

Product Selection & Understanding CDA

JOS (YOS) HERMAN, BCOMM, CPA, CA, CFP, TEP

RESOURCES & SOLUTIONS

Important considerations

This material is for informational purposes only and should not be construed as accounting, legal or tax advice. Reasonable efforts have been made to ensure its accuracy, but errors and omissions are possible.

All comments related to taxation are general in nature and are based on current Canadian tax legislation for Canadian residents, which is subject to change. Persons who are not Canadian residents may be subject to different tax rules in Canada, and persons who are resident in Canada but also citizens of another country may be subject to taxes levied by jurisdictions other than Canada.

For individual circumstances, clients should be advised to consult with their legal or tax advisors.

This information is current as of October 1, 2019.

Outline

1. Ownership Considerations
2. Legal side of ownership
3. Buy Sell Corporate Insurance
4. CDA – Tax & Legal Considerations
5. Term + Permanent Solution

Ownership

CORPORATE OR PERSONAL

The Choice

Corporate vs Personal

-

Corporate vs Personal

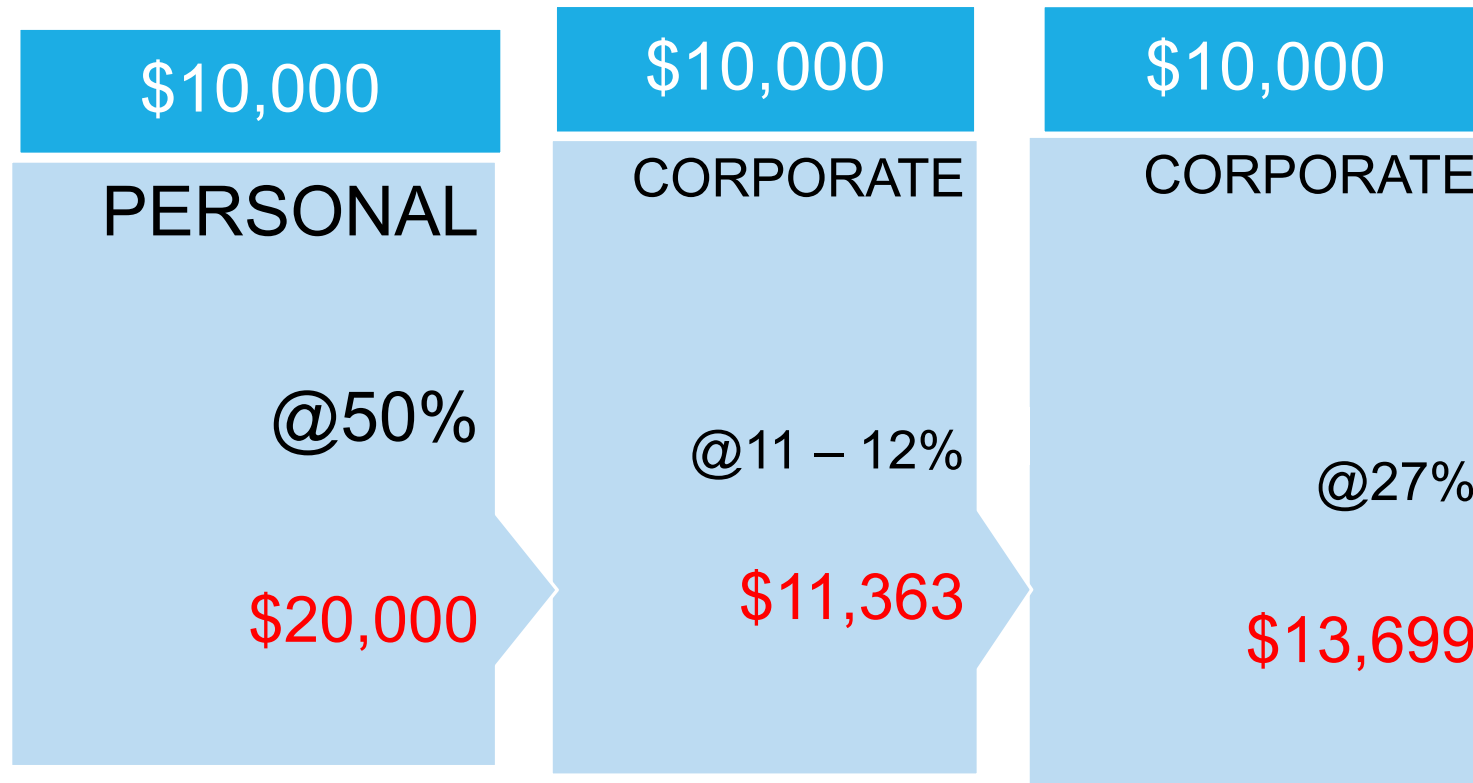
1. What is the purpose/objective of the Life insurance?
2. Where is the Life Insurance proceeds(i.e. cash) needed?
 - When?
3. Where are the funds to support the life insurance premiums?

