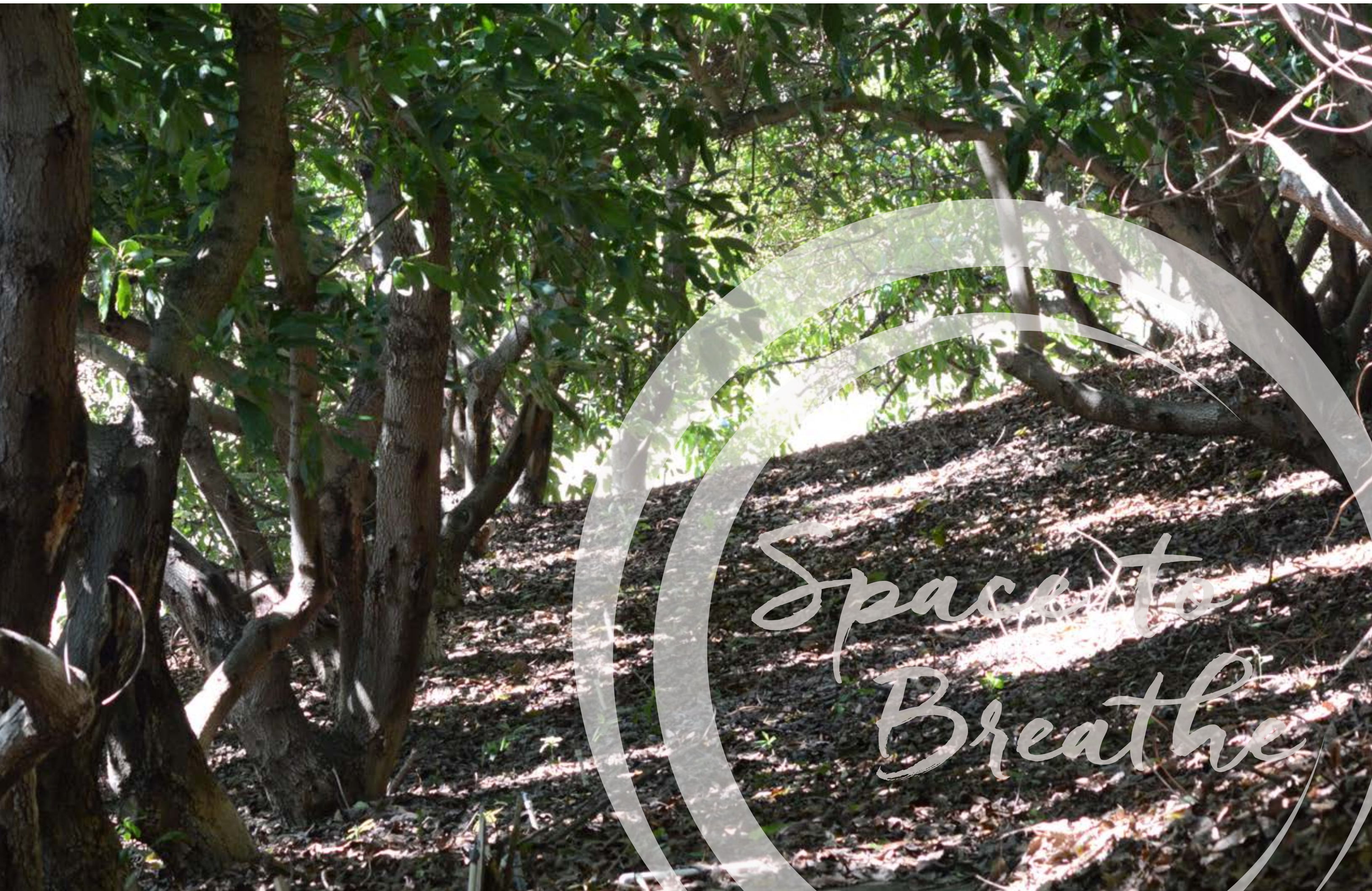
COVE CONTINUITY
ADVISORS INC

Guide to Insuring Impact



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Introduction

This Guide to Insuring Impact, a collaboration between The Benefic Group, The Charitable Impact Foundation (CHIMP), and Cove Continuity Advisors Inc., was created to provide a guide to charities, professional advisors, and their donors and clients.

Most people choose to leave their estate assets to their children or heirs at their death, with their will typically instructing the executor to dispose of assets, pay the appropriate tax, and distribute the residue of the estate to the heirs. Individuals or couples with a charitable intention may name one or more charities to receive a gift out of the residue of the estate.

While this is a common course of events, under the right circumstance, there's a better way: Gifting certain types of assets directly to a charity versus gifting cash can reduce tax and make the ultimate gift larger than when a traditional approach is taken.

Money that would have otherwise gone to the tax department is now directed to the charity to continue its good work. The taxpayer's family has a legacy in the impact of their significant gift.

This guide outlines various ways a gift can be made to charity via a Life Insurance policy, RRSPs, company shares and/or real estate. Each scenario includes a case study, along with a sample financial analysis.

Life Insurance: The Overlooked Impact Tool

Life Insurance has been long overlooked and under-used, in terms of the power it can bring to creating legacy impact capital. There is no other instrument that does what Life Insurance does, which is to create capital at death on a tax-preferred basis for pennies on the dollar. There are many different types of products from numerous companies available in Canada. In addition, there are a myriad of permutations or combination of products and structures that can be combined to achieve the perfect result, whatever that may be.

