

THE TAXATION OF CRITICAL ILLNESS INSURANCE

Critical Illness Coverage Required by an Employee

The Arrangement	<ul style="list-style-type: none"> • The employee owns the individual Critical Illness insurance policy • The employee is the insured under the individual CI policy¹ • Premiums are paid by either the employee or employer
Purpose	<ul style="list-style-type: none"> • The employee shall receive a lump-sum benefit (or partial benefit) upon the diagnosis of a covered condition (subject to survival period requirements) as well as any Return of Premium on Surrender (ROPS or ROPE) benefit. The Return of Premium on Death (ROPD) will be payable to the employee's estate. • The employee 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"> ➢ Paying medical expenses not covered by employer or government plans ➢ Paying off any financial obligations, including mortgages, lines of credit, credit card balances ➢ Making home modifications (some of which may qualify as medical expenses) ➢ Paying for long-term care • The ROPD benefit will enhance the estate left to beneficiaries • Any ROPS (or ROPE) benefits may also be spent in any manner the employee chooses
Tax Treatment	<p>Employee-Paid Premiums Funded by Salary</p> <ul style="list-style-type: none"> • The employer receives a deduction for the additional salary, as well as for any payroll and related taxes • The employee has an income inclusion for the additional salary, and can pay the CI premiums with the after-tax amount. The employer could consider "grossing-up" the amount, so that the after-tax salary retained by the employee is sufficient to pay the full amount of the CI premiums • 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-taxable² • A return of premium (where no investment element is added on) should be tax-free³ <p>Employer-Paid Premiums as a Taxable Benefit</p> <ul style="list-style-type: none"> • The employer receives a deduction for the CI premiums, and for any related payroll and other taxes • The employer-paid premiums are a taxable benefit to the employee, with the amounts being included in the employee's income. Income tax is payable on the benefit. The employer could consider paying the employee an additional salary, so that the after-tax salary is sufficient to pay the taxes on the taxable benefit • The lump-sum and ROP benefits should be tax-free (see above)
Additional Considerations	<ul style="list-style-type: none"> • CI insurance provides essential protection to individuals and their families. People 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 type and amount of coverage is in place. • 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.

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.

¹ It is assumed that the employee is neither a shareholder, nor related to a shareholder, of the corporation.

² 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 have not concluded their review. The industry believes lump-sum benefits (or partial benefits) received under a contract with ROP should 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 non-taxable, which should not change where an ROP feature is present.

³ The industry believes that a return of premiums where no investment element is added on should be non-taxable. CRA and Finance have not concluded their review.