Canadian Life
and Health Insurance
Association Inc.

Association canadienne
des compagnies d'assurances
de personnes inc.

Analysis and Discussion

Regarding the Taxation of

Critical Illness

and

Long-Term Care

Insurance in Canada

March 18, 2004

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Executive Summary

This document summarizes product features of Critical Illness (CI) and Long-Term Care (LTC) insurance policies, the industry's understanding of current tax law and how it applies to such products, and outlines issues for discussion and possible courses of action where tax policy needs to be confirmed or its apparent purpose reconsidered.

This paper seeks the Department of Finance's and the Canada Revenue Agency's views of how the *Income Tax Act* applies to some aspects of CI and LTC insurance policies. In particular, those views with respect to the following regularly-raised questions are sought.

- Are CI and LTC benefit payments subject to income tax?
- Does the presence of benefits that are ancillary to the CI and/or LTC benefits, such as Refund of Premium on Death (ROPD), on Expiry (ROPE), on Surrender (ROPS) or at other pre-determined dates or events alter the (non-)taxability of (some of) the benefits provided?
- Does the presence of other major contractual benefits (such as life insurance death benefits) within the same contract alter the (non-)taxability of CI and LTC benefits?
- Are CI and LTC premiums qualified medical expenses for purposes of the medical expense tax credit?
- Does the occurrence of a critical illness constitute a disability?

Industry analysis of current law suggests that both products should fall within the accident and sickness class of insurance, with the result that benefits under such policies should be non-taxable in most circumstances.

Similarly, the analysis concludes that ancillary benefits such as premium refunds due to the death of the insured life, at pre-specified dates while the coverage remains in force or upon expiry or surrender of coverage should be non-taxable to the extent that they do not exceed the policyholder's total premiums.

The document also provides an analysis of policyholder taxation issues when CI or LTC coverage is included in a single contract in combination with a life insurance policy. It points out a number of areas of uncertainty about the taxation of such policies, some areas where the taxation results may be unintended, and suggests possible resolutions.

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Introduction

Critical Illness (CI) and Long-Term Care (LTC) are relatively new insurance products in the Canadian marketplace. The basic goal of CI and LTC insurance is to finance medical and personal care expenses that are not covered under the terms of the *Canada Health Act* and provincial health programs and that result from the incidence of a critical illness or from functional disabilities arising from ageing, accident or sickness.

In addition to medical care expenses that are beyond the scope of public health insurance plans, CI and LTC policy benefits may be used to address related financial needs arising from such events, such as the renovation of living space to accommodate a wheelchair or to pay the salary of a para-medical or in-home assistant. CI benefits may also fund alternative child-care when a parent or other primary care-giver is medically unable to fulfill that role, or provide a lump-sum of capital as an alternative to employment income that is no longer available due to the insured's inability to work or because of reduced earnings ability.

Although both CI and LTC products were introduced in Canada in the mid-1990s, significant sales growth has only happened fairly recently, and primarily with respect to CI insurance. New sales for individual Critical Illness insurance policies in 2003 generated approximately $71 million of annualized premium, representing a growth rate of 34% from the prior year. As of December 31, 2003, there were over 192,000 individual CI policies in force in Canada with a premium base of $163 million.[1]

The Long-Term Care market is not yet as well established in Canada, perhaps due to the universal availability of public health care programs and facilities. While Long-Term Care has not generally been addressed within Canada's public health scheme, recent recognition of demand and funding pressures on such public services has spurred the desire of Canadians to at least partially fund Long-Term Care services through private insurance. New LTC sales in 2002 were $10.6 million in annualized premium, representing a growth rate of 74% from the prior year. As of December 31, 2002, there were an estimated 27,600 individual LTC policies in force in Canada with a premium base of $27.1 million.[2]

The current tax treatment of life, accident and sickness insurance was developed before CI and LTC insurance products were available in Canada. As a result, there are numerous questions relating to how the current tax regime applies to these products.

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[1] *Canadian Individual Critical Illness Insurance Sales, Fourth Quarter 2003*, 2004, LIMRA International, Inc.

[2] *Canadian Long-Term Care Insurance, 2002, LIMRA International, Inc.*

This paper begins by outlining a number of fundamental tax principles that we believe should provide the framework for a discussion of the various issues that need to be addressed.

The paper then continues with an analysis of the application of the current provisions of the *Income Tax Act* (the Act) to the holders of insurance policies that provide CI and LTC benefits. The purpose of this analysis is to provide background and identify issues for a discussion as to whether:

- the application of the current law to CI and LTC policyholders is consistent with tax policy objectives,

- there are areas of uncertainty that require clarification through amendments to existing legislation, or

- a more comprehensive legislative solution is required to establish an appropriate regime for CI and LTC products.

The paper concludes with a summary of the various issues that were identified in the analysis of the application of the current law and offers industry views of some possible directions that might be taken in addressing these issues.

