

# The Established Years

## Strategies to ensure your financial security



The strategies you need to achieve your goals are as individual as you are. So while we can't make specific recommendations here, we want to give you an example of how insurance can be used to manage the risks to your business and personal financial security – while providing tax-advantaged investment and wealth management opportunities.

One of our TD Waterhouse® Life Licensed Advisors<sup>1</sup> developed this sample scenario of a typical business to illustrate how certain insurance strategies might give the owners the peace of mind and financial tools they need during the established years of their business. Please remember that there are a variety of other strategies that may also be appropriate for your situation. We look forward to working with you to develop a customized plan that is uniquely yours.

### Imagine Pack Brothers Luggage Shop<sup>2</sup>

- Owned by three brothers, this successful retail and manufacturing business employs 120 people.
- The business is valued at \$30 million and is owned equally by the three.
- Ages 45, 48 and 52, the Pack brothers are non-smokers and each draws \$300,000/year.
- The daughter of one of the brothers is the CFO.

### Their situation

#### Assets

#### Operating Company (OpCo)

Annual sales . . . . .	\$15,000,000
Goodwill . . . . .	\$10,000,000
Fixed assets, equipment and real estate . . . . .	\$20,000,000

#### Holding Company (HoldCo)

Each brother holds his shares in a HoldCo that has cash or cash equivalents invested in fixed income vehicles. . . . .	\$3,000,000
--	-------------

- The brothers have a Buy-Sell Agreement in place, based on the \$30 million valuation, but have not funded its provisions.
- Key Person Coverage for the owners and CFO is in place, as are corporate-owned Disability and Critical Illness Insurance policies for each individual.
- The company has a Group Insurance program that provides medical, dental and disability insurance to all full-time employees to help improve morale and reduce turnover.

### Their objectives

- Over the years, the operating company dividends “trapped” inside each of the brothers' HoldCos have grown to \$3 million each. Neither the brothers nor OpCo have an immediate need for this surplus capital. But their HoldCos are taxed at the highest corporate tax rate, and if they take the money out as salary or dividends it will be taxed at their highest personal tax rate. They want to find tax-effective strategies to release the capital.
- The brothers also want to find retirement strategies that will maximize their income while minimizing taxes, wherever possible.
- They're concerned they've put off funding their Buy-Sell Agreement and want to insure as much as possible of the \$10 million that will be required should any of them have to be bought out.

## Our TD Waterhouse Life Licensed Advisor's recommendations<sup>3</sup>

As the first step in tailoring a plan for the Pack brothers, our TD Waterhouse Life Licensed Advisor would conduct a comprehensive review of the business and owners' circumstances and determine the funds available for insurance. The brothers have joint funds of approximately \$275,000 annually plus the cost of the individual retirement plans (\$200,000 each for 10 years) to use to achieve their objectives.

After careful analysis, our TD Waterhouse Life Licensed Advisor recommends a combination of Corporate Surplus Shelter, Insured Buy-Sell Funding (including life, critical illness and disability) and Executive Retirement strategies to address the owners' immediate needs, while providing flexibility to accommodate their evolving plans.

The table below summarizes the various products that can be used when the owners are in good health to effect these strategies. On the next page is the allocation of available funds among the specific products chosen, followed by an overview of the coverage details and a rationale for each recommendation.

### CORPORATE SURPLUS SHELTER OPTIONS

#### Universal Life Insurance

- Combines permanent death benefit protection with tax-advantaged investment opportunities.
- Surplus capital grows tax-free inside the policy. On the death of the insured owner, the company receives a tax-free death benefit, which, minus the adjusted cost base, is credited to the Capital Dividend Account and can be paid out, tax-free, to Canadian resident shareholders (heirs).

#### Whole Life Insurance

- Remains in force for the life of the insured and offers a tax-advantaged build-up of cash value.
- The investment component is professionally managed.
- Guaranteed level premium and minimum death benefit.

### INSURED BUY-SELL FUNDING OPTIONS

#### Term Life Insurance

- Provides a tax-free death benefit for a fixed number of years (e.g., 10-year term) or until the insured reaches a specified age.
- Offers a relatively large amount of coverage for a relatively small premium.
- Typically the cost of coverage remains level throughout the term and the policy may be extended or converted to permanent coverage without proof of health.

#### Disability Buy Out Insurance

- Provides a lump sum benefit after an insured person has been totally and permanently disabled for a defined period.

#### Critical Illness Insurance

- Provides a lump sum benefit if an insured person is diagnosed with any of a number of medical conditions such as heart attack, cancer or stroke.

- Benefits do not depend on the insured being “totally and permanently disabled”. (Even though the critically ill owner may be capable of returning to work, it may be best for all concerned if he or she does not.)

### EXECUTIVE RETIREMENT OPTIONS

#### Individual Pension Plan

- A defined benefit pension plan designed for an individual.
- Because funding for the benefit is actuarially determined, it can enable high-income earners (age 40+) to accumulate significantly more capital than is possible in either an RSP or a defined contribution pension plan.
- Retirement income is based on a pre-retirement income formula and a tax-deferred inter-generational transfer of assets may also be possible.