Traditional approaches to buying and selling insurance, however, have only focused on paying tax liabilities at death and, in some cases, reducing or deferring those tax liabilities through creatively structuring the policy within a corporate structure. This approach works very well, but is focused entirely on economics and paying tax to preserve family wealth. It does not consider redirecting capital to charitable organizations.

We want you to take a different approach. We want to demonstrate how Life Insurance can be used to eliminate tax labilities and create a significant legacy of impact capital.

Some Basic Principles to Keep in Mind:

- Gifting using Life Insurance happens in one of two ways: 1. During the life of the insured, or 2. At/after the death of the insured
- The rate of return realized on the premiums paid is determined at the year of death
- The return on the premiums paid is greatest in year one and declines for each year of life thereafter
- The economic value of insurance is combination the insurance death benefit and the tax dollars saved
- Joint Life Expectancy Assumption is age 89
- Marginal Personal Income Tax Rate assumption is 47.7%
- The ineligible dividend rate assumption is 40.95%
- Discount Rate for determining the net present values (NPV) is 4%

About CHIMP

Give how you want, when you want. Because the choice of how you change the world is yours. ~CHIMP website

CHIMP (Charitable Impact Foundation) is a charitable marketplace that connects donors with the causes they care about.

CHIMP simplifies the administration of giving. You can make a single gift to CHIMP, and then use their online platform to distribute your gift to any one (or more) of Canada's many registered charities. It allows you to donate anonymously, offers flexibility in being able to change the ultimate recipient of your gift during your lifetime without having to change your will, assuming that your gift would otherwise have been directed to each charity through your will. Using CHIMP also provides access to CHIMP's gift planning team to facilitate any one or more of the strategies covered in this paper.

CHIMP's flexible platform makes gifting easy for even the most unsophisticated philanthropists. These strategies are not restricted to using CHIMP as an intermediary charity if an alternative foundation is preferred.

I. Gifting Existing Life Insurance Policies

This is one of the easiest strategies to implement and works well for clients who have an existing Life Insurance policy that they no longer want and are looking to divest themselves of the policy.

CASE STUDY: JOHN AND CINDY HAPPY

John and Cindy Happy are both 65 years old. They are financially independent and in a position to retire. They have multiple Life Insurance policies in place:

- John and Cindy went through an estate-planning process and purchased a new Joint Last to Die Life Insurance policy to fund their estate tax liabilities.
- Seventeen years ago, they purchased two single life Level Cost of Insurance (LCOI) Universal Life Insurance policies on John to provide survivor benefits for Cindy and their kids.
- John also owns a business that owns a single life policy on John—one that's identical in nature to his personal policy—to fund a shareholder buy-sell agreement that is no longer needed. John bought out his other shareholders over the years but kept the plan in place to be used as key person insurance for the company.

John is planning to sell the company soon and needs to deal with those insurance policies by either cancelling or continuing them (either personally or within his holding company). John and Cindy coincidently have a significant tax liability arising from the sale of the company. One policy has a death benefit of $2.5 million and a level guaranteed premium of $8,973. The cash value is zero. The Fair Market Value (FMV) is approximately $1,020,000. The other policy has a premium of $8,173 with a death benefit of $2,300,000. The cash value is $53,000. The FMV of this policy is approximately $938,000.

John's policies are still perfectly functional; however, since estate tax liabilities arise at the second of John's and Cindy's deaths, the policies may pay out long before the funds are needed. They *could* keep the single life policies in place because they represent great value, but they aren't necessary.

John and Cindy do not want to pay for duplicate coverage and decide the best course of action is to get rid of the policies.

- If they cancel the policies, they no longer have to pay premiums, but they also do not get anything out of the policies.
- If they transfer the policies to a charity, they can get out of paying the premium if they want and still get a significant tax benefit.

They decide to donate the policies to charity, both for tax-planning purposes and for the impact their gift will have in charitable terms.

John and Cindy have a CHIMP account that they use for managing their charitable donations to a variety of charities. They use CHIMP because it simplifies administration and also provides them with various other benefits, including the ability to donate anonymously.

CHIMP agrees to receive the policies and will issue a tax receipt for the donation. John and Cindy will continue to pay the premiums and have directed the insurance proceeds go to Ecojustice, a charity they strongly believe in and support. Ecojustice has been made aware of the future gift and offers to find donors who are willing to fund the premiums in the event John and Cindy no longer wish to, to ensure that Ecojustice is the ultimate beneficiary of the insurance proceeds via CHIMP.

If Ecojustice locates donors to pay the premiums, they will instruct the donors to make their donations to CHIMP. It's also possible for CHIMP to distribute the insurance policy to Ecojustice, allowing the charity to directly control the policy on their own behalf.

STRATEGY: GIFTING LIFE INSURANCE POLICIES

This strategy produces significant immediate tax benefits that requires a high taxable income to fully utilize. The donor receives a tax receipt for the Fair Market Value (FMV)* of the policy that is transferred to the charity and also will receive a receipt for premiums paid. Ownership of the policy must be absolutely assigned to the charity.

Having an unwanted Life Insurance policy can arise for a number of reasons and applies equally to single life policies as well as Joint Last to Die policies.

The policy is generally a permanent policy, usually with a guaranteed Level Cost of Insurance (with or without a cash value).

