Estate planning opportunities using insurance investment contracts

INVESTMENT INSIGHT

With an insurance investment contract various persons play an important role in determining how the contract will work. This provides for numerous estate planning opportunities including the ability to bypass an estate and the inherent administration, delay and costs. However, failing to properly set-up your contract may result in your intentions not being fulfilled and the contract not working like you intended. Let's look at a few scenarios.

SUCCESSOR ANNUITANT OR JOINT LIFE FOR NON-REGISTERED CONTRACTS

The annuitant is the measuring life of the contract. Consequently, if there is only one annuitant named, upon the annuitant's death the contract ends and the proceeds are paid to the beneficiary(ies).

For example, let's assume you are both the owner and annuitant of a contract and have named your spouse as the beneficiary of the contract. Your intention is that upon your death, your spouse will have the choice to continue the contract as the owner and annuitant, or receive the death benefit payout. This strategy would work if the contract allowed for spousal continuation. However, with contracts purchased after October 4, 2009, your spouse would not be given this choice and he or she would receive the death benefit payout. Furthermore, since the contract has ended, it would be a taxable disposition with any gain being included on your final tax return.

To ensure that the contract continues tax-free to your spouse where spousal continuation does not apply, make sure he or she is named as the successor owner and successor annuitant, or the Joint Life, if applicable. The beneficiary should be whomever you want to receive the death benefit payout after the death of you and your spouse[1].

Let's look at another example. You are both the owner and annuitant of a contract and have your spouse named as the successor owner, but have failed to name a successor annuitant, or Joint Life. Upon your death, the contract will end and there will be a taxable disposition with any gain being included on your final tax return. Again, in order to ensure that on your death the contract continues to your spouse on a tax-free basis, make sure that he or she has been named as the successor owner and successor annuitant, or the Joint Life, if applicable.

SUCCESSOR OWNER FOR NON-REGISTERED CONTRACTS

Where the owner is not the annuitant or where the owner is the annuitant and a successor annuitant or Joint Life has been named, you should consider whether a successor owner for the contract should be named.

For example, let's assume you are both the owner and annuitant of a contract and have named your spouse as the successor annuitant. Your intention is for the contract to continue after your death with your spouse as the new owner and annuitant. While the contract will continue with your spouse as the successor annuitant, ownership will not transfer directly to him or her. Rather, the contract will continue with your estate as the owner and ultimately will be administered according to the terms of your will.

To ensure that the contract passes to your spouse (or whomever you want the new owner to be), make sure he or she is also named as the successor owner. This way the contract is transferred directly to them avoiding your estate, estate creditors and the delays and costs of administering your estate.

For contracts with the Joint Life Payout Option this may not be an issue. If the owner is either the annuitant or the Joint Life, the surviving spouse will become the owner of the contract, unless otherwise designated. This would allow the contract to continue tax-free to your spouse as owner, unless a successor owner had been named.

Another example is where you are both the owner and beneficiary of a contract and have named your spouse as the annuitant because he or she meets the maximum age requirement, but you do not.

If you die first, then on your death ownership of the contract will transfer to your estate and be dealt with according to the terms of your will. If your spouse dies first, then on his or her death the contract will end as a successor annuitant was not named. While the death benefit will be paid to you, there will be a taxable disposition with any gain being included on your tax return.

If this is not your intention, but instead you want the contract to continue in the event of your death or your spouse's death, then your spouse should be named as the successor owner and you should be named as the successor annuitant. The beneficiary should be whomever you want to receive the death benefit proceeds on the last of you and your spouse's death[1].

Note, this solution is not possible with the Joint Life Payout Option as the latest age to deposit is based on the older of the annuitant and Joint Life's age.

WATCH JOINT OWNERSHIP

A common mistake is to set-up the contract with you and your spouse as joint owners, with one of you as annuitant and your children as beneficiaries. The intent is to have the contract continue upon the death of you or your spouse. However, if the annuitant spouse dies first, the contract terminates and the proceeds would be paid to your children as beneficiaries. The surviving spouse receives nothing. This is further complicated if your children are minors because they cannot disclaim ownership of the funds.

A potential solution may be for you to be owner and the annuitant and to name your spouse as the successor owner and successor annuitant, or Joint Life where permitted, with your children as named beneficiaries[2]. This way the contract ownership stays with the survivor of you and your spouse and only after both of you pass away is the death benefit paid to your children.

If you truly want joint ownership, another alternative would be to have you and your spouse as joint owners, one of you as annuitant, the other as successor annuitant and the children, for example, as beneficiaries. This would work the same as above, but keep in mind that where a contract has multiple owners, all of the owners must agree with every change or transaction.

JOINT LIFE PAYOUT OPTION

With the Joint Life Payout Option in Manulife PensionBuilder or GIF Select IncomePlus contracts there are different rules depending on the taxation type.

Let's assume you have decided to purchase a Manulife PensionBuilder contract with the Joint Life Payout Option. You will be the owner and annuitant, your spouse will be the Joint Life and your intention is to have your children receive the death benefit payout on the death of both you and your spouse. In trying to decide whether to purchase the contract with RRSP, RRIF, or non-registered funds, you wonder what would be the correct contract set-up in each situation.

With your RRSP contract you would be both the owner and annuitant and name your spouse as the Joint Life and the sole primary beneficiary. You would not name a successor owner since upon your death the contract terminates. At this point your spouse will have the option to either receive the death benefit or continue the contractual benefits in a new RRSP or RRIF.

With your RRIF contract you would again be the owner and annuitant with your spouse named as the Joint Life. You would not name a successor owner because upon your death the contract will continue and your spouse will automatically become the new owner. The primary beneficiaries would be your children and they would receive the death benefit when both you and your spouse have died.

If using non-registered funds, you would be the owner and annuitant and name your spouse as the Joint Life and successor owner[3]. If you die first, the contract will automatically continue in the name of your spouse as the successor owner. Again, the primary beneficiaries would be your children who would receive the death benefit on the last of you and your spouse to die[1].

SUMMARY

Whether you are setting up a new contract or reviewing your current one, taking the time to understand the implications of contract set-up will help ensure things work as you intended. Having the right contract set-up will also allow you to take advantage of the significant estate planning opportunities available with insurance investment contracts. Refer to "*Insurance Investments – The Facts*" (MK1164E) for more information on these types of contracts.

[1] Note that if the spouse takes over ownership of the contract he or she has the ability to change the beneficiary designation unless the beneficiary is named irrevocably. [2] If the assets belong to both you and your spouse you could split the assets and set up two contracts this way alternating which of you is named as owner and annuitant, and successor owner and successor annuitant or Joint Life, where applicable. [3] While naming a successor owner is recommended, in this situation you don't need to name your spouse as successor owner because if the owner is either the annuitant or the Joint Life, the surviving spouse will become the owner of the contract, unless otherwise designated.

FOR MORE INFORMATION, CONTACT YOUR ADVISOR OR VISIT MANULIFE.CA/INVESTMENTS

MK2526E 05/12