

IMMEDIATE FINANCING ARRANGEMENT

Protect your estate without
foregoing business or
investment opportunities

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Contents

01

Immediate Financing Arrangement

02

The challenge
How it works

03

The benefits
Who it's for

04

Case study

Immediate Financing Arrangement

The Immediate Financing Arrangement is a financial strategy that provides an opportunity for individuals and incorporated business owners to obtain the permanent life insurance coverage they need while still preserving cash for investment or business opportunities.

The strategy uses the cash surrender value of a participating life insurance policy, and in some cases additional assets as required by the lender, as collateral for a loan or line of credit from a third party lending institution. As the cash surrender value of the policy increases, loans are taken from the third party lending institution. The loan proceeds are used to invest in a business or other income producing investment and the interest expense may be tax deductible. In addition to the interest expense, some or all of the policy premiums may also be deductible when the policy is used to secure a collateral loan. The outstanding loan balance is paid from the death benefit payable under the insurance policy when the life insured dies.

For incorporated business owners, the corporation is the owner and beneficiary under the insurance policy. Under current tax laws, when the insured business owner dies, the company receives the proceeds of the policy tax-free and also receives a credit to its capital dividend account (CDA) for the proceeds minus the adjusted cost basis of the policy. Capital dividends may then be paid out to shareholders tax-free by following set protocols as laid out by the Income Tax Act (Canada).





The challenge

- Permanent life insurance needs can put stress on cash flows for both individuals and incorporated business owners
- Business owners may require the funds they would otherwise use for permanent life insurance for maintaining business operations, growing their business or other investment opportunities
- Similarly, individuals may elect to put their money towards investment opportunities instead of permanent life insurance



How it works

1. The corporation purchases a permanent participating life insurance policy on the life of the business owner that creates significant cash surrender value in the early years of the policy. The corporation is the owner and beneficiary of the policy
2. The policy is then assigned to a lending institution as collateral to secure a line of credit taken out by the corporation
3. The corporation pays the recurring policy premiums and the interest on the loan, monthly or annually. Other options include capitalizing the interest payments
4. The corporation borrows up to 100% of the policy cash surrender value (assuming a participating whole life insurance policy), or may borrow an amount up to the entire annual policy premium that has been paid by providing additional collateral security
5. The corporation uses the line of credit for investment purposes, for example, to fund an operating business, purchase real estate or invest in other income producing assets
6. Steps 3 to 5 are repeated annually
7. When the life insured passes away, the outstanding loan is repaid, directly to the lender, out of the policy death benefit and the remaining proceeds are paid to the corporation. The total death benefit proceeds are paid out tax free. The corporation's Capital Dividend Account will receive a credit for the full death benefit minus the adjusted cost basis of the policy

Please Note: The basic Immediate Financing Arrangement concept assumes the borrower has sufficient income to pay the insurance premiums and meet the loan obligations and qualifies to write off interest payments and take advantage of the collateral premium deduction for income tax purposes. The loan interest rate charged by the third party lender for the loan may be greater than the interest rate assumed in this document . Loan interest rates are not guaranteed and are subject to change by the lender. The cash surrender values for the life insurance product illustration are independent of the loan rate charged by the lender. Total cash surrender values are not guaranteed. The third party lender may reserve the right to demand payment of the loan in full at any time in accordance with the terms and conditions for the loan prior to the time the illustration assumes it will be paid. The life insurance illustrated in this sales concept presentation, is a participating whole life insurance policy that will not expire during the lifetime of the life insured as long as the premiums are paid and the policy remains in force. If the loan amount exceeds the cash surrender value of the policy or the cash surrender value of the policy plus the collateral that was pledged to acquire the loan, the lender may require additional collateral be pledged or, the lender may demand repayment of all or part of the outstanding loan balance. Lender may demand repayment of all or part of the outstanding loan balance.