In certain circumstances, term insurance policies can be donated where the insured is substandard or uninsurable and the policy can be converted to a permanent policy without medical evidence. In rare occasions, a term policy that is not converted can be used, but typically the insured is uninsurable and has a lower-than-average life expectancy.

Cancelling a Life Insurance policy that does not have a cash value is the normal course of action in many circumstances; however, the policy owner is forgoing significant potential benefits by doing so. Even though there is no cash value in the policy, the policy can have a significant FMV- because the policy premiums are fixed at the time of issue; to replace this policy would result in significantly higher premiums than the existing policy.

In other words, if someone were to take over this policy rather than buy a new one, they stand to realize a much higher rate of return on their premiums on the existing policy because the premiums are so much lower and the payout is exactly the same. These forms of permanent policies accrue significant internal cash reverses within the insurance company—referred to as the *embedded policy reserves*—which is not available to the policy owner upon cancellation.

The single biggest motivation for wanting to cancel the policy is to get out of the premium paying commitment verses recapturing a cash value within the policy.

** there are provisions in the Income Tax Act that will deem the receipt to be the adjusted cost basis of the policy where the policy is owned less than 3 years or there was intent to gift the policy when acquired and the policy has been held for less than 10 years. The provisions do not apply for donations made on death.*

The FMV of a Life Insurance policy is determined by an actuary but is based on the following formula:

FMV = Present Value (PV) of the future death benefit
— the Net Present Value (NPV) of future required premiums.

The role of the actuary is to determine:

1. appropriate discount rate to apply to the death benefit and the premium stream

2. appropriate life expectancy to determine when the death benefit might be paid and how long the premium will be paid.

So, what about simply transferring or selling the policy for its Fair Market Value and finding someone else to pay the premium?

A common approach to doing this type of gifting is for the policy owner to donate the policy to the charity and receive a tax receipt for the donation equal to the FMV of the policy.

When gifting an insurance policy to a charity, the donor needs to decide who will pay the future premiums to keep the policy active until the death of the insured. If the donor pays the ongoing premium, they are welcome to make the recommendations as to the final destination of the insurance proceeds at death.

If the gift is made to a single purpose charity, it is assumed that the charity receiving the policy will get the benefit of the Life Insurance proceeds. If the charity that receives the policy is a Donor Advised Fund (DAF) and the DAF continues the premium payments, the donor of the policy is no longer able to recommend how the funds are distributed. It is generally accepted that the donor who makes the donations to the DAF to fund the premiums will be able to recommend the final recipient of the death benefit proceeds.

In short, whoever pays the ongoing premiums can make recommendations as to the distribution of the insurance proceeds.

Some donors may choose to continue paying the premiums and receive a donation tax receipt for the amount of the premiums paid each year, while others might ask the charity to find a donor to cover the future premiums. The implementation of the latter scenario requires that the charity understand this process and that they either have the cash or are able to find a donor to assume the premiums.

The following example illustrates the impact of gifting the two personal policies to a charity and using the corresponding tax deduction to offset tax on the sale of the company:

The Happy Financial Analysis

	No Gift	Gift of Policy No Premiums	Gift of Policy With Premiums
Value of Shares	10,000,000	10,000,000	10,000,000
Share ACB	-	-	-
Gain	10,000,000	10,000,000	10,000,000
Taxable Gain	5,000,000	5,000,000	5,000,000
Deduction for Gifted Policy	-	(1,958,000)	(1,958,000)
Net Taxable Gain	5,000,000	3,042,000	3,042,000
Tax on Gain	(2,385,000)	(1,451,034)	(1,451,034)
After Tax Premiums NPV	-	-	(125,804)
After Tax Proceeds	7,615,000	8,548,966	8,423,162
Gifting Advantage to Vendor	**-**	**933,966**	**808,162**
Tax Paid	**(2,385,000)**	**(1,451,034)**	**(1,451,034)**
Impact Capital Created	**-**	**4,800,000**	**4,800,000**

** Net Present Value*

II. Gifting RRSPs

Registered plans are usually taxed at the second death of a couple. There is a tax-free rollover to a spouse at the first spouse's death; then, at the death of the second spouse, the full amount of the registered plans becomes taxable as normal income on the deceased's terminal tax return.

CASE STUDY: JOHN AND CINDY HAPPY

John and Cindy Happy, both 65, resent the fact that 47.7% of their registered plans are going to be paid to the government on their death. They engage in philanthropy and support various charities based on their intentions to use their wealth as a force for good.

They plan to reduce the income tax on the shares of their company at the time of sale, and now they want to explore how to reduce the tax on their registered plans at death. They both have RRSPs that are equal in value.

They recently purchased a new Joint Last to Die Life Insurance policy with a Level Guaranteed Cost of Insurance that does not have a cash value. They purchased $1,900,000 of coverage to replace the after-tax value for their RRSPs and the cost of the insurance, so that, after all is said and done, their estate will be in an identical position as it would have been if they had not made the gift. The premium for this policy is $34,500 annually level for life. They estimate the value of their registered plans to be approximately $1,900,000 by the time they reach 89.

In this scenario, the corporation could purchase the insurance and pay the premiums with corporate dollars. If John and Cindy live to life expectancy, virtually 100% of the death benefit would flow out of the company on a tax-free basis to the estate. Using a corporation to purchase the insurance versus purchasing the insurance personally produces a better result.

