The BMO® Insurance Corporate Insured Retirement Plan

A life insurance solution that provides security and flexibility to access cash.

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Introduction

Permanent life insurance is a flexible planning tool that contains both insurance and investment components.

Due to this flexibility, this type of product can be structured to fit many different financial planning objectives. In particular, there are several opportunities using the BMO Insurance Corporate Insured Retirement Plan that you may want to consider for your business owner clients who require permanent insurance as well as a tax effective way to access cash.

With this plan, business owners can get the insurance they require, in addition to benefiting from the following:

- tax-deferred growth of deposits (net of charges) into the policy
- a conversion of corporate taxable surplus into non-taxable surplus[1]
- a reduction in future taxable income since assets are transferred into a life insurance policy with tax-deferred accumulation
- creation of a valuable asset that can be leveraged to provide a source of tax-free funds via a third party line of credit (or other loan)[2]
- a significant tax effective benefit payment upon death, (proceeds less ACB flow into the Capital Dividend Account (CDA))
- funds available to settle outstanding debt (such payments do not reduce the CDA)
- funds available to flow out to shareholders tax effectively
- depending on the plan, options to access living benefits including disability payouts, terminal illness advances and special death payouts on the first death of a Joint Last to Die policy

This combination, when structured properly, can create a powerful financial planning tool.

To help support your understanding of the mechanics of the Corporate Insured Retirement Plan, we encourage you to read this Guide and use the latest version of our Wave illustration software to help you prepare personalized proposals for your clients.

Note: The ideas presented in this guide should be reviewed for suitability to individual circumstances. The information contained in this guide is general in nature and should not be construed as legal or tax advice. You and your clients are encouraged to seek the advice of other professionals such as legal and tax experts to ensure that the ideas presented are appropriate for the circumstances of the individual(s) for whom this plan is being considered.

The Opportunity

While most business owners understand the benefits of corporate-owned insurance, many don't realize that permanent life insurance products such as Universal Life (UL) or Whole Life (WL) can provide them with the protection they need as well as a source of future funds for business purposes.

Your clients may be business owners who require insurance to:

- fund a buy-sell agreement between shareholders of the company
- cover the loss of a key employee such as an individual with a special skill
- secure a loan that will only be granted if there is life insurance on the business owner
- fund a capital gains liability that results from the disposition of a shareholder's interest in the company to his/her designated beneficiaries

Should the business need change and the policy has accumulated a significant cash value, your clients may decide to pledge the cash value as collateral for a line of credit (or other loan) from a third party lender which will allow them to do one or several of the following:

- seek out new business opportunities
- expand their businesses or pay for other operational expenses
- provide a source of supplemental income for key employees
- access a source of cash for emergencies

Implementing insurance solutions such as the Corporate Insured Retirement Plan can be complex. So, it is always wise to consult with a team of experts to ensure that your proposal meets the financial objectives of your client and that all of the benefits and risks of the plan are considered. Oftentimes, this team will include you (the insurance expert) as well as other legal, tax, banking and accounting professionals. Therefore, building strong working relationships with experts in each of these fields of practice is important when implementing such ideas.

Target Market

Ideally, the Corporate Insured Retirement Plan is suited to clients with the following profile:

- Small business owners of Canadian Controlled Private Corporations (CCPC) who require and are able to qualify for life insurance protection.
- Business owners who would like to transfer some of their corporate surplus currently invested in passive investment assets into an insurance policy to benefit from tax-deferred investment growth.
- Business owners who are looking for a source of cash to distribute to shareholders of the company in a tax effective manner OR who need access to cash for other business reasons.
- Business owners who will qualify for third party loans and are able to manage these loans as part of their business operations.

The Solution

The Permanent Life Solution

You may wish to use the following as a guideline to implement the BMO Insurance Corporate Insured Retirement Plan. Depending on your client's profile and whether the policy will be held solely for insurance risk requirements or used to manage cash flow needs, additional steps may be required in which case other professionals such as those described in this guide should be engaged.

