ADVISOR USE ONLY

A STRATEGY USING TAX-EXEMPT LIFE INSURANCE

Asset transfer strategy advisor guide

For individuals and corporations

What's inside

We help. You grow.

Sun Life

Important information about this guide

This guide includes information on the asset transfer strategy using tax-exempt life insurance. The information in this guide has been prepared for advisor use only.

This guide doesn't provide tax, legal, accounting or other professional advice. We suggest that you advise Clients to seek the advice of a tax professional when making decisions. It's the Client's responsibility to determine the tax consequences under their relevant tax legislation. Any tax information provided in this advisor guide is based on the provisions of the *Income Tax Act (Canada)* and the regulations as of the date of this guide. In addition, these are subject to Sun Life's current understanding and interpretation of the rules and the administrative practices of the Canada Revenue Agency (CRA) in effect.

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Overview

What is the asset transfer strategy?

The asset transfer strategy compares the value of life insurance against a taxable investment. By transitioning a portion of Clients' existing assets from the fixed income portion of their portfolio to insurance, Clients' estate values may be higher at death, while maintaining access to cash and offering exposure to a more diverse range of assets.

Tax-exempt, cash value life insurance has always been an effective estate planning tool, but it also has additional merits when used as an alternative asset class. The asset transfer strategy can help achieve estate and financial planning objectives using either participating whole life insurance or universal life insurance.

How it works

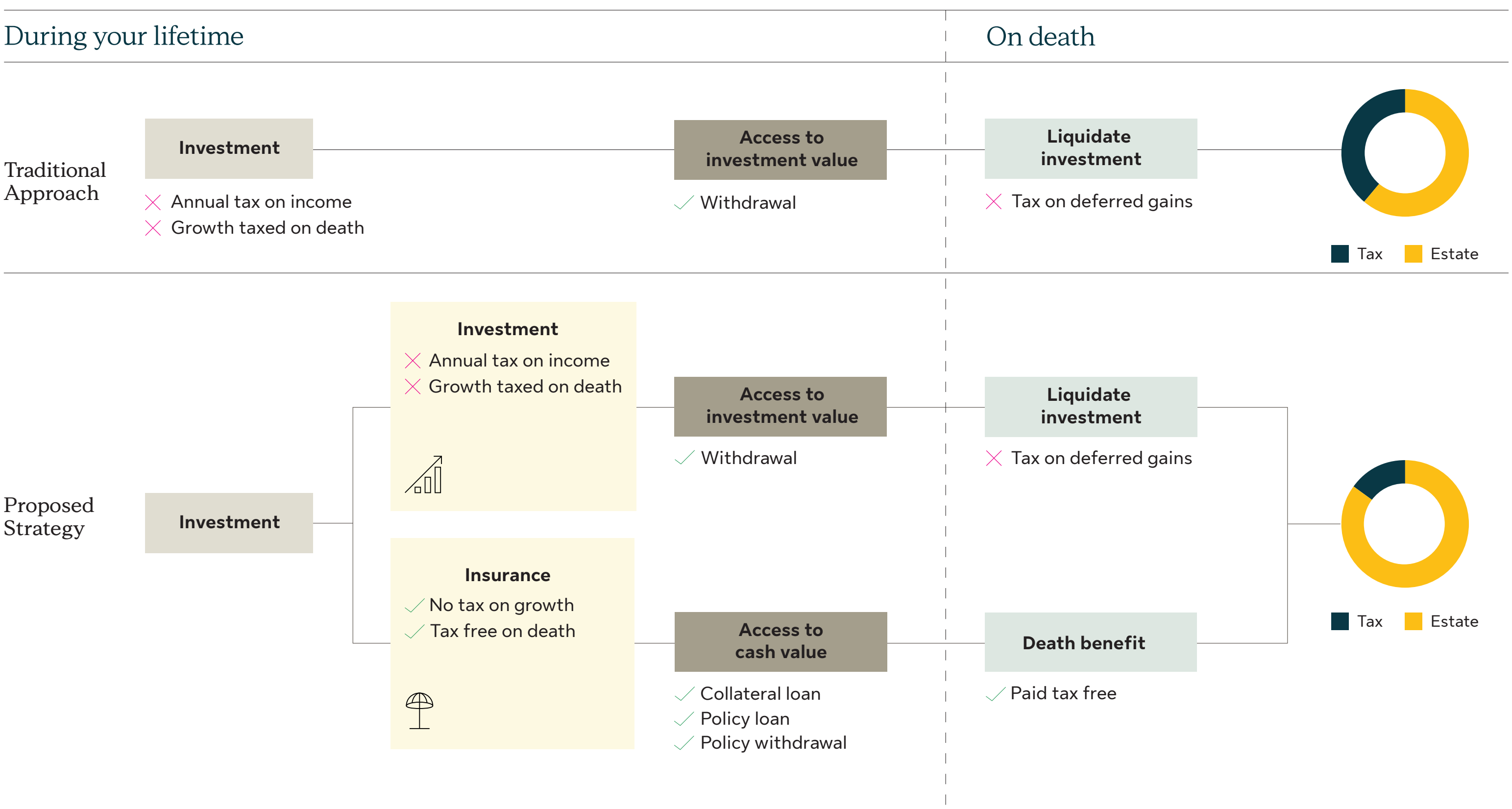
A tax-exempt participating or universal life insurance policy offers advantages that can help to reduce or eliminate some of the challenges that may occur during the life and at the death of the insured person. The following table compares how the Asset Transfer strategy addresses a variety of tax challenges, both while living and at death, and the benefits for Clients compared to taxable investments.

