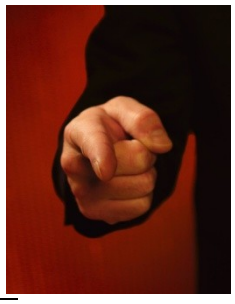
Clients want to know:

"How Much Insurance Should I Have?'



After reading this, you should understand:

➲ How to determine coverage based on need

This chapter contains some of the most important information in the Life License Qualification Program course of studies.

The agent, to properly fulfill his or her duties, must recognize the risks faced by the applicant in order to properly align client need with the type of policy that best addresses that need. Then the agent must work together with the proposed insured to determine the correct amount of coverage. The policy and the amount that is recommended may not be what the client actually acquires, but it is important for the agent to be able to illustrate his or her recommendations if they should ever be questioned by the client or a beneficiary.

Match the Policy to the Need

The best policy for the client will be the one that addresses his or her particular risks. Let's review the risks:

- Loss of income during the period of family obligations — when death is premature, dependents are deprived of a source of income while also being saddled with bills to pay. Disability, in the form of sickness or an accident, also deprives a family of an income on either a permanent or a temporary basis.
- Increased medical expenses due to sickness or injury, inadequate government coverage, or loss of government coverage while travelling abroad.
- Financial inadequacy of the estate — when someone wants to ensure a fair distribution of his or her estate after death, and to ensure that funds are available to both pay the bills and look after last requests.
- Inadequate income during retirement — in short, when one outlives his or her money.

Why is it important to insure an estate?

A To pay outstanding financial obligations of the deceased
B To ensure that funeral expenses, probate costs, taxes, and other debts are paid
C To ensure that a fair distribution of estate proceeds can be made in an unobstructed fashion
D All of the above

Insuring Against the Risk of Permanent Loss of Income

Life insurance provides protection against the permanent loss of income caused by premature death. A life-insurance-needs analysis that the agent completes with the client identifies the immediate, ongoing, and future expenses that dependents face in the absence of a lost income. Income needs should also recognize income-in-kind (e.g., a spouse providing child care at home).

It is important to take income-in-kind into consideration when assessing need. If a stay-at-home mom can no longer provide child care, then costs of day care or nanny services will be a cost for the survivor to pay.

The three phases of financial dependency and the costs that survivors will face during these phases are:

- Readjustment period/last expenses;
- Dependency period/ongoing expenses;
- Survivor life income needs/future expenses.

Readjustment Period/Last Expenses

Emergency fund
Financial planners advise clients to have the equivalent of three months' income available in case of emergency.

The bills that must be paid immediately after death are known as last expenses. They include funeral costs, probate fees, payments of debts such as loans, credit cards, and the mortgage, since it is assumed that survivors will want to continue to live in the family home without mortgage costs. It is also essential to immediately establish an ***emergency fund*** for survivors.

The two years that follow the death of the life insured will be a period of readjustment for survivors. The new financial structure of the family will be determined and, in cases where needs have not been adequately planned for, dependents may have to adjust to a new standard of living.

Why is life insurance so important to Canadian families?

A The cash values of most insurance policies are secure from the demands of creditors.
B Sufficient policy face values can provide capital and income relief on the death of family breadwinners.
C Not only can the lives of principal income-earners be insured, but all forms of debt can be insured.
D All of the above

Dependency Period/Ongoing Expenses

During this time, the surviving spouse must have sufficient income to provide care for the family. It is generally determined that the dependency period for children lasts until the youngest reaches the age of 18, or 25 if they are attending school on a full-time basis.

Ongoing expenses include all the daily costs of living, such as food, clothing, holidays, and saving for post-secondary education.

S***urvivor Life Income Needs/Future Needs***

This is a period of time that may be life-long for the surviving spouse. This spouse may never have worked, or may not have worked for many years. If so, financial support for the duration of his or her life may be needed.

In addition, a retirement income for the spouse may be required if he or she has limited employment opportunities.

A surviving spouse who has been out of the work force for many years may have to take a lower-level job that does not supply enough income just to try and re-establish skills.