On the first to die of John and Cindy, survivor would designate CHIMP as the beneficiary of the remaining RRSPs. CHIMP agrees to receive their RRSPs on the last to die and would issue a tax receipt for the donation upon receipt at death. John and Cindy can direct the RRSP proceeds to their favourite charity, Ecojustice via a Letter of Wishes to the executor or beneficiaries.

STRATEGY: GIFTING RRSPS

The simplest way to avoid paying any tax at all on the registered plans is to gift the entire amount of the registered plan to a charity and offset the income on death on that registered plan with a donation receipt. The downside of this approach, however, is that the estate is reduced by not only the amount of the tax it would have otherwise paid on the RRSP, but also on the after-tax amount of the RRSP. The reduction to the estate value is approximately 52.1% of the value of the registered plans.

One solution to this capital drain is to purchase a Life Insurance policy that replaces the after-tax portion of the registered plan.

The insurance funds come to the estate tax free and, therefore, replaces the after-tax value of the registered plan, making the estate whole again.

This strategy can be taken to the extreme in that the full amount of the RRSP can be replaced; however, most people want to simply ensure their family gets what they would have otherwise received without having made the gift.

The Happy Financial Analysis

	No Gift	Gift + Insurance Personal	Gift + Insurance Corporate
Value of RRSPs	1,900,000	1,900,000	1,900,000
Value of Gift	–	(1,900,000)	(1,900,000)
Tax on RRSP	(906,300)	(906,300)	(906,300)
Donation Tax Benefit	–	906,300	906,300
Insurance Proceeds	–	1,900,000	1,900,000
CDA Credit Value	–	–	775,200
Total Insurance Premium	–	(864,029)	(864,029)
After Tax Estate Value	993,700	1,035,971	1,811,171
Gain to Estate	**-**	**42,271**	**817,471**
Tax Paid	**906,300**	**-**	**-**
Impact Capital Created	**-**	**1,900,000**	**1,900,000**

III. Gifting Publicly Traded Shares

Publicly traded shares are taxed at the second death of a couple (assuming they are rolled over to the spouse on a tax-free basis) when the shares are deemed to be disposed of at FMV. A capital gain will arise on the deemed disposition if the FMV exceeds the adjusted cost base of the shares and will be subject to tax.

CASE STUDY: JOHN AND CINDY HAPPY

John and Cindy Happy have publicly traded shares worth approximately $2,000,000. The cost base on the shares is $1,000,000. They recently purchased a new Joint Last to Die Life Insurance policy with a Level Guaranteed Cost of Insurance. They purchased $1,125,000 of coverage to replace the after-tax value for their shares and the present value cost of the insurance. The insurance places their estate in virtually the same position as if they had not made the gift of the shares. The premium for this policy is $21,316 annually level for life.

The corporation could purchase the insurance and pay the premiums with corporate dollars which is more cost effective. If John and Cindy live to life expectancy, virtually 100% of the death benefit will flow out of the company on a tax-free basis to the estate.

STRATEGY: GIFTING PUBLICLY TRADED SHARES

Using a corporation to purchase the insurance versus purchasing the insurance personally produces a better result. Currently, there is an inclusion rate of fifty percent of the capital gain on the shares from the deemed disposition on the last to die of John and Cindy, which is taxable on the terminal tax return.

To avoid paying tax on the publicly traded shares, they can be gifted, in kind, rather than selling them at the estate level and then gifting cash.

The estate receives a charitable receipt for the FMV value of the shares without having to pay the Capital Gains Tax. The downside of this approach, however, is that the estate is reduced by not only the amount of the tax it would have otherwise paid on the shares, but also by the after-tax value of the shares.

One solution to deal with this capital reduction to the estate is to purchase a Life Insurance policy to replace the after-tax value of the shares donated.

The insurance funds come to the estate tax free, making the estate whole again.

The Happy Financial Analysis

	No Gift	Gift + Insurance Personal	Gift + Insurance Corporate
Value of Shares	2,000,000	2,000,000	2,000,000
Share ACB	1,000,000	1,000,000	1,000,000
Gain	1,000,000	1,000,000	1,000,000
Taxable Gain	500,000	500,000	500,000
Tax on Gain	(238,500)	(238,500)	(238,500)
Value of Gift	-	(2,000,000)	(2,000,000)
Donation Tax Benefit	-	954,000	954,000
Insurance Proceeds	-	1,125,000	1,125,000
CDA Credit Value	-	-	459,000
Insurance Premiums NPV	-	(325,012)	(325,012)
After Tax Estate Value	1,761,500	1,753,988	2,212,988
Gain to Estate	**-**	**(7,512)**	**451,488**
Tax Paid	**(238,500)**	**-**	**-**
Impact Capital Created	**-**	**2,000,000**	**2,000,000**

IV. Gifting Private Company Shares

Private company shares are taxed at the second death of a couple, assuming they are rolled over to the first spouse on a tax-free basis. On the death of the second spouse, the shares are deemed to be disposed of at FMV, resulting in Capital Gains Tax (for excess of FMV over the adjusted cost base of the shares). Currently, there is an inclusion rate of fifty percent of the capital gain on the shares from the deemed disposition on the last to die of John and Cindy, which is taxable on the terminal tax return.

CASE STUDY: JOHN AND CINDY HAPPY

John and Cindy Happy are both engaged in philanthropy and support various charities. They have private company shares worth approximately $1,000,000. The shares are fixed value preferred shares that were frozen during a recent reorganization of their affairs. The cost base on the shares is nominal.