Corporate vs Personal

\$10,000	\$10,000
PERSONAL	CORPORATE
Tax Rate = 50%	Tax Rate = 11 – 12%
	Tax Rate = 27%

Corporate vs Personal

= Premium / (1 – Tax Rate)



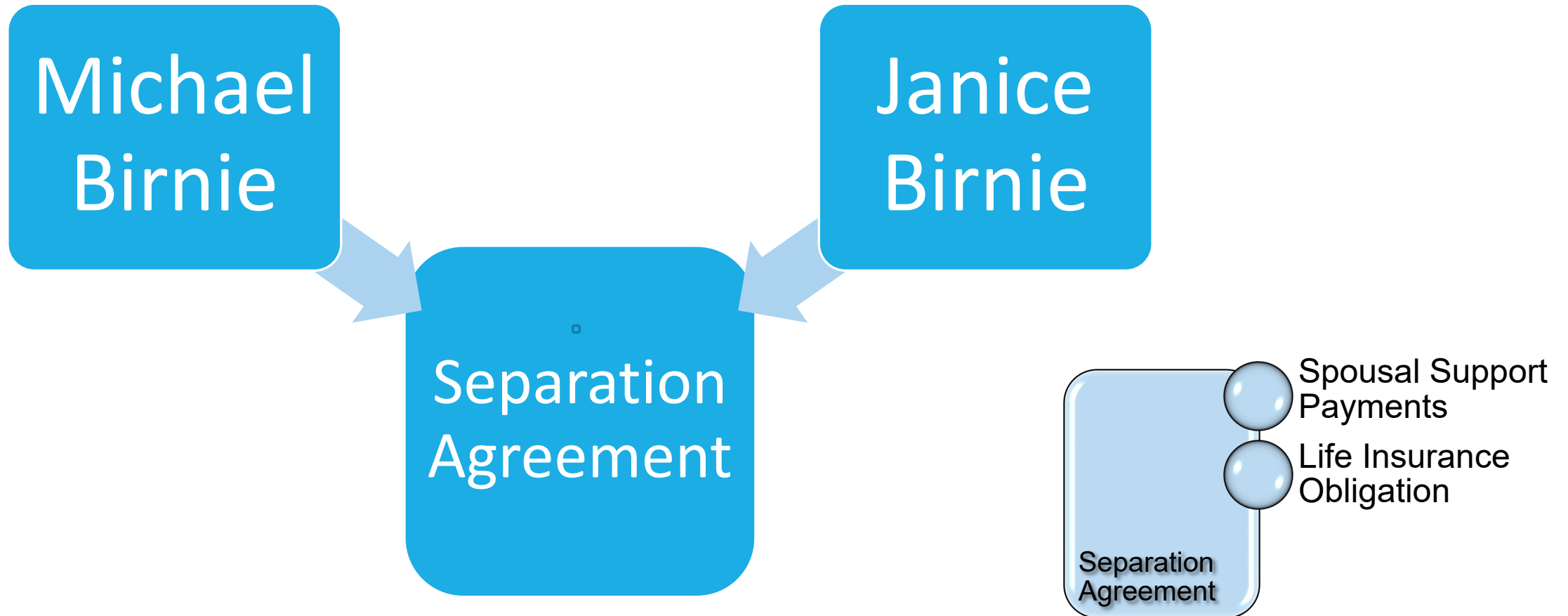
Sometimes it's Personal

PART II

Estate Obligations & Life Insurance

Ontario Superior Court of Justice, *Birnie v Birnie*, 2019 ONSC 2152

Estate Obligations & Life Insurance



Estate Obligations & Life Insurance

Separation Agreement:

The Husband undertakes and agrees to obtain a life insurance policy on his life in the face amount of \$500,000.00.

