

COMMENT

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Creditor Life Insurance

It happened again – a standard paradigm that has existed for many years has been challenged, creating a sense of uncertainty.

It has long been the position of the Canada Revenue Agency that group creditor life insurance should not result in a credit to a company's capital dividend account (CDA) because the company is not the beneficiary of the insurance policy. Rather, the creditor is the designated beneficiary of a group creditor life insurance policy. When a claim occurs, the insurance policy pays an amount equal to the outstanding loan balance to the creditor (lender), as beneficiary under the plan.

A taxpayer, Canadian Motivel Inc., disagreed with the Canada Revenue Agency's standing position and challenged it in the courts. The parties reached an out-of-court settlement. The taxpayer was permitted to claim a CDA credit equal to the amount of insurance proceeds, under the group creditor plan, paid by the insurance carrier, to the creditor in recognition of the repayment of the outstanding loan balance.

Although an out-of-court settlement provides no precedent for subsequent court decisions, another taxpayer followed Canadian Motivel Inc.'s lead and claimed a CDA credit in a similar situation. In this most recent case, the taxpayer, Innovative Installation Inc., had borrowed money from RBC and purchased group creditor insurance offered through an insurance carrier as security for the loan. When the life insured passed away, the bank loan balance was \$192,922. By the time the claim was approved, the loan balance was \$175,500. The insurance carrier paid \$196,422 to RBC, who in turn retired the current loan balance of \$175,500, and then remitted the balance of \$21,422 to the taxpayer. Subsequently, the company paid a capital dividend of \$160,000 to its shareholders.

Not surprisingly, the CRA reassessed, seeking to apply the 75 per cent penalty for over-electing on a CDA dividend. Also unsurprisingly, the matter ended up before the Tax Court of Canada.

In reaching its decision, the Tax Court went to the Income Tax Act to ascertain exactly what the legislators had written. The specific provision of the Income Tax Act is as follows:

(ii) all amounts each of which is the proceeds of a life insurance policy of which the corporation was not a beneficiary on or before June 28, 1982 received by the corporation in the period and after May 23, 1985 in consequence of the death of any person.

The Honourable Justice C. H. McArthur broke the provision into two conditions. The first condition was that the corporation was not a beneficiary on or before June 28, 1982. The second condition was that the corporation received the amount after May 23, 1985 in consequence of the death of any person.

In the judge's opinion, the corporation only needed to receive the proceeds, and there was no requirement that the corporation needed to be the beneficiary. In arriving at his decision, Justice McArthur considered the meaning of the word receive, a term that many court decisions have considered in the past. In this case, the judge interpreted the term receive to include both constructive and notional receipt. There was no requirement that the proceeds pass directly to the taxpayer. It was Justice McArthur's conclusion that the taxpayer derived the primary benefit from the insurance payout and had indeed received the proceeds, though not directly. The judge ruled in the taxpayer's favour; as a result, the insurance proceeds satisfied the definition of the capital dividend account in the Income Tax Act, and the penalty for an excessive CDA election would not apply.

It should be noted that the Crown has appealed this case to the Federal Court of Appeal. At the time of writing, the case has not been scheduled for

hearing by the Federal Court of Appeal.

I/R 2101.07; 2121.00

Rollover of an RRSP or RRIF to an RDSP

The March 4, 2010, the federal budget contained a series of provisions to provide Canadians with financial support. One such provision is to allow the rollover of Registered Retirement Savings Plan (RRSP) and Registered Retirement Income Fund (RRIF) proceeds received, as a consequence of the death of a parent or grandparent, into an individual's Registered Disability Savings Plan (RDSP).

Currently, an individual can name a child or grandchild who was financially dependent on the individual because of physical or mental infirmity, as beneficiary of the individual's RRSP. The value of the RRSP would be included in the deceased individual's income at the time of death; but to the extent that the amount was transferred to a dependent child or grandchild, an offsetting deduction (refund of premium) equal to the amount transferred would be available. The dependent child or grandchild would be taxed upon receipt of the RRSP proceeds, but he or she could defer tax by contributing the proceeds into his or her own RRSP or another qualifying plan, and claiming an offsetting deduction. Similar rules apply to the transfer of funds from a RRIF.

The 2010 federal budget proposes to allow the dependent child or grandchild the further option to transfer the RRSP or RRIF funds into his or her RDSP where the death occurred after March 3, 2010. Note, however, that the amount eligible for transfer is limited by the lifetime contribution limit of \$200,000. As well, since the funds would go into the RDSP as tax-sheltered money (because it rolls from an RRSP or RRIF), the transferred funds will be taxable upon withdrawal from the RDSP.

Registered disability savings plans, introduced three years ago, are designed to assist parents and others in creating a financially secure future for a person who is disabled. As a tax-assisted savings vehicle, the RDSP provides for the tax-free accumulation of investment income. An RDSP can contain funds from a number of sources: tax-paid contributions, Canada Disability Savings Grants, Canada Disability Savings Bonds, and the tax-deferred accumulation of income. The original capital contributions will not be taxed upon withdrawal; however, other items (such as RRSP and RRIF transfers as discussed

above) would be taxable withdrawals.