(It is possible to gift common shares instead of preferred shares; however, the value of the shares would have to be determined at time gift was made for the purposes of issuing a donation receipt. Gifting preferred shares provides greater certainty for the charity.

John and Cindy recently purchased a new Joint Last to Die Life Insurance policy with a Level Guaranteed Cost of Insurance through their holding company. They purchased $1,400,000 of coverage to allow the company to repurchase the shares from the charity and to cover the present value cost of the insurance. Their estate should be in virtually the same position as if they had not made the gift of the shares (it may even have a financial gain).

The premium for this policy is $26,527 annually level for life. The charity receives a gift of a $1,000,000 legacy from John and Cindy, while the Happy heirs receive an estate enhancement of approximately $270,000. Win-win!

In this scenario, the corporation would purchase the insurance and pay the premiums with corporate dollars. If John and Cindy live to life expectancy, a CDA credit worth approximately 100% of the death benefit would allow their heirs to receive $1,400,000 of dividends on a tax-free basis.

Since John and Cindy use CHIMP, CHIMP agrees to receive the private company shares at death and will issue a tax receipt for the donation equal to the fixed value of the preferred shares at death. John and Cindy can direct the share sale proceeds within CHIMP to their charity of choice, Ecojustice. They provide instructions through their wills to the executor to direct the funds according to their wishes.

STRATEGY: GIFTING PRIVATE COMPANY SHARES

Private company shares can be gifted to the charity but a capital gain will result on the gift for the excess of FMV over the adjusted cost base. The estate will receive a charitable receipt for the FMV value of the shares The downside of this approach, however, is that the charity will be left holding illiquid shares, and the corporation will have a charity as a shareholder, which could cause problems in running the company.

Additionally, the estate will have a reduction in terms of value equal to the after-tax value of the shares. The estate is reduced by not only the amount of the tax it would have otherwise paid on the shares, but also on the after-tax amount of the shares. Assuming a gift of shares is made, the reduction to the estate is approximately 28% of the share FMV, considering the tax benefit received from having made the donation.

A corporation can buy a Life Insurance policy to repurchase the preferred shares from the charity at death.

The insurance funds come into the corporation tax free and creates a credit to the Capital Dividend Account of the company. The company then redeems the shares, which triggers a deemed dividend to the charity. The normally taxable dividend is tax free to the charity. The corporation is left with 100% of the company's value being reflected in the issued common shares of the company held by the heirs and a Capital Dividend Account credit of approximately $1,000,000 (assuming death occurs at life expectancy).

The Happy Financial Analysis

	No Gift	Gift + Insurance Personal	Gift + Insurance Corporate
Value of Shares	1,000,000	1,000,000	1,000,000
Share ACB	10	10	10
Gain	999,990	999,990	999,990
Taxable Gain	499,995	499,995	499,995
Tax on Gain	(238,498)	(238,498)	(238,498)
Value of Gift	-	(1,000,000)	(1,000,000)
Donation Tax Benefit	-	477,000	477,000
Insurance Proceeds	-	1,400,000	1,400,000
CDA Credit Value	-	-	571,200
Insurance Premiums NPV	-	(404,459)	(404,459)
After Tax Estate Value	761,502	1,472,541	2,043,741
Gain to Estate	**-**	**711,038**	**1,282,238**
Tax Paid	**(238,498)**	**-**	**-**
Impact Capital Created	**-**	**1,000,000**	**1,000,000**

Assume there is other income on date of death return or estate return (where claim gift depends on whether estate is a GRE) to offset the donation tax credit.

V. Gifting Real Estate

Like RRSPs and shares, real estate can be taxed at the second death of a couple, assuming they are rolled over to the first spouse on a tax-free basis. On the death of the second spouse, real estate is deemed to be disposed, resulting in Capital Gains Tax and recapture of depreciation. There is currently an inclusion rate of fifty percent of the capital gain and 100% of the recapture amount, which is taxable to the deceased on their terminal tax return.

CASE STUDY: JOHN AND CINDY HAPPY

John and Cindy have substantial assets held in real estate, most of which have a very low cost base. The real estate market is currently hot. John and Cindy worry about the real estate bubble bursting and losing much value that has accrued to the property. Selling the property will trigger significant tax costs associated with recapture of deprecation and capital gains.

It seems economically inefficient to sell, so they decide to donate one piece of real estate to CHIMP and use the donation credit to offset depreciation and Capital Gains Tax on other properties which they've sold.

John and Cindy are excited that the proceeds from the sale of the donated property can remain in their CHIMP account to fund charitable giving to their favourite charity, Ecojustice, over the coming years.

In order to replace the capital value relating to the donated real state, John and Cindy purchase a $1,700,000 Joint Last to Die insurance policy that will payout to their estate upon their death via their holding company. This insurance amount not only replaces the after-tax value of the donated property, but it also recovers the Net Present Value of future premiums. The premiums for the policy are $32,212 annual for life. The Happys purchased the policy through their holding company which is more cost effective and to utilize the Capital Dividend Account Credit that gets created when Life Insurance proceeds are paid to a private corporation.

STRATEGY: GIFTING REAL ESTATE

Gifting real estate is a strategy to generate large charitable donation tax credits without gifting cash. The objective is to help clients solve tax problems arising from income, sale of capital assets, or estate planning by donating all, or a portion, of a real estate property so that taxes are reduced and cash is retained for investment or lifestyle purposes, rather than being remitted to Canada Revenue Agency (CRA).