The Husband will designate the Wife as the irrevocable beneficiary under the terms of the aforementioned life insurance policy; with the beneficiary designation to continue for so long as the Husband is required to pay spousal support to the Wife.

Estate Obligations & Life Insurance

The Judge was to decide:

- 1) If it was a stand-alone clause, the Estate would be liable to the former spouse for the entire \$500,000.

- 2) If the clause was only intended to “secure” support payments, then the Estate would not be liable to the former spouse
 - This is because the Deceased had been making the necessary support payments during his lifetime. So the full amount of the insurance proceeds would remain the Estate property.

Estate Obligations & Life Insurance

The Judge found that:

- 1) the language in the agreement did not clearly indicate that the “sole” intention of the insurance clause was to secure support payments.
- 2) there could be any number of other reasons to benefit the former spouse with such a clause, including “affection, appreciation, guilt or regret.”

Estate Obligations & Life Insurance

Lessons:

- The importance of clear and specific drafting.
- The impact existing legal obligations may have on estate plans.

If there are outstanding obligations at the time of death, a court may find the Estate liable for those obligations in priority to intended beneficiaries - \$500,000

Lessons for Advisors?

Term Options – Longer Options

Term Plus Options:

- Term Plus 10
- Term Plus 15
- Term Plus 20
- Term Plus 25
- Term Plus 30
- Term Plus 35

New Term Plus Options:

- Term Plus 40

Life insurance for business owners

PART III

A solid blue horizontal bar spanning the width of the slide at the bottom.

Benefits of a corporately owned permanent insurance policy

Attributes of life insurance:

- Death Benefit is received Tax-Free
- Tax exempt policies are not subject to accrual taxation
- Flexibility to overfund with universal life
- Provides immediate liquidity at death (when it's most important)
- Capital Dividend Account (CDA)

CDA: Capital Dividend Account

Owner: Corporation

Beneficiary: Corporation

$$\text{CDA} = \text{Death Benefit} - \text{ACB}$$

Liquidity

CDA

TAX SIDE

LEGAL SIDE

CDA

TAX SIDE

CDA

CDA

Non-taxable
portion of
Capital Gain
exceeding
the non-
deductible
portion of the
Capital Loss

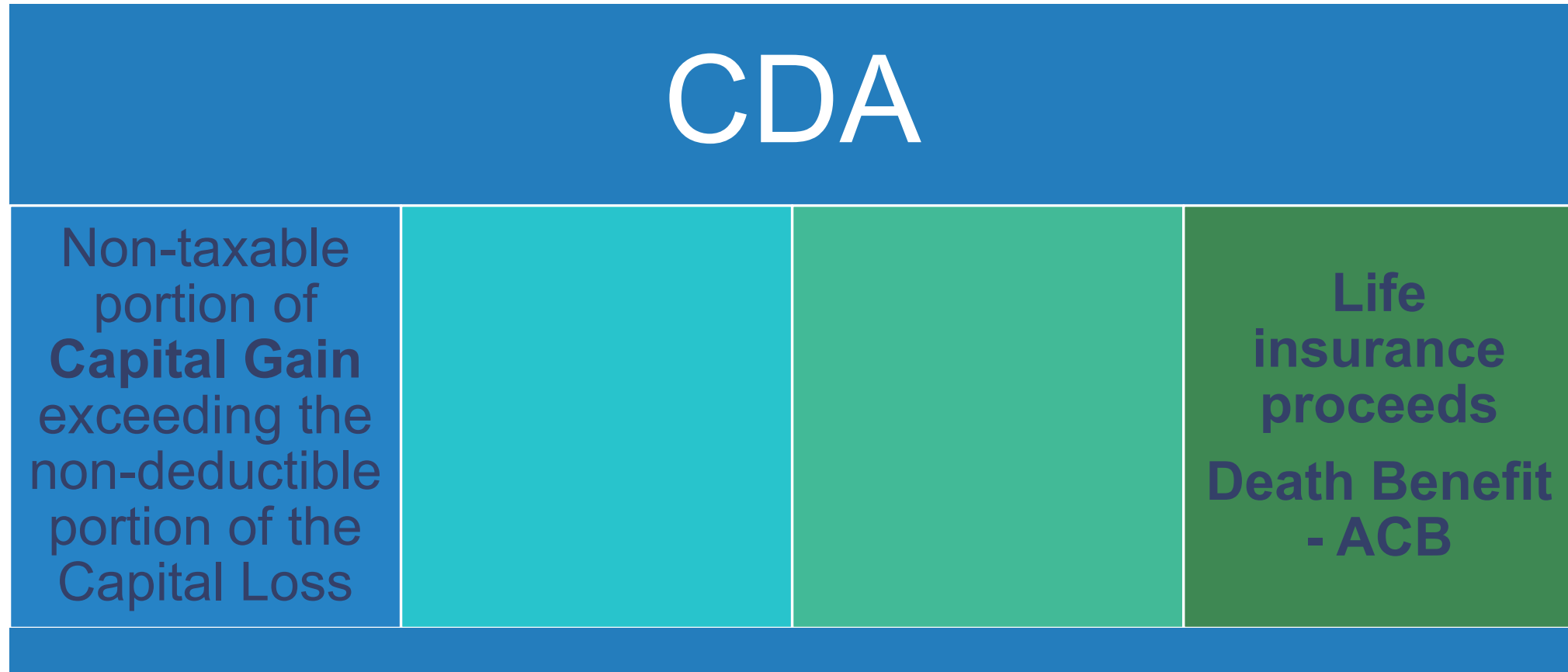
Non-taxable
portion from
the sale of
**Eligible
Property**
(i.e. goodwill)