From a planning point of view, individuals and their advisors will have to consider carefully the various options for the transfer of funds. Does it make more sense to transfer the funds to an RRSP or RRIF, or to an RDSP? That determination will be based on many factors, including the following:

- The rollover of the RRSP or RRIF funds into an RDSP will use up the individual's lifetime RDSP contribution limit of \$200,000, and will not qualify for grants. This may be very important to those who are contributing in order to maximize grants and bonds.
- An RRSP has to mature in the year the child or grandchild turns 71. RDSP withdrawals must begin at age 60. RRIF payments must begin the year after the contract is opened.
- Both an RRSP and an RDSP can be paid out as an annuity. An RRSP annuity would be 100 per cent taxable, and an RDSP annuity would have a capital element based on the non-taxable portion of the fund. Remember that any funds rolled from an RRSP or RRIF to the RDSP would not form part of this capital element, and would be taxable upon withdrawal.
- An RRSP can be converted to a RRIF, which has a prescribed minimum annual payment. An RDSP also has minimum and possibly maximum withdrawal requirements. The relative flexibility of withdrawals should be considered in assessing the options.

Income tax rules do change from time to time, and it is important to keep abreast of new rules and options. More detailed information will likely become known when the legislation to implement these new proposals is released.

I/R 7501.00

Where There Is A Will There Is A Way

If an individual spends the time to create an estate plan and documents the plan in his or her will, there is a general expectation that the plan will be followed. However, extra care may be required if it appears that the plan is unfair to one or more of the testator's beneficiaries. This can be a significant consideration when a testator wants to cut an heir out of the will, or wants to distribute the estate in unequal portions.

Provincial legislation associated with financial responsibilities owed to a spouse and dependants is often relied upon by the courts when overriding a testator's will in order to award a portion of the estate to an unnamed beneficiary. The typical types of challenges include claims made for support by financially dependent family members. An individual not named in a testator's will would have to prove to a court that he or she was dependent on the testator, and that a portion of the testator's estate should be allocated to him or her as a beneficiary. Matrimonial law may also have a say in determining the entitlement of the surviving spouse to the deceased's property.

This is becoming an increasingly central consideration in today's melded family scenarios. Second family situations often tend to favour the new family over the first family. This can be particularly problematic when the wealth was accumulated during the first marriage. The spouse and children from the first union may be financially dependent on the testator, and the question arises as to whether this should be reflected in the testator's estate plan.

Another complex scenario can occur when the first spouse has passed away and the surviving spouse has remarried. Many times, there is a clear expectation that the wealth of the second union will be shared only with the children of the second union. The difficulty arises in the moral and legal responsibilities that the surviving parent has with

respect to children from the first marriage. For example, consider the situation where one parent is deceased, and the surviving parent is remarried and has children with his or her second spouse. The thirty-year old child from the first marriage may be sufficiently independent of his parent, but should he or she be entitled to participate in any portion of his surviving parent's estate?

British Columbia's Wills Variation Act goes a step further and allows claims by financially independent heirs who feel that they have not been treated fairly. In many cases, these situations involve individuals who would normally be expected to participate in the testator's estate but are ignored. For example, a child who has become a financial success might be excluded from a parent's estate to create a larger distribution that is divided amongst less financially fortunate siblings. Societal norms dictate that the estate be divided among all of the children of the testator. Hence the question: What is the moral responsibility of the testator to his or her children? What is "fair"?

If parents want to treat their children differently, they are urged to write a memo setting out the rationale applied in their estate plan. For example, an individual may decide to leave one child more than the other because the second child received more financial support during his or her lifetime than the first child. Documenting this rationale will offer insight that the courts may consider if the will is challenged.

The courts across Canada may vary an individual's will if the testator ignores or does not provide adequately for all of his or her dependants. It is important to understand that their estate plans are not bullet-proof. Individuals need to speak with their advisors to ensure that their estate will be dealt with in a just and equitable manner, and according to their plans.

I/R 8500.00; 2500.00

Government Pension Plans: Benefits And Contributions For 2010

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, 2010, 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
CPP / QPP benefits (for new beneficiaries)			
Retirement pension (at age 65)	\$934.17	\$934.17	
Disability pension	\$1,126.76	\$1,126.73	
Disabled contributor's child benefit (each child)	*\$214.85	*\$68.22	
Survivor's*** pension			
• under age 65	**\$516.57	**\$776.41	
• age 65 or over	\$560.50	\$560.50	
Surviving child's benefit (each child)	*\$214.85	*\$68.22	
Death benefit (lump sum)	\$2,500.00	\$2,500.00	
Combined benefits			
• survivor's*** pension and disability (under age 65)	\$1,126.76	n/a	
• survivor's*** pension and retirement (age 65 and over)	\$934.17	\$934.17	
Annual CPP/QPP contribution			
Self-employed (9.9%)	\$4,326.30	\$4,326.30	
Employee (matched by employer) (4.95%)	\$2,163.15	\$2,163.15	
Old Age Security (OAS)			
January to March 2010			\$516.96
Guaranteed Income Supplement (GIS)			
January to March 2010			
• spouse/common-law partner receives OAS or Allowance			\$430.90
• single person (or spouse/common-law partner receives neither OAS nor Allowance)			\$652.51
Allowance			
January to March 2010			
• age 60 to 64, and spouse/common-law partner receives OAS and GIS			\$947.86
• age 60 to 64, survivor's*** Allowance			\$1,050.68
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			

I/R 3201.01 and 3201.03

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