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## SPLIT-DOLLAR LIFE INSURANCE: IT'S A QUESTION OF FACT

A split-dollar arrangement is a popular insurance planning technique that shares the costs and benefits of an exempt life insurance policy between two (or more) parties. Generally, these arrangements are structured so that one party owns a level death benefit amount and the other owns the remaining interests in the policy (essentially the cash value). The details of the arrangement should be set out in an agreement between the participants. Under the arrangement, each party should pay the portion of the premium for the benefits received, and the parties should each appoint separate beneficiaries for their policy interests.

As an example, Mr. Smith is the owner/manager of ABC Company. ABC Company requires \$1 million of key-person protection on his life. Mr. Smith has funds available to invest and is receptive to new investment opportunities. A split-dollar arrangement using a life insurance policy could be structured between Mr. Smith and ABC Company. ABC Company would pay for and own \$1 million of level death benefit protection, and Mr. Smith would pay for and own the cash value. By splitting the policy costs and benefits, the life policy is able to provide two planning opportunities.

In structuring a split-dollar arrangement, it is important to ensure that each party pays a reasonable amount for the benefits received. What is reasonable? The Canada Customs and Revenue Agency ("CCRA") has indicated on several occasions that the death benefit owner should pay equivalent term insurance rates for the benefit received. The CCRA has further stated that what constitutes equivalent term insurance rates is a question of fact and depends upon the circumstances. Therefore, depending on the situation, a reasonable rate for the death benefit may be term insurance rates (including term 10, term to 100 and term to age 65), the insurance rates charged in the policy, or Net Cost of Pure Insurance (NCPI) rates.

Although the CCRA has commented on what is reasonable for the death benefit owner, they have been silent on what is reasonable for the cash value owner. It should be reasonable, though, for the cash value owner to pay the difference between the total premium and the amount paid by the death benefit owner, where that amount has been appropriately determined.

If an employee or shareholder pays a split-dollar premium that is less than the premium for comparable rights under a separate insurance policy available in the market, the CCRA concludes that the com-

pany has subsidized the amount paid by the individual and this subsidy should be taxable. Thus, a taxable employee benefit or taxable shareholder benefit will result.

The CCRA has also commented on the use of universal life insurance in split-dollar arrangements, but declined to give specific assessment guidelines. The Agency is concerned that the flexibility of the benefits provided under such a policy

makes the general guidelines on how to allocate the premium unworkable. To quote the CCRA, “determination of a taxable benefit under a split-dollar arrangement utilizing a universal life insurance product can only be made on a case by case basis after a review of the relevant facts.”

*I/R 6801.00*

## WHO IS A SPOUSE?

The definition of spouse has been revised over the years to reflect changing social values. Initially, the Income Tax Act (“ITA”) acknowledged only legally married individuals within the definition of spouse. This definition was expanded in 1993 to include individuals of the opposite sex who were living in a common-law relationship. Now the ITA has changed the rules again. “Spouse” has gone back to meaning a legally married partner. However, rules that apply to spouses now also apply to “common-law partners.”

Common-law partners are individuals of the opposite or same sex who live together in a conjugal relationship for a year, or who live together in a conjugal relationship and have a child in common.

These new definitions came into law on July 31, 2000, and are applicable beginning January 1, 2001. An important note is the provision to apply the definitions retroactively to the taxation years of 1998, 1999 and 2000, if a joint election is filed before April 30, 2001 (or June 15, 2001, if one or both partners are in business).

These changes create tax planning opportunities, as well as pitfalls, for same-sex partners.

Same-sex partners can now participate in income tax planning opportunities, including the following:

- Eligibility to contribute to spousal RRSPs, or be the spouse for whom spousal contributions are made. (Note that the terms “spousal plan” and “spousal RRSP” are retained and apply to both spouses and common-law partners.)
- The ability to transfer capital assets and life insurance policies on a rollover basis, both while alive and upon death.
- The ability for both partners to make maximum withdrawals under the Life-long Learning Plan towards the education of one of the partners.
- Expanded eligibility to claim tax credits, including the spousal tax credit, transferable unused personal credits, and tax credits for medical expenses incurred and charitable donations made by a common-law partner.