The tax treatment of corporately-owned or corporately-funded policies may vary, depending on the specifics of the particular situation, such as whether benefits are receivable by the corporation or an individual employee or shareholder, or whether benefits are provided under individual, grouped individual or traditional group insurance arrangements. These issues, however, are consistent with others centred on corporate ownership of insurance or corporate funding of employee or shareholder benefits, and would not appear to pose concerns specific to CI and LTC insurance policies. As such, this paper focuses on product-specific issues in the personal ownership context, rather than more general issues relating to employer-provided benefits, corporate ownership of insurance and corporate taxation.

Fundamental Tax Principles

The following analysis of the application of the current tax legislation to CI and LTC insurance products has identified a number of issues that need to be addressed. We have outlined below the fundamental principles that we believe provide an appropriate framework for deciding what, if any, action should be taken with regard to these issues.

1. There is a need for **clarity** about the tax regime for CI and LTC insurance. Insurers and policyholders should be able to readily determine with certainty how the tax rules apply to them with respect to such policies.

2. There is a need for **simplicity** in the tax regime for CI and LTC insurance so that it is easy for taxpayers to understand, for insurance companies to administer without undue expense, and for the Canada Revenue Agency ("CRA", or the Agency, formerly the Canada Customs and Revenue Agency) to audit.

3. There is a need for **consistency** of application so that, to the extent possible, the same tax regime applies to CI insurance benefits regardless of the form of the product under which those benefits are provided. Where product designs preclude the application of the same tax regime, the tax regimes should be harmonized to produce consistent results. Similarly, consistent tax rules should apply to LTC benefits, regardless of the form of the product in which they are included.

4. Morbidity gains and losses arising from CI and LTC insurance should not be included in the tax base, since they reflect a simple transfer of pooled capital between policyholders, not a return on investment. To the extent that CI and LTC benefits include an element of investment income, an exemption from tax for such income may be warranted where:

    a. the amount of the preference is relatively small,

    b. the provisions required to tax such amounts would be significantly complex in relation to the amounts involved,

    c. there are sound public policy reasons for providing preferential tax treatment, and

    d. effective constraints can be included in the tax legislation to restrict the exemption to the amounts intended.

5. Any changes in the *Income Tax Act* or *Income Tax Regulations* should apply at the beginning of a calendar year with sufficient lead-time provided to the insurance industry to revise product design, marketing material, administration systems and procedures and to train staff and advisors.

6. The holders of insurance contracts issued prior to the implementation date for new or amended legislation should not be disadvantaged by any changes that are implemented.

Product Overview

Critical Illness Insurance

Critical illness (CI) insurance generally pays a lump-sum benefit when the insured survives for a specified period after the diagnosis of a pre-determined serious life-altering illness or medical event. CI insurance has evolved from covering only a few diseases (e.g., heart attack, stroke, cancer) to covering a wide variety of possible life-altering diseases. [3]

Most commonly, CI insurance is offered on a "stand-alone" basis: that is, as a separate policy insuring only one individual. However, CI benefits are also offered under life insurance policies, either as a rider[4] attached to the policy or as an integrated feature within the policy. As well, there are other hybrid policies which may offer combinations of benefits. CI benefits may also be provided within a plan of group insurance.[5]

Most stand-alone CI policies on the market today provide for a refund of all or a portion of the premiums previously paid if the insured dies while the policy is in effect. For most policies, the cost of this benefit is not explicitly charged, although some policies provide the policyholder with the choice to take or not take such "refund of premium on death" benefits and, as a result, such policies charge a specific premium for that benefit.

In addition, some policies provide options to purchase an added benefit whereby all or a portion of premiums may be refunded if the insured survives until the policy coverage expires (e.g., age 75), upon surrender of the policy or at specified intervals throughout the duration of the policy, generally provided that no claims for the CI benefits have previously been made.[6] Most policies on the market that have these types of benefits

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[3] While the range of illnesses and conditions covered varies and some products continue to focus on a narrow range of triggering conditions, Appendix C provides a list of specific medical conditions that is representative of the scope of conditions and events covered by many CI policies.

[4] Riders are structured with separate premiums. When added to a policy that permits premiums to vary both in terms of amount and timing (i.e., a "Universal Life" [UL] policy), the regular periodic premiums relating to the rider are combined with the UL premium, increasing the "fund value" of the life insurance policy; the rider premiums are then "charged" against the fund value on a periodic (typically monthly) basis as the rider premiums become "due."

[5] Since insurance products evolve on a more-or-less continuous basis, it was inevitable that new products would arise during the preparation of this analysis. Indeed, reflecting such on-going product development in this paper has resulted in considerable difficulty, not least of which has been the authors' inability to be aware of all products available. As a result, this paper has not attempted to address products brought to market after December 31, 2003, and may not reflect all products offered prior to that date.

