Sharing Interests in a Life Insurance Policy

Shared Ownership and Shared Benefit Life Insurance Arrangements

A GUIDE FOR LAWYERS AND ACCOUNTANTS
Financial planning goals

Our sales concept materials support seven planning goals. The Sharing Interests in a Life Insurance Policy guide can be used for:

Business Continuation Planning
Business Succession Planning
Executive Benefit Planning
Retirement Planning
Estate Planning
Planned Giving
Tax Planning
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## Disclaimer  
- CRA position on Shared Insurance arrangements  

Sharing Interests In a Life Insurance Policy
This guide is designed to provide you with information on insurance-sharing strategies using universal life insurance.

There are two kinds of insurance sharing strategies:
1. Shared Ownership
2. Shared Benefit

This guide will discuss the different uses of Shared Ownership and Shared Benefit strategies using universal life insurance and the legal and tax issues that arise. Although other life insurance products may be used as part of a Shared Ownership or Shared Benefit strategy, the discussion and illustrations in this guide all refer to the use of SunUniversalLife insurance and might change if another insurance product is used.

These strategies are primarily discussed within a business owner’s context although some family uses may apply.

The information in the guide is intended to provide general guidance on the legal and tax issues that may arise in connection with Shared Ownership and Shared Benefit insurance strategies, but is not intended as a tax opinion or as legal advice.

The sample insurance clauses that are provided are for your reference only and will not replace the need for professional advice that accurately reflects the facts of each specific situation.

See the Disclaimer on page 22.
Why universal life insurance?

Universal life insurance policies are particularly suitable for insurance-sharing strategies because they have two clearly identifiable components:

- a **Face Amount death benefit** that is paid tax-free on the death of the life insured, and
- a savings component that can be accessed during the insured's lifetime and is also paid tax-free on the death of the life insured (**Fund Value**)

The policy statement can clearly show how the amount of each premium deposit is divided between the cost of insurance, the contribution to the Fund Value, any policy fees and provincial taxes. This makes it easy to apportion the amount of the premium deposit between the two parties.

A question of ownership – the key difference between Shared Ownership and Shared Benefit agreements

In both Shared Ownership and Shared Benefit agreements, the parties share the costs and benefits of the insurance coverage. The key difference is with a Shared Ownership agreement, there are **two owners**. With a Shared Benefit agreement, there is only **one policy owner**.

With a **Shared Ownership arrangement**, two parties enter into a contractual agreement to share the ownership of a life insurance policy. Originally called “**Split Dollar**,” these agreements were commonly set up in an employment situation. The employer would typically own the **Fund Value** in order to recover their costs, while the employee¹ would own the **Face Amount death benefit**.

Today it is more common to have the employee own the **Fund Value** in order to take advantage of the tax-sheltered growth inside an exempt life insurance policy. The employee can later supplement other sources of income by either making withdrawals from the fund or pledging the fund as collateral for loans.

Both parties can also agree to share other benefits of the policy, including term riders and disability waivers, and split the cost of those benefits. Occasionally, both parties will have an interest in owning the Fund Value and the Face Amount death benefit in proportion to the amount of premiums paid.

In a family situation, parents or grandparents will share the costs, benefits and ownership of a policy with children or grandchildren.

¹Employee can also include a partner, key-employee (manager, CEO, etc.) or shareholder.
With a Shared Benefit arrangement, the employee is the sole owner of the insurance policy. The employer is designated as the irrevocable beneficiary of the Face Amount death benefit.

At retirement, the employee may change the beneficiary to a person he/she chooses in accordance with the written agreement.

During retirement, the employee may make withdrawals from the policy fund. Or he/she may pledge the fund as collateral for a loan to create retirement income.

Common uses of Shared Ownership and Shared Benefit strategies may include the following:

<table>
<thead>
<tr>
<th>Situation</th>
<th>Shared Ownership</th>
<th>Shared Benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Funding Key Person Protection</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Providing retirement fund for key employees</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Funding Buy-Sell Agreement between owners/shareholders of a closely held corporation (can include sharing among corporations, e.g. between a holding company and an operating company)</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Inter-generational planning</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Estate Planning</td>
<td>✓</td>
<td></td>
</tr>
</tbody>
</table>
Shared Ownership agreements are set up for business or family uses so two different parties can own and benefit from different components of the life insurance policy.

**Benefits of owning the Face Amount death benefit**

- life insurance protection at market cost with the opportunity to pay premiums over a short period to minimize disruptions to cash-flow
- credit to the Capital Dividend Account (CDA) is available when the corporation is the beneficiary of the Face Amount death benefit

**Benefits of owning the Fund Value**

- access to a tax-deferred account without paying for the cost of insurance, which improves the rate of return
- access to the cash value, through policy loans, withdrawals or leveraging (access may be restricted by the terms of the shared ownership agreement) while the insured is alive
- payment of the Fund Value to the Fund Value’s beneficiary on death is tax-free

The diagram below shows how Shared Ownership agreements work:

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**Sharing Interests In a Life Insurance Policy**

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Shared Ownership

Common agreements in a business context

The most common use of Shared Ownership agreements in a business context is to create incentives for key employees or shareholders, including funding a retirement compensation arrangement (RCA) to provide future retirement benefits. They may also be used to fund Buy-Sell Agreements between shareholders of a corporation. (In this particular context, the agreement could take place between a Holding Company and its shareholder(s). By definition, a Holding Company is a “passive entity” and rarely has employees.)

