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Whole Life vs. Universal Life — Selecting the Right Structure for Estate Funding

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Permanent life insurance is one of the most effective tools for funding estate taxes, uniquely capable of delivering tax-free liquidity at the exact moment a tax liability is crystallized. Although both Participating Whole Life and Universal Life provide lifelong protection, they are built on fundamentally different architectures: Participating Whole Life is closed and insurer-controlled, while Universal Life is transparent and client-controlled. For families and business owners planning around a defined future tax liability, Universal Life generally offers greater cost efficiency, flexibility, and transparency.

Participating Whole Life

Participating Whole Life (WL) is built around a fixed premium and a guaranteed base death benefit and is generally one of the more expensive ways to acquire permanent coverage. Value beyond this base is derived from a combination of contractually guaranteed policy values and non-guaranteed annual dividends generated within the insurer's Participating Account—a centrally managed portfolio over which the policyholder has no control [1, 2].

This account is predominantly allocated to interest-sensitive fixed income—government and corporate bonds, private fixed income, commercial mortgages, real estate, and a modest equity sleeve—with the investment strategy determined solely by the insurer [1, 2].

The Dividend "Black Box"

Dividend performance is not merely a reflection of the fund's investment results. It is determined by an internal, undisclosed formula that incorporates investment returns, mortality experience, expenses, lapse behaviour, taxes, and multi-year smoothing techniques [3, 5]. The commonly referenced Dividend Scale Interest Rate (DSIR), used to generate WL illustrations, is frequently misinterpreted. It is neither the dividend credited to the policy nor the return earned by the underlying assets; rather, it is only one component within a broader, non-guaranteed and non-disclosed formula [3].

Because dividends are largely discretionary, WL should always be stress-tested at reduced rates (–1% or –2% below current assumptions, typically 5.25% and 4.25% respectively) [4]. Even modest reductions can materially delay—or prevent—the policy from ever reaching its intended target death benefit [6].

The Structural Dilemma: GAP or BLOAT

Because WL depends on internally funded paid-up additions to increase the death benefit, when it is used to target a known liability, it is structurally inclined toward one of two outcomes:

1. **Under-Insuring Today (The GAP):**
   If the guaranteed base is set below the liability and dividends are expected to "catch up," the policy often remains under-target for much of its duration. Underperformance—even at conservative stress levels—may leave the estate short. Term riders are frequently layered to compensate, but these eventually expire and can become cost-prohibitive.

2. **Over-Insuring for Life (The BLOAT):**
   If the full liability is purchased upfront, dividends compound the death benefit beyond what is required. Clients end up funding unnecessary paid-up additions that often yield only 2–3% IRR at life expectancy—an inefficient use of capital relative to alternative business or investment uses.

Level Universal Life

Universal Life (UL) is designed from inception to deliver a level death benefit that matches the required liability from Day One. The insurance amount is set up front and remains fixed for life, ensuring the estate liability is fully covered at all times, rather than relying on future dividends or internal growth to "grow into" the required amount. UL provides the full amount at all times and applies policy gains to pay down insurance costs.

The objective in UL is not to maximize account value, but to match the liability at the lowest sustainable long-term cost. Investment gains are applied to offset future policy costs rather than inflate the death benefit, preserving a level face amount and avoiding the structural inefficiencies inherent in WL.

Policy gains accumulate within the tax-exempt UL account and may be applied toward policy costs in lieu of additional policyowner deposits. Clients may allocate among equity indices (S&P 500, TSX), institutional mandates (BlackRock, Fidelity), fixed income, or GIC accounts. Reallocations occur on a tax-free basis and do not trigger capital gains [7].

Whole Life–Style UL Funds (Smoothed Yield Accounts)

Many insurers offer smoothed-yield investment options within UL that resemble the investment profile of Whole Life participating funds. These accounts use multi-year smoothing to amortize gains and losses, reducing volatility while preserving stable long-term returns.

Unlike Whole Life dividends—which blend investment performance with non-investment factors such as mortality experience, expenses, and internal dividend formulas—smoothed UL funds isolate the pure investment component of the participating account. They operate within a more transparent funding framework that allows clients to combine them with equity indices or guaranteed-return accounts and adjust allocations over time.

One example is Sun Life's Diversified Account (SLDA), available exclusively within UL contracts. It mirrors the asset allocation, smoothing methodology, and institutional management of the Whole Life participating fund and is overseen by the same investment team. Features are:

- **Capital protection:** Contractual 0% floor—returns credited can never be negative [8].
- **Performance:** Long-term average returns near 4% with near-zero volatility [8].
- **Institutional asset mix:** Government and corporate bonds, private fixed income, commercial mortgages, real estate, and a modest equity allocation [8].
- **Flexible integration:** Can be blended with equity indices or guaranteed accounts to progressively reduce risk as the estate liability approaches [8].