Challenges that can exist with taxable investments	How the asset transfer strategy addresses these issues
• Income earned on non-registered investments is subject to tax during the Client's lifetime. • Annual taxes paid reduce the overall net return and can substantially slow the growth of Clients' assets and estate value over time. • When an individual dies, their assets are deemed to be disposed of at fair market value. There may be rollover opportunities available for the first death of a married or common-law partner, but taxes are triggered upon the second death, reducing the final estate value. • When an asset is disposed of for more than the adjusted cost base, a capital gain is incurred. Currently, 50% of the capital gain is subject to income taxes, which can significantly reduce the final estate value. • Probate, executor and legal fees may also apply, further reducing the amount available to beneficiaries.	• A life insurance policy's cash value grows tax-preferred, within legislative limits. • This cash value may be accessed in a number of ways, helping to satisfy Clients' liquidity concerns. • Transferring funds from taxable investments to an exempt life insurance policy can help reduce overall taxable income. • The tax-free death benefit is paid directly to the named beneficiary, avoiding probate, executor and legal fees, addressing the common tax challenges often faced at death for individual Clients.
Corporate Clients • Passive investment income within the corporation, including interest, dividends and half of all realized capital gains, is taxed at the high corporate investment income tax rates. • Depending on the province, taxable income within the corporation is subject to a tax rate near 50%. • When the assets are liquidated and distributed from the corporation following the shareholder's death, any deferred capital gains are realized, half of which are included in the corporation's taxable income. • The after-tax value of these assets in the company need to be paid out as a taxable dividend to the estate or new shareholders, resulting in an additional layer of taxation.	**Corporate Clients** • The tax-free death benefit is paid to the corporate beneficiary. • The death benefit, minus the policy's adjusted cost basis (ACB) just before death, can be posted to the corporation's capital dividend account (CDA). Since the ACB of a policy decreases as the insured person nears life expectancy, in some circumstances the full death benefit could be credited to the CDA. • The CDA can then be used to pay tax-free capital dividends out of the corporation. Any remaining portion of the death benefit that didn't provide a CDA credit, representing the ACB of the policy, can be paid as a taxable dividend.