Life insurance has other principal functions besides making a cash payment on the death of a life insured. What are they?

A Insurance can provide an emergency cash reserve.
B It can provide capital to pay "last expenses" and operating capital during a family's readjustment period.
C Life insurance proceeds generate a financial lump sum that can be used to cover a family's current and long-term operating expenses.
D All of the above

How is Life Coverage Determined?

Qualitative goals
Qualitative goals are "quality of life" goals. They reveal lifestyle choices that have a direct bearing on expenses, risk tolerance, and investment choices. For example, a family that chooses to vacation each year in England for a month has made a qualitative decision.

Quantitative goals
Quantitative goals are the dollar figures assigned to qualitative goals. For example, the family who vacations in England for a month needs $22,000 to pay for their holiday.

In order to estimate the amount of life insurance that is required, an agent must be able to assess with the client which costs would be faced by the survivors during these three phases of financial dependency. A fact-finding interview with the client will begin by establishing ***qualitative goals***. These goals define the quality of life expected, or desired, for the survivors. Then a dollar figure can be determined through the needs analysis that will ensure those goals are met. The dollar figure is the amount of money needed. This is called the ***quantitative goal***.

Driving a convertible is a qualitative choice. Such a choice is quantified by the higher cost of the vehicle and higher auto-insurance rates.

The two most commonly used methods to determine the amount of life insurance for a client are:

- The capitalization-of-income approach (or human-life-value approach);
- The ***capital***-retention approach (or capital-needs approach).

Capital
Capital refers to cash and assets that can be invested or used for financial gain. For example, capital property includes stocks, bonds, real property, mutual funds, etc.

Both approaches are based on the principle that a life has economic value. Economic value is the result of the capital, or wealth, that a person creates during their lifetime by working and saving. This is the capitalized value of life.

Each of these approaches forms a basis by which the correct amount of insurance for the life insured is determined.

- Capitalization of income is based on the notion that *only* the income of the deceased is to be replaced by the lump sum.

- Capital retention is based on the notion that the entire financial picture — assets, liabilities, and other ongoing sources of income — should be considered in determining the lump-sum requirement.

An interest rate is applied to both calculations, because it is assumed that the lump sum received from the insurance policy will be invested. The interest earned on that lump sum will provide an ongoing income to the survivors. Note that the principal is not diminished in these models. Only the interest is used for expenses. The principal forms a tidy sum that can provide the emergency fund, be available for unanticipated expenses, or create an estate for heirs.

The interest rate used to calculate the amount of insurance needed can be the "nominal" rate or "real" rate of interest. The ***nominal interest rate*** is the posted interest rate that would be received today for a deposit made to a financial institution.

Nominal Interest Rate
Also called the nominal rate of return, the nominal interest rate is the named rate of return for an investment. For example, a GIC that pays 4% interest has a nominal interest rate of 4%.

The **real** rate of interest takes inflation into account. It is calculated as the nominal rate minus the inflation rate. For instance, *if* the nominal interest rate is 3% and *if* the rate of inflation is 2%, the real rate of interest would be 1%. Using the real rate of interest provides a more accurate projection.

To determine the need for life insurance, we must calculate the lump sum that will produce enough interest to provide an income for survivors.

How do you calculate "inflation-adjusted capitalized value"?

A It is not possible to do so.
B Use the capitalized value and multiply the answer by the prevailing inflation rate.
C Use the capitalized value and multiply the answer by the prevailing interest rate.
D Take the prevailing interest or investment rate, deduct the nominal inflation rate, and complete the formula calculations.

Capitalization-of-Income Approach (Human-Life-Value Approach)

This approach to determining how much insurance is needed is based simply on how much income the proposed insured earns at the time of application.

The formula is annual income ÷ interest rate = lump sum (the human life value).

For example, if the annual income of the primary wage-earner is $30,000, and the nominal rate of interest is 5%, the total amount of insurance needed would be:

$30,000 ÷ .05 = $600,000 (the human life value)

Thus, the amount of insurance required would be $600,000.

If $600,000 is invested at 5%, the return will be $30,000 annually. The insured has, in economic terms, replaced the income-earning value of his or her life to the surviving family with a policy having a $600,000 death benefit.