Older or risk-averse clients may allocate 100% to SLDA for a low-volatility, capital-protected approach, while younger clients may adopt a blended allocation (e.g., 50% SLDA / 50% S&P 500) to capitalize on market opportunities in earlier years, and then progressively transition toward 100% SLDA to systematically remove volatility as the estate liability approaches.

Corporate Considerations: Net-to-Estate Analysis

For corporately held life insurance, the relevant metric is not the policy's face amount, but the **Net-to-Estate value** delivered after accounting for Adjusted Cost Basis (ACB), Capital Dividend Account (CDA) credits, and corporate share valuation at death. The CDA credit generated on death equals the death benefit minus the policy's ACB, while the policy's Cash Surrender Value (CSV) is included in the Fair Market Value (FMV) of the corporation's shares under subsection 70(5.3), which introduces an unintended capital gain on death [10].

Whole Life

When evaluated under this framework, Participating WL is structurally exposed to two adverse tax outcomes. First, its design tends to generate a higher ACB, directly reducing the portion of the death benefit that can be distributed tax-free through the CDA. Second, WL is intentionally structured to accumulate significant cash surrender value over time— approaching the death benefit at endowment—which increases corporate share value at death and can create an additional capital gains liability. As a result, the gross death benefit and the net amount ultimately received by the estate can diverge materially.

Universal Life

UL, by contrast, can be structured with greater tax precision. Under a Level + ACB design, the policy pays a death benefit equal to the required face amount **plus** the policy's ACB. Since the CDA credit equals death benefit **less** ACB, this structure guarantees that the full intended amount is always credited to the CDA, independent of the policy's cost basis. [9]. In addition, a properly structured level-face UL is designed to approach nil CSV at life expectancy, thereby mitigating the capital gains exposure associated with excess corporate cash value.

Conclusion

When evaluated under identical funding assumptions and through a corporate **Net-to-Estate** lens, UL consistently outperforms Participating WL for liability-driven estate planning. UL delivers the required death benefit at materially lower cost, with greater transparency, flexibility, tax efficiency, and long-term predictability.

Crucially, by separating insurance from investment performance, avoiding unnecessary cash accumulation, and aligning policy design directly with corporate tax mechanics, UL provides a more precise and economically efficient structure for funding known future tax liabilities. While Whole Life remains appropriate for certain objectives, where precision, predictability, and after-tax outcomes matter most, Universal Life offers the more effective planning architecture.

Methodology: Comparing Whole Life & Universal Life

A meaningful comparison between Whole Life and Universal Life requires a normalized, tax-adjusted Net-to-Estate analysis that evaluates each structure under identical funding assumptions and through the lens of after-tax estate value.

The following framework should be applied:

1. **Establish the Target Liability:** Define the required death benefit based on the estate's projected tax obligation at life expectancy.
2. **Solve for Universal Life First:** Using a conservative assumption rate, determine the premium required to fund a **level-face Universal Life policy** that fully covers the target death benefit from inception through life expectancy, and beyond.
3. **Apply the Same Premium to Whole Life:** Using the *same premium schedule*, solve for a Participating Whole Life policy under conservative dividend assumptions. This ensures the comparison isolates **structure**, not funding bias.
4. **Net-to-Estate Evaluation:** Evaluate both policies on a Net-to-Estate basis by:
    a. Distributing death benefits tax-free up to the Capital Dividend Account (CDA),
    b. Paying any excess as a taxable (eligible) dividend, and
    c. Reducing estate value by any capital gains tax arising from the policy's cash surrender value (CSV) at death pursuant to ITA subsection 70(5.3) [10].

The comparison should consider outcomes over the **entire policy horizon, from inception through life expectancy**. Relevant measures include total premiums and the net value ultimately received by the estate. Single-point illustrations or headline face amounts can materially misstate the true economic result.

Special Consideration: Financed Whole Life Strategies

If a Whole Life policy is presented as a part of a **financed strategy**, where premiums are borrowed, and interest is either serviced or capitalized, the analysis must be thoroughly stress-tested using **conservative assumptions**, including:

- Policy performance at the **current dividend scale minus 2%**,
- A **lifetime loan interest rate of at least 6%**,
- **No tax deductibility** of interest expense, recognizing that recent GAAR developments have materially undermined the reliability of assumed interest deductibility in insurance-based borrowing strategies.

Where tax credit deductions are illustrated, the presenter should confirm in writing that such treatment complies with current CRA guidance and GAAR for the duration of the strategy [11].