Key employee agreements
A Shared Ownership agreement between a key employee and an employer can accomplish two goals:
• protect the employer against loss if the employee dies
• provide an employee incentive by creating a tax-deferred retirement fund which the employee can access at retirement

The method of sharing costs and benefits should be thoroughly examined to ensure that the parties’ goals are satisfied and adverse tax consequences are avoided. In particular, the legal agreement must be carefully drafted to prevent the Canada Revenue Agency (CRA) from treating the policy as a deemed RCA\(^2\) or a Salary Deferral Arrangement\(^3\), which could substantially increase the costs for each party. While this type of Shared Ownership agreement has the widest range of options for sharing the ownership of the insurance policy, it also has the widest range of potential tax assessments.

Retirement Compensation Arrangements (RCA)

Scenario A: The employer owns the Face Amount death benefit and the RCA trust owns the Fund Value
The portion of the premium paid to fund the RCA trust can be deducted by the owner from his/her income as a business expense. However, the portion of the premium used to pay for the Face Amount death benefit cannot be deducted.

Scenario B: Employee owns the Face Amount death benefit and the RCA trust owns the Fund Value
The cost of the premium for the Face Amount death benefit must be paid with the employee’s after-tax income. If the employer pays the entire premium, the value of the premium that relates to the Face Amount death benefit is a taxable benefit to the employee. If the employee is also a major shareholder of the employer, the arrangement needs to be structured so it does not confer a taxable benefit on the shareholder.

Buy-Sell Agreements
Although term insurance is often used to fund Buy-Sell Agreements, it has the following disadvantages:
• cost increases at each renewal
• may be difficult to obtain additional insurance protection if the value of the shares increases significantly
• insurance coverage can’t be combined with tax-sheltered savings

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\(^2\) Subsection 207.6(2) of the Income Tax Act.
For these reasons, a universal life insurance policy may be a preferred funding choice. There are many ways to set up a Shared Ownership strategy using universal life insurance in connection with a Buy-Sell Agreement. The most popular method is for the employer to own the Face Amount death benefit and the shareholder to own the Fund Value, either personally or through a holding corporation.

Common agreements in a family situation

The most common use of Shared Ownership strategies in a family situation, is to share the benefits of the contract between two generations of one family in an estate planning context.

Typically, a parent will use a Shared Ownership agreement to provide life insurance coverage for an adult child while funding their own retirement savings. This strategy works equally well between a grandparent and an adult grandchild.

The child is more likely to meet the medical underwriting requirements for life insurance coverage than his/her parents and the cost of the life insurance will be relatively low since it is based on the child’s age. Usually, the child owns the Face Amount death benefit while the parents jointly own the Fund Value. The child pays his/her share of the premiums based on the costs of an equivalent term or permanent life insurance policy, and designates the beneficiary. The parents pay the balance of the premiums and use the Fund Value for their retirement savings.

If the parents want a specific child (as opposed to their estate) to receive the Fund Value on their death, they should designate the child whose life is insured as the contingent owner of the cash value on the death of the last surviving parent. Without such a designation, the child may not have survivorship rights in the common law provinces and definitely will not have survivorship rights in Québec.

Designating the child as the contingent owner also allows them to take advantage of the tax-free rollover provided under subsection 148(7) & (8) of the Income Tax Act (ITA).

Another inter-generational income planning strategy is for the parents to insure their own lives and own the Face Amount death benefit, with the child owning the Fund Value. The parents can use the death benefit to cover their own needs for life insurance at death and the Fund Value accumulates for the child.

The attribution rules apply to such an arrangement unless the child does not make any withdrawals or policy loans until he or she is 18.

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*An adult child/grandchild includes those who can apply for and sign an application on their own. The age at which a child/grandchild can apply for insurance varies by province.

*Subsection 74.1(2) of the Income Tax Act.
Legal framework for Shared Ownership agreements

**Life Insurance Policy**
Shared Ownership agreements involve two contracts – the insurance policy and the Shared Ownership agreement – and two sets of rules:
1. provincial life insurance legislation governs the insurance contract and the relationship between the policy owner and the life insurance company
2. common law or civil law rules govern the Shared Ownership agreement and the relationship between the co-owners of the insurance policy

Under provincial laws, the life insurance policy is a contract in which the insurer agrees to pay a benefit on the death of the insured or on the occurrence of a specific event, in return for the payment of premiums. The rights of the irrevocable beneficiaries or collateral assignees (or creditors under a moveable hypothec in Québec), may limit the policy owner’s interest. In addition to specific life insurance legislation, other provincial laws addressing contracts, Powers of Attorney and rights of trustees may all impact a Shared Ownership agreement.