The Individual Asset Transfer (IAT) strategy

Implementing the strategy for individual Clients involves the following steps:

1. An individual or a couple purchases a participating or universal life insurance policy. For couples, the effectiveness of the IAT strategy may be improved by illustrating a joint last-to-die policy, compared to a single life contract.
2. Premiums are paid by transferring a portion of the Client's assets from their non-registered investment portfolio to the life insurance policy.
3. The cash value accumulates within the life insurance policy on a tax-preferred basis. Depending on the policy type, the death benefit may also grow over time. By transferring funds from taxable non-registered investments to a life insurance policy, an individual can reduce their annual taxable income, potentially resulting in greater asset growth.
4. If Clients require access to the cash value in the policy, they may be able to take a policy loan, make a withdrawal from the policy, or collaterally assign the policy to a lending institution for a loan.*
5. When the insured person or the second spouse for a joint last-to-die plan dies, the life insurance tax-free death benefit is paid directly to the named beneficiaries.

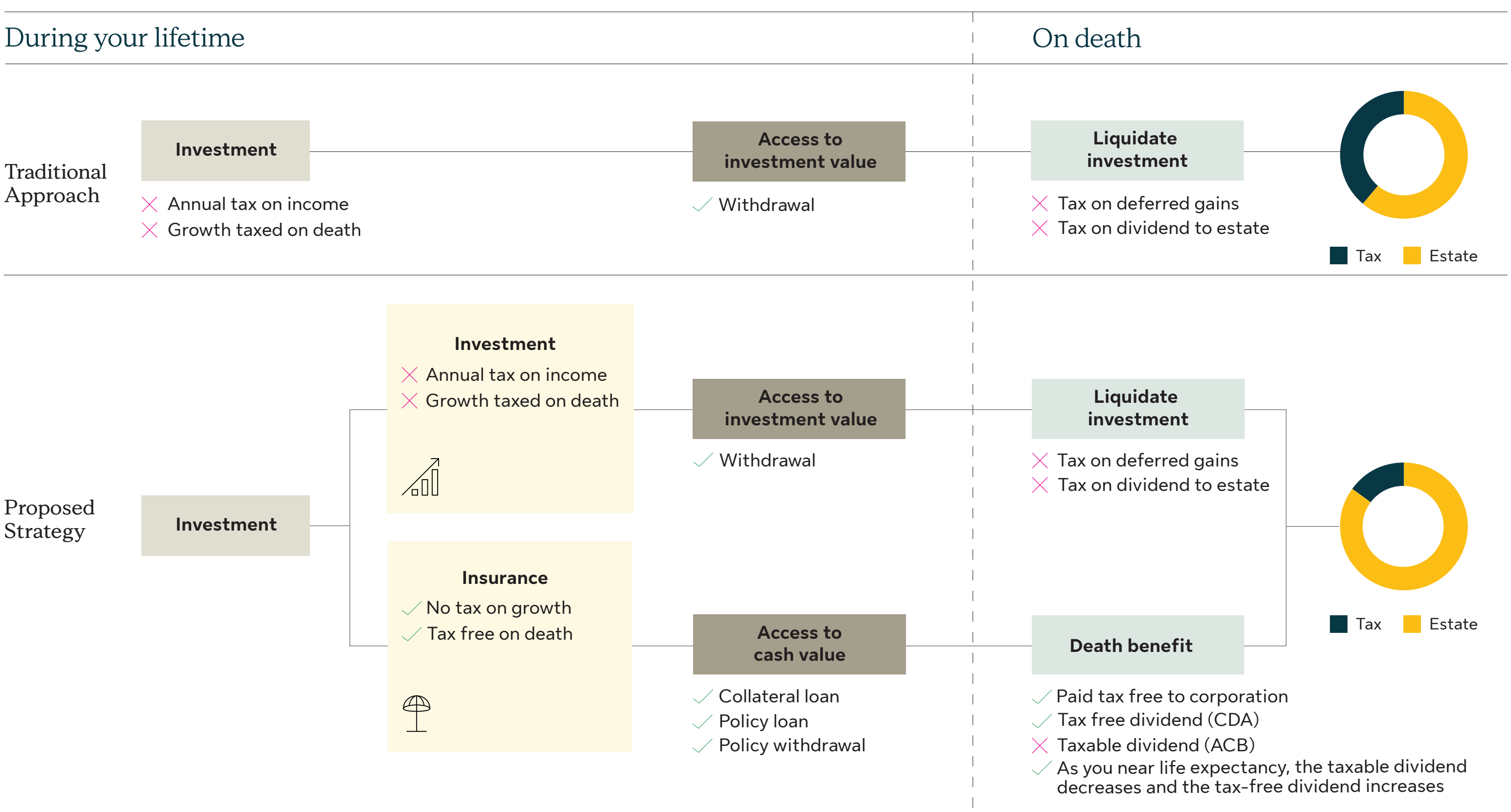


*In Quebec, using a life insurance policy as collateral involves the use of a movable hypothec. Like a collateral assignment, the movable hypothec doesn't involve the transfer of policy ownership. It provides security for the loan by giving the lender rights in the policy to the extent of the loan balance.

The Corporate Asset Transfer (CAT) strategy

The CAT strategy has similar considerations to that of the IAT, but there are additional elements involved. The main differences are how the cash value and death benefit flows to the shareholder and their estate. Implementing this strategy for corporate Clients involves the following steps:

1. A corporation purchases a participating or universal life insurance policy on the life of a shareholder. The corporation owns the policy, pays the premiums, and names itself as the beneficiary.
2. Premiums are paid by transferring assets from the corporation's investment portfolio to the insurance policy.
