

## THE TAXATION OF CRITICAL ILLNESS INSURANCE

### Critical Illness Coverage Required by a Shareholder

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| <b>The Arrangement</b>           | <ul style="list-style-type: none"> <li>• The shareholder will own the individual Critical Illness insurance policy</li> <li>• The shareholder is the insured under the individual CI policy</li> <li>• Premiums are paid by either the shareholder or company</li> </ul>   |
| <b>Purpose</b>                   | <ul style="list-style-type: none"> <li>• The shareholder will receive a lump-sum benefit (or partial benefit) upon diagnosis of covered condition (subject to survival period requirements)</li> <li>• The shareholder has complete discretion as to how the lump-sum benefit (or partial benefit) is spent, including (but not limited to):             <ul style="list-style-type: none"> <li>➢ Paying medical expenses not covered by company or government plans</li> <li>➢ Paying off any financial obligations, such as mortgages, lines of credit, credit card balances</li> <li>➢ Making home modifications (some of which may qualify as medical expenses)</li> <li>➢ Paying for long-term care</li> </ul> </li> <li>• The ROPD benefit will enhance the estate left to beneficiaries</li> <li>• Any ROPS (or ROPE) benefits may also be spent in any manner the shareholder chooses</li> </ul>   |
| <b>Tax Treatment</b>             | <p>Shareholder-Paid Premiums Funded by Salary</p> <ul style="list-style-type: none"> <li>• The company has a deduction for the additional salary, and for any payroll and related taxes</li> <li>• The shareholder has an income inclusion for the additional salary, and will be able to pay the CI premiums with the after-tax amount. The employer could consider “grossing-up” the amount, so the after-tax salary retained by the employee is sufficient to pay the full amount of the CI premiums</li> <li>• The Canada Revenue Agency (CRA) generally accepts that stand-alone CI contracts that do not provide for ROP benefits are “accident and sickness” contracts. Thus, lump-sum benefits (including partial benefits) are non-taxable<sup>1</sup></li> <li>• A return of premiums (where no investment element is added on) should be tax-free<sup>2</sup></li> </ul> <p>Employer-Paid Premiums as a Shareholder Benefit</p> <ul style="list-style-type: none"> <li>• The company-paid premiums are considered a shareholder benefit, with the amounts being included in the shareholder’s income, and income taxes being payable on the amount. The company could consider paying the shareholder additional salary, or a taxable dividend, so that the after-tax amount is sufficient to pay the taxes on the shareholder benefit</li> <li>• The lump-sum benefits, including partial benefits, and ROP benefits should be tax-free (see above)</li> </ul> |
| <b>Additional Considerations</b> | <ul style="list-style-type: none"> <li>• CI insurance provides essential protection to shareholders and their families. Shareholders should review all of their existing insurance arrangements, including those provided via any group and/or association plans or those that are personally owned, and ensure that the appropriate types and amounts of coverage are in place.</li> <li>• Coordinate CI insurance coverage with provisions made in the insured’s Will. As it is possible that the recipient of a CI benefit will not be in an ideal position to make financial decisions, put appropriate Powers of Attorney in place.</li> <li>• Always seek appropriate professional advice when the insurance is being acquired for a share redemption or acquisition, or pursuant to the terms of a shareholder’s agreement. Analyze whether the insurance should be owned personally or by the corporation.</li> </ul>  |

*This analysis is not necessarily appropriate for contracts issued by other insurers, as the product features, etc. are not necessarily identical to those of Standard Life’s Protecta contract. It is intended for general information only. It should not be construed as legal, accounting, tax or specific investment advice. Clients should consult a professional advisor concerning their situations and any specific investment matters. While reasonable steps have been taken to ensure that this information was accurate as of the date hereof, The Standard Life Assurance Company of Canada and its affiliates make no representation or warranty as to the accuracy of this information and assume no responsibility for reliance upon it.*

<sup>1</sup> CRA has stated that the existence of a ROP feature will not necessarily disqualify a CI contract from being considered an “accident and sickness” contract. However, CRA and the Department of Finance (Finance) have not concluded their review. The industry believes that lump-sum benefits (or partial benefits) received under contracts with ROP should also be non-taxable. For contracts issued in Quebec, CRA appears to be of the view that under Quebec Law, the contract is an “accident and sickness” contract. Thus, in Quebec, lump-sum benefits received are not taxable, which should not change where an ROP feature is present.

<sup>2</sup> It is the industry’s view that a return of premiums (where no investment element is added on) should be non-taxable. CRA and Finance have not concluded their review.