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Gift the cottage and replace the wealth

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Replacing a taxable asset with tax-free cash

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The tax-free nature of the death benefit is a powerful incentive to use life insurance as part of their tax planning strategies for clients. A common use of insurance has been to replace taxes paid by the estate (AKA wealth replacement). The estate would still pay the tax, but the death benefit would restore the estate to its pre-tax level.

Given the rule change for claiming tax receipts on the year of death, another use for life insurance has emerged. Taxable property is gifted to charities, and tax-free death benefits are used to replace the gifted assets. The resulting tax savings from the gift are sufficient to purchase a life insurance contract of equal or greater value than the property gifted.

The end result, a taxable asset that no one really wanted is converted into tax-free cash that everyone wants at no cost to the donor!

Here is how it works:

Sylvia age 73 and a non-smoker cannot use her cottage any longer. All of her children have moved out of province and she has been assured that they do not want the family cottage.

Sylvia is a regular contributor to XYZ charity. After discussing the issues with her advisors, she decides to donate the cottage to XYZ charity for a $150,000 tax receipt. The resulting tax saving of $67,500 (assuming a 45% tax rate) was sufficient to purchase a $250,000 insurance policy with her children as equal beneficiaries.

In short, XYZ charity sold the cottage to help fund its activities, and Sylvia left $250,000 tax-free cash to her family.

The power of insurance is best realized when it is used in combination with other estate planning tools to create unique planned gift strategies. Such strategies provide a clear win-win situation for both the donor and the charity.

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