3. The cash value accumulates within the life insurance policy on a tax-preferred basis. Depending on the policy type, the death benefit may also grow over time. By transferring funds from taxable corporate investments to a tax-exempt life insurance policy, the corporation can reduce its annual taxable income, potentially resulting in greater asset growth.
4. If the corporation requires access to the cash value in the policy, it may be able to take a policy loan, make a withdrawal from the policy, or collaterally assign the policy to a lending institution for a loan.
5. When the insured person dies, the tax-free life insurance death benefit is paid to the corporation as the beneficiary. The death benefit, less the adjusted cost basis (ACB) of the policy at the time of death, can create a credit to the corporation's capital dividend account (CDA).
6. Working with its tax advisors, the corporation can use the CDA credit created by the life insurance policy death benefit to pay tax-free capital dividends out of the corporation. Any additional money can be paid out as a taxable dividend.



Client profiles

The asset transfer strategy may be most suitable for individual or corporate Clients with significant assets in taxable non-registered fixed income investments. They'll be looking to enhance the value of their estate while diversifying assets and reducing risk without sacrificing liquidity.

The strategy is most appropriate for those Clients that have excess assets not required to fund lifestyle or income needs. For individual Clients, it should only be used after maximizing other tax-preferred registered savings, i.e. registered retirement savings plans (RRSP) and tax-free savings accounts (TFSA). This strategy may not be suitable for Clients with variable income and fewer assets.

The asset transfer strategy uses life insurance, so Clients must be reasonably healthy and able to qualify for coverage to take advantage of the benefits this strategy offers. The asset transfer strategy is intended to be in place for the life of the insured person. A long-term view is essential to maximizing the benefits of this strategy.

Whether the strategy is implemented on an individual or corporate basis, the individual or shareholder will want to maximize the value of their legacy. Ensure that maximizing the value of assets passed on after death is consistent with the Client's goals and what they want to achieve.