[6] Some CI policies provide partial benefits depending on the severity of the illness or injury suffered. If CI benefits paid do not exceed the sum of premiums paid, refund of premium benefits may provide for payment of that difference. While references to refund of premium benefits throughout this paper refer

offer them on an optional basis only; that is, a specific additional premium is charged to provide any optional benefit.

Most of these policies state that the maximum amount that can be refunded under a policy from all refund of premium benefits combined cannot exceed the premiums paid for the policy.

Long-Term Care Insurance

With an ageing population, Long-Term Care insurance (LTC) plans are gaining acceptance in Canada as a means of providing funding to individuals to supplement benefits available under government programs for loss of functional or cognitive abilities. This can include on-going medical, para-medical and related housing and support costs arising from a loss of functional independence. Generally speaking, LTC insurance provides coverage for both care in a Long-Term Care facility (e.g., licensed convalescent, custodial, nursing or retirement homes providing continuous nursing services) and medically necessary services performed by qualified medical practitioners in the home of the person who is insured.[7]

In order for an individual to receive benefits under an LTC policy, it is generally necessary that the individual be assessed by a health professional to determine that a loss of abilities has occurred. Such an assessment is generally made on the basis of the individual not being able to perform a specified number of "activities of daily living" (ADLs) or having a cognitive impairment. ADLs are generally considered to include bathing, eating, dressing, toileting and transferring (e.g., the ability to get into or out of a chair), while cognitive impairment generally refers to a loss of mental capacity, as demonstrated by the individual's inability to think, perceive, reason or remember.

An LTC policy may be structured as:

- an "indemnity policy" that pays benefits of a set dollar amount on a daily, weekly, or monthly basis and the amount payable is not contingent on either the actual cost of the services received or when such costs are actually billed[8], or

- a "reimbursement policy" that reimburses the insured for a percentage of the actual cost incurred for the service. A reimbursement policy is administratively more complex than an indemnity policy because supporting evidence of the eligible expenses paid has to be submitted with any claim and each claim has to be adjudicated.

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to no CI or LTC benefits having been paid, adjustments should be "read in" to reflect plans that permit payment of partial CI and/or LTC benefit payments.

[7] Representative benefit criteria are outlined in Appendix E.

[8] The adoption of the term "indemnity" in this context may seem inappropriate, given the fixed income benefit nature of the contract. While the term indemnity has become commonplace in this context, its origins are unclear.

Other features offered under these plans include refund of premium on death, expiry, surrender or at various times throughout the duration of the policy provided that claims have not previously been paid.

Markets

CI insurance may be acquired by individuals to protect themselves and their families against the added financial burden that arises when a family member is stricken with a critical illness. Corporations or partnerships may also acquire CI policies insuring employees or the business owners in connection with benefit plans for the employees or owners, to fund the buy/sell provisions of shareholders agreements or to indemnify the business for the added costs that would be incurred if the employee or owner is stricken with a critical illness.

LTC insurance is typically purchased for similar reasons, although in some cases, adult children may purchase LTC coverage to fund care of their parents as an estate preservation tool. The corporate market for LTC policies is not yet well developed.

Stand-alone Policies

Legal Nature as Accident and Sickness or Life Insurance Policies

> Issues for discussion:
>
> Does the current regime for the taxation of life insurance policyholders apply to the holders of all or certain types of stand-alone CI and LTC policies?[9]

The Act prescribes a comprehensive set of rules for taxing the holders of life insurance policies [10] but does not contain specific rules for the taxation of other types or classes of insurance policies. However, the Act does not define a "life insurance policy", other than to specify that the term includes an annuity contract and a segregated fund policy.[11] In the absence of a specific definition in the Act, the question arises as to whether a CI or

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[9] Throughout this paper, issues relating to the current interpretation of the *Income Tax Act* are identified within "text boxes"; these issues are discussed in the paragraphs following each box, and are summarized in the context of both CI and LTC insurance in the "Issues for Discussion" section later in this paper.

[10] Sections 12.2 and 148, and 138.1 for segregated fund policies.

[11] "Life insurance policy" is defined in subsection 138(12), and this definition has general application throughout the Act, based on a referential definition of the same term in subsection 248(1).

LTC policy could be considered to be a life insurance policy and therefore subject to the special tax rules referred to above. This question is only logically relevant in situations where refund of premium features of CI or LTC policies provide potential benefits payable as a consequence of the death of the person insured.[12]

To determine what a life insurance policy is, the approach taken by the CRA is to look to the ordinary usage of the term in the life insurance industry. In a 1993 interpretation letter,[13] the CRA stated that:

> [T]he act does not contain a detailed definition of what constitutes a "life insurance policy." Paragraphs 138(12)(f) and (g)[14] of the Act provide some guidance as to what will constitute a "life insurance policy" for purposes of the Act, however this is not an exhaustive definition. It is, therefore, necessary to look at the common usage of what constitutes a life insurance policy particularly as employed by the insurance industry. In this regard the definitions of this term in the relevant provincial insurance statutes will be relevant although not necessarily conclusive.

