Insuring the Future

In this Newsletter:

- The tax liability of your RSP/RIF.
- How life insurance is invaluable for funding tax liabilities.
- What is the cost?
- Universal life basics
- Don't disinherit your heirs when passing down the family cottage.

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PROVIDING... **ESTATE PLANNING ♦ CHARITABLE GIFT PLANNING ♦ BUSINESS SUCCESSION PLANNING**

RSP/RIF Tax Protector

Protect Yourself and Your Family from an Unplanned Tax Bill

Are you and your family members prepared for the tax liability that your RSP/RIF (Retirement Savings Plan/Retirement Income Fund) must ultimately assume? Often the maximum marginal tax rate is applied to these funds (approximately 46.00%) in the plan holder's final tax return or that of his/her surviving spouse.

Many RSP/RIF plan holder's are not aware that almost half of their retirement savings balances are payable directly to the government when they die for their use and distribution.

Life insurance is now commonly used to pay this tax bill, as it is most often the least costly and most suitable method. Also, there are insurance plans specifically designed to pay a lump sum of cash on the second death of two spouses (the exact same time as the tax is due). The annual cost of joint last-to-die coverage is much less than the cost for equivalent individual coverage.

The insurance used for tax protection (referred to as RIF Insurance) is ideal for those who consider their RSP/RIF funds to be an estate asset as well as for income. The lump sum of cash (equal to the tax) provided by the RIF Insurance can be purchased with an annual deposit of approximately 2.5 – 5% of the average RSP/RIF account balance. These annual deposits may cease as early as 3 years.

The RIF Insurance will pay the lump sum of cash at death to the desired beneficiary(s), totally tax-free, without executor, legal, or probate fees.

Let's look at an example:

Dave and Dorothy Smithers are both 65 years old and have $300,000 combined total in their RSP. They plan on deferring RIF payments until age 69 and then draw the minimum payment required by CCRA. We'll assume that they will achieve a 6.00% rate of return and that the tax rate at the second death will be 46.00%

RSP/RIF Tax Protector

Current RSP Value:	$300,000
Age:	65
Assumed Growth Rate:	6.00%
Annual Withdrawal at age 69:	Minimum RIF
Marginal Tax Rate in year of death:	46.00%

Age	Annual Withdrawals	RSP/RIF Balance at End of Year	Tax Liability at Death
65	$0	$300,000	$138,000
69	$18,358	$385,514	$177,336
75	$28,891	$374,726	$172,374
80	$28,674	$336,149	$154,629
85	$28,390	$285,904	$131,516

Table 1.

"Using a Universal Life insurance plan makes the cost of funding the tax liability the most cost effective."

Solution

Using a Universal Life insurance plan makes the cost of funding the tax liability the most cost effective. The chart below will show the costs of a universal life plan being funded for 3 years at an assumed rate of return of 6.00% on the investment account in the plan. At death, the universal life insurance plan will pay the face amount of insurance plus the investment account value tax-free to the designated beneficiaries.

Face amount of insurance:	$150,000
Cost of Insurance:	Level
Death Benefit:	Insurance value plus account value
Assumed Rate of Return:	6.00%[1]
Payment Period:	3 years

	Annual Deposit	Total Deposits	Annual Deposit as Percentage of RIF Account	Investment Account Value after Year 3	Death Benefit in 20 years
Joint - Male, Female - Age 65, nonsmokers	$11,000	$33,000	3.50% annually for 3 years	$29,930	$182,361

Table 2.

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Universal Life basics…

Cheaper is not necessarily better!

The most cost effective and tax efficient way to fund a life insurance plan is to use Universal Life. The object is to build the investment account value as quickly as possible to enable the tax-exempt growth inside the plan to pay for the insurance costs.

In our above example, the $29,930 in the investment account after 3 years will produce enough tax-exempt growth annually to pay for the cost of keeping the insurance plan in force at the assumed rate of 6.00%. In other words, after 3 years, we are using "before tax dollars" to pay the plan costs. The death benefit in 20 years would be projected at $182,361 ($150,000 plus the projected investment account of $32,361) all tax-free and returning most of the deposits made.

With other plans such as Term to 100, even though the premium may be less, the plan is always paid with "after tax dollars" and may have to be paid until the second death. As well, Term to 100 pays a level death benefit of the original amount insured and not an increasing death benefit. Considering both of these previous points, this can prove more costly in the long term.

Don't forget about the family cottage!

Another tax liability that a lot of people tend to forget about is the capital gain on the family cottage.

Most often, the family cottage has been around for a couple of generations, and over the past couple of decades, inflation has dramatically increased the value of the cottage. Along with that, the capital gains tax liability has increased.

If your estate plan includes passing down the family cottage to the next generation, be sure not to pass on a tax bill that may disinherit your heirs.

If cash is not available to pay the tax when it is due, your family may have to sell the cottage for "fire sale" prices in order to pay for the tax.

In the same manner that the RSP/RIF Protector works, life insurance can provide the liquid cash exactly when it's needed to fund the tax bill. Most often, this will prove to be the most cost effective manner in funding the tax liability.

For more information…

If you need to have any specific information in relation to these articles or any other insurance related matters, call or email me and I'll provide you with the information needed to help solve these and other estate planning needs.

Regards,

***John Jordan*, CFP**

1. Assumed rates of return are NOT GUARANTEED. The actual performance of your policy will depend upon the investment options chosen and the rate of return credited to each option.