Step	The BMO Insurance Corporate Insured Retirement Plan
1	Determine the amount of permanent business insurance your client's need and can afford.
2	Work with your clients to determine what portion of their passive investment portfolio could be earmarked for this strategy and how quickly those assets should be transferred into the policy.
3	Your client then applies for a whole life or universal life insurance policy from BMO Insurance and in the case of UL, selects an investment portfolio for the policy that suits their long-term objectives and risk tolerance.
4	Once the policy is in-force, check on a regular basis to determine whether the accumulation in the plan continues to meet your client's original objectives. Adjust the plan, if necessary.
5	Once the policy has accumulated a significant Cash Value, if funds are required, the corporation or shareholder may apply for a line of credit from a third party lender using the policy as collateral. Please note that the structure and tax consequences will vary depending on which option is selected (see Tax Considerations below).
6	If the policy is leveraged, the interest on the loan may be capitalized or funded through additional borrowings. Alternately, your client may wish to pay the interest on the loan.
7	At death, if a loan is outstanding within the corporation, it can be repaid by the company from the tax-free Death Benefit proceeds of the policy without impacting the CDA. If the loan is personally held with the corporate owned policy used as collateral, the shareholder's estate would repay the loan through amounts received from the corporation via tax-free dividends (see Tax Considerations below).
8	The remaining death benefit can be used to settle the insurance risk originally identified or used to distribute funds to shareholders tax effectively.

Please note that the process to pay-off the loan differs, depending on whether the corporation or shareholder does the borrowing. There could be serious tax consequences if this process is not implemented correctly (see Tax Considerations below). To ensure that the proper steps are followed you and your clients should consult with legal, tax, banking and accounting professionals.

The Solution

The Results

By using the ideas of the Corporate Insured Retirement Plan from BMO Insurance, your clients will benefit from the following:[3]

From the insurance policy	From the third party line of credit/loan (if utilized)
The corporation is protected with the valuable insurance protection that it needs.	The cash value of the policy is used as collateral for a loan, usually in the form of a line of credit that can provide a source of supplemental tax-free funds for the borrower.
Deposits into the policy grow on a tax-deferred basis (up to the maximum allowed under the Income Tax Act), reducing your client's corporate tax bill.	Depending on the agreement with the lender, the principal and interest payments may be capitalized or serviced through additional borrowing. Therefore, no payments to service the loan may be required before death, at which time it is paid using the tax-free proceeds from the Death Benefit.
The Death Benefit is paid to the corporation tax-free and creates a credit to the Capital Dividend Account for the amount in excess of the Adjusted Cost Basis of the policy.	The interest expense may be a deductible expense if the proceeds of the loan are used to earn income. However, you should consult with your team of professionals to ensure that this is feasible for your client's specific situation as well as what amount can be deducted.

Is the BMO Insurance Corporate Insured Retirement Plan Right for Your Clients?

When considering whether to suggest The BMO Insurance Corporate Insured Retirement Plan to any of your clients, you may want to run through the following checklist to determine if the plan is appropriate for their needs:

- Are your clients business owners that require permanent life insurance to protect their business?
- Will the proposed lives associated with the business qualify for life insurance?
- Would they like to transfer taxable corporate surplus into a tax-deferred vehicle?
- Do they want to lower the company's corporate tax bill?
- Does the corporation require flexibility to access funds in the future in a tax effective manner?
- Are your clients comfortable with carrying debt?

If your client answers "yes" to these questions, then the BMO Insurance Corporate Insured Retirement Plan may be an ideal solution for them.

Tax Considerations

The information contained in this section is general in nature and should not be construed as legal or tax advice. The comments are provided as discussion points only for you and your client to review with their team of professionals including legal and tax experts.