**Capital
Dividends**
received
from other
private
corporations

**Life
insurance
proceeds**
**Death
Benefit -
ACB**

Less:
Any Capital
Dividends
Paid

CDA & Each Component



CDA & Each Component

A negative balance in one component of the CDA does not affect the other components that go into the calculation of the balance.

- A negative balance will not reduce the overall positive CDA balance created in the other categories.

Example) Capital loss realized on the sale of a property does not “subtract” from the calculation from the component/calculation that includes the receipt of the Life Insurance Death Benefit

CDA & Each Component

But:

Possible for a negative balance in one CDA component to affect the **amount of capital dividends a corporation is able to pay** from the receipt of life insurance.

1. Capital Gain = \$1,000,000. $\frac{1}{2}$ creates a CDA credit. Pay a capital dividend of \$500,000
2. Then assume a Capital Loss is realized = \$400,000. $\frac{1}{2}$ = \$200,000
3. Life Insurance proceeds, CDA credit = \$2,000,000

CDA & Each Component

½ Capital Gains less
½ Capital Loss

- \$300,000 (\$500,000 less \$200,000)

Capital Dividends
(previously paid)

- (\$500,000)

Life Insurance CDA

- \$2,000,000

CDA Balance

\$1,800,000

CDA shortfall = \$200,000 (if you want to pay out the insurance proceeds)

