

HOW THINGS

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EASY RIDER

Don't dismiss CI just because the CRA isn't done with its tax application.

Critical Illness Insurance (CI) is growing more popular by the day. This type of insurance often includes a return of premium (ROP) guarantee that's either integrated into the contract itself or included as a rider. The ROP, payable when the contract comes to term, or upon the death of the participant, is doubly attractive since a benefit is paid even if a critical illness does not occur.

A CI market study conducted by LIMRA in November 2007 reveals people are becoming more concerned about the risks of health crises. Indeed, an opinion voiced by one study participant, a consumer in Calgary, reflects the opinion of the majority: "When you are 25 years old, you just don't care. You have your whole life to save and do whatever you have to do," he said. "But when you are approaching your 40s, 50s, 60s, people start to panic."

Overall, the focus group participants found the following aspects of CI appealing:

- > the lump-sum payment;

- > the return of premium feature; and particularly
- > the tax-free benefit.

But let's talk about taxation. It appears this product is outpacing legislative change dealing with the applicable tax treatment, because the Canadian Income Tax Act does not deal specifically with sickness insurance. Therefore, information for sickness insurance comes primarily from technical interpretations offered by the CRA.

It would be reckless of us to try to definitively determine the tax treatment that applies to CI and its related ROP. We will also limit ourselves to stating certain factors that, we hope, will keep us on the tax authorities' good side and ensure the amount paid as a premium refund is not taxable.

The benefit paid on the ROP is currently not taxable, nor is the amount paid to the beneficiary in the event of a critical illness, because it is income that's not earned from either employment, a business, or from property. The CI benefit represents an amount paid in consideration of the payment of premiums that are treated as a non-deductible expense for personal or living costs.

In a commercial context, such as financing a buyback of stock shares, or to compensate for the financial losses resulting from the absence of a key employee, the subsection 18 (1) (a) of the Income Tax Act states the premiums paid are not deductible since they are not a cost of doing business.

For this to be the case concerning ROP payments, there is a real

need for protection and clearly demonstrated action on the part of the client to protect against the risk of being diagnosed with a critical illness.

To this end, the following must be considered:

- > the terms of ROP payments must be stipulated in the contract;
- > the amount of the ROP must not be greater than the total value of premiums paid or the sum insured because all excess could be considered as income from a property and could be considered taxable by the CRA;
- > the cost of the benefit (ROP) must not exceed the cost of the main risk (critical illness).

It should therefore be remembered that it's easier to distinguish the cost of the ROP guarantee when it is contained in a rider, and the cost is not included in the main premium.

Since the tax treatment of CI and the ROP guarantee essentially rests upon interpretations that don't yet have the force of law, it's better to err on the side of caution. This grey area reinforces the importance of showing the existence of a real need to protect against the risk of being diagnosed with a critical illness. Though the taxation that applies to CI is vague in some areas, don't lose sight of the fact that this product remains a suitable solution and can meet very real needs. But representatives must be absolutely thorough and make sure their clients fully understand the tax consequences that could result from certain techniques. ^{AE} **KINCH**