Individual Clients	Corporate Clients
• Individuals in good health • Have a large permanent life insurance need • Have a regular, high income stream that exceeds their lifestyle needs • High net worth with a secure financial future • Have significant taxable, non-registered, fixed-income assets • Have already maximized RRSP and TFSA contributions • Want to enhance estate value for their beneficiaries • Want to minimize the tax burden associated with their taxable investments • Want to satisfy their life insurance need without giving up liquidity within their existing investment portfolio	• Shareholders of a Canadian-controlled private corporation (CCPC) in good health • Corporation has a large permanent life insurance need • Holding companies with a significant fixed-income investment portfolio • Looking for ways to diversify their asset mix • Want to enhance estate value for their beneficiaries • Want to minimize the tax burden associated with their taxable investments • Want to satisfy the corporation's life insurance need without giving up liquidity within their existing investment portfolio

Benefits of the asset transfer strategy

With this strategy, benefits to the Client's estate are greatly enhanced and liquidity may be comparable to traditional, non-registered investment portfolios. Here's a summary of the benefits the strategy can provide for Clients looking to diversify their non-registered fixed-income portfolio, enhance their estate value and maintain the peace of mind knowing that they can have access to cash in the future, should they need it.

- **Tax-preferred cash accumulation –** The policy's cash value grows tax-free as long as it stays in the policy.
- **Tax-free death benefit –** The named beneficiary receives the tax-free death benefit, avoiding probate and estate settlement costs for individuals. For corporate Clients, the CDA credit provides a tax-efficient way of moving the proceeds out of the corporation. This allows a larger amount to be passed directly to beneficiaries compared to taxable investments.
- **Liquidity –** If the policy owner requires access to the accumulated funds within their policy, they may take a policy loan, withdraw cash value, or collaterally assign the policy in exchange for a loan from a third-party financial institution. Many Clients appreciate the comfort and flexibility that comes from knowing they can access the cash value of their life insurance policy at any time.
- **Diversification opportunities –** Participating life insurance policies have access to the participating account through policy owner dividends. The account consists of a diversified mix of bonds, real estate, equities and mortgages. As an additional asset class, participating whole life plans allow for diversification of a Client's existing asset base. Universal life insurance gives Clients access to a number of investment account options.
- **Address risk and return challenges –** Each individual asset class in a portfolio contains a level of risk related to the returns each asset class provides. Being too heavily weighted in one asset class, even a conservative one, may increase overall portfolio risk. Adding life insurance to this mix helps reduce the overall risk.
- **Potential creditor protection –** For personally-owned policies, the accumulated cash value of the policy may be protected from the claims of the policy owner's creditors during the policy owner's life and after their death. Policies owned by holding companies may offer some degree of protection against creditors of a related operating company.
- **Protection of privacy –** By naming a beneficiary, life insurance proceeds don't pass through the policy owner's estate, but go directly to the person or organization named. The tax-free death benefit isn't part of the probate process and doesn't become a matter of public record. This helps Clients keep their final wishes and the distribution of their assets private.

FAQs

What if Clients want access to money?

Maintaining liquidity is an important element of the asset transfer strategy. The ability to access the cash value from the policy in a number of ways may allow for the asset transfer strategy to maintain comparable liquidity to traditional investment portfolios. Clients are able to create a diversified, stable pool of assets without sacrificing long-term returns or cash accessibility.

Individuals or corporations may be able to access the money by taking a policy loan, making a withdrawal, or collaterally assigning the policy in exchange for a bank loan or line of credit. There may be tax consequences to some of these options. If Clients choose to access money from the policy, the net estate value of the strategy will be reduced.

How are the net estate values of the strategy using life insurance able to out-perform an alternate taxable investment?

Traditional investment portfolios are subject to annual taxation of earned interest, dividends received, and realized capital gains. When these assets are liquidated, it also triggers taxation of deferred capital gains. For corporations, money is typically moved to the estate or new shareholders by payment of a taxable dividend.

