CORPORATE LEGACY BUILDER

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

FOR ADVISOR USE ONLY

Insurance & Investments
Simple. Fast. Easy.®

Empire Life®

Contents

Corporate Legacy Builder

Corporate Legacy Builder is a strategy that enables business owners to grow passive assets and/or surplus profits within a life insurance policy 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 tax liability realized upon the death of a shareholder. Another objective may be to safeguard the small business deduction against clawbacks due to high, passive income earnings.

Under current tax laws, when an insured business owner dies, the company receives the proceeds of the life insurance policy tax-free and also receives a credit to its capital dividend account for the proceeds minus the adjusted cost basis of the policy. Credits in the company's notional capital dividend account can be paid out to Canadian resident 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 high tax rates. High amounts of passive income could also create increased taxes on a small business's active income after the 2018 tax changes by reducing access to the small business deduction.

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

How it works

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 permanent life insurance policy contract as quickly as possible. These transfers of tax-exposed monies take advantage of tax-sheltered growth inside a permanent life insurance contract.

Retained earnings and their growth, 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.

The strategy capitalizes on the tax-free payout of life insurance proceeds on the death of the person insured. It also takes advantage of the Corporate Capital Dividend Account to pay tax-free capital dividends to Canadian resident shareholders. This is in contrast to the personal tax rates that apply when regular dividends are taken by shareholders.

This strategy typically appeals to client ages 50+

The 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 triggered on the death of a shareholder or key person, as well as paying down debts, and funding 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 the cash values or equity sitting within a permanent participating life insurance policy to buy back shares. They can borrow or withdraw accumulated dividends directly from the policy. Alternatively, they can use policy values as collateral when applying for a bank loan to fund a share repurchase or funding a business initiative.

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

Who it's for

This strategy typically appeals to clients 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 on the death of shareholders or key persons, funding buy sell agreements, covering collateral arrangements and bank loans and/or capital gains liabilities.

Meet John & Jane Smith

John owns a manufacturing company and Jane has her own career. The company has been in John's family for three generations and John wants to pass the company on to his son Paul. John realizes that passing the company on to Paul will require some financial planning so John and Jane met with their financial advisor.

John Smith
51 year old Male
non-smoker
healthy, active lifestyle

Paul Smith
26 year old Male
non-smoker
healthy, active lifestyle

The company:
The company is incorporated. John is the only shareholder

Their family:
They have an eldest son Paul who is actively involved in the management of the company.

Objectives

- Keep the company in the family
- Pass ownership of the company to Paul when John passes away
- Ensure the company is financially solvent when Paul takes over ownership

The Potential Problem

There may be significant income taxes payable on the capital gains generated on the death of John. The family wants to find the most efficient and economical way to pay the income taxes due on John's passing, and without Jane becoming involved in the business as an owner, so that ownership of the company can go directly to Paul.

Finding a Solution

After meeting with John & Jane, their Advisor considers possible solutions to ensure a smooth transition of ownership for the company from John to their son Paul. The Advisor decides to recommend the Corporate Legacy Builder strategy from Empire Life for the following reasons:

The Strategy

- Enables John to grow passive assets from corporate surplus on a tax deferred basis
- Creates a higher after-tax value of the company for the estate and their heir Paul
- Provides access to cash values during their lifetime for business needs

The Opportunity

- Using assets from within the corporation to fund a life insurance policy provides a viable opportunity to:
  - Convert assets to tax-free corporate estate benefits
  - Provide tax-sheltering on surplus retained earnings
  - Reduce exposure to potential reductions in access to the small business deduction
  - Creates a versatile and flexible tax favoured asset class

How it works:

- Re-allocates a portion of retained earnings from passive assets into a life insurance contract
- Takes advantage of tax-sheltered growth inside a specially designed life insurance policy
- Provides a tax-free payout to the corporation on the death of the life insureds
- Takes advantage of the Capital Dividend Account for reduced taxation to Canadian resident shareholders
- Enhances the value to their heir Paul

Capital Dividend Account (CDA):

