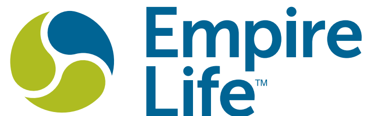
CORPORATE LEGACY BUILDER

Creating tax-free payout to shareholders using your company's surplus profits



Corporate Legacy Builder is a strategy that enables business owners to grow passive assets and/or surplus profits on a tax-deferred basis. This alternative to a company's taxable investments is designed to provide a business with a higher tax-free value of the business for the estate or surviving shareholders. It permits a business to benefit from a tax-deferred program with no increased risk, while still permitting access to cash for business needs. One objective of the Corporate Legacy Builder strategy may be to reduce ultimate capital gains realized upon the death of a shareholder

Under current tax laws, when an insured business owner dies, the company receives the proceeds of the policy tax-free and also receives a credit to its capital dividend account for the proceeds minus the adjusted cost basis of the policy. Capital dividends can be paid out to shareholders tax-free.

The Challenge

Operating companies, holding companies and management companies often contain cash and investment assets that are not used in active businesses. These assets, locked within the corporation, can usually only be paid out to the individual shareholders as taxable distributions unless there is a capital dividend account available with a credit balance. There appears to be no effective way of getting retained earnings out of a corporation to shareholders on a tax-free basis.

Frequently, retained earnings or surplus cash is invested in GICs or other short-term investments. These vehicles provide guarantees and easy access to cash in exchange for lower rates of return. While active business income may be taxed at the small business rate, invested retained earnings and surplus are treated as passive income and are taxed at the top marginal tax rates.

The business owner may wish to leave something to a church, favourite cause, school, community, etc. but also wants to leave something to children or grandchildren. The feel that they don't have the kind of money to do both.

How does it work?

Holding Companies are often set up to protect retained earnings of the operating company from potential liabilities. Excess funds are transferred from the operating company to the holding company to maintain the small business status of the operating company and allow it to remain eligible for lower tax rates.

The strategy re-allocates or invests a portion of retained earnings (passive assets) into a universal life contract as quickly as possible. These transfers of tax-exposed monies take advantage of tax-sheltered growth inside a universal life contract.

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The strategy capitalizes on the tax-free payout on death and minimizes Capital Gains tax. It also takes advantage of the Corporate Capital Dividend Account to pay tax-free capital dividends to shareholders. This is in contrast to the personal tax rates that apply when regular dividends are taken by shareholders.

Benefits

Business owners benefit from the ability to shelter growth on corporate invested assets from tax during their lifetime.

They are able to access cash for emergencies. The strategy provides liquid dollars for business needs such as key person, debts, and buy-sell agreements. They can also use the tax-free proceeds at death to replace assets donated to charity or leave a legacy for heirs and favourite causes.

Owners can use retained earnings sitting within a specially designed universal life policy to buy back shares. They can borrow or withdraw directly from the policy. Alternatively, they can use policy values as collateral when applying for a bank loan to fund a share repurchase.

The strategy provides an effective mechanism to remove funds from a holding company and can optimize the estate value at death by reducing capital gains exposure.

One objective of this strategy may be to reduce ultimate capital gains realized upon the death of a shareholder. This is accomplished by converting corporate assets into life insurance with a minimal cash surrender value (optimize the death benefit).

The Fair Market Value of corporate shares immediately prior to death only reflects the cash surrender value of corporate owned life insurance immediately prior to death (as described in Subsection 70(5.3) of the *Income Tax Act* (Canada)). In this particular application of the strategy, that value will be very small at life expectancy and perhaps throughout the life of the contract.

Business owners benefit from the ability to shelter growth from tax on corporate invested assets during their lifetime.

Who is it for?

This strategy is best suited for client ages 50+ who own corporations with large retained earnings which sit in holding companies, investment or management companies or can be moved to companies from an operating company. A demonstrated need can be established for insurance coverage to provide liquid dollars for key persons, funding buy sell agreements, covering collateral arrangements and bank loans and/or capital gains liabilities.

STEPUP

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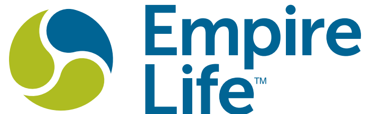

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