Within life and health insurance companies and among agents and brokers engaged in marketing CI and LTC policies, there is general acceptance that CI and LTC policies are accident and sickness policies, and not life insurance policies. Where alternative views exist regarding the status of such policies under provincial insurance law, those views reflect antiquated provincial definitions of classes of insurance that predate such policies and do not adequately address the broad range of benefits offered by many CI and LTC policies.

Unfortunately, despite past attempts to harmonize terminology, provincial insurance statutes have not been totally consistent in their definitions of various classes of insurance. The current Ontario definitions appear as Appendix A, and these are generally representative of the approach historically taken throughout both the common law provinces and in Quebec.

In 2002, the Canadian Council of Insurance Regulators (CCIR), consisting of insurance regulators from all provinces and territories of Canada, together with the Office of the

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[12] See Canada Revenue Agency ("CRA") documents 2003-0026385, December 10, 2003; 2003-0004265, June 18, 2003; 2001-0113597, May 24, 2002; 2001-0072757, May 8, 2001 (2001 CALU Annual meeting – CALU Report July 2001, Q. 10); 1999-0013605, January 28, 2000; 9908430, June 30, 1999 (1999 CALU Annual Meeting – CALU Report July 1999, Q. 5); 9730255, February 9, 1998; 9711505, June 2, 1997.

[13] CRA document 9214825, March 9, 1993.

[14] These paragraph references predate the 5th Supplement version of the Act; paragraphs (f) and (g) defined "life insurance policy" and "life insurance policy in Canada", and are substantively the same as the definitions that appear in the current subsection 138(12) of the Act.

Superintendent of Financial Institutions, developed a set of standard insurance classes, including "life insurance" and "accident and sickness insurance." (See Appendix B.)[15]

The basic definition of life insurance under the CCIR standard insurance classes is as follows:

> life insurance means insurance that is payable
> (a) on the death of a person;
> (b) on the happening of an event or contingency dependent on human life;
> (c) at a fixed or determinable future time; or
> (d) for a term dependent on human life …

Where a contract of life insurance provides for life insurance benefits as described above but also provides other benefits, the definition of life insurance is expanded to include:

> (e) an additional amount of insurance money in the event of the death by accident of the person whose life is insured; and
> (f) insurance money or other benefits in the event that the person whose life is insured becomes disabled as a result of bodily injury or disease.

The definition of life insurance is further expanded to include all forms of annuities, whether or not they are for a term dependent solely or partly on human life.

The definition of accident and sickness insurance[16] under the CCIR standard insurance classes includes "insurance whereby an insurer undertakes to pay a certain sum or sums of insurance money in the event of the sickness or disability of a person …"

Disability insurance is generally thought of in the context of income replacement insurance resulting from the inability to perform substantial duties of a job or occupation.[17] For instance, Black's Law Dictionary defines "disability insurance" as "coverage purchased to protect a person from a loss of income during a period of

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[15] While some provinces will be able to adopt these definitions via Superintendent's Orders, many jurisdictions require legislative or regulatory changes in order to bring the CCIR definitions into effect. Thus, some time may pass before these new classes of insurance are universally applicable.

[16] The *Income Tax Act* refers to both "accident and sickness insurance" and "sickness or accident insurance." The generally-used terms within the industry, under provincial insurance legislation and under the Insurance Companies Act are "accident insurance," "sickness insurance," and "accident and sickness" insurance. Throughout this Discussion Paper, "accident and sickness" insurance is meant to include all of these terms. Where the Discussion Paper refers to "sickness or accident" insurance, the reference is specific to the current wording and context of the *Income Tax Act*.

[17] See for example the discussion of disability insurance found in Norwood and Weir, "Norwood on Life Insurance Law in Canada, 3rd edition, (Carswell: 2000) Chapter 19. As well, Appendix D provides a representative definition of "disability" as found in traditional income replacement insurance policies.

incapacity for work."[18] However, disability itself is not logically a function of employment. Where an individual is no longer able to perform a number of the essential activities of daily living or has suffered a cognitive impairment, by any reasonable definition of the term, that individual would be disabled. Benefits payable under an LTC policy as a consequence of the loss by an insured of functional or cognitive ability would therefore seem to be properly classified as disability benefits.

