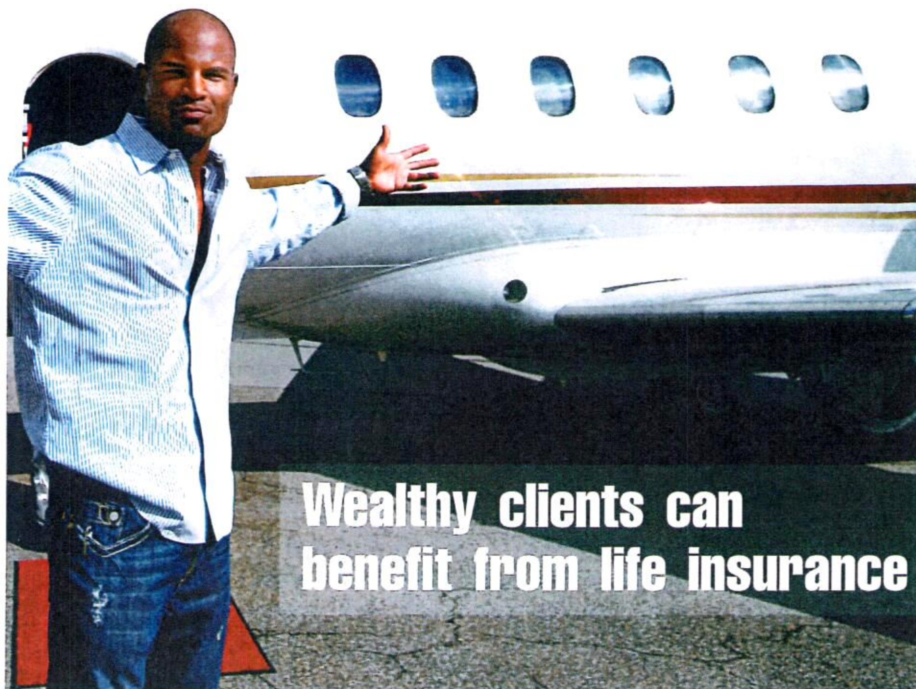

Wealthy clients can benefit from life insurance

Although many high net worth clients may be wealthy enough to self-insure, there are a number of circumstances in which they could benefit from life insurance, says Florence Marino, Assistant Vice President of the tax and estate planning group at Manulife Financial. In a presentation at the *Canadian Institute of Financial Planners* (CIFPs) conference in Niagara Falls last June, Ms. Marino outlined several different scenarios where life insurance could be used for wealthy clients.

Ms. Marino suggests that if a high net worth client has assets that cannot be sold quickly or easily, or assets that he or she simply does not want to liquidate, then life insurance could have an important role in estate planning. While the family cottage is the typical example, she notes that the concept applies to any asset that someone wants to transfer to the next generation in specie, such as the shares of a family business. "A lot of high net worth money is tied up in that kind of asset," notes Ms. Marino.

Take the case of a business owner who has three children, but only one wants to take over the operation. Life insurance can be used to equalize the estate, so that each child receives a fair share. One child keeps the business, and the other will receive an equivalent amount in cash, paid through tax-free insurance proceeds. "You see this a lot in family farm situations," says Ms. Marino.

Using life insurance to provide a capital injection instead can be less expensive than borrowing the funds from a traditional lender. Used this way, life insurance "really is quite a good deal," she comments.

Shareholders of publicly held companies may also want their assets to remain intact, she adds. Take the case of an executive who may have shepherded a firm through an initial public offering, and now holds shares that trade on the stock market. At death, the shares can roll over to the executive's spouse without triggering any immediate tax consequences, but at the second death there will be a deemed disposition. Will the executive's children be forced to sell some of these shares, perhaps in a down market, in order to pay the tax bill? "Life insurance pays the tax so that the assets can pass to the beneficiary," she says.

Asset diversification

And what if the client doesn't require liquidity because he or she has plenty of excess capital on hand to invest today? If the return on those investments subject to taxation and the client's ultimate goal is to pass that money on to the next generation, Ms. Marino suggests it might make sense to shelter that capital inside of a life insurance policy, and encourages advisors to think of life insurance as another asset class. Life insurance can be a tax-deferred investment vehicle where the return on investment occurs after death. "It really is very good at delivering estate values," she says.

She gives as one example the case of a 65-year-old male, and a 60-year-old female (both non-smokers) who purchase a joint, last-to-die whole life policy with a $1 million face value. If they were to deposit $80,000 a year into that policy for six years and then died after 28 years, their estate would receive a total death benefit of $1.768 million. To achieve the same after-tax result over the same period of time using an interest-bearing investment, she calculates that the couple would have to earn a pre-tax rate of return of 9.51%.

Besides offering a way to diversify into non-traditional asset classes, Ms. Marino says that life insurance can also function as a retirement income strategy in its own right. She suggests advisors ask clients if they would be interested in a long-term investment with a guaranteed return for life, non-redeemable before death, which matures at death.

The strategy involves pairing a life insurance policy with a life annuity. By taking out an annuity, the insured is able to increase their cash flow while they are living, while the life insurance replaces the capital at death.

Since annuity payments are a combination of capital and earnings, taxes decrease and the client is left with more money to spend while they are alive, and the client's heirs receive a tax-free benefit from the life insurance at death. Ms. Marino says that a 70-year-old female could use this strategy to earn a return equal to 7.42% in interest bearing investments, but she notes that the result will vary with each individual depending on age and health, as well as on prevailing interest rates.

The ideal prospect for this strategy is over 70, a conservative investor, and in good health, she says. By this age, she suggests that most people have come to terms with their own mortality. "They realize it's not 'if' I die, but 'when' I die," she says. Clients find comfort in this kind of strategy because they know that their income is guaranteed for life, and that their estate has been arranged for their children.

Finally, Ms. Marino suggests that wealthy clients use insurance to leave money to a favourite charity. If advisors want to start a conversation with a prospect about charitable giving, she suggests asking them the following question: If I could show you how to reduce the amount of tax paid by your estate, and a way to leave money to a charity at the same time, would you be interested?

She gives the example of family business that will face a $500,000 tax liability when the parents shares are passed to the next generation at death. By spending $462,000 to purchase a $1 million joint, last to die life insurance policy, and then leaving that $1 million to a charity in their wills, the couple can use the $500,000 tax credit resulting from the charitable donation to cancel out the $500,000 tax liability on the shares.

"Many high net worth people are very thankful for their wealth, and want to give back," says Ms. Marino. "Life insurance can help provide that gift."

Andrew Rickard, CFP