WESTWARD ADVISORS

ICF RISK CONSIDERATIONS

THE ISSUE

Adding an investment credit facility (ICF) to a life insurance policy offers significant benefits to entrepreneurs and their families in the right circumstances.

The benefits are sometimes so significant that an ICF candidate might reject it before investigating it, on the basis that it is "too good to be true." The danger in this approach is that the entrepreneur could pay millions of dollars in income taxes over his lifetime that could otherwise be avoided by investigating the ICF with outside professional advice in consultation with Westward's specialists.

This Viewpoint highlights the key ICF risks and related safeguards.

What if I have other questions?

The ICF has surprisingly low risk when compared to the potential rewards. ICF candidates will undoubtedly have many questions regarding the risks and rewards. Westward Advisors works with clients and advisors to address the issues so they can make a reasoned decision about whether the ICF is right. For the ultra cautious seeking an extra layer of assurance, hiring Westward under the Navigator option includes an independent tax opinion from a nationally recognized law firm specific to the ICF proposal.

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WESTWARD'S VIEWPOINT

How is ICF risk minimized?

Westward minimizes ICF risk by designing a clean exit strategy at any time. The ICF provides the following safeguards:

- The policy cash value is always equal to or greater than the loan balance
- There are no surrender charges to withdraw policy cash value
- When withdrawing cash value, the policyholder also receives a "top-up" of cash to help cover the income tax applicable to the withdrawal

As a result, a complete windup of the ICF is possible at any time while generally retaining a cumulative benefit to the date of windup.

What are the potential risks? How does the Strategy address them?

1. **Finance changes the tax legislation**
   Legislative changes affecting life insurance taxation are generally prospective, meaning they will not impact any tax benefits claimed prior to the legislative change. If a future legislative change renders the ICF useless, the policyholder can proceed to wind up.
2. **CRA reassesses for tax compliance**
   The ICF is a solid tax structure explicitly recognized by CRA. In 2008, the CRA wrote that the ICF upholds the "object, spirit, and purpose of the tax exempt policy provisions in the ACT." CRA concluded that ICF complies with the Income Tax Act and GAAR should not apply to ICF transactions.
3. **CRA reassesses for interest rate reasonableness**
   A mountain of evidence has been delivered to CRA to support the reasonableness of the ICF interest rate and CRA continues to consider the submissions. In the meantime, it is comforting to know that reducing the deductible portion of the ICF loan interest just reduces the ICF benefits – it does not negate them entirely.
4. **Loan interest rates change**
   ICF loan interest rates are adjusted to market every ten years. Policyholders are protected by a corresponding adjustment to the interest rate in the policy which is guaranteed to remain 2% less than the interest rate charged on the loan. Consequently, the policyholder's cash flow is always 2% of the loan balance before taxes, regardless of loan interest rates.
5. **Income tax rates change**
   The ICF cash flow benefits will vary over time depending on personal income tax rates. Generally, positive cash flow is produced when the personal tax rate is greater than 22%.
6. **Policy deposits not made as scheduled**
   The projected ICF benefits assume the policyholder makes scheduled policy deposits. The plan is flexible and will accommodate changes in scheduled deposits mid-stream.
7. **Taxable income decreases**
   The projected ICF benefits assume sufficient taxable income to benefit from loan interest deductions. If there is insufficient taxable income, the size of the ICF can be reduced mid-stream to accommodate. In extreme cases, the policyholder can proceed to windup.
8. **The bank does not renew the loan**
   The ICF loan has a ten year term. Renewal is likely but not guaranteed. If the lender does not renew the loan, the policyholder proceeds to windup.
9. **The insurer becomes insolvent**
   Although highly unlikely, the insurer could become insolvent. The cash value in the policy might devalue but the loan balance remains payable. Assuris is a government mandated protector of life insurance policies. Assuris will oversee the transfer of policies from the insolvent insurer to solvent insurers, and protect policyholders for at least 85% of policy cash values.

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