Four Reasons It Makes Sense To Buy Life Insurance In Retirement

Darren Farwell

Many Canadians have a fairly narrow view of life insurance, thinking of it only as a tool for managing risk, with a primary focus on providing financial relief to loved ones in the event of an unexpected death

Although this is a great reason to buy life insurance, it is not the only reason. Many of Canada's most affluent families are not only buying life insurance to manage risk, but are also buying life insurance for tax and estate planning purposes.

Although life insurance is generally less expensive the younger you are, it should be noted that most insurers in Canada allow individuals to purchase life insurance right up to age 80.

Below are four reasons why individuals approaching or in retirement would consider purchasing life insurance.

1. Leaving A Legacy To Children Or Grandchildren

Life insurance isn't just for people managing the risks associated with raising a family. It can also be a useful tool for leaving a legacy for your heirs. Consider this example. A retired couple may want to leave an estate to their children or grandchildren, however at the same time they want to spend their retirement funds on travel and other entertainment, without feeling like they are spending too much money and hence depleting the estate they plan to leave to their three children. In this example, the parents would like to leave $500,000 to each child. Life insurance can be used in this scenario to provide a tax-free death benefit to each child upon the death of the last surviving parent. This requires purchasing a life insurance policy based on the lives of both parents for a total death benefit payable on a joint last to die basis for $1,500,000. This would ensure that $500,000 per child would be available upon the last parent's death, hence the term joint last to die. Parents can now enjoy their hard-earned savings, confident that they are still providing significant funds to their children even after they are gone.

2. Cover Potential Estate Taxes Due On Death

Another consideration for a retiree may involve ensuring that family traditions continue after their death. If your family has an income property, a cottage, or another vacation property like a ski chalet, insurance can be a useful tool to cover estate taxes owing on non-principal residences upon the retirees' death.

For many children and grandchildren, it's an agonizing decision to give up a beloved family cottage upon the death of a parent or grandparent because the taxes owed by the estate are just too much to pay. Rather than forcing your heirs to decide to pay the outstanding taxes or give up a time-honoured tradition, a life insurance policy could be purchased on the life of the property owner with a death benefit equal to the tax liability. Upon the death of the owner, the life insurance proceeds would be used to pay the outstanding tax liability, and the cottage could then be passed to the next generation.

3. A Tax-Efficient Alternative To Fixed Income Investing

Beyond managing risk and helping to pay estate taxes, life insurance can be a prudent financial investment when compared to traditional conservative investments like GICs or bonds.

Consider this scenario. Mark, a 68-year old male retiree wants to invest $50,000 a year for the next 10 years towards a conservative investment. Mark does not need access to this pool of capital, and plans to leave it to the next generation. Mark could invest in traditional GICs, however with current GIC rates being so low, he is looking for an alternative approach. As a result, Mark decides to reallocate the $50,000 a year for the next 10 years into a permanent life insurance policy. Assuming Mark dies at age 90, the life insurance policy would pay out a death benefit to Mark's beneficiaries of $1,045,000, an increase of $545,000 over a 22 year period.

For the GIC investment to provide the same estate value as the life insurance policie's death benefit proceeds, the GIC would have to earn an average annual before-tax rate of return of 8.67% (assuming a 53.53% tax rate) which is quite high considering current GIC rates of about 2.5%.

4. A Tax-Efficient Way To Contribute To Charities And Causes That Matter To You

To me, this is one of the most exciting ways that life insurance can help people leave a meaningful legacy, not only to their family but to their wider community. You can use life insurance to contribute to causes and charities that matter most to you.

Here's another scenario to explain the idea. A woman I'll call Sandy sold her company at age 70. Based on the sale of her company and with all her other investments, she is confident that she has all the money she needs to retire comfortably. As per Canadian legislation, at the end of the calendar year Sandy turns age 71, she must convert her Registered Retirement Savings Plan (RRSP) into Registered Retirement Income Fund (RRIF). Then at age 72, legislation dictates that Sandy must start withdrawing a minimum prescribed percentage from her RRIF each year. The prescribed percentage that must be withdrawn each year is predetermined by the government, based on your age at the time of withdrawal. It's important to note, that while there is a minimum that needs to be withdrawn each year, there is no set maximum.

The good news is, Sandy is doing quite well, and doesn't need the income the RRIF will produce. However, due to legislation she will need to commence withdrawals at age 72. Any RRIF withdrawals will be considered taxable income from a Canada Revenue Agency (CRA) perspective, and will be taxed at Sandy's highest marginal tax rate. Since Sandy doesn't really need the income, she is looking for a way to reallocate these RRIF payments to a strategy that will help her achieve some of her other aspirations, while at the same time, mitigate the tax consequences these RRIF withdrawals will create.

A proud alumna of her university, Sandy remembered not being able to afford her third year tuition when she was a student all those years ago. She received a bursary in the name of a private family foundation and Sandy was enormously grateful for the hand up to help her complete her studies.

Sandy wanted to do something similar. As a result, she purchased a 10 year pay life insurance policy with an annual premium of $32,000 payable over the next 10 years on her life and named the university as the beneficiary and the owner. She then withdrew $32,000 per year in taxable income from her RRIF and used it to pay the annual insurance premium. Since the policyowner is the charity, this means the insurance premiums are considered a charitable donation as they are made, and the tax savings realized as a result of those donations help mitigate most of the tax that was generated from the RRIF withdrawal.

Upon Sandy's death, the university will receive a benefit of $430,000 that may be used to support many students for years to come. Through insurance, Sandy is giving a hand up to a new generation of students, just like she received all those years ago.

Insurance: A Good Investment Strategy At Any Age

Discussing the advantages of including life insurance as part of your investment and retirement strategies should be an important component of your financial planning conversations with your advisor. It can be a valuable tool to protect your family and plan for the future.

Darren Farwell is a Senior Wealth Advisor and Director, Wealth Management with The Farwell Group at ScotiaMcLeod®, and an Insurance Advisor at Scotia Wealth Insurance Services Inc., both members of Scotia Wealth Management™. Follow Darren on Twitter @ DarrenSFarwell or visit www.thefarwellgroup.com.