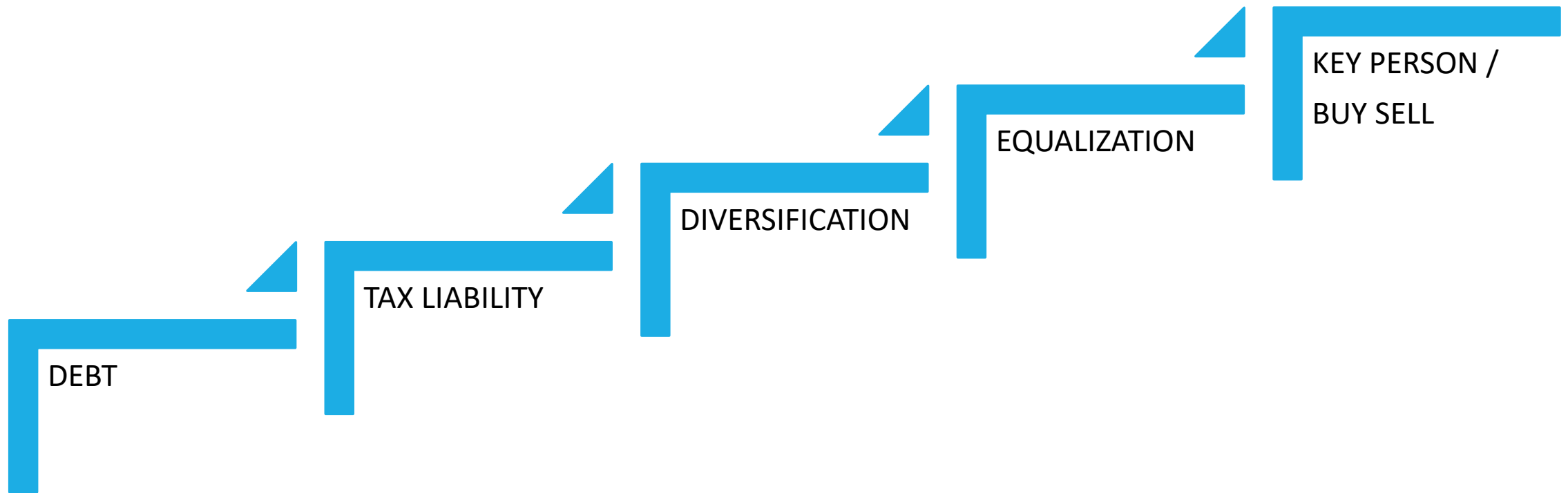
CDA: Capital Dividend Account

Election Form (to file Capital Dividend)

=

T2054

Opportunities - Insurance for Business Owners

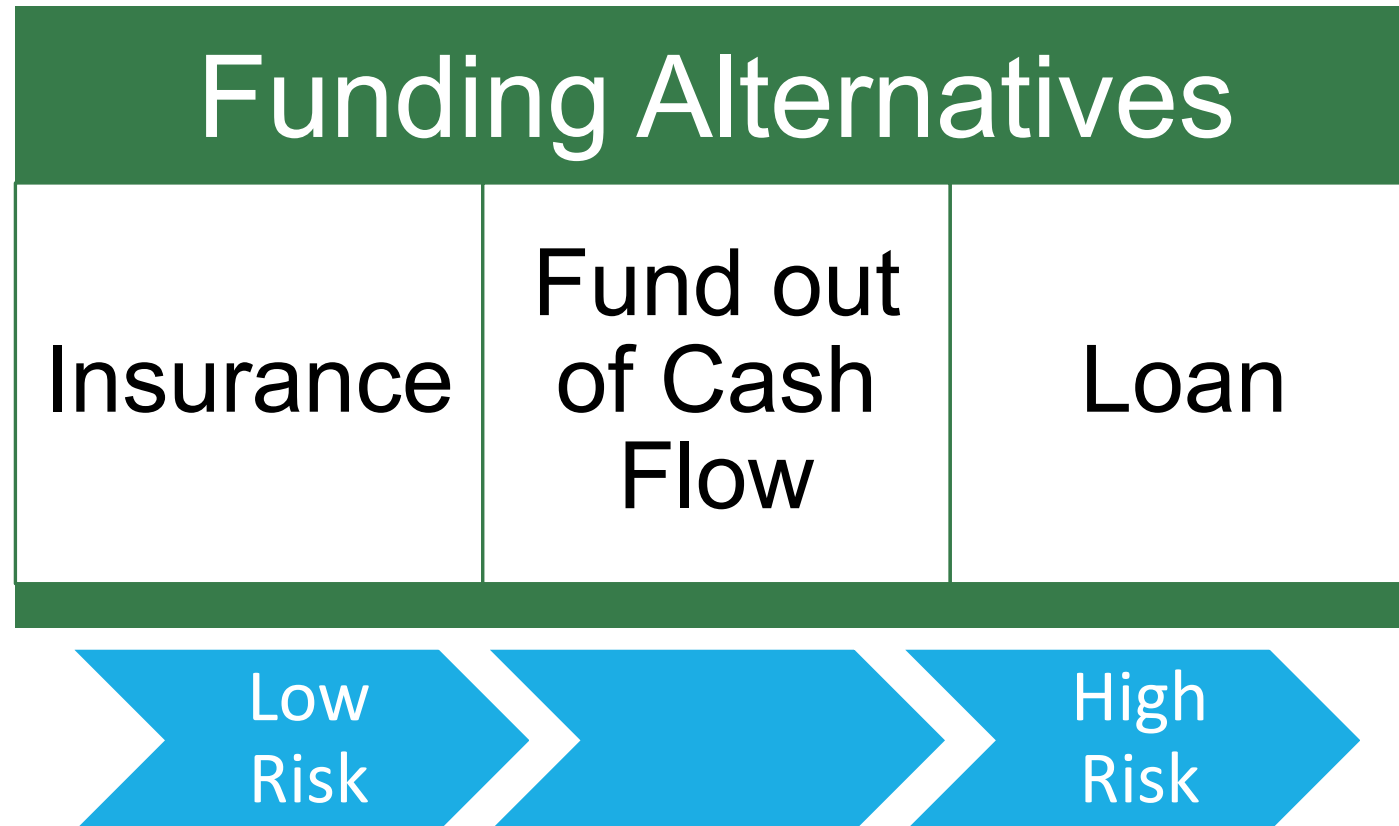


Buy Sell Agreements

PART IV

A solid blue horizontal bar spanning the width of the slide at the bottom.

