Tax-advantaged Growth Through Universal Life

Canadians who maximize RRSP and pension contributions and need another means of tax advantaged growth to supplement their savings are increasingly looking to Universal Life insurance.

Universal Life is an insurance product but it also has some attractive investment features. Deposits to the policy over and above the premium are funnelled into an investment account, which can be allocated to a variety of investment options. The funds can accumulate on a tax deferred basis, although there are constraints on the size of the investment component under the Income Tax Act. In addition, a Universal Life policy can be paid out to named beneficiaries on a tax-free basis after death.

The Universal Life policy can be used to provide retirement income either by making withdrawals from the plan or – in an innovative feature – by pledging the plan as collateral for a loan. Over time, the cash value of the deposits in the investment account can have significant accumulation, which can be withdrawn, if required. The proceeds upon withdrawal may be subject to taxation.

A Stream of Tax-free Income

Some people choose an alternative path, however, pledging the plan as collateral for a series of bank loans during their retirement years. That sets up a stream of annual income that does not face taxation because it is a loan. The loan is then repaid from the insurance payout after death, and any amount in excess of what is owed is paid out to designated beneficiaries, tax-free.

Universal Life is a flexible product that can be customized to your needs. If your financial situation changes, for example, you can alter the amount of your premium payment, subject to certain restrictions of the Income Tax Act and the need to maintain sufficient value within the contract to pay all insurance costs and other expenses. You can also increase or decrease the amount of insurance, add additional lives insured, or substitute one life for another.

Universal Life is not for everybody. Experience shows it's best for those who:

• are above the age of 35, which allows significant time for accumulation and growth;

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• are in good health;

• are taxed in the highest bracket;

• have paid down non-tax deductible debt such as their mortgage,

• maximize their RRSP contributions, but still have funds that they want to shelter from taxes until they retire.

The plan may also be appropriate for major shareholders in a mid-sized business who would like their company to set aside additional funds on a tax-sheltered basis for their retirement.

Universal Life is a complex product, and it may not be for everyone. It's best to have your life insurance licensed Investment Executive walk you through the variety of Universal Life choices available to you.

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