Based on the definitions of the standard insurance classes as agreed to by OSFI and the CCIR, it seems clear that a policy that provides only CI or LTC benefits (i.e., no refund of premium benefits) would be classified as accident and sickness insurance and not as life insurance. Therefore, it seems only reasonable to conclude that a policy that provides only CI or LTC benefits would not be a "life insurance policy" within the meaning of the Act. In a 2003 interpretation, in the context of CI insurance, the CRA has stated that they agree with this position:

> Where a policy provides benefits only in the event of critical illness, we agree with your view that the policy should be viewed as a "sickness" policy, rather than a life insurance policy for purposes of the Act, notwithstanding that such policies are primarily issued by life insurers. In our view, the proceeds of disposition of such a policy would generally not be included in the policyholder's income under section 3 of the Act.[19]

Where a critical illness or Long-Term Care insurance policy includes refund of premium (ROP) benefits, particularly on death, the correct classification of the policy as accident and sickness insurance or life insurance may not be as clear.[20] This is true both for purposes of provincial insurance law and for income tax purposes. However, it seems reasonable to classify the policy based on its primary purpose. This is the approach taken in Quebec provincial insurance legislation, and accepted by CRA as applicable to contracts issued in Quebec.[21] The primary purpose of a stand-alone critical illness insurance policy is to pay a lump-sum benefit when the insured survives for a specified period after the diagnosis of a critical illness. The primary purpose of a stand-alone Long-Term Care insurance policy is to pay periodic benefits when the insured becomes

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18 Bryan A. Garner, ed., *Black's Law Dictionary*, 7th ed. (St. Paul, MN: West Group, 1999), p. 804.

19 CRA Document 2003-0004265, June 18, 2003.

20 On January 28, 2002, the Superintendent of Insurance of Saskatchewan, in response to a question regarding licensing requirements for the sale of critical illness insurance in that province stated, "[I]n my analysis, if the critical illness product has life insurance features, refund of premium or payment upon death characteristics, it suggests that critical illness insurance is a life insurance product." While these comments cause some uncertainty over the broader legal characterization of critical illness insurance under provincial insurance law, in subsequent correspondence the Superintendent has confined his comments to the agent licensing context. Within the broad context of insurance law, the better view appears to be to characterize such contracts as sickness insurance. These issues of what type of insurance coverage is provided by a policy are entirely different issues from the question of whether a policy is a "life insurance policy" for purposes of the Income Tax Act.

21 See CRA Document 2001-0113597, May 23, 2002.

functionally disabled due to injury or illness. Features such as refund of premiums on death are an ancillary feature of the contract, which do not alter the essential nature of the contract, and should not alter its nature for tax purposes. Similarly, a refund of premiums on expiry or surrender, or at specified periods where no claims have been paid under the contract, although payable at a fixed and determinable time in the future (but only if the contingency has been met), are also ancillary to the primary purpose of the contract.

These views are supported by the 1957 Supreme Court of Canada decision in the case of *Gray v. Kerslake*.[22] This case dealt with the application of the Ontario *Insurance Act* to an annuity contract that provided for a refund of premiums should death occur before the age of 60. In the reasons for the decision, Mr. Justice Rand noted that "[T]he repayment when death is before the age of 60 years is simply the return of premiums to that moment paid." The Supreme Court concluded that the return of premiums on death was only "…a resulting contingent incident…" that did not convert the annuity contract into "life insurance" as that term was then defined under the Ontario *Insurance Act*. This case resulted in the Ontario and other provincial insurance acts being amended shortly thereafter to include annuities in the list of undertakings or risks that are considered to be "life insurance" under those acts. As indicated above, the standard classes of insurance adopted by the CCIR continue to include annuities in the definition of life insurance.

The facts in *Gray v. Kerslake* are analogous to the situation where CI or LTC policies include refund of premium benefits on death, expiry, surrender or at any other time. The reasoning of the Supreme Court should be just as relevant for purposes of the interpretation of tax legislation as it was for insurance legislation. Consequently, the inclusion of refund of premium benefits under a stand-alone CI or LTC insurance policy should not subject the policy to the income tax regime governing life insurance policies.

Taxation of Stand-alone CI or LTC Insurance

The following comments on the tax treatment of stand-alone CI or LTC insurance assume that policyholders are not subject to the special rules for the taxation of life insurance policyholders, but are subject to the more general provisions for the taxation of income of all taxpayers

Premiums

> Issues for discussion:
>
> Are premiums paid for a stand-alone CI or LTC policy a qualified expense for purposes of the medical expense tax credit?

Premiums paid for an insurance policy are a qualified expense for purposes of the medical expense tax credit only if the policy is a private health services plan ("PHSP"),

[22] *Gray v. Kerslake, 1958 S.C.R. 3.*

as defined in subsection 248(1). CI and "indemnity style" LTC policies as described in this paper will not qualify as PHSPs. In the case of CI policies, this is because benefits are payable based on diagnosis of a contractually prescribed condition or occurrence of a contractually prescribed event, and are not contingent on either hospital or medical expenses being incurred. Similarly, "indemnity style" LTC policies provide benefits that are payable based on diagnosis of functional disability.

