

Your Company Name

Corporate Key Person Protection

(current date)

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"Use a tax sheltered plan to protect against the economic loss of a Key Employee!"

Yes, there is a way for a corporation to protect against the dire consequences of the loss of their key employees in a more cost effective manner than by accumulating funds as a contingency reserve. By funding a tax sheltered life insurance policy on the life of the key employee, the protection is available when you need it.

Many companies are unaware that:

- * The growth of the fund value in the policy is not subject to accrual taxation as long as the policy qualifies as an exempt plan.
- * The substantial fund value that can be created in tax-advantaged policies can increase the tax-free payment to the corporation on the death of a key employee/shareholder.
- * A private corporation does not have to use the death proceeds from the life insurance policy to pay for the expenses of finding and recruiting a new key employee. Since all or most of the proceeds create a credit to the Capital Dividend Account, they can instead be used to pay a tax-free dividend to shareholders.

Utilizing a life insurance policy that qualifies under section 148 of the Income Tax Act is an excellent planning tool because it creates a growing tax-advantaged account. This account is accessible to the corporation while the employee is alive, and is paid out tax-free with the corporation as beneficiary when the employee dies. The funds received can be used to cover expenses incurred in replacing the key person or, in the case of a private corporation, the proceeds - in excess of the Adjusted Cost Basis (ACB) - can be added to the Capital Dividend Account and then be paid out tax-free to shareholders.

As long as the tax-advantaged account does not cause the policy to become non-exempt, the policy can be funded with large deposits over a short period.

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Many small corporations have at least one person upon whom the business depends for its success. Life insurance can protect the business against the loss of this individual. It is referred to as key person insurance. Prudent business practice calls for the corporation to set up a contingency fund should the individual suddenly quit or die. The following illustrations compare accumulating the contingency fund within the company through periodic deposits in an Alternative Investment and creating the contingency fund through life insurance using the same periodic deposits.

The illustrated values in the Alternative Investment take into account that earnings of the fund are considered investment income and are not subject to the small business deduction; they are taxed at the high corporate rate. The Income Tax Act requires that an extra refundable tax on investment income be collected. The extra rate is 6 2/3% on income from investments and taxable gains. Income from investments in the form of dividends is subject to 33 1/3% tax. The tax is credited to a notional tax account called the Refundable Dividend Tax On Hand (RDTOH) account. When the corporation pays taxable dividends to its shareholders, the tax is refunded at a 3:1 rate, regardless of what rate the RDTOH was collected. Earnings on accumulated funds in an exempt life insurance policy are not subject to corporate tax as long as the funds remain in the policy.

If access to the fund value is required while the insured is living, a portion of the withdrawal may be subjected to taxation depending on the Adjusted Cost Basis (ACB) of the life insurance policy at the time of withdrawal. In this case it may be preferable to use the cash value as collateral for a fully secured loan from a registered financial institution. It may result in both the interest on the loan and a portion of the insurance deposit becoming tax deductible to the corporation.

If the insured key person dies, the full proceeds of the policy are received tax-free by the corporation as a beneficiary. They may then be used by the corporation as it sees fit. If a private corporation chooses to pay those proceeds to shareholders as a tax-free dividend, it may do so since proceeds in excess of the ACB portion of the policy can be credited to the Capital Dividend Account.

The illustration shows the amounts that are available if insurance proceeds are used to pay for key person replacement expenses and what is available if proceeds are paid to shareholders instead.

The comparison between accumulating the contingency fund within the company with creating the fund through a corporate owned life insurance policy shows that when the key person dies a much larger fund is usually created if the latter approach is used.

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NOTE: For illustration purposes, the dividend tax rate is simplified and calculated as follows:

$$\text{Dividend Tax Rate} = 1.25 \times (\text{MarginalTaxRate} - 0.2)$$

Withdrawals from the policy may be subject to income tax, depending on the Adjusted Cost Basis (ACB) of the policy, at the time of withdrawal. However, the proceeds of a life insurance policy upon death of the insured are received tax free in the hands of the beneficiaries.

This is an illustration only and NOT a Contract. Rates of return and values contained within are projections only and are not guarantees or forecasts of future performance. It must be read in conjunction with a policy illustration from the Life Company.