Structuring Third Party Lending Arrangements for the Business Owner

If the insurance policy is leveraged, structuring the loan appropriately is crucial to the successful implementation of the BMO Insurance Corporate Insured Retirement Plan. Either the corporation or the business owner may borrow funds using the policy as collateral. However, you should note the following:

If the corporation does the borrowing	If the shareholder/business owner does the borrowing using the corporate policy as collateral
The policy is assigned as collateral to the third party lender and as a result, the loans are advanced to the corporation.	The shareholder uses the corporate policy as collateral and receives the proceeds of the loans personally.
The corporation can use those funds for business purposes or to make payments to the shareholder through dividends.	While the shareholder is alive, he/she may be deemed to incur a shareholder benefit if the borrowing is done personally. To minimize this concern, the shareholder may consider paying a guarantee fee to the corporation.
Upon death of the insured, since the corporation is the beneficiary of the policy, the life insurance benefit is used to retire the principal and interest outstanding on the loan. Any residual amount is paid to the corporation tax-free.	Upon his/her death, the Death Benefit would first be paid to the corporation then distributed to the shareholder's estate via tax-free dividends created by the company's Capital Dividend Account credit. Once received, the shareholder's estate would pay off the outstanding loan using the dividend payment and any residual amount would be added to the value of the shareholder's estate.
The amount of the Death Benefit in excess of the policy's Adjusted Cost Basis creates a Capital Dividend Account credit. This credit is not impacted when the funds are used to repay the loan. As a result, the company can elect to pay up to this amount as a tax-free dividend to the shareholder's estate.	The process to pay off the loan using this option is more complex. You should therefore consult with a team of professionals to determine if a taxable benefit would be assessed and to ensure that when the loan is paid off, it is done so correctly and minimizes any unforeseen tax consequences.

If the borrowed funds are required personally, the two options (corporate borrowing to fund dividends versus personal borrowing) should be analyzed for your client's specific circumstances; each option will have its advantages and disadvantages. The option selected should be made based on the facts of the case in question.

Tax Considerations

Interest Expense Deduction

If the funds are borrowed by the corporation and used to earn income from the business or to replace capital (fund a dividend) and as a condition of the loan, life insurance is required to secure the loan, the interest on the loan should be tax deductible. In addition, if interest is deductible, a portion of the premiums may also be deductible (this Collateral Insurance Deduction equals the lesser of the premium paid or the Net Cost of Pure Insurance (NCPI) prorated by the amount of the outstanding loan over the policy's face amount).

If the funds are borrowed personally using the corporate policy as collateral and the proceeds of the loan are invested to earn income, the interest may be deductible from the borrower's taxable income. The ability to deduct interest expense on a loan has been recently scrutinized by the Canada Revenue Agency (CRA). Your client's legal, tax and accounting advisors should determine whether this is feasible for their individual circumstance. The Collateral Insurance Deduction is not available for third party leveraging situations. Interest deductibility is not available if the funds are used for personal life style purposes.

Retirement Compensation Arrangements (RCA)

If the proceeds of the loan are used to supplement a shareholder's retirement income, the amounts advanced could be considered to fall under a RCA. Under the rules of an RCA, if there is a legal obligation for an employer to provide post-retirement benefits to an employee, a refundable tax must be paid to Canada Revenue Agency (CRA). If the BMO Insurance Corporate Insured Retirement Plan is set-up to provide such benefits, this tax would need to be paid on the amounts deposited into the insurance policy which would therefore affect the amounts that could be borrowed.

Taxation of Bank Loans

General Anti-Avoidance Rules (GAAR) prohibit financial transactions that are generated solely for the purpose of creating tax benefits. Using the BMO Insurance Corporate Insured Retirement Plan and based on the current interpretation of the Canadian Income Tax Act, the income from a bank loan should be received tax-free by the recipient. However, CRA could apply GAAR rules to the third party loan and consider the amount to be a policy loan. This result would mean that a portion (or all) of the loan amount would be taxed as income. Your clients should be aware that this risk exists, but also that the Agency accepts the fact that taxpayers should be allowed to structure their affairs in an efficient manner.