Source References

(1) "As of December 31, 2024, the Sun Life Participating Account was allocated 27.0 % to government bonds, 11.9 % to corporate bonds, 15.6 % to private fixed income, 8.7 % to commercial mortgages, 15.3 % to real estate, and 19.2 % to equities." *(Sun Life Participating Whole Life Insurance Facts & Figures, 2025 / https://cdn.armfs.com/memos/sources/810-3827.pdf)*

(2) "You don't choose the investments that make up the participating account. We invest the account to meet the long-term objectives and guarantees of participating policies." *(Sun Life Participating Whole Life Insurance Facts & Figures, 2025 / https://cdn.armfs.com/memos/sources/810-3827.pdf)*

(3) "The dividend scale interest rate is not guaranteed and is based on factors that are certain to change. The dividend scale interest rate is neither an estimate nor a guarantee of how the products will perform in future. Dividends take into account factors such as investment yield, mortality, expenses, taxes, and lapses." *(Sun Life Participating Whole Life Insurance Facts & Figures, 2025 / https://cdn.armfs.com/memos/sources/810-3827.pdf)*

(4) "To make the comparison as fair as possible, a dividend interest rate of 4.75 % is used. The 4.75 % represents what a dividend scale interest rate could ultimately be if the interest rate environment was the same as that described for the fixed income portfolio, and if real estate performs at historical levels while equities return an average of 8 %." *(Sun Life Financial - Life Insurance as an Asset Class, https://cdn.armfs.com/memos/sources/810-4764.pdf)*

(5) "We also employ smoothing techniques to help keep the dividend scale interest rate more stable over time. Smoothing refers to the process of amortizing various investment gains and losses over a number of years." *(Sun Life Participating Whole Life Insurance Facts & Figures, 2025 / https://cdn.armfs.com/memos/sources/810-3827.pdf)*

(6) "The Sun Life dividend scale interest rate has declined or remained unchanged in 29 of the past 34 years, representing a more than 40 % decrease from its 1991 peak." *(Sun Life Participating Account Historical Returns, 2025 / https://cdn.armfs.com/memos/sources/810-3599.pdf)*

(7) "SunUniversalLife II provides you with some control over how the assets within your life insurance policy are invested. You can choose to invest in guaranteed accounts, managed accounts—including portfolio and index-based—or the Sun Life Diversified Account (SLDA)." (*Sun Life UniversalLife II Client Guide, 2025 / https://cdn.armfs.com/memos/sources/810-4554.pdf)*

(8) "The Sun Life Diversified Account is managed by the same group of professionals that are responsible for the Sun Life participating account." "The diversified account is unique in that it offers Clients the investment philosophy and design of a participating account, but with the flexibility and transparency only offered by universal life insurance." "To help minimize the volatility of returns, we use a smoothed portfolio asset yield to set the interest rate. The process of smoothing involves amortizing gains and losses on assets within the portfolio over time." "Sun Life guarantees that the interest rate credited to your policy for the SLDA will never be negative." *(Sun Life Diversified Account, 2025 / https://cdn.armfs.com/memos/sources/810-4936.pdf)*

(9) "Level insurance amount plus adjusted cost basis (ACB): The death benefit will always be equal to the basic insurance amount plus the policy's adjusted cost basis. This option is designed for business owners who want to optimize credits to the corporation's capital dividend account." (Sun Life UniversalLife II Client Guide, 2025 / *https://cdn.armfs.com/memos/sources/810-4554.pdf*)

(10) "The Income Tax Act (ITA) provides in subsection 70(5.3) that in the event of the death of a shareholder of a corporation, only the cash surrender value (CSV) of any insurance policy on the shareholder's life needs to be considered for purposes of determining the fair market value (FMV) of the deceased's shares in order to calculate the capital gain or loss on the shares. This means that even if the FMV of the life insurance policy was very high immediately before the insured's death (because, for example, he or she had a terminal illness), only the CSV of the policy would be taken into account for the valuation of shares. In some cases the difference between a policy's CSV (which is nil in the case of term insurance) and its FMV can be quite substantial. Nonetheless, there are certain factors to keep in mind when it comes to this provision of the ITA." *(Fair Market Value of Corporate Shares and Life Insurance, 2020 / https://cdn.armfs.com/memos/sources/810-7053.pdf)*

(11) "The tax treatment applicable to loans, interest deductibility and life insurance policies may change over time without any grandfathering provisions." "In addition, the CRA could decide to invoke the GAAR in section 245 of the ITA." "The concern is that, in circumstances where it determines that it is appropriate to do so, the CRA could use the GAAR to characterize a collateral loan as a policy loan. Any money received from a policy loan is tax-free to the extent the borrowed funds do not exceed the policy's ACB, and taxable to the extent they do." *(Leveraging a Life Insurance Policy, 2024 / https://cdn.armfs.com/memos/sources/810-2876.pdf)*