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CONCEPT ASSUMPTIONS

Insureds

Insured: Business Owner,
Male Age 40 Non-Smoker

Prepared By:

Name: Agent / Broker

Product

Name: Universal Life
Policy Type: Single Life
Face Amount: \$200,000
Payment Method: Planned Deposits (20 Years)
Projected Annual Growth Rate: 6.000%

Alternative Investment

Growth Breakdown: 50% Interest
50% Realized Capital Gains
Effective Tax Rate On Interest: 54.67%
Effective Tax Rate On Realized Capital Gains: 41.00%
Projected Annual Growth Rate: 6.000%

Other Details

Corporate Tax Rate: 48.00%

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ACCUMULATING FUNDS WITHIN A COMPANY THROUGH PERIODIC DEPOSITS FOR KEY PERSON PROTECTION

Pol Yr	Age	Periodic Deposit	Annual Growth	Tax Due on Growth	Tax Due on Unrealized Capital Gains (if any)	Fund Available For Key Person Purposes
1	41	1,414	85	41	0	1,458
2	42	1,414	172	82		2,962
3	43	1,414	263	126		4,513
4	44	1,414	356	170		6,113
5	45	1,414	452	216		7,762
6	46	1,414	551	263		9,463
7	47	1,414	653	312		11,218
8	48	1,414	758	363		13,027
9	49	1,414	866	414		14,893
10	50	1,414	978	468		16,818
11	51	1,414	1,094	523		18,802
12	52	1,414	1,213	580		20,849
13	53	1,414	1,336	639		22,960
14	54	1,414	1,462	700		25,137
15	55	1,414	1,593	762		27,382
16	56	1,414	1,728	826		29,697
17	57	1,414	1,867	893		32,085
18	58	1,414	2,010	961		34,547
19	59	1,414	2,158	1,032		37,086
20	60	1,414	2,310	1,105		39,705
25	65		2,695	1,289		46,320
30	70		3,144	1,504		54,037
35	75		3,668	1,754		63,040
60	100		7,925	3,791		136,214

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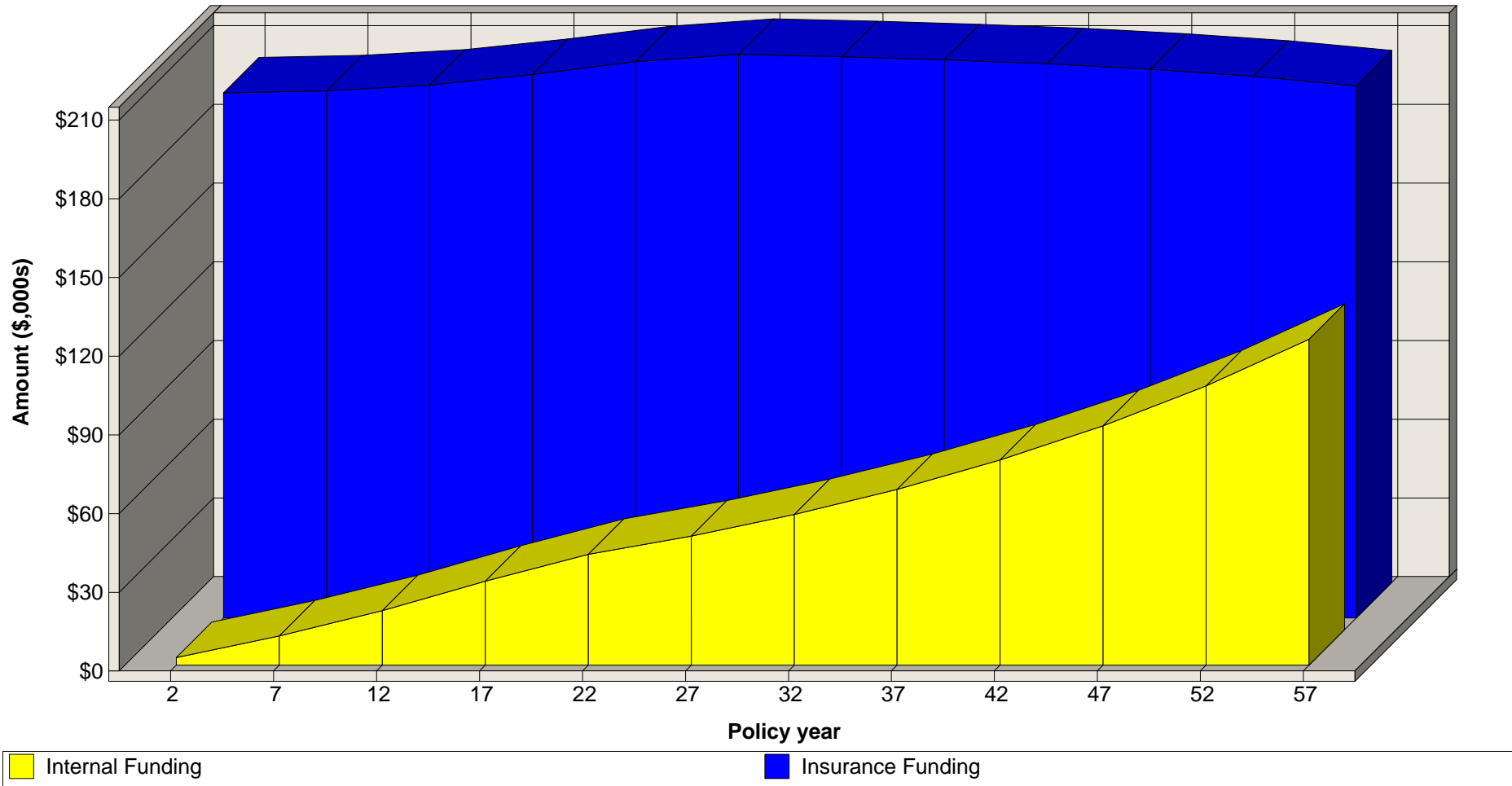
CREATING FUNDS THROUGH PERIODIC DEPOSITS IN A LIFE INSURANCE POLICY FOR KEY PERSON PROTECTION