#### Insured Retirement Plan

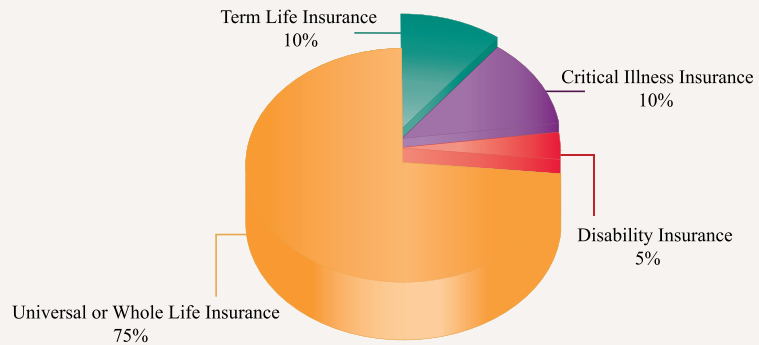
- Combines the tax-advantaged benefits of an exempt life insurance policy (either Universal or Whole Life Insurance) with potentially tax-free future cash flow.
- The value of the policy is maximized pre-retirement. When retirement income is required, the policy is used as collateral for a bank loan. The loan is structured with deferred interest and, at death, the tax-free benefit is used to pay off the loan and the balance passes to beneficiaries.

#### Retirement Compensation Arrangement

- A special non-registered retirement plan that a company may establish to supplement the retirement income of individuals whose employment income exceeds a certain threshold.
- The plan is governed by federal legislation to ensure the accumulated capital is used for retirement income.
- Typically, there are significant tax-related advantages if the investment component is inside an exempt life insurance policy (either Universal or Whole Life).

## Funding allocation

This graph shows the approximate allocation of available funds<sup>4</sup> to achieve the business owners' objectives. These funds are in addition to the premiums for the Key Person and Group Insurance already in place.



## Recommended coverage

Type of coverage	Amount of coverage for each owner	Rationale
<p><b>Term Life Insurance</b> (20-year term) <b>Owner:</b> HoldCo or OpCo<sup>5</sup> <b>Beneficiary:</b> Owner</p>	\$10,000,000 per individual	This is the death benefit funding for the brothers Buy-Sell Agreement, enabling the corporation to buy back the shares from the deceased's estate. The coverage could be either individual Term Insurance policies or one or more Term Riders on permanent insurance policies.
<p><b>Disability Insurance</b> (Lump sum payment after 1 year disability – Return of Premium after 20 years) <b>Owner:</b> HoldCo or OpCo<sup>5</sup> <b>Beneficiary:</b> Owner</p>	\$1,000,000 per individual	The brothers' Buy-Sell Agreement includes a disability buy-out clause in recognition of the fact that a permanent disability suffered by any one of them could put the firm in serious jeopardy. The maximum coverage currently available in Canada is \$1 million. They have set up a separate side fund to provide the balance of the necessary funding.
<p><b>Critical Illness Insurance</b> (Return of Premium after year 20) <b>Owner:</b> HoldCo or OpCo<sup>5</sup> <b>Beneficiary:</b> Owner</p>	\$2,000,000 per individual	This coverage is the third component in the funding of the brothers' Buy-Sell Agreement – and \$2 million is the maximum benefit currently available. The owner-company may cancel the policy in year 20 and receive a return of all premiums paid. As with the disability coverage, the side fund will provide the balance of the funding.
<p><b>Permanent Insurance</b> (Universal or Whole Life) <b>Owner:</b> HoldCo <b>Beneficiary:</b> HoldCo</p>	Each HoldCo would deposit \$200,000 annually for 10 years. The \$2 million total deposit would then generate individual retirement benefits of approximately \$200,000, after tax, or two-thirds of their current salary.	<p>Permanent insurance funded in this way shelters the capital surplus in each HoldCo, allowing the money to grow tax-free. This is also a highly efficient way to accumulate capital that can be assigned and then borrowed against to provide tax-free retirement income, withdrawn or accessed through policy loans. In addition, any policy value not used during retirement will pass through each HoldCo's Capital Dividend Account (less the Adjusted Cost Base) for tax-free distribution to the deceased brother's estate.</p> <p>To maintain flexibility, the HoldCos have retained at least \$1 million for salaries, dividends, insurance premiums or funds for OpCo.</p>

## Ensure your financial well being

As a TD Waterhouse client, you have access to an exceptional team of banking, estate, trust, insurance and investment professionals who work together to deliver sophisticated wealth management solutions. As an integral part of this team, your TD Waterhouse Life Licensed Advisor is an objective specialist who has been carefully trained to provide a customized strategy using products from a variety of leading insurance suppliers.

Protect your business and personal financial goals – and the well being of your family. Find out what specific strategy recommendations your TD Waterhouse Life Licensed Advisor has for your unique situation.

*We look forward to being of service.*

<sup>1</sup> TD Waterhouse Life Licensed Advisors are licensed insurance agents of TD Waterhouse Insurance Services Inc. They offer insurance products from a variety of leading insurance suppliers.

<sup>2</sup> The people and situations identified in this brochure are fictional. The life stages and strategies identified are presented for illustration purposes only and are not intended to reflect the full range of stages or strategies available to customers. These examples are intended to assist customers in identifying their needs. While assumptions and values used for the examples were reasonable at the time the examples were prepared, using tax laws in effect at that time, they are for illustration purposes only. The circumstances emphasize the attributes of the products and strategies being described.

<sup>3</sup> The insurance strategies described are not always appropriate. Particular insurance strategies should be evaluated in consultation with a TD Waterhouse Life Licensed Advisor or other professional.

<sup>4</sup> While the allocation of funds is the same for each of the three brothers, the premium depends on the age of the individual.

<sup>5</sup> Whether policies should be owned by HoldCo or OpCo will depend on accounting and legal advice.

All insurance products and services are offered by licensed agents of TD Waterhouse Insurance Services Inc., a member of TD Bank Financial Group. All insurance products contain certain restrictions, limitations and terms for continuing coverage as outlined in the specific policy documents. Please be sure to read all materials carefully.

®Trademark of The Toronto-Dominion Bank. TD Waterhouse Insurance Services Inc. is a licensed user.

