Life Insurance as an estate planning tool

Common objectives in estate planning are to create, preserve, or maximize the value of the estate left to your beneficiaries. However, expenses incurred at death, such as income tax and probate fees, can erode the value of your estate. The strategic use of life insurance can help you cover these expenses and achieve your estate planning goals.

Life Insurance and estate planning

Life insurance can play an important role in estate planning and typically includes two aspects:

- Estate Preservation or Maximization: Life insurance proceeds can provide funds to pay for expenses and liabilities that arise on death. Life insurance proceeds can be used to help pay for your funeral expenses, debts, legal fees, tax liabilities, and probate fees thereby keeping the value of your estate intact for your beneficiaries.

- Estate Creation: The proceeds can be used to create an estate for your family or beneficiaries.

Estate Preservation or Maximization

Life insurance can help pay for final expenses, debts, taxes or fees so that an estate's assets (such as a family cottage) will not have to be sold to cover these expenses. Here are some of the more common expenses that an estate may pay upon an individual's death:

Income taxes: Any registered plans that you owned, such as a Registered Retirement Savings Plan (RRSP) or Registered Retirement Income Fund (RRIF), will typically be deemed to be de-registered as of the date of your death and included as taxable income on your final tax return. In situations where capital property and registered plans are inherited by the surviving spouse or common law partner, the tax liability can be deferred until the death of the surviving spouse or common-law partner.

Your estate will be responsible for paying taxes on any income you earned up to the date of your death. That typically includes the deemed disposition of all capital property, including investment portfolios, business and real estate holdings, which do not pass to a surviving spouse or common law partner. This deemed disposition may give rise to potentially significant capital gains taxes.

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The tax-free death benefit from a life insurance policy can be used to help cover the income tax liability at death. This is especially helpful if your beneficiaries wish to retain any inherited property, such as a family cottage.

Legal, probate and other estate costs: Costs associated with the administration of an estate can erode an estate's value. In addition, if a Will requires probate certification, additional fees may be incurred. Other estate costs may include funeral and burial/cremation expenses along with executors' fees, valuator or appraiser fees, and legal and accounting fees.

Fees or Taxes in other jurisdictions: If you own assets in other jurisdictions, your estate may be subject to fees or taxes imposed by those jurisdictions, which may be different from Canadian law related to insurance proceeds.

Estate Creation

Given that the death benefit of an exempt life insurance policy is paid tax-free to the beneficiary/beneficiaries, life insurance can be an efficient way to create an estate for your named beneficiaries.

Here are a few examples of how this works:

Tax-free accumulation: You can accumulate funds inside an "exempt" life insurance policy. This type of policy allows funds invested in it to grow on a tax-deferred basis until your death. This may provide a larger death benefit to your beneficiary upon your death.

Estate equalization: Life insurance can also be used to facilitate an equitable distribution of your estate among your beneficiaries. For example, if your family cottage has not been deemed to be your principal residence, and it was purchased several years ago, it may have increased in value. When you die, you are deemed to have disposed of the cottage at its fair market value, attracting a capital gains tax bill. Life insurance proceeds could pay the tax liability. Alternatively, if the cottage is given to one child, the proceeds could be used to provide a comparable inheritance to your other children to equalize the estate for all beneficiaries

Insured annuity strategy: An annuity provides you with a stream of income for a specified period or for your lifetime. With an insured annuity strategy, all or a portion of annuity income would be used to pay premiums for a life insurance policy with a death benefit equal to the amount of the annuity principal. Upon your death, the death benefit would be paid to your beneficiaries in place of the capital originally invested in the annuity.

Facilitating charitable donations: Individuals can use life insurance as part of their charitable giving plan. You can donate life insurance proceeds through a Will, or by naming a charity as the beneficiary under your life insurance policy.

Generally, donations of a life insurance death benefit made by Will to a registered charity, as a result of a donor's death, are considered to be made by the individual's estate.

The charitable donation may be used to lower the taxes payable on the estate's tax return in the form of a donation tax credit. Please note that if the proceeds become part of the estate, they may be subject to probate fees, and will also be accessible to creditors.

By designating a charity as beneficiary under a life insurance policy, one may maintain privacy and avoid potential probate costs, where applicable.

Considerations

Speak with your TD Advisor to plan for your estate needs and help determine if insurance can help you meet your estate planning objectives.