The benefits

- Business owners will benefit from the ability to shelter growth on corporate invested assets from tax, inside the life insurance policy, during their lifetime. Although owners can use the retained earnings sitting within a participating life insurance policy as they see fit, the Immediate Financing Arrangement strategy allows a corporately owned participating life insurance policy to be used as collateral for a tax-free loan that enables the corporation to re-invest into its business or other income producing investment
- If a corporate loan is being used to earn income from a business or other investment, the interest on the tax-free loan may be tax deductible to the corporation. Additionally, a portion of the life insurance policy's premiums may also be tax deductible when the lender requires the life insurance for a collateral loan
- The strategy will also provide liquidity for corporate life insurance needs, such as coverage for a key person, debts or to fund buy-sell agreements or dividend payments to shareholders. Death benefit proceeds can also be used to help fund tax liabilities, estate equalization or to leave a legacy to heirs or favourite charities
- The death benefit in excess of the policy's adjusted cost basis will create a credit to the corporation's Capital Dividend Account. Capital dividends may then be paid out to shareholders tax-free



Who it's for

This strategy is best suited for healthy, financially stable clients who are 35 to 65 years of age. This may be appropriate for individuals as well as for business owners. The client will often be a shareholder of a successful business and will have a need for permanent life insurance. The client's corporation will often generate a significant annual surplus or have large retained earnings sitting in taxable investments. Examples of life insurance needs for the corporation and its business owner include key person, funding a buy-sell agreement, funding capital gains liabilities and the permanent needs of the shareholder which could be the desire to leave a tax-efficient legacy to heirs or favourite charities. The client will also want access to funds to help grow their business or invest in other income producing assets.





Meet Jack

Jack is the owner of a successful, incorporated, family operated business. Although Jack is married with 2 children, only one of the children has shown a desire to continue the family business. Jack has built the business from the ground up and after meeting with his accountant, Jack understands he has significant permanent life insurance needs. Along with the life insurance needs, Jack also has a desire to re-invest into his business. Understanding his situation will require some financial planning, Jack decided to meet with his financial advisor.



Jack

60 year old healthy male non-smoker

The company

Jack is the only shareholder of his Canadian Controlled Private Corporation.

The family

Jack is married with two adult children. Only one child is active in the business and has shown a desire to continue the family business.



Objectives

- Provide funds upon Jack's death in the most efficient and economical way to cover estate equalization issues as well as future capital gains liabilities
- Have immediate access to cash to be able to re-invest into his business

The Potential Problem

Jack's current, corporately owned passive investments (about \$1M of GICs) are being heavily taxed. Jack has longer term concerns that the passive income may impact his small business tax rate if monies are invested where they could potentially earn a higher rate of return. Then there are the investment risks associated with doing that. There are potential capital gains liabilities and estate equalization issues that will need to be settled upon Jack's death. Jack's business requires some upgrades and reinvesting funds into his business is a priority. Accessing existing funds in his corporation for reinvestment into his business will leave little funding available for Jack's longer term needs which may be permanent. Leaving the funds for the future leaves Jack with a shortfall of necessary cash required to reinvest into his business in the interim.

Finding a Solution

After meeting with Jack, his advisor considers possible solutions to ensure funding is available upon Jack's death in the most efficient and economical way to cover his long term needs without depleting existing cash surpluses in the corporation needed for reinvestment purposes today.

The Strategy

- The immediate financing arrangement strategy enables Jack to grow passive assets in the policy from corporate surplus on a tax deferred basis
- Creates sufficient permanent life insurance coverage for funding needs upon Jack's death
- Provides a tax-efficient strategy to access the funds required for reinvestment into the business

The Opportunity

Using assets from within the corporation to fund a permanent life insurance policy that has a growing cash value component provides a viable opportunity to:

- Provide tax-sheltering on the corporation's surplus retained earnings
- Convert corporate assets into tax free benefits paid directly to the corporation. Dividends can be paid to Jack's estate, tax free
- Enable tax-efficient funding required for reinvestment purposes