- It is a notional tax account available only to Canadian-Controlled Private Corporations (CCPC)
- It is comprised of tax-free amounts received by corporations including:
  - Tax-free portion of capital gains
  - Capital distributions from trusts
  - Death benefit proceeds of life insurance policies
  - Capital dividends received from other corporations
- Amounts credited to the Capital Dividend Account can be paid out as capital dividends tax-free to Canadian resident shareholders
- Amount credited to the Capital Dividend Account from life insurance proceeds reduced by the Adjusted Cost Basis (ACB) of the life insurance policy
- CDA credit = life insurance policy death benefit – ACB

The Recommendation:

John’s company has a combination of unallocated retained earnings and a healthy surplus cash flow. He and Jane feel that they do not need this money to support their own lifestyles. They agree that the company should try to fund a solution as quickly as possible while the company is in such good shape financially. They value guarantees in any recommendation. They would also like to see what would happen if they invested surplus monies into an alternate, conservative investment.

John & Jane’s Advisor recommends an EstateMax 8 Pay permanent participating life insurance policy from Empire Life with the Enhanced Coverage dividend option. This dividend option uses the annual policy dividend to provide the largest coverage amount for the policy premium in the early policy years.

Policy Structure: **Single Life, Male, Age 51, Non Smoker**

Initial Coverage amount: **$3,600,000**

Annual Premium: **$202,072 payable for only 8 years**

In addition to the Guaranteed Level premiums payable for only 8 years, EstateMax 8 Pay offers affordable permanent life insurance protection through the Enhanced Coverage dividend option. The following table shows the credit to the company’s capital dividend account, from which an election can be made to pay out this money tax-free to Canadian resident shareholders.

Age	Years	Empire Life WL — single life male — $187,500/yr for 8 yrs. Credit to the CDA
52	1	$3,401,126.74
56	5	$2,615,983.53
61	10	$2,059,180.47
66	15	$2,143,430.96
71	20	$2,658,537.64
76	25	$3,548,826.87
81	30	$4,682,353.07
86	35	$6,118,729.36
91	40	$7,482,393.11

Illustrated figures as of August 2021

CASE STUDY

Using Empire Life's sales illustration and strategy software, John and Jane's Advisor was able to create a Corporate Legacy Builder sales presentation to help explain and highlight the advantages of the Corporate Legacy Builder strategy over investing the funds in an alternate investment.

Here is an overview of the assumptions used in creating the Corporate Legacy Builder sales presentation:

Concept assumptions

Insureds

Life Insured: .... John Smith,
Male, Age 51, Non-Smoker

Product

Name .... $3,600,000 EstateMax,
Single Life
Annual Premiums (8 years)

Alternative Investment

Growth Breakdown .... 100% Interest
Effective Tax Rate On Interest 50.00%
Projected Annual Growth Rate 3.000%

Policy year	After-Tax Benefit		Comparison		Equivalent Pre-Tax Return (%)
	Insurance After-Tax Legacy Benefit	Investment After-Tax Legacy Benefit	After-Tax Benefit Insurance vs. Investment	Insurance % Increase over Investment	
10	$2,860,407	$979,285	$1,881,121	192%	28.50%
20	$3,348,138	$1,219,254	$2,128,884	175%	12.97%
30	$5,082,013	$1,497,748	$3,584,265	239%	10.93%
40	$7,482,393	$1,820,951	$5,661,442	311%	9.93%

Illustrated figures as of August 2021

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.

John & Jane's advisor uses Empire Life's online "Fast & Full" eApplication sales process to complete the application for life insurance from his office while John is in the comfort of his own home. Empire Life's Non Face - to - Face limit for life applications is now $5,000,000.

After the application is instantly received at Empire Life's head office, the application undergoes VIP processing, including:

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

After the policy is issued, John 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 John's office and home to complete the application and deliver the policy contract. John & Jane were 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!

The Empire Life Insurance Company
259 King Street East,
Kingston, ON K7L 3A8

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.

Our mission is to make it simple, fast and easy for Canadians to get the products and services they need to build wealth, generate income, and achieve financial security.

Follow us on social media @EmpireLife or visit empire.ca for more information, including current ratings and financial results.

For more information on how you can add these products to your coverage plan, contact your financial advisor or visit empire.ca.