**The Shared Ownership agreement**
Common law or civil law rules govern the Shared Ownership agreement. The insurance company is not a party to it. It sets out the terms governing the relationship between the parties and includes provisions addressing:
- payment of premiums
- designation of beneficiaries
- contingent ownership and joint ownership survivorship rights
- decision making and instructions with respect to the policy investment accounts
- withdrawals, policy loans and collateral assignments (moveable hypothec in Québec)
- the length of the sharing arrangement
- conflict resolution
- termination of the agreement

An agreement checklist is included in Appendix C. You can also view a detailed sample draft of a Shared Ownership agreement at [www.sunlife.ca/advisor](http://www.sunlife.ca/advisor).

**Managing the insurance contract**
The life insurance company will manage one contract, regardless of the number of owners, and will accept only one set of instructions about the policy. All owners will be required to authorize all transactions unless they grant one party the right to make decisions by a power of attorney (mandate in Québec) or equivalent document.

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*Due to statutory limitations, insurers may not carry out requests to change a beneficiary by a Power of Attorney.*
Tax issues relating to Shared Ownership agreements

Shared Ownership insurance agreements raise a number of tax issues. One of the most important is how to share both the costs and the benefits in a way that avoids adverse tax consequences for the parties.

**Taxable benefits**
The CRA has taken the position that Yearly Renewable Term (YRT) insurance represents the true cost of the life insurance, but is open to “reasonable” alternatives. Appendix B includes six methods used to share the costs of an insurance sharing arrangement for either a Shared Ownership or Shared Benefit agreement.

**Taxable benefit to an employee**
Section 6 of the ITA establishes the rules for including taxable benefits from an office or employment in the employee’s income. If an employer pays the total or partial costs of an insurance contract on the life of an employee who benefits from it, the costs are considered “personal or living expenses” as defined under subsection 248(1) of the ITA and must be included as income.

A life insurance premium is always paid with after-tax money.

In order to avoid adverse tax consequences for the employer and the employee, such as double taxation and loss of deduction, the Shared Ownership agreement should contain clauses setting out:

- the method chosen to share premiums
- the value of the benefit to the employee (if any)
- the valuation criteria for each party’s payments for the interest they own in the policy

This may also permit the employer to deduct the value of the benefit to the employee from its taxable income in cases where the employer pays the entire premium.

**Taxable benefit to a shareholder**
Section 15(1) of the ITA establishes the rules for including taxable benefits to shareholders in the shareholder’s income. If an employee is also a shareholder of a corporation and receives a taxable benefit, the CRA will treat it as a shareholder benefit rather than an employee benefit. Taxable benefits to shareholders are more costly for both the individual and the employer than taxable benefits to employees because:

- the employer can’t claim an income tax deduction or a credit to its Refundable Dividend Tax On Hand account (RDTOH)
- the shareholder can’t treat the payment as a dividend, and can’t take advantage of the dividend tax credit and is taxed as if the benefit were regular income

In order to avoid this double taxation, the Shared Ownership agreement should set out:

- the value of the benefit to the shareholder or an appropriate method of calculation
- the nature of the payment to the shareholder (i.e. remuneration, bonus or dividend)
**Prepayment or limited number of deposits**

In order not to confer a benefit on its employees or shareholders and because future earnings may be unpredictable, an employer may decide to prepay insurance premiums when it has the cash available. In such circumstances, a taxable benefit is likely to occur. A well-documented request for an advanced tax ruling should be submitted to the CRA to avoid unexpected adverse tax consequences for both the employer and the employee or shareholder.

**Taxation on disposition of interest in a life insurance policy**

Taxable dispositions of an interest in a life insurance policy can occur either during the lifetime or on the death of the insured. In general, the policy owner will be deemed to have disposed of his/her interest in the policy at its Fair Market Value (FMV). The policy owner must then include the amount of the policy gain in his/her income. If a Shared Ownership agreement is in place, this amount will be allocated between the owners in accordance with the Shared Ownership agreement.

**Disposition during the insured’s lifetime**

Taxable dispositions during the insured’s lifetime occur when:
- one owner of an insurance policy transfers his/her interest to another owner or to a third party
- policy loans, withdrawals or surrenders take place

If one owner transfers his/her interest to another owner, the transferor will be deemed to have disposed of his/her interest at its FMV and the transferee will acquire it for the same value. The transferor will usually be responsible for the tax payable. If the transferor is the employer or a corporation and transfers its interest to an employee or shareholder at less than its FMV, the difference between the FMV and the amount paid will be taxable as an employee or shareholder benefit.