In addition, it is important when proposing the BMO Insurance Corporate Insured Retirement Plan to your clients that the life insurance established be a key requirement for your clients.

The Value of a Permanent Life Policy in a Corporation

The Cash Value of a life insurance policy is considered to be a passive asset within the corporation. Your clients should therefore be aware of the following:

- If more than 50% of the corporation's assets are passive assets, the corporation may not qualify for the small business deduction tax rate.
- Also, if a significant amount of a corporation's total assets are passive (often looked at as 10% or more), the shareholders may not qualify for the capital gains exemption if they dispose of their shares.

For a more complete understanding of these issues, it is wise for you and your clients to seek out the advice of a tax professional.

Other Considerations

When proposing the BMO Insurance Corporate Insured Retirement Plan, you and your clients should consider the following:

Longevity risk
Be conservative with the projected values on the illustration you present to your clients. If your client outlives the projection, additional collateral security may be required to continue to capitalize the loan or draw additional amount to fund the interest costs. Alternatively, the policy may have to be surrendered for its cash value to get the loan back within acceptable lending limits. This latter option would mean a taxable disposition and tax would need to be paid by the policy owner.

Rates earned on the life insurance cash and loan not connected
The growth of the cash value is independent of the accumulated balance of the loan and the interest rate charged on the loan is negotiated between your client and their lender. The lending institution advancing the loans will monitor the policy's cash value to ensure that it is sufficient to pay-off the outstanding loan balance, but you should also check to make sure that your client's objectives are still on track. In-force illustrations may be a good tool to monitor this progress.

Case Study

Client Details

Andy is 45 years old and is a business owner of AndyCo. Working with you, he realizes that his corporation needs permanent insurance protection on his life. Andy has $250,000 of surplus invested in passive assets in his company that is currently being taxed at 50% and would like to find a more tax effective method to deploy that surplus. He also would like a portion of those funds to be accessible in a tax efficient manner should they be required in the future.

Solution: the BMO Insurance Corporate Insured Retirement Plan

Insurance details:

- Planned deposits: $25,000 for 10 years (reallocated from his corporate surplus)
- Insured life: Andy
- Owner of policy: AndyCo
- Beneficiary: AndyCo
- Product: BMO Insurance Whole Life Estate Protector

Other details:

- Projected values illustrated at:
  - 4.50% net return in the whole life policy
  - 5.00% net return[4] before-tax on an Alternative Investment
  - 5.50% annual interest expense on a third party line of credit with the policy assigned as collateral.
- Andy's personal tax rate: 50% on income, 45% on ineligible dividends

After 20 years, Andy's corporate-owned policy may be used as collateral for a loan which could provide him with a source of income in one of two ways:

Collateral	Borrower	Projected Annual Loan	After-Tax Funds for Andy (based on use of annual loan)
Corporate Owned Insurance	Andy	$24,740 for 20 years (age 65 to 84)	Personal Borrowing $24,740
	AndyCo		Corporate Borrowing (Dividend paid to Andy) $13,607

Case Study

Using the insurance solution and the personal loan approach, when Andy's interest in the corporation is realized as part of his estate, the insurance solution is projected to provide better value compared to investing the surplus in an alternative taxable investment.

Comparison of Values

The BMO Insurance Corporate Insured Retirement Plan with corporate leveraging and personal loan versus an Alternative Investment

	BMO Insurance Whole Life (assuming a 4.50% Performance Bonus Rate)	Alternative Investment (Fixed Income portfolio projected at a 5.00% net annual rate of return)[5]
Annual Deposits	$25,000 for 10 years	$25,000 for 10 years
After-Tax Funds	$24,740 (assumes annual bank loans from age 65 to 84)	$24,740 (assumes withdrawals from the portfolio from age 65 to 78 with a final withdrawal of $3,494 at age 79). See note below.
Gross Estate Value[6]	$1,264,217	$0
Accumulated bank loan[6]	$902,867	$0
Net After-tax Estate Value[6] (net of bank loan)	$361,350	$0

Note: These examples are based on a BMO Insurance Whole Life (Wave version 45.0) policy and are merely a projection of future results, using a set of assumptions that will change over time. Actual results displayed are not guaranteed and will vary.

