THINK OF INSURANCE AS INVESTMENT

A 'Joint Last to Die' policy can offer a better return for your money

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FINANCIAL POST

Life insurance. After just those two words I can sense your attention starting to waver.

But if you are a high-net-worth Canadian who cares about your investment returns and paying less in taxes, you should pay attention to life insurance. In this context, "high net worth" is someone who will very likely be leaving an estate of at least $2 million, as well as anyone who has $500,000 or more in a holding company.

My tax and insurance partner at TriDelta, Asher Tward, helped to develop three strategies that can meaningfully help you:

1 Pulling money out of corporations tax-free

This example uses a 70-year-old couple who have a holding company. The strategy here is to have the company purchase a "Joint Last to Die" policy on the couple.

Unlike term insurance, which may never pay out, permanent insurance will definitely have a payout and can therefore be looked at as an investment.

The question is, is it a better investment than stocks or real estate?

To begin with, the insurance will pay out the same amount if someone dies in five years as if he or she dies in 15 or 25 years.

Going back to our couple, at 15 years, the pre-tax equivalent rate of return would be 20.1 per cent on the insurance.

This means that if there was an insurance payout in 15 years, the corporation's investments would have had to earn 20.1 per cent a year to equal the after-tax amount from the insurance payout. Even if one member of the couple lives to age 100, the insurance rate of return would be equivalent to 5.6 per cent on a pre-tax basis. (This assumes the alternative was capital gains investments in the corporation being taxed at a top rate of 25 per cent.)

This is better than many investment returns, even if someone lives long past life expectancy. Furthermore, unlike these investments, which will all be taxed inside the corporation and will also be taxed (likely) as ineligible dividends if withdrawn from the corporation, life insurance can help to eliminate most of this tax.

One caveat: There are some tax changes coming in 2017 that will make this strategy a bit weaker; if put in place in 2015 or 2016, though, you can take advantage of the current rules.

2 TFSA on steroids

Here is the strategy: A Universal Life Insurance policy allows you to add additional investments into funds (stock, bond, global, domestic, etc.), with the advantage that these investments are tax sheltered if they are held within a life insurance policy.

The amount you can hold depends on a number of factors, but can allow for hundreds of thousands of tax sheltered investments. While there can be some small drawbacks to investing in an insurance policy, for those holding significant non-registered assets, the tax shelter can meaningfully overcome any drawbacks.

The challenge is getting the funds out in a tax efficient way.

The key is that you can set up a joint policy with multiple people — say, you, your spouse and your parents. In some cases, if any one of the people has an "insurable event," it allows you to withdraw the accumulated investments funds with no tax implications. So, just like a TFSA, there was tax sheltered growth and no tax to withdraw funds.

These significant amounts will be somewhat reduced effective 2017 on new insurance policies, but not on those taken out before 2017.

3 Guarantee a part of your estate

This strategy is for those who will likely leave an estate (including real estate) of $2 million-plus. The idea is to take a small portion of that $2 million and guarantee it, while providing a decent rate of return.

Guaranteed returns these days hover around two per cent, so an ability to guarantee a much higher return on money targeted for your estate is a good thing. In addition, insurance money bypasses any probate fees that might be found in some provinces.

The strategy example uses a 65-year-old couple — with a likely estate value in the range of $4 million — who take out a $1 million "Joint Last to Die" policy that would be fully paid in 20 years.

This would require a shift of $27,000 a year from the investment portfolio (much of which is going to the estate anyway) to insurance that is definitely going to be paid out at death.

The key to this approach is that you can be certain that $1 million is being left to your family (or charity), and while the remaining estate may fluctuate up or down depending on markets, this is a certainty, and one that delivers a pretty good rate of return in most cases.

Life insurance may have been something you thought you no longer needed as a high-net-worth individual, but when you look at the tax and investment benefits, it might just become a new financial friend.

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Asher Tward, vice-president of estate planning at TriDelta, has compiled three money strategies that "high net worth" Canadians will find useful. BRENT FOSTER/NATIONAL POST