There are, however, disadvantages to be considered. Some of these include:

- Attribution of income and capital gains will apply. Numerous rules relating to “non-arm’s length” relationships (for example, the corporate control rules) will also be applicable. (Though the non-arm’s length rules applied before adoption of the common-law partner definition, the relationship may now be more conspicuous.)
- Income must be reported on a family basis for the purposes of claiming certain tax credits (for example, the Goods

and Services Tax credit and some provincial tax credits) and other benefits (such as the Child Tax Benefit).

- The equivalent-to-spouse deduction will no longer be available to either partner.
- Only one principal residence designation will be available for each year.
- Childcare expenses will have to be claimed by the lower-income partner.

It is a question of fact whether the relationship between two individuals makes them common-law partners for income tax purposes. Other than the special election available to same-sex partners for the 1998, 1999 and 2000 taxation years, common-law partners do not have a choice as to whether they will be treated as such (except to the extent that they change their living arrangements).

It remains to be seen how the Canada Customs and Revenue Agency (“CCRA”) will assess in respect to this issue. Depending upon the circumstances, the CCRA may challenge the claim by two individuals that they have a common-law partnership, or may challenge the claim that they do not. Also note that a couple’s status under income tax legislation may be relevant for other types of legislation. For example, a couple’s claim to have a common-law partnership for income tax purposes may come into play in family law matters.

*I/R 7401.00*

## GOVERNMENT BENEFITS AND CONTRIBUTIONS FOR 2001

Contributions and benefits under government pension plans are adjusted periodically to reflect increases in the Consumer Price Index or the average Canadian wage. The new amounts, commencing January 1, 2001, are shown in the table

below. Each benefit is subject to income tax when received, with the exception of the Guaranteed Income Supplement and the Allowance. All benefits shown are paid monthly unless otherwise indicated, and are the maximum amounts.

	CPP	QPP	OAS
<b>CPP / QPP benefits</b> (for new beneficiaries)			
Retirement pension (at age 65)	\$775.00	\$775.00	
Disability pension	\$935.12	\$935.09	
Disabled contributor’s child benefit (each child)	*\$178.42	*\$56.65	
Survivor’s*** pension			
• under age 55	**\$428.70	**\$644.47	
• age 55 to 64	\$428.70	\$690.22	
• age 65 or over	\$465.00	\$465.00	
Surviving child’s benefit (each child)	*\$178.42	*\$56.65	
Death benefit (lump sum)	\$2,500.00	\$2,500.00	
Combined benefits			
• survivor’s*** pension and disability (under age 65)	\$935.12	\$1,227.71	
• survivor’s*** pension and retirement (age 65 and over)	\$775.00	\$775.00	

	CPP	QPP	OAS
<b>Annual CPP/QPP Contribution</b>			
Self-employed (8.6%)	\$2,992.80		
Employee (matched by employer) (4.3%)	\$1,496.40		
<b>Old Age Security (OAS)</b>			
January to March 2001			\$431.36
<b>Guaranteed Income Supplement (GIS)</b>			
January to March 2001			
• spouse/common-law partner receives OAS or Allowance			\$333.92
• single person (or spouse/common-law partner receives neither OAS nor Allowance)			\$512.65
<b>Allowance</b>			
January to March 2001			
• age 60 to 64, and spouse/common-law partner receives OAS and GIS			\$765.28
• age 60 to 64, survivor's*** Allowance			\$844.88

**Notes:**

\* flat benefit amounts

\*\* these amounts may vary depending on whether the survivor is under age 45, disabled, or with or without children

\*\*\* a survivor is the spouse or common-law partner of a deceased individual

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