The real estate may be owned personally or jointly, and it may even be owned indirectly through a corporation. The real estate can be a recreational or investment property, residential or commercial, agricultural or industrial, developed or bare land, or a strata title property. It can be clear title or encumbered by a mortgage. It can even be a person's principal residence.

One of the problems in donating real estate is determining the appropriate Fair Market Value for the charitable donation receipt. This is often done by taking the average of two independent appraisals. However, if the property is going to be immediately sold by CHIMP after the donation, it's possible for the proceeds from disposition to be used as the value of the tax receipt without the additional cost of appraisals.

Typically, the property will be immediately sold by CHIMP after the donation is complete. Selling the property generates liquidity and avoids ongoing costs such as property tax, maintenance, and property management. All proceeds of the sale by CHIMP are tax exempt. The net cash proceeds from the sale will be placed in the donor's CHIMP Account which is a Donor Advised Fund (DAF). From there, the donor can:

a. Recommend what amount to give to any Canadian charities; or,

b. Reinvest the money, on a tax-exempt basis, to generate income and gains to grow their CHIMP Account.

It's possible for the donated real estate to be held by CHIMP rather than being immediately sold. Any income by the property generated will be tax exempt and will first be used to cover costs associated with holding and operating the property. If income does not cover all costs, alternative payment of methods for the costs must be agreed upon prior to the donation.

One way for the donor to recover the after-tax capital value of the property is to put an insurance policy in place on the life of the donor. At death, the estate will receive the insurance benefits that, in effect, replaces the value of the real estate donated.

The Happy Financial Analysis

	No Gift	Gift + Insurance Personal	Gift + Insurance Corporate
Value of Real Estate	2,000,000	2,000,000	2,000,000
Real Estate ACB	400,000	400,000	400,000
Tax on Gain	(381,600)	(381,600)	(381,600)
Tax on Recapture	(95,400)	(95,400)	(95,400)
Net Donation Tax Benefit*	-	477,000	477,000
Insurance Proceeds	-	1,700,000	1,700,000
CDA Credit Value	-	-	693,600
Insurance Premiums NPV	-	(491,129)	(491,129)
After Tax Estate Value	1,618,400	1,618,400	2,379,471
Gain to Estate	**-**	**67,471**	**761,071**
Tax Paid	**(381,600)**	**-**	**-**
Impact Capital Created	**-**	**2,000,000**	**2,000,000**

**The gift is a taxable disposition for tax purposes so results in recapture of $200,000 and a taxable capital gain of $800,000. The tax otherwise payable on the recapture and taxable capital gain can be eliminated by utilizing $1,000,000 of the charitable donation tax credits. Any tax credit not used in the year of the donation can be carried forward for up to five years.*

VI. Purchasing a Policy & Paying the Premiums

Common charitable gifting alternatives involve either naming a charity as the beneficiary of a Life Insurance policy or transferring a policy to the charity. It's up to the donor to decide whether they want the tax relief during their lifetime or upon death.

From the donor's perspective, the use of a Life Insurance policy allows them to make a larger, more meaningful gift. The charity benefits from the gift, and, by replicating this plan among their donor base, the charity increases the frequency by which these gifts are created.

CASE STUDY: JOHN AND CINDY HAPPY

John and Cindy Happy have been donating to their favorite charity for years. After discussions with their family and estate planning advisors, they decide that they want to make a more meaningful gift upon their passing.

They decide to set up a $1 million Joint Last to Die Life Insurance policy. After reviewing all the various permanent Life Insurance options, they decide to set up a Term to 100 policy and make annual premium payments for life. They also decide, after reviewing the analysis of their options to own the policy, that, for them, it makes sense for the charity to own the policy.

John and Cindy apply for the policy personally and complete the required medicals. Their insurance advisor instructs the insurance company that the policy is intended to be owned by a charity.

After the insurance company approves their application, John and Cindy take delivery of the Life Insurance contract and are all set to donate the policy and ongoing premiums to charity.

John and Cindy instruct CHIMP to direct the insurance proceeds to Ecojustice. Ecojustice has been made aware of the future gift and offers to find donors who are willing to fund the premium in the event John and Cindy no longer wish to, ensuring that Ecojustice is the ultimate beneficiary of the insurance proceeds via CHIMP.

If John and Cindy decide not to pay future premiums, Ecojustice will instruct specific donors to make their donations to CHIMP, who now owns the policy, with the understanding that CHIMP is holding that policy in trust for Ecojustice. Another option is for CHIMP to distribute the insurance policy to Ecojustice, allowing the charity to directly control the policy on its own behalf.

STRATEGY: PAYING THE PREMIUMS ON PURCHASED POLICY

While the charity will gladly accept being the owner of any type of Life Insurance policy, it's preferred that the policy is a permanent policy, whereby the insurance proceeds will pay out whenever the insured passes away (as opposed to a term policy, where the proceeds only pay out if the insured dies during the term of the policy).

Having a charity own a Life Insurance policy provides the donor with an opportunity to create some immediate tax relief.

Where it is desired to create the tax benefits during the donor's lifetime, the charity must own the Life Insurance policy. Once the insurance contract has been issued, the donor can then transfer the policy to the charity without an adverse tax consequence.