This approach has a number of drawbacks: it fails to consider other sources of money, such the individual's savings; it is calculated by using a constant income stream over the life of the insured, since it is difficult to know what increase in income is probable; and it ignores the financial commitments of the family.

An insured makes $42,000 a year, and the current interest rate is 3.4%. She has a generous A&S policy, plus disability benefits that pay 70% of her salary. How much life insurance does she need based on capitalization of income?

A $1,428
B $12,352
C $142,800
D $1,235,294

Capital-Retention Approach (Capital-Needs Approach)

The capital-retention approach (also known as the capital-needs approach) is a more thorough examination of liabilities and income than the capitalization-of-income approach. It begins by valuing the assets of the individual's estate at death to determine whether needs can be met from existing resources, then obligations are determined.

Obligations are of two types: final expenses, including funeral, legal fees, taxes, debts, and the mortgage, and continuing expenses for dependents, including food, medical, and dental costs, and education funding. To successfully perform this calculation, you must memorize which expenses fall into each of the two categories: final expenses and continuing expenses.

Funding post-secondary education is a significant future expense to include in the needs analysis.

A true picture of assets is best revealed by preparing a net worth statement for the proposed life insured that adds together all assets and subtracts all liabilities to arrive at "net worth." Then a needs analysis is prepared that uses some information from the net worth statement and additional information that pertains to the death of the proposed life insured. This financial position of the life insured and the family determines whether the client needs a term insurance or permanent insurance solution.

The needs analysis will consider the mortgage as a final expense — but it does not include the value of the real estate (usually the family home) as an asset. This is because, when dependents are to be provided for, it is assumed that they will want to continue to live in the home. Therefore, the objective of the life coverage is to pay off the mortgage while ensuring the family can live mortgage-free.

The formula for the capital-retention approach is a four-step process:

Step 1: A (assets) - B (final expenses) = C (cash needs)
Step 2: D (continuing income) – E (continuing expenses) = F (income needs)
Step 3: F (income needs) ÷ interest rate = G (capitalized value)
Step 4: G (capitalized value) +/– C (cash needs)* = H (insurance needs)

* C (cash needs) may show a positive number that indicates that assets exceed expenses, or a negative number, indicating expenses exceed assets. If the cash needs are a positive number (a surplus), they are **subtracted** from the capitalized value. This is because cash is available to help meet costs on death. If there is a negative number (a deficit), they are **added** to the capitalized value. This is because there is not enough cash to help meet costs, so this shortfall must also be accommodated by the life insurance coverage.

Similarly, if income needs are a negative number, then the shortfall forms the capitalized value of the life of the proposed insured. If there are no income needs, because continuing income exceeds continuing expenses, then insurance requirements will be based on cash needs at death.

A System to Help You Remember

The capital-retention formula is one that must be memorized. Try this to help:

Step 1: **A** (**A**ssets) – **B** (**B**ills) = **C** (**C**ash needs)
Step 2: **D** (**D**ollars in) – **E** (**E**xpenses) = **F** (**F**unds required)
Step 3: **F** (**F**unds required) ÷ interest rate = **G** (**G**ross value of life)
Step 4: **G** (**G**ross value of life) +/– **C** (**C**ash needs)* = **H** (**H**ow much insurance)

Write out what the letters stand for to help you remember:

A: _____

B: _____

C: _____ _____

D: _____ _____

E: _____

F: _____ _____

G: _____ _____ _____ _____

H: _____ _____ _____

Now, write out the steps using the letters given:

Step 1:

Step 2:

Step 3:

Step 4:

Repeat this exercise until you have it memorized.

An often-overlooked asset is the group creditor life coverage that institutions such as banks provide to people who hold mortgages with them. Such coverage repays the mortgage if the person with the mortgage dies. If such coverage exists for the mortgage or another debt, the amount of personal insurance needed will be reduced by the amount of the group coverage.

Practice the Capital-Retention Formula

This worksheet gives you an opportunity to ensure that you are comfortable making the capitalized value of a human life calculation.