With respect to "reimbursement-style" LTC policies, the Canada Revenue Agency has stated the following: where such a policy provides coverage in respect of only hospital care or expenses or medical care or expenses which would otherwise have qualified as medical expenses under subsection 118.2(2), the policy would be considered to be a PHSP. Therefore, premiums under the policy would be qualified medical expenses for the purposes of the medical expense tax credit. However, the Agency has indicated that, in its view, a plan that also provides coverage for ineligible medical expenses (those not provided for under subsection 118.2(2)), would not qualify as a PHSP.[23]

In a technical interpretation issued in 2001,[24] the contractual description of the covered expenses differed from the wording of subsection 118.2(2), but the descriptions were similar enough to those expenses described in subsection 118.2(2) for the CRA to determine that the LTC policy in question would be a PHSP. However, in the interpretation noted in the previous paragraph, the CRA determined that the terminology in the policy was not sufficiently close to the wording in subsection 118.2(2) and thus the policy would not qualify as a PHSP. As an example, the policy provided for the reimbursement of claims for expenses for "adult day care, consisting of a group setting outside the home, with social and health-related services." The CRA's response noted that unless the amounts qualified as remuneration for attendant care, it would be unlikely that these amounts would qualify as eligible medical expenses.

The CRA's view that the covered expenses must be limited to expenses described in subsection 118.2(2) may not be correct in law, since the provision of other benefits may not prevent the policy from being "a contract of insurance in respect of hospital expenses, medical expenses or any combination of such expenses" as referred to in paragraph (a) of the definition of "private health services plan". In particular, the CRA's position that the inclusion of a death benefit prevents a policy from being a PHSP may not be correct.[25]

This alternative view leads to the conclusion that many reimbursement-style LTC policies may qualify as PHSPs. As long as the premiums paid under such a policy are in respect of an eligible individual referred to in paragraph 118.2(2)(q), the premiums may be considered to be medical expenses eligible for the medical expense tax credit.

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[23] CRA document 2000-0018375, dated May 29, 2000.

[24] CRA document 2001-0082757, dated July 12, 2001.

[25] See, for instance, CRA document 2001-0072855, May 31, 2001.

CI and LTC Benefits

> Issues for discussion:
>
> Are CI and LTC benefits received under a stand-alone policy subject to tax?

CI and LTC benefits received pursuant to a CI or LTC policy should not be subject to tax. Such benefits cannot reasonably be considered to constitute income from employment, business, property or any other source. This result is analogous to the situation for traditional "disability" insurance, where the CRA has consistently treated benefits under individually-owned income replacement insurance as non-taxable receipts, generally on the basis that such treatment is consistent with the fact that the premiums paid by the individual are non-deductible personal or living expenses. The CRA has stated, in a 2003 interpretation, that they agree with this position:

> Where a policy provides benefits only in the event of critical illness, we agree with your view that the policy should be viewed as a "sickness" policy, rather than a life insurance policy for purposes of the Act, notwithstanding that such policies are primarily issued by life insurers. In our view, the proceeds of disposition of such a policy would generally not be included in the policyholder's income under section 3 of the Act.[26]

Similarly, the CRA has confirmed that where the premiums for an LTC plan are paid with after-tax dollars, the benefit received should not be taxable to the individual.[27]

> Issues for discussion:
>
> To what extent is a taxpayer prevented from claiming the medical expense tax credit in respect of eligible expenses, if the taxpayer receives benefits under a CI or LTC policy?

Medical expenses that would otherwise qualify for the medical expense tax credit ("METC") cannot be claimed to the extent that an individual is entitled to be reimbursed for the expenses.[28] Benefits under a CI policy or an indemnity type of LTC policy do not depend on whether expenses are actually incurred, and so cannot be considered to be a reimbursement of medical expenses. Thus, benefits received under such policies do not have any effect on the amount of medical expenses that may be claimed for the purposes of the METC. This is an appropriate result, since the premiums for such policies are not eligible medical expenses for the METC.

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[26] See note 19, supra.

[27] Ibid.

[28] Paragraph 118.2(3)(b).

A reimbursement-style LTC policy reimburses the insured for all or a portion of specified medical expenses. The portion of each expense that is reimbursed cannot be claimed for the METC. The unreimbursed portion of an eligible medical expense can be claimed.

Where a reimbursement type of LTC policy does not qualify as a PHSP, the premiums paid cannot be included in the insured's eligible medical expenses. Furthermore, to the extent that the benefits paid are reimbursements of medical expenses incurred by the insured that would otherwise qualify, such expenses are also not included in the insured's eligible medical expenses. Consequently, a medical expense tax credit is not available in respect of either the insurance premiums or the related medical expenses. This does not seem to be an appropriate result from a tax policy perspective.

Refund of Premium Benefits

> Issues for discussion:
>
> Are refund of premium benefits received under a CI or LTC policy included in income in whole or in part:
> (a) in all circumstances, or
> (b) depending upon the nature of the triggering event?
>
> If included in income, how is that portion determined?