A life insurance policy's cash value grows tax-preferred. Transferring funds from taxable investments to an exempt life insurance policy can help to reduce overall taxable income. When an individual owns the policy, the tax-free death benefit is paid to the beneficiary, avoiding probate, executor and legal fees, addressing the common tax challenges individual Clients often face at death. For corporate beneficiaries, the capital dividend account (CDA) provides a tax-efficient method of moving money out of the corporation to the estate or new shareholders.

These factors will often allow the strategy to outperform an alternate taxable investment, in particular when the policy is held until the death of the life insured.

If insurance offers such benefits, why would Clients choose any other asset?

As with any type of long-term strategy, diversification is important. The amount of life insurance held by a Client is determined solely based on insurance need. Its primary purpose is the death benefit coverage. An additional benefit is the improved risk and return ratio of their portfolio. Participating life insurance can provide access to a diversified mix of bonds, real estate, equities, private fixed income and mortgages, while universal life insurance can offer a number of investment options, including guaranteed and managed accounts.

What additional benefits can the strategy offer, besides liquidity, diversification and higher estate values?

Life insurance may also offer an element of creditor protection when properly structured. If the beneficiary of an insurance policy is irrevocable or a member of a specified family class, the cash value of the policy and the death benefit may be protected against creditors of the individual policy owner. Policies owned by holding companies may offer some degree of protection against creditors of a related operating company. In any situation though, creditor protection can never be guaranteed.

By designating a beneficiary, death benefits can flow directly to them, bypassing the estate, resulting in reduced probate fees and other costs. These benefits allow for an efficient transfer of assets to the named beneficiaries of the policy upon death of the insured person. This can lead to a significantly faster settlement process, and increased privacy when compared to probating an estate.

When the insured person dies, how does the estate access the death benefit with the corporate asset transfer strategy?

The capital dividend account (CDA) is part of the system of integration in the Income Tax Act (ITA).

The ITA attempts to ensure that income is subject to the same total tax burden, regardless of whether it's earned directly by an individual or through a corporation and then distributed to an individual.

With the corporate asset transfer strategy, the tax-free death benefit is paid to the corporate beneficiary. The death benefit, less the policy's adjusted cost basis, can be credited to the corporation's CDA.

To flow money out of the corporation, a capital dividend must be declared by the directors of the corporation and paid to the shareholders. A resolution of the directors declaring the dividend is recorded in the minutes of the corporation. An election must also be filed with the Canada Revenue Agency. Given the complexity of this process, Clients should work with their legal and tax advisor to ensure it's properly completed.

Any portion of the death benefit that exceeds the CDA credit can be paid out of the corporation as a taxable dividend.

Why would a Client choose corporate ownership of the policy over individual?

Many factors need to be considered when a Client is choosing between individual versus corporate ownership of a policy. At the top of the list is choosing an ownership option that properly reflects the insurance need. The following are a few additional considerations, although there may be more. Clients should work with their advisor, their estate planning specialist, and their tax and legal advisors to determine the best ownership structure. They'll want to avoid the need for a transfer of ownership at some point in the future, since this could trigger taxable gains and taxable shareholder benefits, depending on the situation.

In general, life insurance premiums are paid for with after-tax dollars. A corporation that's a Canadian controlled private corporation (CCPC) is generally eligible for the small business tax deduction, and may pay tax at a lower rate than the insured shareholder. If so, the corporation won't need to earn as much money as the insured to pay the premiums.

Shareholders of qualifying small business corporations benefit from the lifetime capital gains exemption. However, qualifying the company for the exemption is very important. One of the requirements is that at the time the gain is realized, 90% of the fair market value (FMV) of the corporation's assets must be used in an active business carried on in Canada. Life insurance policy cash values are passive assets, and don't count towards this requirement. The CRA uses the policy's cash surrender value to measure the value of a life insurance policy when determining eligibility for capital gains exemption purposes. It may be useful to have the policy owned by a holding company rather than own policies in an operating company to avoid jeopardizing the operating company's status as a qualifying small business corporation.

