TAX MATTERS

Four reasons why business owners should consider life insurance

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This week I had the opportunity to speak at a conference for insurance advisers. You have to respect the persistence of a good insurance professional. My friend, Bruce, is one of the best. He was telling me that, after pursuing a particular client for more than two years, the man finally agreed to a meeting. “I hope you’re feeling very honoured,” the man said to Bruce. “After all, my assistant has turned away nine insurance salespeople today alone.” “Yes, I know,” Bruce said. “I’m all of them.”

The fact is, few people wake up in the morning hoping to run into someone who will sell them an insurance policy. I think it’s because insurance can be expensive. I did buy a really cheap group policy a while back. But read the fine print. I just found out that my group policy only pays off if I die in a group. Go figure.

Today, I want to speak to those who are business owners – big or small. There are four situations in which life insurance can provide needed cash to solve some pretty big problems.

Death of a key person

The smaller your business, the more critical you’re likely to be to the success of the business. What if you were gone tomorrow? What if another employee – perhaps your most important employee – dies suddenly? Having insurance on the lives of key people in your business will provide cash to the business that could be critical to smoothing over a rough period, or even keeping the business afloat, while the rest of the team looks to find a successor. No wonder many lenders, and investors, require companies to carry key-person insurance.

You’ll be glad to know that if the insurance is required as a condition of borrowing money, a portion of the premiums will be deductible for tax purposes. But if you buy a $500,000 policy to pay off a $100,000 debt in the event of death, don’t expect to deduct the full premium on that policy. You have to look at the amount of the insurance that would be needed to pay off the loan. The net cost of pure insurance (NCPI) on that portion of the policy can be deducted.

Equalizing an estate

If you own a business and have one or more children, but not all of them, working with you, you need to consider what would happen if you passed away. It often makes sense to leave the shares of the business to the child, or children, who are working in the business day to day. The reason is that the children who are not working in the business would likely have different objectives; they may prefer to receive dividends from the business rather than see all the profits reinvested each year, while those working in the business may have a different perspective.

A better solution may be to leave the shares to the children working in the business and equalize things by leaving the other children cash provided by an insurance policy. The insurance premiums may be a small price to pay to maintain harmony in the family when you’re gone.

Covering taxes on death

At the time you pass away, you'll be deemed to have sold, among other capital property, your private company shares. While you may be able to claim the lifetime capital gains exemption (LCGE) to shelter up to $848,252 of the capital gain (in 2018) if the shares qualify, you could end up paying approximately 25-per-cent tax on any capital gains that can't be sheltered with the LCGE. How will your executor pay that tax bill? It's not like an investment portfolio where you can liquidate some shares to pay the taxes owing. Life insurance could be very important to enable your executor to pay your final tax bill.

By the way, if you're going to buy insurance to cover taxes on death, it will be cheaper to have your corporation pay the premiums than to pay yourself salary or dividends and then pay the premiums personally.

Providing for your heirs

If you're a shareholder along with others, it can make sense to purchase insurance on your life to provide the surviving shareholders, or the company, cash at the time of your death. That cash can be used to buy your shares from your estate so that your heirs ultimately receive that cash. It's a great way to provide for them.

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