When underwriting the insured, the insurance company should be made aware of the proposed transfer of ownership to the charity. In many such instances, it is often easier for the donor to be the applicant and initial owner of the policy with the charity as the beneficiary. If there are any underwriting problems, including health issues, the insurance company will notify the applicant, not the charity.

As compared to donating an existing Life Insurance policy, when donating a new policy, a donation receipt is not issued (since the policy itself has no inherent value). In this type of arrangement, it is assumed that the donor commits to funding the ongoing insurance premiums. The donor then has the choice to pay the premiums to the charity, who will forward the funds to the insurance company, or pay the premiums directly to the insurance company.

The CRA has indicated in Archived Interpretation Bulletin IT-244R3, "Gifts by Individuals of Life Insurance Policies as Charitable Donations" (September 6, 1991) that the fact that a donor makes a cash contribution to a charity and specifies that it be used to pay the premium on a Life Insurance policy does not influence the determination of whether the donation qualifies as a gift under subsection 118.1(1) of the Act. Likewise, if the premiums are paid directly to the insurance company, the premiums will be considered a constructive payment of a donation to a charity and will, therefore, be considered a charitable gift.

If the donor ceases paying premiums, the charity may continue to pay the premiums or find a replacement donor to fund the premiums to keep the policy in force.

The policy could also be surrendered for its cash value, if any. If the policy has been in force for several years, it may be beneficial to the charity to keep the policy, as the timeframe to the insured's life expectancy has shortened.

The Happy Financial Analysis

	Gift of Premiums
Value of Insurance	1,000,000
Annual Premium Gift	(18,950)
Donation Receipt	18,950
Donation Tax Benefit	9,039
Net Cost of Gift	(9,911)
Lifetime NPV Cost to Donor	**(151,094)**
Impact Capital Created	**1,000,000**
Compound Return at age 80	**20%**

VII. Purchasing a Policy & Gift of the Death Benefit

From the donor's perspective, the use of a Life Insurance policy allows the donor to make a large gift at death and use the donation receipt from the gift to offset taxes that'll arise at death. The charity benefits from the gift, and by replicating this plan among their donor base, the charity increases the frequency by which these gifts are created.

CASE STUDY: JOHN AND CINDY HAPPY

After discussions with their family and estate planning advisors, John and Cindy Happy decide to make a significant charitable gift upon their passing. Their $1,000,000 Joint Last to Die Life Insurance policy has level lifetime premiums, and they make annual premium payments of

$18, 948 for life. After reviewing the analysis of their options to own the policy, they decide it makes sense for them to own the policy personally.

John and Cindy name CHIMP as the beneficiary under the policy as their charity of choice and provide instructions in their will that the funds are to be distributed by CHIMP. John and Cindy use CHIMP to donate to a variety of charities because it simplifies administration and allows them various other benefits, including the ability to donate anonymously. The will directs the executor to instruct CHIMP to distribute the insurance proceeds to their chosen charities, Ecojustice and several others.

STRATEGY: GIFT OF THE DEATH BENEFITS

Where it is desired to create tax benefits to offset taxes at death, the policy is owned and maintained by the taxpayer or their representative company for the life of the insured.

The policy used in this type of arrangement can be an existing policy or a new policy.

In this type of arrangement, the donor has complete control over the Life Insurance policy since the donor retains ownership and can change the use and purpose of the policy during their lifetime without consulting the charity. The reason that this is possible is because the charity does not provide tax receipts during the donor's lifetime relating to this policy. The tax receipt is issued by the charity once the death benefit is received.

The Happy Financial Analysis

	Gift of Death Benefits
Value of Insurance	1,000,000
Lump Sum Gift	(1,000,000)
Donation Receipt	1,000,000
Donation Tax Benefit	477,000
Total Premiums	454,752
Gain to Estate	**22,248**
Impact Capital Created	**1,000,000**
Compound Return at age 80	**13%**

VIII. Shared Ownership of Life Insurance Policy with Cash Value

Permanent Life Insurance policies come in many shapes and sizes, but they all can be maintained for the lifetime of the insured and they all will pay out a death benefit (unless the policy is cancelled by the owner of the policy). Permanent plans can develop cash values and can be paid up so that they stay in force for the life of the insured.

CASE STUDY: JOHN AND CINDY HAPPY

After donating to their favourite charity for years, John and Cindy Happy decide they want to make an even more significant gift upon their passing. They set up a $1,000,000 Joint Last to Die Life Insurance policy. After reviewing all the various permanent Life Insurance options, they decide to set up a policy that has level lifetime premiums for the *Base Life Benefit* and make additional annual Excess Deposits for 10 years. The policy cash value is earning 4.6% and will accumulate on a tax-deferred basis. The premium is $18,948 payable for life, plus an additional Excess Deposit Maximum of $48,000, which is optional, that they also want to pay for life. After reviewing their options, they decide it is best for them to own the policy personally.

They update their will, directing the executor to instruct CHIMP to distribute the insurance proceeds to their charity of choice, Ecojustice.

STRATEGY: SHARED OWNERSHIP OF LIFE INSURANCE POLICY WITH CASH VALUE

The cash value of a permanent insurance policy is not subject to annual taxation as long as the policy is an exempt policy. This tax-deferred account can be used as a supplemental retirement accumulation account to pay the internal insurance charges within the policy from investment earnings or to support a loan against the policy as part of an insurance leverage strategy or can be donated.