The Result

- Over a period of ten years, $250,000 of passive assets in AndyCo (net of charges) will grow tax-deferred within the policy, reducing Andy's corporate tax bill.
- If Andy leverages the corporate-owned policy as collateral to fund personal income, he would receive $24,740 (after-tax) each year from age 65 to 84. This does not reflect costs that may be incurred to address potential taxable benefit/shareholder benefit issues.
- At age 85, there would still be $361,350 left to his estate even after the outstanding balance of the loan is paid-off.
- With the alternative investment, if the same deposits are made and the same after-tax income distributed, Andy would only be able to receive the income from age 65 to age 78 (plus a remaining withdrawal of $3,494 at age 79) after which time the value of the portfolio would be depleted, leaving nothing for his estate.

Underwriting and Administration Considerations

When proposing the BMO Insurance Corporate Insured Retirement Plan, you should consider the following:

- Check to ensure that the amount of insurance you are proposing on any life is reasonable and justifiable; this amount will need to be approved by a BMO Insurance Underwriter.
- Refer to BMO Insurance's Underwriting Guidelines found under the Underwriting Guidelines menu of our Wave software for details on age, amount and financial underwriting requirements.
- Run a personalized illustration for your client, using the latest version of the Wave illustration software and include a signed copy with the application.
- To ensure that the Underwriter reviewing the application for insurance understands the purpose of the insurance, include a covering letter with a summary of what is being proposed.

Frequently Asked Questions

The information contained in this section is general in nature and should not be construed as legal, tax, or lending advice. The comments are provided as discussion points only for your client to review with their professionals advisors including legal and tax experts, as well as lending professionals.

Q 1

When presenting the BMO Insurance Corporate Insured Retirement Plan, what are some of the risks that should be discussed with your client?

i. Interest rate spread
The spread between the interest credited within the policy versus the interest rate charged on the bank loan is key and should be set conservatively given the long term nature of the plan. Although the absolute rates of interest on the two products are certain to differ from those illustrated, as long as the spread doesn't change much, the solution shouldn't be drastically impacted by such changes. Ideally, multiple illustrations should be run to demonstrate to your client the impact of such fluctuations in rates.

ii. Outliving projection
The possibility (and consequences) of the insured outliving the projected values (i.e. the year the projected loan to CSV ratio exceeds the lender's lending limit in the illustration) could mean that additional security would need to be pledged for the loan or repayments may be required to get back within lending limits. This typically happens at later years when a client's ability to come up with additional values or funds is limited. You should always project hitting the maximum loan to cash value ratio several years beyond expected mortality to reduce this risk.

iii. Interest deductibility
The interest expense on borrowed funds may not be deductible or may get so large that insufficient taxable income is available to take advantage of the deduction. Even if income is sufficient to absorb the tax deductions you and your clients should evaluate whether those deductions will still be at the assumed marginal tax rate.

iv. Loan availability
There are no assurances that loans will be available in the future when the client is expected to access them. In addition, most lenders have minimum loan amounts that must be met before considering a lending program that involves their life insurance policy. So, be sure that the projected annual loan amounts meet the lenders minimum requirements.

v. Tax risks
As mentioned in this guide, RCA considerations and GAAR implications should be considered and reviewed with a professional tax consultant before implementing this plan.

Q 2

What are some of the bank lending considerations that you and your client should be aware of?
The insurance values are only one criteria that the lender evaluates during their underwriting process. A full lending application will be required to demonstrate the client's credit worthiness and that this plan is part of a balanced financial strategy. To determine if your client is suitable, the lender will look at such metrics as debt servicing ratios, net worth ratios, and credit reports in addition to the illustration (which must be based on reasonable assumptions).