In this case, Stephen and Maria McDonald have asked you to estimate the cash needs of the family in the event of Stephen's death. (Answers appear below.)

As described above, the value of the home real estate is not considered an asset because the home must be retained; however, the mortgage must be paid off.

Assets	
Death benefit of CPP	$ 2,500
Investments	22,118
Cash on hand	21,903
Total current assets (student to complete)	$_____(**A***)
Final expenses	
Funeral	19,236
Legal and accounting fees	9,347
Taxes	49,278
Debts	28,472
Mortgage	257,667
Total final expenses at death (student to complete)	$ _____(**B***)
Total cash needs (**A** – **B**) *(student to complete)*	**$_____(C*)**
Continuing income	
Maria's salary $2,315/mo *(student to complete)*	$ _____
Rental income	18,220
Total continuing income (student to complete)	$ _____ (**D***)
Continuing expenses	
Housing	3,026
Food	8,160
Clothing	5,200
Medical and dental	3,400
Vehicle expenses	11,844
Entertainment and holidays	8,200
Education fund $347.50/mo *(student to complete)*	_____
Miscellaneous	8,700
Total continuing expenses (*student to complete)*	$_____ (**E***)
Total income needs (**D** – **E**) *(student to complete)*	$ _____ (**F***)
Total needs *(student to complete)*	
Total income needs ÷ current interest rate of 3.5**%**	$ _____(**F** ÷ 0.035 = **G***)
Plus/minus cash needs	$_____ **(C)**
Insurance requirements (student to complete)	$_____ (**H***)

Therefore, the amount represented by H is the amount of life insurance Stephen requires.

*Answers: A=$46,521, B=$364,000, C=$317,479, D=$46,000, E=$52,700, F=$6,700, G=$191,429, H=$508,908

In your opinion, is the "capital-needs approach" the best insurance calculation option? Choose the correct answer.

A Yes, the capital-needs approach is based on an end-needs analysis first, followed by an analysis to determine if current assets are sufficient to meet current and future income requirements.
B No, it is too complicated for the average client to comprehend, it is difficult to calculate, and it can lead to financial errors that could end in a financial shortfall for the insured.
C No, the CNA is not available to insurance agents because of its complexity — it is a tool available to and applied by insurance company auditors to insure that the correct amount of insurance has been applied for.
D None of the above

Insuring Against the Risk of a Temporary Loss of Income

The risk of being disabled is much greater than the risk of premature death, and the risk increases dramatically with age. Disability income insurance is based on the concept of replacing salary or wages lost when disability prevents work. Gainful employment is so fundamental to the concept of disability income insurance that this form of insurance is available only to those who work full-time.

Disability income insurance provides an income in the form of monthly benefits to replace income no longer being provided by an employer.

How Is Disability Insurance Coverage Determined?

Earned income
For the purposes of disability insurance, earned income means income received from employment. Income that is received without having to work, such as alimony, is not earned income.

The benefit of a disability income policy is the monthly payment received by the insured. The amount that will be received is based on many factors including:

- ***Earned income***;
- Other sources of disability benefits;
- Tax bracket of the applicant.

Earned income enters into the LLQP studies on three separate occasions, and it is important to understand the difference between the definitions:

1. The basis for determining the disability benefit:
   - Earned income means income that is received as a result of work activity. Think of this form of income as *active* income, including salary or wages, commissions, and possibly research grants and net business income. If an absence from an "undertaking" would mean income from that undertaking stops, then that undertaking is a form of earned income on which the disability benefit is based.
   - Sources of income that continue whether someone is working or not, such as royalties, alimony, pensions, and investment income, do not enter into the calculation. These forms of income can be considered *passive* income.
   - Though unearned or passive income is not covered by disability insurance, a high proportion of unearned income in the total income mix

of an individual may lead to the reduction in the amount of an eligible disability benefit or a decline to issue disability insurance.
- Therefore, though disability income policies will cover only for earned income, insurers take into account the unearned (passive) income of a person to arrive at the final disability eligibility amount for each person.

2. The basis for determining the contribution to a Registered Retirement Savings Plan (RRSP):
   - Earned income for an RRSP includes rental income and disability benefits and is therefore a combination of active and passive income.