While corporate-owned life insurance can increase the after-tax value to the estate, it may also increase the tax liability on the shareholder's terminal tax return. Shares of a closely held corporation are deemed to be disposed of at death for their FMV immediately before death. The value of all the assets, including the cash value of any life insurance policies the corporation owns, helps determine the FMV of the corporation's shares. The significant cash value growth of the insurance policy may exceed what would otherwise have accumulated in the taxable investment. This may increase the tax liability on the terminal return and reduce the advantage of the corporate-owned insurance. Careful planning should be done with the Client's tax advisor to minimize this risk.

What if the Client changes their mind?

The Asset Transfer strategy assumes Clients will take a long-term planning perspective, and the policy won't be cancelled before the insured person's death. If a Client surrenders their policy during the insured person's lifetime, the Client receives the policy's cash surrender value. If the policy's cash surrender value exceeds its adjusted cost basis, the Client has to include the difference between those two amounts (the taxable policy gain) as income and pay tax on it.

Depending on the policy type chosen, there may be additional options for reducing or stopping premium payments for the insurance policy. Advisors and Clients should refer to specific product information for more details.

What types of life insurance policies are typically used with the strategy?

The asset transfer strategy can be illustrated using either participating whole life or universal life insurance. A Client's specific needs will determine which type of policy is best for their situation.

Participating life insurance may offer Clients the opportunity to have their policy credited with policyholder dividends. It allows Clients to benefit from the stability offered from a diversified mix of bonds, real estate, equities, private fixed income and mortgages through the Sun Life participating account.

Universal life insurance provides Clients with access to a number of investment account options, allowing them to build their own portfolio, and may be more suitable for Clients who prefer a high degree of control over their investment decisions.

For couples, the effectiveness of the IAT strategy may be improved by illustrating a joint last-to-die policy, compared to a single life contract.

What assets are best for Clients to consider when implementing the asset transfer strategy?

This strategy is based on transferring taxable investment assets to the tax-preferred environment of a life insurance policy. It's most effective when compared with traditional investment options that produce the highest level of taxable income. Because of this, most Clients would focus on a portion of the fixed-income part of their portfolio when implementing the asset transfer strategy.

Transferring funds to the life insurance policy from individual or corporate owned investments such as stocks, mutual funds or fixed income investments may trigger capital gains, generating taxable income. Clients should consult their tax advisor to ensure a tax-efficient transfer can be made where possible.

What impact does a change in assumptions have on the strategy?

There are a number of factors to be considered before implementing the asset transfer strategy. Clients must understand there are many variables that contribute to the projection of any values in the report. Even a small change in the assumptions used in the strategy can have a significant impact on their effectiveness. Advisors should illustrate the strategy using a number of different assumptions, so Clients can fully understand the impact changes can have on the results.

When comparing the growth of a life insurance policy to a taxable investment, policy performance is an important consideration.

- When using participating whole life insurance policies, illustrate at alternate dividend scales to help Clients understand the impact of a reduction in dividend scale on the cash values and death benefit of their life insurance plan.
- When illustrating using universal life insurance plans, be sure to show the impact of alternate rates of return.

What if tax rules change?

The asset transfer strategy is based upon current tax rules, which are subject to change. It's possible that legislative changes could affect this strategy in the future. The tax rules surrounding these strategies can be complicated. Clients should work with their tax advisor to ensure this strategy is right for them.

Where to go for more information

The Asset Transfer strategy allows Clients to grow estate assets, maintain liquidity and lower portfolio risk. For additional information, contact your Sun Life Sales Director.

Why choose Sun Life?

Sun Life is a leading international financial services organization. In Canada, we started selling life insurance in 1871. Since then, our commitment to helping people achieve lifetime financial security through market leading products, expert advice and innovative solutions has made us a household name – a name that people trust.

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