Lenders typically request the following information during the application process:

- purpose of requested financing and amounts
- net worth statement on the lender's prescribed form
- three years of income tax returns
- policy illustration (may request several scenarios using different assumptions)
- insurance policy details
- for corporations, the most recent income statement balance sheet and cash flow statement

When the loan is approved, and before advances are made, the following additional information may be required:

- original copy of the insurance policy
- acknowledgement letter from the client confirming that the lender:
  - has made no representations with respect to specific tax outcomes
  - has no liability for any taxes payable by your client and that may result from their participation in the arrangement
- confirmation from the insurer:
  - that the assignment in the bank's favour has been implemented and they have the only claim to the cash value and death benefit proceeds
  - the current cash value
  - of the policy details such as current owner, insured, beneficiary, that policy changes will be restricted and that no policy loans are outstanding nor will any be advanced after the assignment

Frequently Asked Questions (cont'd)

Q 3

How much will the lender advance against the policy values?
Advances are limited to a portion of the cash value available. Depending on the type of policy and underlying investment risk, the advances can range from 50% to 100% of the cash value. Lenders tend to accept a maximum loan to cash value ratio of 90% to 100% on whole life plans. For universal life plans, the typical range is 50% to 90% depending on the underlying investment options selected by the client on the universal life policy. Fixed income options like GIC's or BMO Insurance's Guaranteed Market Indexed Account (GMIA) tend to be at the higher end of the range whereas equity linked investment options would be at the lower end of the range. Clients may want to be a little more aggressive with their investment options up to the point they decide to leverage the policy and then switch over to fixed income options as required to maximize lending limits. BMO Insurance's Wave illustration software allows this type of transfer to be projected easily. The lender will determine the loan to cash value ratio for each specific case and is not bound by the examples suggested in this response.

The credit limit on the loan typically reflects the clients requested advances over the next five years. So if the client needed $100,000 for five years, the lending vehicle would be set at $500,000. The $500,000 lender's limit is what would typically be compared to the lenders minimum requirements to determine if they would participate in the arrangement.

Q 4

Is it better to leverage corporately or personally using the corporate-owned policy as collateral?
It is always easier and less risky for the policy owner to leverage their own asset. So having the corporation borrow for their needs including paying or dividends to shareholders is simpler but may be less tax efficient.

Personal borrowing may yield greater after-tax funds available to the shareholder/employee but introduce additional tax and process risks. From a tax perspective, using the corporate asset may result in a shareholder/taxable benefit. Paying a guarantor fee to address the value of the benefit may help with potential future tax assessments.

RCA rules must also be considered when contemplating a personal leveraging strategy to supplement retirement income.

(See the section on Tax Considerations for more details and be sure to involve a tax professional before implementing such a strategy for your client).

The process for paying off the loan must also be carefully structured to avoid adverse financial consequences.

Q 5

Is it safe to assume that the bank will allow the client to capitalize the loan interest?
Banks don't tend to allow capitalization of interest on these types of loans as it impacts their ability to recognize income on the loans (they become non-performing loans). Instead, they prefer that clients either pay the interest each year or borrow additional amounts to cover interest costs each year.

Let’s connect

To find out more about BMO Insurance products, please call your MGA, contact the BMO Insurance regional sales office in your area or call 1-877-742-5244.

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[1] Certain limits apply to the tax-exempt growth within the policy. Refer to an illustration for a projection of these amounts.
[2] Based on current interpretation of the Income Tax Act (Canada).
[3] Based on Rules and Regulations in effect at the time of writing this Guide.
[4] After investment expenses such as a fund managers management expense ratio (MER).
[5] 0% probate fees and 45% individual dividend tax. Probate fees are not applicable in Quebec.
[6] Values displayed at attained age 85.

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