Income Investment Strategy

An alternative approach is to invest $15K annually in passive income strategies with reinvestment of annual after-tax profits. To achieve $1M net to the Estate at year 23 (when Abe and Sarah are both 88), an annual return of 18% is required. This target is highly ambitious and uncertain. Even if an 18% annual return could be achieved, the strategy would face timing risk, exposing the estate to a significant shortfall up until year 23.

Conclusion

Given its guaranteed nature and protection from market and timing risks, the life insurance solution stands out as the optimal choice for securing Abe and Sarah's estate planning goals.

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GUL Life Policy Memorandum

Policy Information & Assumptions

Client Profile

Insureds: Male 65 Pref NS & Female 65 Pref NS
Quebec residents and Canadian citizens
Not residents or citizens of any other jurisdiction, not tax residents of the US
Have a nexus to the US through property or business ties
No intention of changing Canadian residency

Policy Profile

Joint survivorship (last-to-die) T100 type Guaranteed UL (GUL) policy
Issued by Prudential Life (See attached policy illustration)
Owner, payor, and beneficiary will be client-owned CCPC Holding Corp
Guaranteed Level face value $1M (USD), no lapse lifetime guarantee
Limited guaranteed premium schedule: 35 x $15,381 (USD)
Fixed, non-variable structure and accumulation fund, no risk of variance
De minimis cash value, dwindles to zero over a short time horizon

Policy Performance

The policy provides an 18% tax-equivalent IRR at life expectancy
Due to its fully guaranteed structure, the policy is free of any market correlation
Coverage remains level from the start, providing protection from timing risk
Safe estate hedge against forced asset liquidation for unwanted estate taxation
Exempt Policy according to Act s.s. 12.2(11) and Reg. 306 of the Regulations
Final pricing is subject to medical review & carrier underwriting

Guaranteed UL - Corporate Summary

Year	Age	Premium	Cash Value	Face Value	CDA Credit [1]	Net to Estate [2]
1	66/66	15,381	-	$1,000,000	$986,229	$994,722
2	67/67	15,381	-	1,000,000	973,258	989,750
3	68/68	15,381	-	1,000,000	960,924	985,022
4	69/69	15,381	-	1,000,000	949,258	980,551
5	70/70	15,381	-	1,000,000	938,310	976,354
6	71/71	15,381	5,972	1,000,000	928,138	972,455
7	72/72	15,381	12,791	1,000,000	918,823	968,885
8	73/73	15,381	18,868	1,000,000	910,455	965,677
9	74/74	15,381	24,668	1,000,000	903,130	962,870
10	75/75	15,381	29,414	1,000,000	896,939	960,497
11	76/76	15,381	33,494	1,000,000	891,992	958,601
12	77/77	15,381	36,052	1,000,000	888,403	957,225
13	78/78	15,381	37,363	1,000,000	886,293	956,416
14	79/79	15,381	36,404	1,000,000	885,793	956,224
15	80/80	15,381	33,210	1,000,000	887,022	956,696
16	81/81	15,381	26,449	1,000,000	890,116	957,881
17	82/82	15,381	15,929	1,000,000	894,480	959,554
18	83/83	15,381	119	1,000,000	900,142	961,724
19	84/84	15,381	-	1,000,000	907,128	964,402
20	85/85	15,381	-	1,000,000	915,443	967,589
21	86/86	15,381	-	1,000,000	925,091	971,287
22	87/87	15,381	-	1,000,000	936,056	975,490
23	**88/88**	**15,381**	**-**	**1,000,000**	**948,312**	**980,188**
24	89/89	15,381	-	1,000,000	961,816	985,364
25	90/90	15,381	-	1,000,000	976,507	990,995
26	91/91	15,381	-	1,000,000	992,302	997,049
27	92/92	15,381	-	1,000,000	1,000,000	1,000,000
28	93/93	15,381	-	1,000,000	1,000,000	1,000,000
29	94/94	15,381	-	1,000,000	1,000,000	1,000,000
30	95/95	15,381	-	1,000,000	1,000,000	1,000,000
31	96/96	15,381	-	1,000,000	1,000,000	1,000,000
32	97/97	15,381	-	1,000,000	1,000,000	1,000,000
33	98/98	15,381	-	1,000,000	1,000,000	1,000,000
34	99/99	15,381	-	1,000,000	1,000,000	1,000,000
35	100/100	15,381	-	1,000,000	1,000,000	1,000,000
36	101/101	-	-	1,000,000	1,000,000	1,000,000
37	102/102	-	-	1,000,000	1,000,000	1,000,000
38	103/103	-	-	1,000,000	1,000,000	1,000,000
39	104/104	-	-	1,000,000	1,000,000	1,000,000
40	105/105	-	-	1,000,000	1,000,000	1,000,000

Insureds: Male 65 Pref NS & Female 65 Pref NS
(1) Values shown in USD, actual annual CAD rates required
(2) Assumed dividend income tax rate: 38.33%

