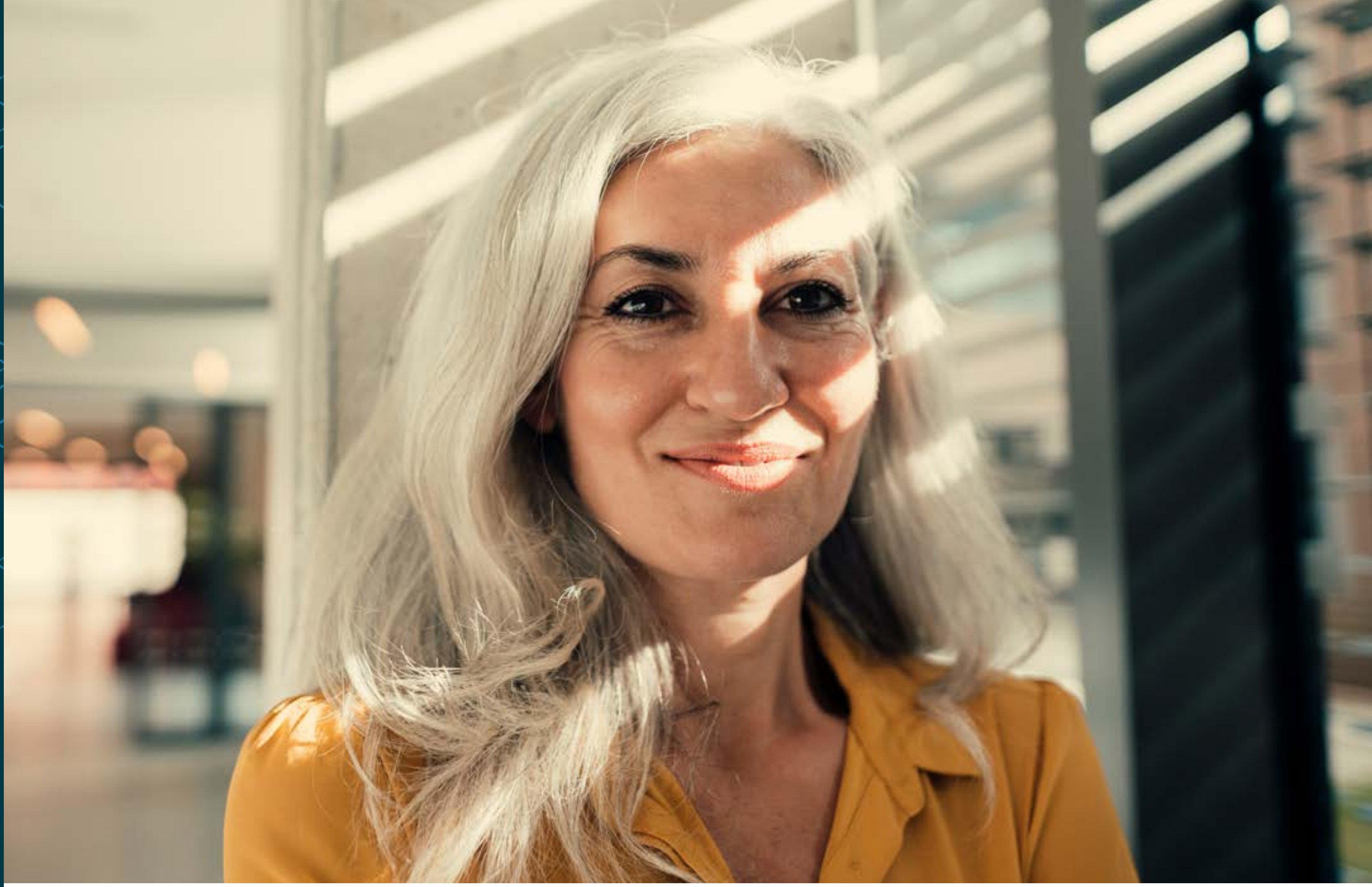

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Corporate vs. shareholder borrowing

There are various ways a policyholder can access cash inside their permanent life insurance policy[1]. The most popular option is the collateral loan, i.e., assigning the policy's cash value as collateral to obtain a loan from a third party financial institution.

For corporate-owned insurance, the most common question is whether the collateral loan should be obtained by the corporation or by the shareholder.

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Let's look at the considerations for each borrowing type

	Corporate (corp) borrowing	Shareholder borrowing
Purpose of loan	To reinvest back into the corp or to distribute out as a taxable dividend	To personally invest or to spend
Loan interest deduction allowed?	Yes, if loan proceeds are invested to earn income from a business or property	Yes, if loan proceeds are invested to earn income from a business or property
Net cost of pure insurance (NCPI) deduction allowed?	Yes, if loan interest is being deducted (and is also allowed after offset year on Par for the duration of the guaranteed premium period)	No, policyowner and borrower must be the same to claim NCPI deduction
Guarantee fee (paid by shareholder to the corp)?	Not required	Yes, so loan is not seen as a taxable benefit to shareholder
Guarantee fee deductible?	Not applicable	Yes, if loan interest is deductible
Excess capital dividend account (CDA) available?	Yes, when (death benefit-loan balance) < CDA	No
Loan financing fees?	Yes	Yes
Repayment of loan at death	Death benefit proceeds paid to corp are used to pay loan owed by corp	Death benefit proceeds must first come out of corp (net of CDA) for shareholder's estate to pay off personal loan*

[1] Refer to our recent rethink on Liquid Life Insurance.

*Lenders may require personal assets/estate assets to be used as collateral before releasing the policy as security for the loan. The loan balance can then be paid off using either personal assets or death benefit proceeds that are coming out of the corp as CDA.

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Let's look at an example of the net estate values for corporate borrowing and shareholder borrowing

$1,000,000
Death benefit (DB)

$100,000
Adjusted cost basis (ACB)

$900,000
Credit to CDA = DB – ACB

$200,000
Loan balance (LB)

45%
Shareholder dividend tax rate

	Corporate (corp) borrowing	Shareholder borrowing
Death benefit paid to	Corporation	Corporation
Loan repaid by	Corporation	Shareholder (or the estate)
Net to corp at death	DB – LB $800,000	$1,000,000
Excess CDA (if > 0) **CDA – net to corp**	$100,000	$0
Excess CDA tax savings	$45,000	$0
Net to estate	Net to corp + excess CDA tax savings $800,000 + $45,000 = $845,000	Net to corp – ACB × tax – LB $1,000,000 – $100,000 × 45% – $200,000 = $755,000

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Takeaway

Corporate borrowing results in a higher net to estate value by $90,000 in this example. As well, while alive, corporate borrowing allows for NCPI deductions while shareholder borrowing requires a guarantee fee to be paid. But with shareholder borrowing, it's a way to access tax-free loans (income) to typically spend rather than extracting money out of the corporation paid out as a dividend or as income.

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