Funding the Buy Sell Agreement



Term Options – Longer Options

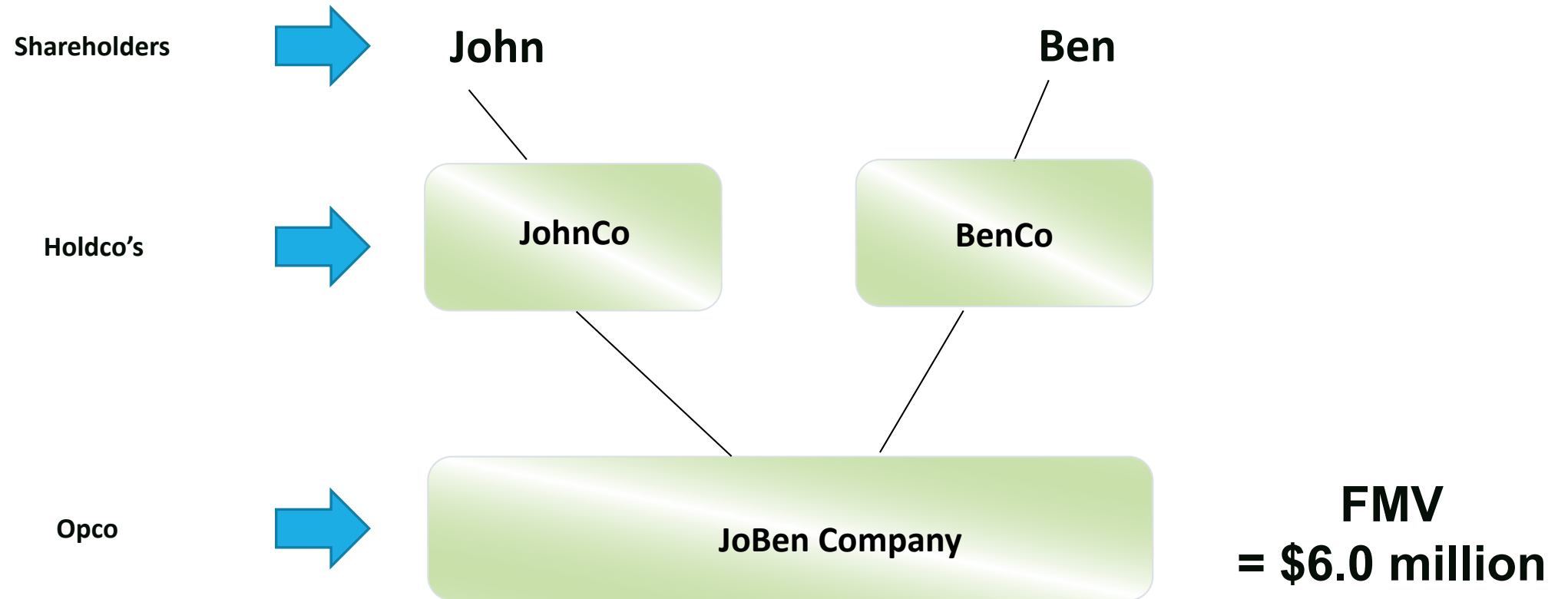
Term Plus Options:

- Term Plus 10
- Term Plus 15
- Term Plus 20
- Term Plus 25
- Term Plus 30
- Term Plus 35
- Term Plus 40

New Term Plus Options:

- Exchange Program
- Term Plus 40
 - Renewable to Age 85

Where to hold the Insurance



Buy Sell Arrangements

1. Cross purchase (promissory note)
2. Share Redemption
3. Hybrid

Buy Sell Arrangement

Cross Purchase Method:

A. Flow of Funds

B. Tax Impact

Upon John's death...