Establishing the FMV of an interest in an insurance policy transferred during the insured’s lifetime can be complicated. The following factors should be considered:
- the Cash Surrender Value (CSV)
- the policy loan value
- the Face Amount death benefit value
- the state of health and the life expectancy of the insured and the likelihood of the insured's imminent death
- the conversion privileges
- other policy terms such as riders and double indemnity provisions
- the replacement value
- future earning expectations and prospects for dividends
Disposition on death
If a Shared Ownership agreement is in place on the death of the insured, no taxable disposition occurs because the death benefit, including the Fund Value, is paid tax-free to the beneficiaries. However, the Fund Value owned by a corporation affects the FMV of the shares of the corporation, and their eligibility for the $500,000 enhanced capital gains exemption. The FMV of the Fund Value will equal the CSV of the policy immediately before death.

Calculation of Adjusted Cost Basis (ACB)
Section 148(9) of the ITA defines a life insurance policy’s Adjusted Cost Basis (ACB). Although the detailed calculation is complex and depends on whether the policy was last acquired before or after December 1, 1982, the ACB is the total of the premiums paid less the Net Cost of Pure Insurance (NCPI).

The insurer will usually provide the policy owner with the ACB of the policy. However, if a Shared Ownership agreement is in place, the insurer may not be aware of the details of the sharing arrangement, so the policy statement may not apportion the ACB between the owners.

The CRA has recently stated that the insurer is required to prepare separate T5 slips to report the gain realized by each owner on the disposition of his/her interest in the life insurance policy. In order for the insurer to do this, the co-owners should provide the insurer with sufficient information to determine the ACB of each interest. Such information will likely include:
• a copy of the Shared Ownership agreement
• the allocation of the premiums and benefits
• the calculation method used in the sharing arrangement

There may be situations where the cash value owner will receive the entire ACB of the policy. For example, if the cash value owner has no interest in the Face Amount death benefit, the NCPI will equal 0. The Face Amount death benefit owner will have the full NCPI deduction for the ACB calculation. This is significant since the proceeds in excess of the ACB create a credit to the corporation’s CDA. The smaller the ACB is, the higher the CDA credit and the higher the amount available to be paid to shareholders as a tax-free capital dividend. Similarly, the higher the ACB for the cash value owner, the more of the cash value that is accessible tax free.

\[\text{Due to statutory limitations, insurers may not carry out requests to change a beneficiary by a Power of Attorney.}\]
Deductibility of premiums

**Face Amount death benefit owner**
Life insurance premiums are generally not deductible for tax purposes. For accounting purposes, the full amount is expensed when the premium is paid, and then is added back into income for tax purposes at year-end. However, if a financial institution makes a loan and requires the insurance as collateral for the loan, a portion of the cost of insurance may be deductible.

**Fund Value or CSV owner**
The money deposited into the Fund Value of a universal life insurance policy is part of the life insurance premium and is not deductible from taxable income.

**Insurance proceeds and CDA**
If a corporation is the owner and the beneficiary of a life insurance policy, and the life insured dies, the portion of the life insurance proceed that exceeds the policy's ACB, is included in the CDA of the corporation.

Documents required to implement a Shared Ownership strategy

To implement a Shared Ownership strategy, you will need the following documents:

- life insurance application
- Shared Ownership agreement
- transfer of ownership form, unless both owners have signed the life insurance application
- beneficiary designation form signed by both owners designating beneficiaries for each of the Face Amount death benefit and the Fund Value
- Power of Attorney* (mandate in Québec) if decisions are to be authorized by one owner
- corporate resolutions authorizing the corporation to enter into a Shared Ownership agreement

Since the Canada Revenue Agency (CRA) has not provided any guidance on the tax treatment of Shared Ownership insurance agreements, it is advisable that you receive an advance ruling on the tax treatment of payments made and payments received on a case-by-case basis. Please refer to the Disclaimer at the end of this guide for more information.
Shared Benefit agreements are commonly set up for employers who want to provide additional benefits specifically designed to recruit, reward and retain key employees.

There are a number of ways to supplement an employee’s retirement income, each with its own tax consequences for both the employee and employer. Common options for funding retirement income are the “Pay as You Go” method and the Individual Pension Plan.

A Shared Benefit insurance agreement supplements an employee’s retirement income, while protecting the business against the premature death of that person.

**Shared Benefit Agreements**

This strategy is designed for key employees or owner/managers who have:

- maximized RRSPs or pension contributions
- minimized non-deductible debt
- the need for additional retirement income
- 10 to 15 years until retirement income is needed

and for employers who want to:

- protect against the loss they will suffer if a key employee dies
- create additional benefits to recruit, reward and retain employees

**Implementation**

Employee purchases a SunUniversalLife policy

Employee and employer enter into a legal agreement governing the arrangement

Employee names the beneficiary of the Fund Value

Employer is named as irrevocable beneficiary of the Face Amount portion of the death benefit

Fund Value

Death Benefit

*Sharing Interests In a Life Insurance Policy*
An overview of Sun Life Financial’s Shared Benefit Concept –
the Executive Retirement Account (ERA)