There are strong arguments in support of the proposition that the tax treatment of the refund of premium benefits under a CI or LTC policy should not be any different than the treatment of the CI or LTC benefits themselves. In this regard, we first note that the premiums paid under a CI or LTC policy in respect of both the CI or LTC benefits and refund of premium benefits are non-deductible personal or living expenses.

In the case of a CI benefit, the benefit is payable in the event that the insured is diagnosed with a critical illness and survives for a specified period of time thereafter. In the case of an LTC benefit, the benefit is payable in the event that the insured is functionally disabled. In the case of a refund of premium benefit, the benefit is payable in the event that the insured does not qualify for the CI or LTC benefit before death, expiry or surrender of the CI or LTC coverage or at other specified durations throughout the term of the policy. As is the case with CI or LTC benefits, a refund of premium benefit is only contingently payable and thus has the essential characteristics of an insurance benefit and not an investment return.

A contrary argument could be made in favour of taxing the excess of the amounts received as premium refunds over the amounts charged in respect of such benefits. A position could be taken that the refund of premium feature of a CI or LTC policy should be viewed as an "investment contract" for the purposes of subsection 12(4) of the Act. If this were to be the case, then accrual taxation might be applied on an annual basis, although how this would work is unclear.

An “investment contract” is generally defined in subsection 12(11) to be any debt obligation of a taxpayer, but the term “debt obligation” is not defined in the Act. A premium refund is not, however, debt-like[29], and it does not seem reasonable to conclude that an insurance policy (or any component thereof) should be considered to be a “debt obligation”, regardless of how broadly that term might be construed in its ordinary everyday or commercial usage.

Subsection 16(1) of the Act may also provide authority for taxing the excess of the amounts received as a refund of premium benefit over the amounts paid in respect thereof; this subsection could apply to a premium refund only where the amount of the premium refund “can reasonably be regarded as being in part interest or other amount of an income nature and in part an amount of a capital nature…”

There are several arguments that can be advanced in support of the position that no part of the amount received as a refund of premiums under a CI or LTC policy can reasonably be regarded as interest or other amount of an income nature, including the following:

1. A CI or LTC policy is a contract of insurance, not an investment instrument. As indicated above, the refund of premium benefit is an insurance benefit.

2. Because the potential amount of the premium refund cannot exceed the aggregate of the premiums previously paid, no part can be considered to be income, profit or a gain. The refund simply represents a recovery of all or part of the cost of the policy.

   However, this argument may be problematic, particularly where a separate charge is made for the refund of premium benefit. In these circumstances, the excess of the amount received as a refund of premium benefit over the amount paid in respect thereof can be determined. If the refund of premium feature of the policy is viewed in isolation, this excess amount could be considered as a profit or gain arising from this component of the policy. However, there is no basis in the Act for viewing this benefit in isolation.

The position that refund of premium benefits should not be taxable is consistent with a CRA technical interpretation regarding a refund of premium feature of a disability insurance policy.[30] Under the terms of the policy, the policyholder was able to choose a plan that refunded either 50% or 62.5% of all premiums paid, less 100% of any disability benefits received. The refund of premiums would occur when the disability insurance contract expired or the policyholder decided to discontinue the coverage prior to the contract expiry date.

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[29] A useful discussion of the fundamental characteristics of a debt obligation is contained in the 1989 Tax Court of Canada decision in *James McTamney & Co. Ltd. V. The Minister of National Revenue*, 89 DTC 194.

[30] See CRA document 2002-0117495, dated March 4, 2002.

The CRA indicated that the refund of the premiums would not be required to be included in the policyholder's income unless the policyholder previously deducted such premiums in computing income. The CRA further stated that, in these circumstances, the refund of the premium is simply a return of a personal living expense.

Alternatively, a gain realized from a refund of premium provision upon the expiry or surrender of a CI or LTC policy may be viewed as a gain from a disposition of an interest in the policy. However, a gain realized from the disposition of an insurance policy is specifically excluded from the meaning of a capital gain for tax purposes by virtue of subparagraph 39(1)(a)(iii) of the Act.

In summary, the tax treatment of the refund of premium benefit under a CI or LTC policy is a complex issue. Where the payment of the refund of premiums is contingent upon the policyholder not having made a claim for a CI or LTC benefit, cannot exceed the aggregate amount of premiums previously paid and is payable only upon the death of the insured, at pre-specified durations while the policy remains in force, or upon the expiry or surrender of the policy, strong arguments can be made to support the position that the refund of premiums is not subject to tax.

Disposition of an Interest in a CI or LTC Policy

Issues for discussion: What is the tax treatment of a transfer of an ownership interest in a CI or LTC policy?

The sale, transfer or other disposition of an interest in a CI or LTC policy should not normally be a taxable event.[31] Except in the most unusual circumstances, such a disposition would not be made in the course of carrying on a business of trading or dealing in CI or LTC policies or as an adventure or concern in the nature of trade. Accordingly, any gain realized would not constitute income from a business.