How it works

- Re-allocate a portion of retained earnings from corporate surpluses into a life insurance contract owned by the corporation
- Take advantage of tax-sheltered growth inside a customized life insurance policy
- Provides tax-efficient collateral for a bank loan that can be used to help grow the business
- The corporation makes monthly or annual interest payments with the loan balance repayment deferred until Jack's death
- Interest and a portion of premiums may be tax deductible to Jack's corporation
- By making the corporation the beneficiary, the death benefit proceeds will be used to repay the loan with the remainder being paid to Jack's corporation tax-free
- The Capital Dividend Account is credited with the total death benefit in excess of the policy's adjusted cost basis, not simply the excess death benefit minus the loan amount. The net value in the Capital Dividend Account may be used to distribute other trapped surplus tax-free over and above the net life insurance proceeds paid out as a death benefit

Capital Dividend Account (CDA)

- It is a notional tax account available only to Canadian Controlled Private Corporations
- The Capital Dividend Account is comprised of tax-free amounts received by corporations including:
 - Tax-free portion of capital gains
 - Capital distributions from trusts
 - Net death benefit proceeds of life insurance policies (excess of death benefits over policy's adjusted cost basis)
 - Capital dividends received from other corporations
- Amounts credited to the Capital Dividend Account may be paid out as capital dividends tax-free to Canadian resident shareholders
- Amount credited to the Capital Dividend Account from life proceeds adjusted by the Adjusted Cost Basis (ACB) of the life insurance policy
- $CDA\ credit = \text{life insurance policy death benefit} - ACB$



The Recommendation

Jack's advisor recommends a customized Optimax Wealth 8 pay participating life insurance policy from Empire Life with the enhanced dividend option.

Policy structure: **Single Life, Male, Age 60, Non Smoker**

Initial coverage amount: **\$1,770,392**

Annual premium: **\$125,000 payable for 8 years**

The guaranteed 8 pay payment structure was used to enhance corporate assets while satisfying lender financing requirements. Jack also liked that the policy would be paid off around the time he plans to retire. Optimax Wealth was used to provide higher early cash values and reduce the additional collateral requirement. The enhanced dividend option was utilized to maximize the guaranteed death benefit to ensure the funds required upon the death of Jack are there when needed. Should there be sufficient exempt room in the policy, Jack also liked the idea of potentially making additional deposits (ADO) into the contract beyond the 8 year guaranteed payment requirement.

Age	Year	Net Death Benefit credit to the CDA
60	1	\$1,648,662.78
65	5	\$1,173,765.20
70	10	\$849,003.38
75	15	\$929,830.77
80	20	\$1,306,647.85
85	25	\$1,789,506.11
90	30	\$2,392,647.57
95	35	\$3,112,565.07

Using Empire Life's sales concept software, Jack's advisor was able to create an Immediate Financing Arrangement sales presentation to help explain and highlight the advantages and risks of the strategy. Here is an overview of the assumptions used in creating the Immediate Financing Arrangement sales presentation: Important Information; This chart is for illustrative purposes only and is not a contract or offer of insurance. The current dividend scale is used for illustration purposes only and is not guaranteed. The tax treatment used in this document is based on the current Canadian Federal Income Tax Act and its regulations. Changes to the Act or its regulations could affect the amounts shown in document. The amounts shown in this sales concept presentation are based in part on dividends which are not guaranteed and on the assumptions indicated. Actual values may be more or less than those shown depending on actual experience.



Strategy assumptions

Insureds

Life insured: Jack,
Male, age 60, non-smoker

Product

Name \$1,770,392 Optimax Wealth,
Single Life
Annual Premiums (8 years)
Beneficiary..... Corporation
Dividend Option..... Enhanced
Insurance Premium..... \$125,000

Other Details

Allow for additional collateral Yes
Corporate tax rate..... 50.50%
Percentage of CSV borrowed 90.00%
Pay loan interest..... Yes
Annualized bank loan rate..... 5.00%