<table>
<thead>
<tr>
<th>Key employee or owner-manager</th>
<th>Key employee/owner</th>
<th>Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>buys universal life policy and makes annual deposits to the fund</td>
<td>names company irrevocable beneficiary for the Face Amount</td>
<td>pays annual amount to cover the Cost of Insurance (COI)</td>
</tr>
</tbody>
</table>

**Benefits of a SunUniversalLife policy**

<table>
<thead>
<tr>
<th>Fund Value</th>
<th>Face Amount</th>
</tr>
</thead>
</table>
| • Source of funds to provide retirement income  
  • Accumulations are tax-deferred | • Tax-free at death  
  • Covers replacement costs  
  • Creates tax-free dividends for private corporations |

**Fund Value**
- the employee pays for contributions to the Fund Value to build a tax-deferred retirement fund
- on retirement, the employee can access the funds either by:
  - directly withdrawing from or taking a loan from the policy (may be taxable)
  - taking a loan from a lending institution against the policy Fund Value (not taxable)

**Face Amount death benefit**
- the employer pays for the Face Amount death benefit to protect the company against the loss of a key person
- if the employee/shareholder dies, proceeds in excess of ACB of policy received by the employer are credited to its CDA and can be paid out as tax-free capital dividends
- when the term of the agreement ends or the employer no longer requires the insurance, it agrees to change the beneficiary to a person the employee/shareholder selects

You can view detailed information on the ERA account on [www.sunlife.ca/advisor](http://www.sunlife.ca/advisor)

**Legal framework for Shared Benefit agreements**

Two of the issues you will need to address in the Shared Benefit agreement are: a change of beneficiary and the terms of the agreement.

**Change of beneficiary**
The Shared Benefit agreement should state that the employer’s rights expire and that the employer will agree to a change of beneficiary when the agreement expires. The employee can then appoint a new beneficiary in accordance with his or her estate plan.

**Terms of agreement**
Terms of the agreement may depend on whether the key employee is also a shareholder of the corporation.
If the key employee is not a shareholder:

In most cases, the employer will only want life insurance on the key employee during the period of employment. The agreement may be structured as a fixed term agreement, with renewal provisions in the event that the period of employment is extended. The employer is less likely to have unexpected adverse tax consequences by structuring the agreement as a fixed term agreement because the agreement has no value and nothing to transfer to the employee upon expiry.

The agreement should also contemplate that the relationship between the employee and the employer might terminate for reasons other than the employee’s retirement. The agreement will usually provide that if employment ends prior to retirement, the employer will stop paying for the insurance protection and will agree to a change in beneficiary.

If the key employee is a shareholder:

The employer may need permanent insurance on the life of the shareholder as part of a business succession plan and the wording of the agreement should reflect the particular circumstances applicable to the parties. Otherwise, an agreement for a fixed term with provisions for renewal may also be appropriate for a shareholder.

An agreement checklist is included in Appendix C. You can also view a detailed sample draft of a Shared Benefit agreement at www.sunlife.ca/advisor.

Tax issues relating to Shared Benefit agreements

As with Shared Ownership agreements, the CRA has not provided guidance on the tax treatment of Shared Benefit agreements. It is advisable that you receive an advance tax ruling on the tax treatment of payments made and received, on a case-by-case basis. Please refer to the Disclaimer at the end of this guide for more information. Appendix B includes six methods used to share the costs of an insurance sharing arrangement for either a Shared Ownership or Shared Benefit agreement.

Tax advisors asked to comment on a Shared Benefit agreement will need to address the following four questions:
1. Does the employee or shareholder receive a taxable benefit because the employer pays into the life insurance policy?
2. What is the tax treatment of the death benefits received by the parties?
3. What are the tax implications if the life insurance policy is used to create retirement income?
4. What are the tax issues if the Shared Benefit agreement terminates for reasons other than death?

Taxable benefits to employees or shareholders

The issues relating to taxable benefits under a Shared Benefit agreement are the same as those under a Shared Ownership agreement, and are discussed in the Shared Ownership “Tax Issues” section of this guide.

Tax treatment of the death benefit

If the insured dies during the term of the agreement, the death benefit will be paid directly to the beneficiaries. The Face Amount death benefit is paid to the employer tax-free. The amount of the proceeds received by the company less the ACB, if any, creates a credit to its CDA.

The employee’s beneficiary receives a tax-free benefit equal to the Fund Value of the policy.
**Tax implications of using an insurance policy to create retirement income**

There are three ways to create income from the policy:

1. **Withdrawals and policy loans**
   Withdrawals from a life insurance policy are included in income in proportion to the ratio of the ACB to the total CSV. At some point, the ACB will be nil, and 100% of the withdrawals will be taxable to the life insurance policy owner. Actual investment returns on the funds within the policy will determine the amount of income available for withdrawal.

   The policy loan tax treatment differs from withdrawals, since the policy ACB is reduced by the amount of the loan. Therefore, if the policy loan is less than the ACB, no taxation will occur. However, when the policy loan exceeds the ACB, the excess of the policy loan over the ACB is taxable.

