Part II: Retirement Compensation Arrangement – Funding with universal life insurance

Shared ownership arrangements can help minimize COI and offer maximum advantages to your clients

Hélène Marquis, L.L.L., D.Fis., Pl. Fin, TEP
Senior Planning Consultant
Wealth Protection Group
Sun Life Financial

In brief
An exempt universal life insurance policy – such as Sun Universal Life – can be a highly attractive tool for funding a retirement compensation arrangement (RCA).

However, when contemplating this type of funding method it is important to structure it in such a way that minimizes the cost associated with using an insurance contract (i.e. COI), maximizes the fund value and protects the tax-free status of the death benefit. A shared ownership arrangement is one such strategy that can help you achieve these goals.

NOTE: To review how an RCA is structured and funded, refer to Advisor Notes, Part I - Retirement Compensation Arrangements: The benefits can indeed outweigh the costs.

Pros and cons of funding with universal life insurance
As explained in Part I, a retirement compensation arrangement (RCA) is subject to a specific tax treatment where 50% of the employer’s contribution and 50% of the annual return on investment is directed to a refundable tax account (RTA) that is held by the Canada Revenue Agency (CRA). The portion of the invested money held in the RTA does not earn any return.

Funding an RCA with an exempt life insurance policy – such as Sun Universal Life – is an effective way to reduce the cost of the RTA. Because the fund value grows tax sheltered (as long as the cash surrender value is maintained inside of the policy during the insured’s lifetime), this eliminates having to send 50% of the policy annual earning to the RTA.

On the downside, a portion of the employer’s contribution to the RCA is used to pay the COI, which reduces the amount invested to accumulate retirement benefits. In addition, although the RCA trust receives the life insurance death benefit and fund value tax-free at the insured’s death, all the money paid out from the RCA to the beneficiaries is fully taxable.¹

¹ Para 56(1)(x) or 12(1)(n.3) ITA
Fortunately, there are planning strategies and product options you can use to overcome the drawbacks of funding an RCA with a universal life insurance policy.

**Planning Strategies: Shared ownership arrangement**

A shared ownership arrangement is an excellent strategy to consider for clients who are interested in setting up an RCA and also have a need to obtain temporary or permanent life insurance coverage on a business owner or other key person.

This strategy minimizes the cost associated with using an insurance contract (i.e. COI) by keeping the basic death benefit out of the RCA. It is structured so that the employer is the policy owner and the beneficiary of the death benefit, while the RCA owns and is the beneficiary of the fund value. The employer pays for the COI premiums using after-tax business income. Since the COI paid is not a contribution to the RCA, it is not subject to the 50% annual RTA deposit requirement.

Under this arrangement, the employer receives the face amount death benefit tax-free. If the employer is a corporation, the portion of the death benefit that exceeds the adjusted capital basis (ACB) of the policy qualifies for a credit to the capital dividend account (CDA). The money contributed by the employer to the life insurance fund value held by the RCA and the annual amounts remitted to the RTA is fully deductible from the employer’s taxable income as long as it qualifies as reasonable expense to gain income from the business. Unlike RRSPs, there is no specific limit on the contribution amount. However, the contribution must be reasonable in relation to the employer’s usual remuneration policy.

At retirement, a series of policy loans or a leveraging strategy may be used to access funds in the RCA. Or, if the need for life insurance coverage no longer exists, the policy may be surrendered. If the insured dies before the policy is surrendered, the fund value is paid tax-free as a death benefit to the RCA.

As mentioned earlier, all the benefits paid out of the RCA are fully taxable – even if it comes from a tax-free death benefit. However, implementing a shared ownership agreement using the Face Amount Plus Fund death benefit option protects the after-tax value of an exempt life insurance policy death benefit.

**Product Options: Death benefit**

**SunUniversalLife** offers two death benefit options that allow you to minimize the drawback related to the COI when funding an RCA:

- **Level Face Amount** – the death benefit remains level, resulting in a lower COI and larger fund value accumulation.

- **Fund Builder** – a Face Amount Plus Fund death benefit type that allows the face amount to be reduced as low as $10,000 in order to minimize charges while maximizing fund value.

---

2 Subpar 18(1)(o.2), 20(1)(r) and Sect. 67 ITA
**Pitfall to avoid: Deemed RCA**

Under the *Income Tax Act*, it is possible for a well-funded corporate-owned life insurance policy to be “deemed” an RCA, even if the employer did not intend for it to be considered as such. In this case, the company would immediately have to pay all of the annual 50% deposits to the RTA owing to date, plus possible penalties. The employer is also required to pay the annual 50% refundable tax on all future contributions to the policy. Bear in mind that an employer owned life insurance policy and/or annuity acquired to fund retirement or termination benefits create a deemed RCA.

**Advising clients**

When funded with a universal life insurance policy, the death benefit options and planning strategies must be carefully considered to maximize the tax-sheltered growth of the fund value while limiting the disadvantage related to a high COI and the loss of the exempt benefit in the hands of the RCA beneficiary.

- Sun *Universal* Life is an excellent choice for funding an RCA arrangement. Our unique COI discount and “bonus” and “no bonus” option offer maximum flexibility to create customized solutions for your clients.

- The CRA’s position on shared ownership arrangements states that each arrangement must be considered on a case-by-case basis.³

- It’s important to consult with proficient advisors, trust lawyers and actuaries to avoid the potential traps and pitfalls of an RCA. For example, negative tax consequences can occur if the plan fails to qualify as an RCA and is instead considered a salary deferral arrangement (SDA).

**For advice and support**

- Call 1-800-800-4SUN (1-800-800-4786), option 5 (for Regional Distribution Offices), then select:
  1. Vancouver (BC)
  2. Calgary (AB, SK, MN)
  3. Waterloo (ON)
  4. Toronto (ON)
  5. Montreal (QC)
  6. Halifax (NB, NS, PE, NL)

- Advisor and client information is available on the Sun Life Financial Advisor site at [www.sunlife.ca/advisor](http://www.sunlife.ca/advisor).

*The information presented here is for your information only. Sun Life Assurance Company of Canada does not provide legal, accounting, taxation or other professional advice to advisors or their clients. Before you act on any of this information on behalf of a client, always have your client seek advice from a qualified professional including a thorough examination of your client’s specific legal/tax situation.***

---