There are two components that make up a permanent policy that can be shared between two parties, the Cash Accumulation Account and the death benefits of the policy. This works the same way that a bond can be separated into distinct instruments: the underlying bond and the interest coupon.

While the insured is alive, the cash accumulation account of the policy can belong to one party and the death benefit(s) can belong to a second party. Additionally, there are two distinct death benefits that can be shared between the two parties: Base Life Benefit (most permanent policies) and *Fund Value Rider* (Universal Life policies) or *paid up additions* (Whole Life or Hybrid Life policies). The Fund Value Rider ensures that the estate receives the accumulated cash value of the policy at the death of the insured. The cash value can be invested in traditional investment options within the policy and can be leveraged on a favourable basis.

One situation where the two features of a policy can be shared is in the case of a donor and a charity. The charity would have the interest in the death benefit similarly to other strategies of gifting insurance for charitable purposes.

Where a policy is shared, the charity would have an equity interest in the policy by way of a claim on the death benefit.

The charity would be the owner and beneficiary of the base benefit of the policy. This provides security for the charity, ensuring the policy is properly maintained until the death of the insured. The cash value feature of the policy would be owned by a different party. The cash value owner would have an equity interest in the policy by way of a claim against the cash value of the policy. At death, each beneficiary would be entitled to the separately identified death benefits outline above.

The attractiveness of this strategy is that the charity can benefit from the receipt of the death benefit, while the other interested party receives a donation tax credit for the payment of the death benefit premiums and will receive insurance proceeds on death for their estate. In addition, the other party can use the tax-deferred account for retirement planning.

Shared ownership arrangements should be set up with the guidance of a tax advisor.

All appropriate documentation should be drafted and signed to ensure that all parties to the arrangement understand their rights and obligations and to ensure that the arrangement is tax compliant.

The Happy Financial Analysis

Charity	
Base Life Benefit	1,000,000
Annual Premium Gift	(18,950)
Donation Receipt	18,950
Donation Tax Benefit	9,039
Net Cost of Gift	(9,911)
Lifetime NPV Cost to Donor	**(151,094)**
Impact Capital Created	**1,000,000**
Compound Return at age 80	**20%**

Donor	Cash Value Death Benefit	IRR @ 4.6%
$48,000 to age 70	269,869	3.94 %
$48,000 to age 75	611,781	4.37%
$48,000 to age 80	1,027,064	4.32%
$48,000 to age 85	2,073,261	4.48%

IX. Shared Ownership of Life Insurance with Leverage

This strategy is identical to the Shared Ownership scenario above; however, rather than simply relying on the insurance company returns to grow the value of the policy, an extra step is added.

CASE STUDY: JOHN AND CINDY HAPPY

John and Cindy Happy set up a policy that has level lifetime premiums for the Base Life Benefit and decide to make additional annual Excess Deposits for 10 years. The policy cash value is earning 4.6% and will accumulate on a tax deferred basis. The premium is $18,948 payable for life, plus an additional Excess Deposit Maximum of $48,000 that they also want to pay for life.

John and Cindy wish to leverage the policy to improve their overall cash flow.

In addition to setting up a shared ownership policy with CHIMP and making Excess Deposits to the policy (as in case IX), John and Cindy enter a loan arrangement using their Life Insurance policy for collateral. The Happys' policy is with an insurer that offers an internal credit facility with the option of using a third-party lender (such as a bank). John and Cindy already have an excellent relationship with their banker, and their accountant manager arranges to have the policy assigned to the bank as part of securing a $2,500,000 line of credit. They are able to get the loan at Prime plus .25% or 3.20% on a floating rate basis. After each deposit to the policy, an approximately equal amount to the deposits becomes available on that line of credit. The amount available each time is subject to the individual terms of the loan that is set up and, the options are numerous.

The proceeds of the loans are invested in a managed portfolio outside of the holding company that owns the policy. It is in Cindy and John's personal name and is managed by their portfolio manager in the same way their other investments are managed. Each month, an interest payment is made to the lender and is deductible against their personal income each year.

It is also possible to capitalize the loan interest and have it paid off at death. The rule of thumb is as long as the investment earnings inside the policy are equal to or greater than the borrowing costs, the loan can continue to be capitalized. This ensures that the loan will never exceed the cash value of the policy.

There may be tax consequences at death; however, in John and Cindy's case, there will be sufficient Capital Dividend Account credits, along with the outside investment account that allows for the repayment of the loan on a tax-free basis. The loan is repaid with the Fund Value Rider death benefit that is always equal to the cash value of the policy.

STRATEGY: SHARED OWNERSHIP OF LIFE INSURANCE POLICY WITH LEVERAGE

The policy is assigned to a financial institution for collateral and a loan is taken out equal to up to 100% of the cash value. This means that capital that is securing the loan is growing on a tax- deferred basis and the equivalent amount of capital is available to invest in other investments outside of the policy.

This strategy adds a level of complexity to the insurance structure; however, it has proven to be effective in creating cash flow benefits.

Leveraging Life Insurance policies is common in business and estate plans as an effective way to improve cash flow.

When considering this approach to funding insurance, it is important to work with an advisor experienced in leveraged insurance strategies. They can help you manage the program in a seamless and effective way avoiding some of the pitfalls that can arise.

COVE CONTINUITY
ADVISORS INC

270—2255 Dollarton Highway
North Vancouver, BC V7H 3B1
T: 604.924.9152
Toll Free: 888.783.5402
www.coveadvisors.com

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