2. **Policy surrender**
   At the end of the arrangement the policy owner can surrender the policy and withdraw the entire cash value. The policy will no longer exist in that case. The tax treatment will be the same as the policy withdrawals although the entire cash value will be taken all at once instead of over time as with withdrawals.

3. **Loans from a third-party provider**
   Loans\(^8\) from a third-party financial institution, using the policy as collateral, are not taxable. Some lenders are prepared to capitalize the interest on these loans and will not require repayment of the accumulated loan until the death of the insured. There are risks associated with this strategy beyond the usual investment risks, including a mismatch of interest rates and the possibility of future changes to tax rules.

**Termination of a Shared Benefit agreement for reasons other than death**

If the Shared Benefit agreement terminates for reasons other than death, the life insured will appoint a new beneficiary in accordance with the agreement. If this occurs, there is no disposition of the policy because a change of beneficiary is not a taxable disposition. If the employer has prepaid costs or has another claim to values, such as prepaid levelized premiums in the policy, those values will likely constitute a benefit to the employee or shareholder, unless he or she purchases them from the employer at their fair market value (FMV).

**Documents required to implement a Shared Benefit strategy**

To implement a Shared Benefit strategy, you will need the following documents:

- life insurance application
- Shared Benefit agreement
- corporate resolutions authorizing the corporation to enter into a shared benefit agreement
- irrevocable beneficiary designation form

An agreement checklist is included in Appendix C. You can also view a detailed sample draft of a Shared Benefit agreement at [www.sunlife.ca/advisor](http://www.sunlife.ca/advisor).

\(^8\)See Sun Life Financial’s “An Advisor’s Guide to Leveraging Life Insurance” for more information on the pros and cons of this option.
## Key differences between Shared Ownership and Shared Benefit strategies

This table compares some of the key features of these two methods of sharing interests in a life insurance policy:

<table>
<thead>
<tr>
<th></th>
<th>Shared Ownership</th>
<th>Shared Benefit (ERA)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Ownership</strong></td>
<td>• Employer and individual are co-owners of the policy.</td>
<td>• Individual is sole owner.</td>
</tr>
<tr>
<td></td>
<td>• Employer is the policy owner and/or beneficiary, so the death benefit is not creditor protected.</td>
<td></td>
</tr>
<tr>
<td><strong>Creditor protection</strong></td>
<td>• Personally owned portion may not be subject to employer’s creditors, depending upon how the agreement is set up.</td>
<td>• Personally owned policy with an eligible named beneficiary; may be creditor protected.</td>
</tr>
<tr>
<td></td>
<td>• While the employer is the beneficiary, the death benefit payable to the employer is not creditor protected.</td>
<td></td>
</tr>
<tr>
<td><strong>CDA credit</strong></td>
<td>• Death benefit payable to an eligible Canadian private corporation in excess of the policy ACB, could be credited to the CDA.</td>
<td>• Death benefit payable to an eligible Canadian private corporation in excess of the policy ACB, could be credited to the CDA.</td>
</tr>
<tr>
<td><strong>Change to sole ownership</strong></td>
<td>• Disposition triggers tax on policy gain as well as a taxable benefit to employee/shareholder.</td>
<td>• N/A since the individual is already the sole owner.</td>
</tr>
<tr>
<td><strong>Ownership change when health is impaired</strong></td>
<td>• Transfer must occur at policy FMV to avoid any adverse tax consequences.</td>
<td>• Depending upon the structure of the agreement, the taxable benefit to employee/shareholder may or may not apply.</td>
</tr>
<tr>
<td><strong>Leveraging the cash value</strong></td>
<td>• May be an employee/shareholder benefit if the employer is still the co-owner of the policy.</td>
<td>• The individual is the sole owner. Possibility of taxable benefit if employer consents to the assignment of its portion.</td>
</tr>
<tr>
<td><strong>NCPI deduction</strong></td>
<td>• Possible if assigned as collateral and all other requirements are met.</td>
<td></td>
</tr>
</tbody>
</table>
Appendix B

Methods to share the costs of an insurance sharing arrangement

The various methods to share life insurance interest described in this document are designed to provide the reader with examples only. None of these sharing methods have been tested or otherwise recognized or acknowledged by the CRA. A life insurance shared interest strategy must be implemented very carefully with the assistance of knowledgeable legal and tax experts. In order to avoid adverse tax consequences, you should request an advanced tax ruling from the CRA.

Here are the six most common methods used to share the costs of an insurance sharing arrangement for either a Shared Ownership or Shared Benefit agreement outlined below, described in a business context. These arrangements are appropriate for both business and family scenarios. For family scenarios, the parent/grandparent assumes the role of employer and the children assume the role of the employee. The ITA allows for the tax-free transfer of ownership from a parent or grandparent to a child or grandchild.

