Corporately Owned Insurance

By Tracy Broeze, CFP

Most business owners, sooner or later, recognize the value of incorporating. We all want protection from litigation and why pay more tax than we absolutely have to?

As the incorporated operating company, or opco, grows and begins to have excess cash, the value of the addition of a holding company, or holdco, comes into focus. In order to qualify for the small business exemption, at least 90% of the value in the operating company must be used in an active business, so if the investment value within the corporation is over 10%, the company is disqualified for the small business exemption. Even the thought of losing a tax break of $750,000 is simply staggering. So to shelter the extra cash in a holdco only makes sense. A holding company simply holds the investment assets of the operating company. The addition of a holdco will also further reduce the yearly tax bill on income within the holdco to 16%.

Individually, we also understand the need for risk management. If a couple buys a house using a mortgage, we know that if an income is lost to the household, then the household may not be able to afford to continue in the family home. Insurance coverage for mortgage cancellation and income replacement is a perfect solution for this worry and can be obtained fairly reasonably if health is good.

In addition to personal risk management, there is business risk management. Here again, insurance can be used to cover liabilities or final taxes so that the surviving spouse doesn't need to worry. Insurance can also be used to fund a share buyout if the company has more than one owner.

Along with holding the operating company investment assets, the holdco can also hold the insurance policy. The value of sheltering the insurance in this manner is a simple matter of tax. If the insurance premium is $1,000 per year, then an individual earning taxable income in the highest bracket of 46.41% would need to earn $1,866 gross to pay $1,000 after tax. If the same premium is paid by the holding company at a tax rate of 16%, then the before tax amount needed is $1,190, a savings of $676.

At death, the insurance value is paid tax free to the corporation and received into the Capital Dividend Account. The value of the insurance minus the Adjusted Cost Base of the policy can be paid out as a Capital Dividend and is therefore tax free to the beneficiary. The value of the ACB is taxable but represents a very small percentage of the actual coverage. The savings on the cost of the insurance far outweighs any tax that may be owed on the ACB at collection.

For the business owner who wants to have added estate value, insurance held within a holdco makes excellent financial sense. It can also be used for tax deferred retirement savings if desired. The benefits are so great that it may even be appropriate to change the ownership on an existing policy. Proper evaluation must be done in advance of making any changes, however. Transferring the title on an existing policy can have tax consequences.

Be sure to have professional advice when implementing this type of strategy. Call us for assistance with your personal situation.