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Alternative: Corporate Interest Income @ 18%

Year	Age	Deposit	Income	Taxes	Total Fund	RDTOH	Net to Estate [1]
1	66/66	$15,381	$2,692	($1,350)	$16,722	$826	$10,822
2	67/67	15,381	5,618	(2,819)	34,903	2,549	23,096
3	68/68	15,381	8,800	(4,415)	54,669	5,247	36,950
4	69/69	15,381	12,259	(6,150)	76,158	9,007	52,521
5	70/70	15,381	16,019	(8,037)	99,522	13,920	69,960
6	71/71	15,381	20,108	(10,088)	124,922	20,087	89,428
7	72/72	15,381	24,553	(12,318)	152,538	27,618	111,102
8	73/73	15,381	29,386	(14,743)	182,562	36,631	135,176
9	74/74	15,381	34,640	(17,379)	215,204	47,255	161,858
10	75/75	15,381	40,352	(20,245)	250,693	59,631	191,377
11	76/76	15,381	46,563	(23,361)	289,276	73,912	223,978
12	77/77	15,381	53,315	(26,748)	331,224	90,263	259,931
13	78/78	15,381	60,656	(30,431)	376,830	108,866	299,529
14	79/79	15,381	68,637	(34,435)	426,413	129,917	343,089
15	80/80	15,381	77,314	(38,788)	480,319	153,630	390,956
16	81/81	15,381	86,748	(43,521)	538,926	180,235	443,507
17	82/82	15,381	97,004	(48,667)	602,644	209,986	501,149
18	83/83	15,381	108,154	(54,261)	671,919	243,157	564,327
19	84/84	15,381	120,277	(60,343)	747,234	280,046	633,524
20	85/85	15,381	133,458	(66,956)	829,117	320,978	709,263
21	86/86	15,381	147,787	(74,145)	918,140	366,304	792,117
22	87/87	15,381	163,366	(81,961)	1,014,927	416,408	882,704
23	**88/88**	**15,381**	**180,304**	**(90,458)**	**1,120,153**	**471,708**	**981,700**
24	89/89	15,381	198,718	(99,697)	1,234,556	532,654	1,089,838
25	90/90	15,381	218,739	(109,741)	1,358,934	599,742	1,207,915

(1) Assumed corporate income tax rate: 50.17%
(1) Assumed dividend income tax rate: 38.33%
For discussion purposes only, not tax advice

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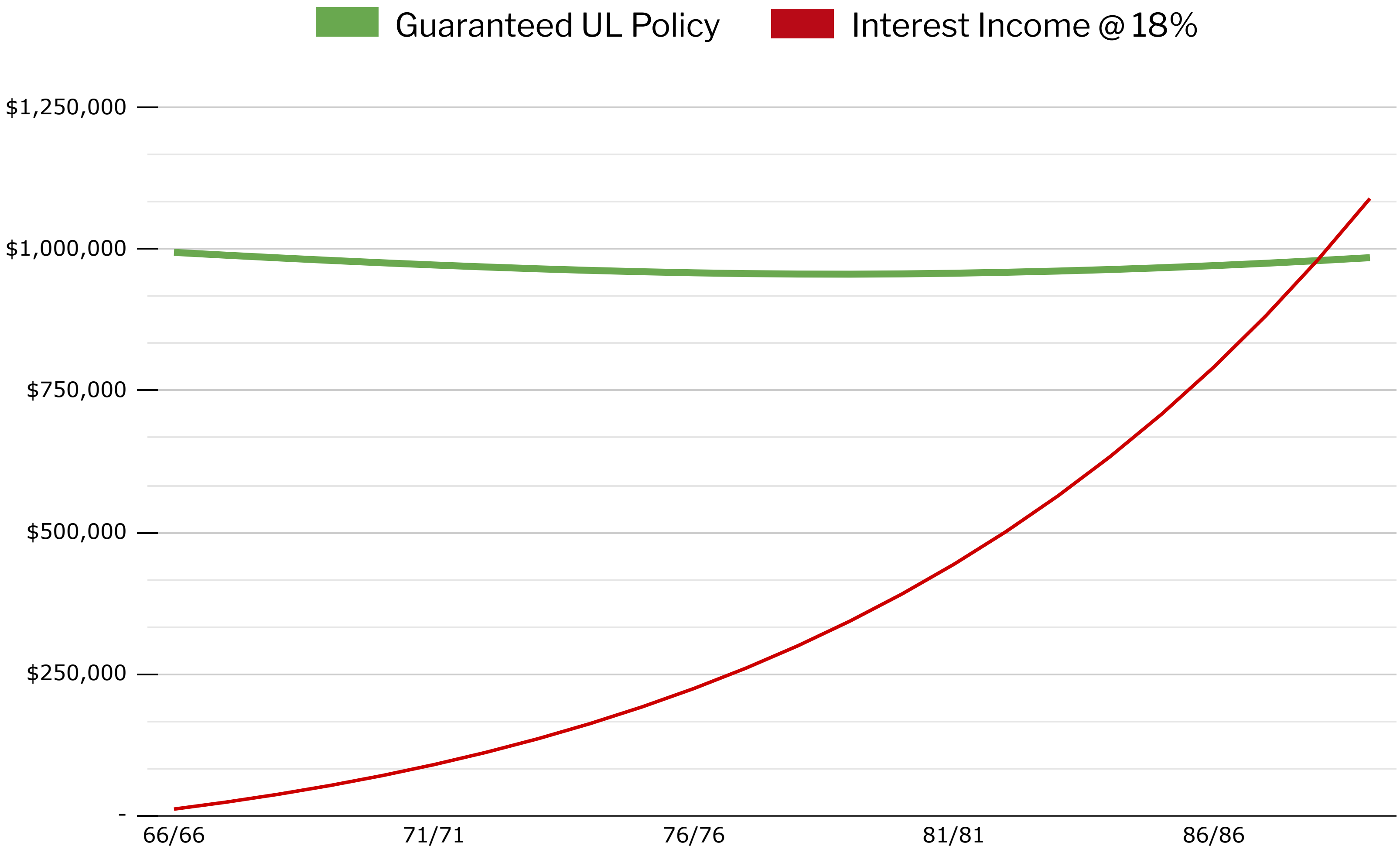
Guaranteed UL vs Interest Income @ 18%