Pol Yr	Age	Periodic Deposit	Life Insurance Corporate Asset Builder				Comparison	
			After-Tax Insurance Proceeds for Key Person Purposes	Adjusted Cost Basis (ACB)	Credit to Capital Dividend Account	Fund Available for Tax-Free Distribution to S/Hs	CAB Value less AI Value	Percent Increase Using Corporate Asset Builder
1	41	1,414	200,425	1,278	199,147	200,026	198,567	13617%
2	42	1,414	200,875	2,533	198,342	200,083	197,121	6655%
3	43	1,414	201,352	3,763	197,589	200,176	195,663	4335%
4	44	1,414	201,858	4,964	196,894	200,307	194,194	3177%
5	45	1,414	202,394	6,134	196,260	200,477	192,715	2483%
6	46	1,414	202,963	7,265	195,698	200,693	191,229	2021%
7	47	1,414	203,565	8,353	195,212	200,955	189,737	1691%
8	48	1,414	204,204	9,386	194,818	201,271	188,244	1445%
9	49	1,414	204,881	10,366	194,515	201,642	186,748	1254%
10	50	1,414	205,599	11,289	194,310	202,071	185,254	1102%
11	51	1,414	206,359	12,155	194,204	202,561	183,758	977%
12	52	1,414	207,165	12,953	194,212	203,117	182,268	874%
13	53	1,414	208,020	13,664	194,356	203,750	180,790	787%
14	54	1,414	208,926	14,272	194,654	204,466	179,329	713%
15	55	1,414	209,886	14,761	195,125	205,273	177,892	650%
16	56	1,414	210,904	15,071	195,833	206,194	176,498	594%
17	57	1,414	211,983	15,246	196,737	207,219	175,134	546%
18	58	1,414	213,127	15,280	197,847	208,352	173,805	503%
19	59	1,414	214,339	15,163	199,176	209,601	172,514	465%
20	60	1,414	215,625	14,879	200,746	210,975	171,270	431%
25	65		215,056	2,567	212,489	214,254	167,933	363%
30	70		214,294		214,294	214,294	160,257	297%
35	75		213,275		213,275	213,275	150,235	238%
60	100		200,005		200,005	200,005	63,791	47%

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Proposal For: Business Owner Prepared By: Agent / Broker

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Male 40 NS. PRODUCT: Universal Life. FACE AMOUNT: \$200,000. TAX RATE: 45.00%

AI RATE SPREAD: 0.00%.

NOTE: F.V. shown as portion of D.B. Must accompany a policy illustration. E.&O.E.