Policy year	Participating Life Insurance Plan			Bank Loan				
	Annual Premium	Total Cash Surrender Value	Total Coverage Amount	Loan to CSV %	Annual Loan Advance	Loan Interest Repayment	Outstanding Loan Balance	Additional Collateral Required
5	\$125,000	\$444,840	\$1,770,392	140.50%	\$125,000	\$31,250	\$625,000	\$224,644
10	0	\$972,682	\$1,770,392	102.81%	0	\$50,000	\$1,000,000	\$124,587
15	0	\$1,244,721	\$1,772,456	80.34%	0	\$50,000	\$1,000,000	0
20	0	\$1,571,035	\$2,028,070	63.65%	0	\$50,000	\$1,000,000	0
25	0	\$1,954,341	\$2,333,606	51.17%	0	\$50,000	\$1,000,000	0
30	0	\$2,398,802	\$2,695,143	41.69%	0	\$50,000	\$1,000,000	0
35	0	\$2,916,234	\$3,114,445	34.29%	0	\$50,000	\$1,000,000	0
40	0	\$3,636,096	\$3,560,430	27.50%	0	\$50,000	\$1,000,000	0

Policy year	Net Values & Capital Dividend Account Credit			
	Annual Net Cash Flow	Net Death Benefit	CDA Credit	Corporate Death Benefit IRR
5	\$125,000	\$1,145,392	\$1,173,765	177.31%
10	0	\$770,392	\$849,003	37.34%
15	0	\$772,456	\$929,831	15.16%
20	0	\$1,028,070	\$1,306,648	10.00%
25	0	\$1,333,606	\$1,789,506	7.67%
30	0	\$1,695,143	\$2,392,648	6.41%
35	0	\$2,114,445	\$3,112,565	5.64%
40	0	\$2,560,430	\$3,560,430	5.06%

Values shown are at end of policy year and are for illustrative purposes only. Any non-guaranteed portion of the Total Cash Surrender Value and Total Coverage Amount depends on the annual dividends that are declared on the policy, which are not guaranteed, and values shown assume dividends are declared each year using Empire Life's current dividend scale.



Jack's advisor uses Empire Life's online "Fast & Full" eApplication sales process to complete the application for life insurance from his office while Jack is in the comfort of his own home. Empire Life's Non Face-to-Face limit for life applications is now \$10,000,000.

After the application is instantly received at Empire Life's head office, the application undergoes VIP processing, as it is considered a large case, including:

- A welcome email to advisor and distribution partner on receipt of the application in underwriting
- Direct contact with your underwriter is available throughout the underwriting process
- Priority processing of your file and prompt updates on any developments or decision
- A doctors report (APS), if required, will be ordered and followed on a priority basis
- We will shop for best offer
- You will be contacted on final policy decision (standard, rated or declined)
- Before any close out, we will contact advisor for any possible need for extension

After the policy is issued, Jack receives his policy contract electronically using Empire Life's eContract delivery process.

Empire's online eApplication sales process "Fast & Full" offering a Non Face-to-Face sales process and eContract delivery is a real time saver for the Advisor, saving all those trips to Jack's office and home to complete the application and deliver the policy contract. Jack was very impressed with the online sale capabilities and contract delivery. It makes doing business with Empire Life Simple, Fast & Easy for Advisors and Clients alike!

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The Empire Life Insurance Company

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The Empire Life Insurance Company (Empire Life) is a proud Canadian company that has been in business since 1923. We offer individual and group life and health insurance, investment and retirement products, including mutual funds through our wholly-owned subsidiary Empire Life Investments Inc.

Empire Life is among the top 10 life insurance companies in Canada¹ and is rated A (Excellent) by A.M. Best Company². Our mission is to make it simple, fast and easy for Canadians to get the investment, insurance and group benefits coverage they need to build wealth, generate income, and achieve financial security.

Follow Empire Life on Twitter @EmpireLife or visit our website, www.empire.ca for more information.

¹ Based on total assets as reported in December 31, 2019 OSFI filings

² As at June 24, 2020. For the latest rating, access www.ambest.com.

The information in this document is for general information purposes only and is not to be construed as providing legal, tax, financial or professional advice. The Empire Life Insurance Company assumes no responsibility for any reliance made on or misuse or omissions of the information contained in this document. Please seek professional advice before making any decision.

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**For more information on whether this strategy is right for you,
contact your financial advisor or visit empire.ca.**

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