1. Cost of Insurance (COI) method

<table>
<thead>
<tr>
<th>Structure</th>
<th>• The employer pays the actual cost of insurance as specified in the insurance contract. The employee/shareholder pays the balance of the planned deposit or premium.</th>
</tr>
</thead>
</table>
| Tax discussion | • If the employer pays a Yearly Renewable Term (YRT) cost, there is unlikely to be any taxable benefit, since this represents the actual cost of the Face Amount each year.  
  • If the employer pays a Level Term cost, it is paying more than the true cost of coverage in the early years and less than the actual cost in later years.  
    • If the agreement is permanent in nature, the employer will always be the irrevocable beneficiary of the life insurance. The employer is paying the same cost as if it bought a policy expressly for this purpose and there is unlikely to be any taxable benefit to the employee/shareholder.  
    • If the agreement is temporary, there may be a benefit to the employee/shareholder. This is calculated as the difference between the total amount paid by the employer and the comparable cost of term insurance for the period of the agreement.  
    • If the agreement provides for the recovery of any prepayment by the company on the death of the employee/shareholder or on the termination of the agreement, it is possible that there has been no taxable benefit. Each party pays its respective share of the premium tax. |
### 2. Net cost of Pure Insurance (NCPI) method

**Structure**
- The employer pays the NCPI and the insured employee/shareholder pays the balance of the planned deposit or premium.

**Tax discussion**
- The NCPI is a notional amount defined in the ITA that, in theory, represents the actual cost of the mortality risk. Its cost will be slightly lower than a YRT cost in the early years but higher in later years.
- If the Face Amount death benefit owner is an employer, the ACB will be nil and 100% of the death benefit will be credited to the employer’s CDA.
- The employee/shareholder pays the entire premium tax.

### 3. Level NCPI method

**Structure**
- The employer pays the average NCPI over the term of the deposit period, with or without a discount rate. It results in a level cost in contrast to the annually increasing cost of YRT or NCPI.
- The employee/shareholder pays the balance of the planned deposit or premium.

**Tax discussion**
- The employer will be paying slightly more than the NCPI in the early years and less in later years. As with paying a level cost of insurance (option 1 above), the excess over the actual NCPI in the early years could constitute a taxable benefit. If the agreement provides for the recovery of any prepayment by the employer on the death of the employee/shareholder or on the termination of the agreement, it is possible that there has been no taxable benefit.
- The employee/shareholder pays the entire premium tax.

### 4. Specified amount method

**Structure**
- The employer pays a specified amount, and the employee/shareholder pays the balance of the planned deposit or premium.

**Tax discussion**
- This option allows the employer to set the amount paid. If the rationale for choosing this amount is consistent with the terms of the agreement, then there may be no taxable benefit. It is recommended that you apply for an advanced tax ruling to avoid any adverse tax consequences. Here are two examples:
  - The term of the agreement is 20 years with provision for a renewal. The employer pays an annual cost equal to the premium for a 20-year term insurance policy available in the marketplace. It is unlikely there would be a taxable benefit in this scenario.
  - The term of the agreement is for 10 years with provision for renewal. The employer pays an annual amount equal to a 20-year term insurance policy, which is more than the premium for a 10-year term. As the employer is paying more than a reasonable amount for the insurance protection, the difference would likely be a taxable benefit.
- The parties may want to include the premium tax in the specified amount.
The next two methods were commonly used in sharing costs under “Split Dollar” arrangements using traditional Whole Life policies. In these ‘bundled’ policies, it is impossible to determine the relationship between the premium and the components of the policy. They are unlikely to be used in a Shared Benefit agreement.

<table>
<thead>
<tr>
<th>5. Increase in Fund Value method</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Structure</strong></td>
</tr>
<tr>
<td>• The employee/shareholder pays the annual increase in the Fund Value and the employer pays the balance. This usually results in the employer paying significantly less than its share of the cost, making it an unlikely basis for cost sharing under a Shared Benefit arrangement.</td>
</tr>
<tr>
<td><strong>Tax discussion</strong></td>
</tr>
<tr>
<td>• While there would be no taxable benefit to the employee/shareholder, the employee/shareholder would likely want recognition for benefitting the employer, either through a loan arrangement or share allotment.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>6. Increase in cash surrender value method</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Structure</strong></td>
</tr>
<tr>
<td>• The employee/shareholder pays the annual increase in the cash surrender value and the employer pays the balance. While the employer pays more than the Fund Value (option 5 above), it still pays significantly less than its share of the cost, making it an unlikely basis for cost sharing under a Shared Benefit agreement.</td>
</tr>
<tr>
<td><strong>Tax discussion</strong></td>
</tr>
<tr>
<td>• While there would be no taxable benefit to the employee/shareholder, the employee/shareholder would likely want recognition for benefitting the employer, either through a loan agreement or share allotment.</td>
</tr>
</tbody>
</table>
Shared Ownership/Shared Benefit Agreement checklist

A Shared Ownership/Shared Benefit agreement should include the following:

- Date: ________________________________
- Between: ________________________________
- Strategy:  □ Shared Ownership  □ Shared Benefit
- Goals and objectives: ________________________________
- Duration and renewal of the agreement: ________________________________
- Insurance product: ________________________________
- Method for:
  - Allocating premiums:
  - Allocating benefits:
  - Designating beneficiaries
- Policy transactions:
  - Decision making
  - Investment selection
  - Power of Attorney
  - Premium payments
  - Corporate resolutions
  - Policy withdrawals
  - Policy loans
  - Collateral assignments (Hypothecation in Québec)
  - Bookkeeping
- Resolution of conflicts:
  - Mediation
  - Litigation
  - Arbitration
- Termination of the agreement:
  - Cause of termination
  - Transfers
  - Division of policy
  - Penalties in case of breakdown of the agreement
- General provisions
  - Jurisdiction
Disclaimer - CRA Position on Shared Insurance arrangements

This document is intended to provide the reader with generic information with regard to the different concepts and methods surrounding the sharing of an interest in a life insurance policy.

In order to provide an advance ruling, the CRA requires:
- an illustration of the proposed insurance policy with the Face Amount death benefit, cash values and premiums
- a copy of the life insurance Shared Ownership and/or Shared Benefit agreement
- the allocation of the premiums and benefits and the calculation method used in the sharing agreement
- the age of the insured and his or her state of health
- any other relevant documents

On a number of occasions, the CRA has formally stated the following elements that must be considered before implementing a life insurance shared interest strategy:

1. Each situation must be considered on a case-by-case review of the terms of the particular life insurance policy and the rights that have been made available to someone other than the original owner of the policy. (CALU, Tax Policy Round Table 1992, Question 7 and 1998, Question 6)

2. These strategies are likely to create an employee or shareholder taxable benefit under the ITA Paragraph 6(1)(a) and Subsection 15(1). (Revenue Canada Taxation, Letter from Directorate, October 25, 1988)

3. It is a question of fact whether or not a benefit is received. No benefit will be created if each of the parties to the agreement pays a premium equal to the premium for comparable rights available on the market under a separate insurance policy. The benefit to be included in the employee/shareholder’s income is the amount by which the premium cost for equivalent term coverage exceeds the premium paid. (CTF, Revenue Canada Round Table, 1992 Prairie Provinces Tax Conference, Question 16)

4. Assignment of the interest by the original owner to a third-party employee, shareholder or corporation is a “disposition” of an interest in a life insurance policy under Subsection 148(9) of the Canada ITA “disposition”, the taxable portion of which must be included in the original owner’s income tax return for the year under ITA Paragraph 56(1)(j). On the other hand, the FMV of the specific rights that have been assigned to a third-party employee or shareholder

The various methods to share life insurance interest described in this document are designed to provide the reader with examples only. None of these sharing methods has been tested or otherwise recognized or acknowledged by the Canada Revenue Agency (CRA). A life insurance shared interest strategy must be implemented very carefully with the assistance of skillful lawyers and tax experts. To help minimize or to avoid adverse tax consequences, request an advance tax ruling from the Canada Revenue Agency (CRA).
would constitute a taxable benefit under ITA Paragraph 6(1)(a) or/and Subsection 15(1) and
taxed accordingly\(^9\). Whether or not a taxable benefit to the employee or shareholder takes place
is a question of fact. However the department may confirm there is no taxable benefit that
arises when the premium paid by the employee or the shareholder under the policy is equal to
the premium for comparable rights available in the market under a separate insurance policy.
(CALU, Tax Policy Round Table 1992, Question 7).

5. As a general CRA rule, advance tax rulings are provided to confirm tax implications inherent
to particular situations. With “Split Dollar” insurance arrangements, the CRA has identified
information that would be required as well as some of the specific concerns that would need
to be addressed.

All relevant terms and conditions of the particular life insurance policy would have to be
provided including: the death benefit, the Cash Surrender Value or the accumulation within
the policy (if any), the premium to be paid under the policy, and the age and health condition
of the individual to be insured under the policy. The CRA also requires a copy of any side
agreement, which is to be entered into between the employer, the employee and/or the
insurance employer, and any other related documentation.

It is necessary to establish whether each of the employer and employee have an interest in the
policy. This is relevant in determining not only the nature and the income tax treatment of
payments made by each of the parties, but the nature and income tax treatment of the payment
received by each of the parties.

The CRA needs to know how the amount of the premium (which is to be reimbursed by the
employer to the employee) is arrived at. It also requires evidence of the premium amount that
the employee would be required to pay if he or she were to obtain coverage comparable to that
retained by him/her.

The CRA assumes the reason for entering into this agreement is a cost reduction from what
would be the total premium if two separate policies were acquired. It would require evidence
of how this saving will be determined and how it will be shared between the two parties.
(CALU, Tax Policy Round Table 2001, Question 10).

\(^9\)A corporation or an employer providing the benefit is under an obligation to report the nature and size of the
employee/shareholder benefit typically by way of a T4 slip. Under the Canadian self-assessing tax system, an employee or a
shareholder has the duty to report the taxable benefit in his/her T1 for the year it is conferred even if the corporation or the
employer neglects to report the benefit.
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