3. The basis for determining taxable income:
   - Earned income includes all income, both active and passive.

The policy owner will receive a monthly disability benefit that is 60% to 70% of earned income, an amount roughly equal to his or her income after tax. This amount equates to take-home pay, because the benefit is received tax-free.

High income earners may find their benefit is much lower.

As a person may be entitled to make claims from different sources when disabled, the rule is that a person may not receive more income by way of disability claims than he or she was making prior to disability. In fact, the 60 to 70% rule ensures that the person is not overinsured. This is further ensured by incorporating an All Sources Maximum Clause and, optionally, an Offset clause in a policy. We will discuss these in a later section.

Disability policies have a number of variables by which the proposed insured can retain some risk, including:
- Which definition of total disability is adopted by the insured (own occ, any occ, regular occ);
- The length of time benefits will be received (called the benefit period);
- The length of time between being disabled and when benefits begin (called the elimination period or waiting period);
- The amount of benefit applied for (between 60% and 70%).

The formula to determine how much will be received is:

earned income x 60% (assuming a 60% benefit payment) ÷ 12 =
disability income benefit

For example: if the earned income of the proposed insured is $50,000 and the amount of benefit is 60%, the amount he or she would receive is:

$$\$50,000 \text{ x } 60\% = \$30,000 \div 12 = \$2,500 \text{ per month}$$

In a group plan in which the employer was the policy owner, the employer might choose to pay the premiums for the employees. If the employer shows the amount of premium paid on behalf of the employee as a taxable benefit to the employee, the disability benefit received from the group policy is tax-free. If the employer pays the premium and does not show it as a taxable benefit to the employee, the benefit received from the policy is taxable income to the employee.

A disability does not rule out work, but it may mean a reduction in income. This translates into a lower standard of living for the insured and his or her dependents unless disability income insurance is available.

As an agent, how do you calculate a client's disability payment?

A Total annual client income X client's tax bracket ÷ 12 = benefit amount per month;
B Earned income X client's tax bracket ÷ 12 = benefit amount per month;
C Total annual client income X percentage benefit payment = income benefit
D Total annual client earned income X percentage of benefit payment ÷ 12 = benefit amount per month

Practice the Disability Income Benefit Calculation

Sources of income for Stephen McDonald:

Salary	$97,644
Commissions	113,989
Investment income	22,863

Assuming a benefit payment of 65%, Stephen McDonald could qualify to receive $_____* as a monthly disability income benefit

*Answer: Earned income: $211,633 x 65% = $137,561.45 ÷ 12 = $11,463.45 (Note: Investment income was not included in the calculation because it will continue during the period of disability.)

Insuring Against the Risk of Increased Medical Costs

Health insurance, sold through accident and sickness policies, reimburses out-of-pocket expenses incurred by the insured. Thus, the amount of coverage will be determined by:

- Existing costs;
- Anticipated costs.

How Is A&S Insurance Coverage Determined?

There is no formula to determine the right amount of coverage, as there is with life and disability; the decision on the amount of coverage is based (within reasonable limits) on how much coverage a person wants, needs, and can pay for.

The insured will exercise risk retention by assuming a deductible or co-insurance factor, both of which reduce the amount of reimbursement. These factors will be covered in detail later in this module.

Insuring Against the Risk of Estate Inadequacy

We have seen how life insurance is an effective way to protect against loss by providing dependents or a beneficiary with a means to pay final expenses and provide a continuing income.

Life insurance also manages the risk of estate inadequacy, in other words, an estate that is not large enough to pay tax on the assets of the deceased or an estate that must be planned to equalize the amount each heir is to receive.

The use of life insurance for such purposes is enhanced, because the proceeds of a life policy are received tax-free.

In order to plan for estate protection and equalization, the agent must understand what will happen to the assets of the policy owner upon his or her death.

The broad categories of assets are:

- The principal residence;
- Investments;
- Other items that may have increased in value since their acquisition, such as art or jewellery;
- A partnership interest;
- Shares of a privately held company.