Buy Sell Arrangement

A. Flow of Funds

1. JohnCo would sell its Opco shares to BenCo for \$3.0 million.
2. Benco would purchase the Opco shares owned by JohnCo for a \$3.0 million promissory note.
3. Opco would pay a \$3.0 million capital dividend to Benco
4. Benco would use the funds to pay off the note

Buy Sell Arrangement

B. Tax Impact

1. JohnCo would realize a \$3.0 million capital gain (sale proceeds less ACB)
2. $\frac{1}{2}$ is taxable = Taxable capital gain is taxed to JohnCo
3. As JohnCo is a private corporation, other $\frac{1}{2}$ creates a CDA credit
4. Life insurance would be received tax free to Opco
5. Opco = Credit to the Capital Dividend Account
6. CDA = Death Benefit – ACB
7. Opco  its CDA by paying a capital dividend AND BenCo's CDA 
8. BenCo retains the CDA credit after the purchase of Opco's shares.
BenCo can receive future tax free dividends.

Buy Sell Agreement

Funds the Buy Sell

Provides Liquidity

CDA

CDA

LEGAL SIDE

ONTARIO SUPERIOR COURT 2009 RIBEIRO VS. BRAUN NURSERY LTD.

CDA - Ribeiro Case

Majority shareholdings were owned by the son of the founder at the time the USA was entered into.

The company had granted shares to:

- six key employees
- including Fernando Ribeiro who had worked with the company for 25 years.

Share value: \$1.6 million

CDA - Ribeiro Case

1. The company had Keyperson Insurance: \$1.0 million
2. The shareholders agreement stipulated that Fernando's shares would be purchased at FMV,
 - - payable 25% on the date of closing,
- balance in 5 equal annual installments with interest on the unpaid balance at 7%).
3. Fernando's widow received these installments

CDA - Ribeiro Case

The Bad:

The installments were received as taxable income

Corporation required to use insurance for buyout

- (but no mention of capital dividend account)

Estate took the corporation to court

Sought “oppression remedy”

- damages equal to additional tax paid (~\$250,000)

Alleged that Corporation acted unfairly in failing to declare capital dividends on Fernando’s share buyout

CDA - Ribeiro Case

The Bad:

The Court

- found that Corporation had fulfilled all obligations under shareholders agreement
- found that deceased could not have reasonably expected Corporation to go beyond wording of the agreement

The Claim  Dismissed

CDA & Corporate Insurance



Key Person. Buy/Sell

KEY POINTS:

- Language in the Shareholder Agreement
- Tax Implications

Dual Solution – Term + Permanent

PART V

Dual Solution

Case Study:

50 Year old Shareholders

Incorporated

- \$1.5 million of life insurance

➤ Corporate Life insurance Solution

Dual Solution

What are the benefits of combining Term + Permanent:

Term Plus Options:

- Term Plus 10
- Term Plus 15
- Term Plus 20
- Term Plus 25
- Term Plus 30
- Term Plus 35
- Term Plus 40

Permanent Options:

- UL YRT
- Level
- Non-participating Whole Life

Dual Solution

What are the benefits of combining Term + Permanent:


- Term coverage:
 - Ability to convert in the future as needs/objectives change.
 - This offers flexibility for the corporate client.
- Permanent coverage (with a reduced cashflow requirement)
 - Efficiency of CDA (Capital Dividend Account)
 - $CDA = \text{Death Benefit} - ACB$

Dual Solution

Coordinating Premium/Death Benefit/CDA:

➤ Male: NS, Age 50

\$1,500,000	SSQ	Company 2 (Reduced Dividend Scale)	Premium Difference
Premium	\$39,090	\$52,310	
Premium Difference			\$264,000
Death Benefit (Age 85)	\$1,500,000	\$1,943,460	
CDA (Age 85)	\$1,135,552	\$1,395,823	
Add: T-35 (with premium difference)	\$1,034,993		
New CDA (T-35 + WL)	\$2,170,545	\$1,395,823	



Dual Solution

Client looking for:

- Guarantees
- Flexibility
- CDA (efficiency of ACB)

Conclusion

Life Insurance

=

Liquidity & CDA when it's most important

Thank you.

QUESTIONS

RESOURCES & SOLUTIONS

JHERMAN@RESOURCESANDSOLUTIONS.CA

A solid blue horizontal bar at the bottom of the slide.