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Understanding Taxation of CI Insurance - Policy structured for corporate protection

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Purpose of Insurance

To provide a cash benefit to the corporation in the event a key employee or shareholder of a corporation is:

- diagnosed with a critical illness covered in the contract, and
- survives the waiting period.

The benefit can provide the corporation with the financial flexibility needed to:

- meet the immediate cash needs of the company and to find a replacement for a key employee
- repay business debts
- fund buy-sell obligations
- maintain premium payments to existing corporate insurance plans.

Structure

Insured: Key employee or shareholder

Owner: Corporation

Premium Payor: Corporation

Benefits Payable to: Corporation

Tax Treatment

Premium is a non-deductible expenditure by the corporation.

Cash benefits and Return of Premium benefits are non-taxable* to the corporation.

If the corporation pays the cash benefit, or a portion of the benefit, to the employee or shareholder, depending upon the purpose of the payment, the amount may be included in the income of the employee or shareholder either as:

- an employee benefit
- a shareholder benefit
- a dividend (e.g. on the redemption of shares under buy-sell obligations).

Planning Points

If the corporation no longer needs the critical illness insurance policy for corporate protection, it can transfer ownership to the insured employee or shareholder without tax consequences* to the corporation; however:

- the employee or shareholder would have to include in his or her income the amount by which the fair market value of the policy exceeds the amount paid for it.
- the amount included in the employee or shareholder's income would only be deductible to the corporation if it were provided as an employee benefit.

Tip: If the benefit is to be received by a shareholder, transferring the policy as a dividend may allow the individual to benefit from the lower personal tax rates that apply to dividend income.

Sharing ownership of a policy by having the corporation own and pay for part of the policy, and the employee or shareholder the other part, should be examined carefully to determine if it would result in a taxable benefit to the employee or shareholder.

*Provided the policy is accident and sickness insurance.

The CRA has confirmed that it views critical illness insurance policies providing no Return of Premium benefits as accident and sickness insurance. It has not confirmed this view for policies containing Return of Premium on death benefits outside Quebec. It is Manulife's view that Lifecheque with Return of Premium on Death and optional Return of Premium Riders should be viewed as accident and sickness insurance.

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