The Principal Residence

Proceeds of selling the principal residence of the taxpayer are not declared for tax purposes when the residence is sold during the lifetime of the taxpayer.

On death, the property may roll over tax-free when there is a surviving spouse. After the death of that spouse, the property becomes part of the estate of the deceased and is transferred to the inheritor at its fair market value (FMV). Any future increase in the value of the property becomes a capital gain to the inheritor.

What happens to a deceased's residence if there is a surviving spouse?

A Nothing, the value of the home may transfer to the spouse tax-free.
B One-half of the value of the market value of the house is taxed.
C 100% of the house value is taxed, less mortgage-financing costs and property taxes.
D If the house was held in joint ownership, taxes are levied against the survivor spouse.

Investments

Investments are typically categorized by the type of returns they earn. Each has its own impact on the estate, because each is taxed differently. Returns are earned as:

- Interest;
- Capital gains;
- Dividends.

Interest

Interest is received by investors with:

- Savings accounts;
- Term deposits;
- Guaranteed Investment Certificates (GICs);
- Mutual funds (when invested in interest-bearing investments);
- Bonds;
- Segregated funds (when invested in interest-bearing investments).

In addition, interest can be earned by policy owners and beneficiaries on:

- Dividends left on deposit;
- Policy proceeds left on deposit as a settlement option;
- Prepaid premiums held in premium deposit accounts;
- The interest portion of family income benefit payments;
- Delayed claim payments;
- The interest portion of annuity payments.

Marginal tax rate
The marginal tax rate, or MTR, is the rate at which an individual will pay tax on the next dollar of taxable income earned.

All interest for which a T5 slip is issued must be declared for tax purposes as income. It is taxed at the ***marginal tax rate*** of the investor, or taxpayer.

When the final tax return (the terminal return) of a taxpayer is prepared after his or her death, any interest paid during the period between the last tax filing and the terminal return is declared as income and taxed accordingly.

A spouse or common-law partner can inherit these investments tax-free, if he or she is named a beneficiary. If the spouse is not a beneficiary of any properties/assets, the estate of the deceased must pay tax on the income earned. Exceptions to this rule are insurance products that do not pass through the estate if a beneficiary has been named.

"I am an only child. After my parents died their GICs became part of their estate. The estate was willed to me. So, after the estate was settled by the executor and probate fees and so forth were paid, I received the remaining estate value. I inherited their house tax-free, since I was living in a rental apartment when they died."

How Interest Is Taxed

If a deposit in a savings account earned $1,000 in interest during a calendar year, the $1,000 would be included on the tax return as income. If the taxpayer had a 35% marginal tax rate, $350 would be paid in tax.

How are interest earnings taxed in Canada? Choose the best answer below.

A All interest is taxed regardless of origin, ownership, registration or source;
B Interest earnings are taxed at a taxpayer's marginal tax rate;
C Interest earned on registered investments is not normally taxed on an accrual basis;
D All interest for which a T5 is issued must be declared for tax purposes as income each year and taxed at the taxpayer's marginal tax rate (MTR).

Capital Gains

Capital gains can be received when investments classified as capital property are sold for more than their ***adjusted cost base*** or are given away, or when the owner emigrates from Canada. Capital property includes:

- Stocks;
- Mutual funds (when invested in investments that produce capital gains such as stocks);
- Segregated funds (when invested in investments that produce capital gains such as stocks);
- Real estate (other than the principal residence).

Adjusted cost base
Not to be confused with adjusted cost basis, used for insurance tax purposes. Adjusted cost base is the investor's cost to buy capital property. For instance, when buying stocks, the adjusted cost base of the stock is its trading price plus the commission earned by the stockbroker to buy or sell the stock on behalf of the investor.

When a taxpayer dies, his or her capital property is treated as if it had been sold immediately before the death of the taxpayer at its fair market value. It can be rolled over without being taxed to a spouse or common-law partner, if the spouse has been named a beneficiary, but when the spouse dies, it is assumed that the property has been sold just before his or her death. In other words, tax will not be avoided by a rollover, just deferred.