Comparison of after-tax yield (net to estate) assuming input of: $15,381



Please see relevant policy data and interest income tables for value assumptions, for discussion purposes only. E&OE

Memo: Tax Status of Foreign Life Insurance Policies in Canada

An "exempt policy" under Canadian tax law refers to a life insurance policy meeting the criteria set out in section 306 of the Income Tax Regulations. Exempt policies are not subject to annual taxes on their internal earnings and are exempt from being considered taxable income upon the receipt of death benefits.

The preamble to Income Tax Regulation 306(1) indicates that a life insurance policy that is exempt from accrual taxation must, first and foremost, be a life insurance policy. This Regulation does not reference a "life insurance policy in Canada" as defined in subsection 138(12) of the Income Tax Act, with the result that a life insurance policy issued by a non-resident insurer on the life of a person resident in Canada can be an exempt policy under the Act. Notably, it is important to emphasize that the issuer of the policy does not have to be Canadian.

The following question was presented to Steven Szilagyi, Tax Policy Advisor for the Federal Department of Finance Canada at the 2019 CLHIA (Canadian Life and Health Insurance Association) Round Table:

> ***Will the CRA provide guidance as to how to apply the exempt test to policies that are not "life insurance policies in Canada"?***
>
> ***CRA Response****: A life insurance policy is essentially a contract between the policyholder and the life insurance company that issues the policy. While there may be types of policies that are issued in the same form to many policyholders, each policy issued by an insurer is conceivably different from every other policy issued by the insurer. An "exempt policy" for income tax purposes, is a life insurance policy that satisfies certain criteria, set out in section 306 of the Income Tax Regulations ("Regulations"). In general terms, a taxpayer who holds an interest in a life insurance policy that is an exempt policy is not subject to annual accrual taxation under section 12.2 of the Income Tax Act ("the Act") with respect to the income earned within the policy, and will not have an income inclusion under subsection 148(1) and paragraph 56(1)(j) of the Act, with respect to the proceeds received as a consequence of the death of the life insured under the policy.*

> *We acknowledge that the rules for determining whether any particular life insurance policy is an exempt policy under section 306 of the Regulations are themselves complex. The rules in section 306 of the Regulations apply on a policy-by-policy basis and require actuarial calculations and information that only the issuing insurer will possess. The tests in section 306 of the Regulations may be applied at any time but the tests are generally performed by the insurer that issued the policy on each policy anniversary date.*
>
> *A life insurance policy issued by a non-resident insurer is not specifically precluded from qualifying as an "exempt policy" and thus, such a policy could qualify provided the criteria in section 306 of the Regulations are satisfied. Given that the information to determine the exempt status of a particular life insurance policy is only available in the accounts of the insurer, the onus is on the policyholder to establish that the policy qualifies as an exempt policy. This would include supporting evidence that the life insurance policy satisfies the exempt policy tests in section 306 of the Regulations. The CRA's mandate is to administer the Act and does not include resolving issues between policyholders and their insurer about the terms and conditions of a particular life insurance policy.*

As can be seen from this response, a policy's exempt status is a question of fact, based on whether it meets the requirements of the Income Tax Act and Regulations. Evidence to support the exempt status of a policy is to be provided by the policyholder. Given the complexity of this calculation, I, as a Fellow of the Canadian Institute of Actuaries (FCIA) specializing in this field and qualified to perform these tests, am able to make that determination and generate the necessary documentation to validate the test results.

Respectfully Submitted,

Ryan Wall

Ryan Wall FCIA