Fair market value is what the property is worth in the market of the day. An amount called the adjusted cost base (ACB) is deducted from the fair market value (FMV); this is how much the property cost.

The amount between the adjusted cost base and fair market value is called the capital gain. This is the amount that will be subject to capital gains tax. If the estate of the deceased does not have funds to pay the capital gains tax on the property, and beneficiaries or heirs cannot pay the capital gains tax, the property will have to be sold to pay the tax.

While this will not be a concern in regards to stocks and mutual funds, since they cannot be directly inherited by anyone, except in a rollover to a spouse or common-law partner, the capital gains that arise on property such as a cottage may be a significant concern to those who expect to inherit the property.

"We love our cottage and we want to make sure our children and grandchildren can enjoy it in the future just as much. Our second-to-die whole life policy will ensure that our estate is adequately funded to pay the capital gains tax on the property. They will inherit the cottage without any worries about tax."

A life insurance policy can be structured so that the capital property owner is named as the life insured. The face amount must be large enough to pay the capital gains tax that will be due. The beneficiary of the policy uses the funds to pay the capital gains tax, without having to use other assets for this purpose.

How Capital Gains Are Taxed

The government taxes 50% of the increase of the value of the capital property at the marginal tax rate of the owner. The calculation for capital gains tax is:

capital gain x 50% x MTR

Capital gains tax is triggered by growth in an investment; if a loss is sustained, then the investor receives the benefit of a **capital loss**.

If an investor sells some stock at $1,000 more than its cost, $500 will be the taxable capital gain. The taxable capital gain is taxed at the marginal tax rate of the investor. Therefore, if her marginal tax rate is 35%, she will owe $500 x 35% = $175 in tax.

When payment of capital gains tax is the intended use of a policy, then permanent insurance must be used, because insurance must be in place when the life insured dies.

How is the taxable capital gain calculated?

A Investment gain X 50%
B Investment gain X 50% X MTR
C Capital gain X 50%
D Investment X 50%.

Capital Gains in Business

Capital gains can be created by the sale of a proprietorship, partnership interest, or shares held by a shareholder. However, there is a total lifetime exemption of $750,000 on capital gains earned on the disposition of Qualified Small Business Corporation (QSBC) shares and qualified farm or qualified fishing property.

If a capital loss results from the sale, because the shares are sold for less than their adjusted cost base, it can be deducted from any capital gains the seller of the property must declare from other transactions of capital property.

Typically, when a business interest exists, business succession becomes an issue. If a business owner and his or her child or children work together in the family business, then the business owner would logically choose to have those children inherit the business. But what about the other children who aren't involved in the business? How can they all be treated equally?

Life insurance provides the answer. A valuation of the business will show its worth to the children who stand to inherit; an equivalent amount of life insurance on the life of the business owner can ensure that those who are not involved in the business receive proceeds from the policy equal to the business shares.

A partner owns partnership property, partnership interest, and partnership debt. All three must be retired when a partner leaves the firm.

Dividends

Dividends are paid by corporations to their shareholders to distribute excess profits. They are not guaranteed. Investors may receive dividends when they own:

- Stocks;
- Mutual funds (when the funds are invested in stocks that pay dividends);
- Segregated funds (when the funds are invested in stocks that pay dividends).

For the purpose of the terminal return and taxes owing, dividends receive a special "gross-up and credit" mechanism that results in a tax position that is better than the tax position for interest.

Investments that pay dividends cannot be directly inherited, except in a rollover to a spouse or common-law partner.

Life Insurance Manages Need to Supplement Income

Life insurance products that can be used to provide or supplement an income during retirement are:

- Those with cash surrender value, such as whole life;
- Universal life, because of its ability to provide for withdrawals from the account;
- Annuities.

To determine the amount of insurance to satisfy this purpose, the agent must fulfil his or her duties as a financial planner to determine the income that will be received during retirement, and the client's retirement goals and objectives. This aspect of life insurance will be reviewed in the Retirement module of this course.

Retirement income can be supplemented by borrowing up to 90% of the cash surrender value of a whole life policy or universal life policy. A cash withdrawal from a universal life (UL) account can serve the same purpose.