Subparagraph 39(1)(a)(iii) provides that gains realized by a taxpayer from the disposition of insurance policies are not capital gains. Consequently, a gain realized from the disposition of an interest in a CI or LTC policy is not subject to tax.

Combination Policies

Legal Nature of Combination Life and CI/LTC Insurance Policies

CI and/or LTC benefits may be offered under permanent life insurance policies, either as a rider attached to the policy (with a separate premium) or as an integrated benefit under

[31] See CRA Document 2003-0182875, dated June 30, 2003.

the general terms and conditions of a universal life (UL) policy. Term policies that provide for the payment of either a death benefit or a CI benefit depending on which event occurs first are also available, although we are not aware of any products that offer term life insurance and LTC benefits in combination. As well, it is theoretically possible for a life insurance benefit to be offered as a rider attached to a CI or LTC policy, although we are not aware of any such arrangements having been offered in Canada. Thus, in combination policies, the CI or LTC benefit is an ancillary benefit to the primary life insurance benefit.

Based on the discussion of the CCIR's classes of insurance earlier in this paper, it is assumed that a combination policy would be characterized as a "life insurance policy" for purposes of the Act.

Where a CI or LTC benefit is provided by a rider attached to a life insurance policy, the policyholder ordinarily pays a separately identifiable premium or monthly charge against the UL fund value for the CI or LTC insurance benefit. The terms and conditions of the CI or LTC rider usually closely resemble those of a stand-alone CI or LTC policy (including the provision of any refund of premium benefits on death, although return of premium benefits on expiry or surrender, or at specified durations based on no claims having been made, are not typically included).

Where CI or LTC benefits are integrated into the general terms and conditions of a UL or term life policy, the CI or LTC benefits are generally payable based on similar criteria as under stand-alone CI or LTC policies (e.g., the insured has been diagnosed with a specified critical illness and has survived for a specified period after diagnosis, or is functionally disabled). However the policyholder does not generally pay an explicit premium with respect to the CI or LTC benefit and the policy does not ordinarily provide refund of premium benefits.

A policyholder typically has considerable flexibility with regard to the amount and timing of premium payments under a UL policy. The amount of a premium payment made by a UL policyholder (sometimes after deducting a specified "front-end load") is added to the fund value of the policy and allocated among various investment accounts selected by the policyholder. Risk and administrative charges for the life, CI, LTC and perhaps other insurance coverages selected by the policyholder are deducted from the fund value of the policy, on a monthly basis. The amount that a policyholder is entitled to receive upon the surrender of a UL policy ["cash surrender value"(CSV)] would generally be the fund value at the particular time less specified early surrender charges, if any, and possible market value adjustments (depending on the nature of the selected investment accounts). In general, a policyholder is entitled to make withdrawals from the policy at any time up to the amount of the CSV of the policy at that time.

Depending on how the life and CI or LTC insurance coverages under a combination policy have been structured, the payment of a CI or LTC benefit may or may not reduce the fund value (and hence the CSV) of the policy. For example, where a CI or LTC benefit is provided by a rider attached to a life insurance policy and a separate premium is

charged for the CI or LTC benefit, the payment of the premiums by the policyholder and the payment of CI, LTC and refund of premium benefits by the insurer will not ordinarily have any impact on the fund value or CSV of the policy. However, under a fully integrated UL policy, there is a great deal of flexibility in the design of the life, CI and LTC insurance coverages. The terms of such a policy could specify that none, a portion or all of the CI or LTC benefits paid reduce the fund value and CSV of the policy. Similarly, some plan designs may provide that the payment of a CI or LTC benefit may reduce any death benefit subsequently payable under the UL policy.

Taxation of Combination Policies

Issues for discussion: How is a CI or LTC benefit attached to a life insurance policy treated for income tax purposes?

In general, the Act treats a life insurance policy as a single instrument for tax purposes.[32] The combination policies considered in this paper are regarded as single contracts under general legal principles, i.e., the CI or LTC elements of a policy are not considered to be a separate contract. Therefore, unless a specific rule provides otherwise, there does not appear to be any basis for treating the CI or LTC elements as a separate policy for purposes of the Act.

Premiums

As is the case with a stand-alone CI or LTC policy, the premiums paid under a life insurance policy that also provides CI or LTC benefits are non-deductible personal or living expenses.

Application of Annual Accrual Rules

Generally, subsection 12.2(1) provides that where a taxpayer holds an interest in a life insurance policy that is not an "exempt policy", the taxpayer is required each year to include in income the amount by which the accumulating fund in respect of the taxpayer's interest in the policy at the end of the policy year exceeds the taxpayer's adjusted cost basis (acb) in respect of the taxpayer's interest in the policy. To determine whether subsection 12.2(1) applies, it must be determined whether the particular policy qualifies as an exempt policy.

[32] An exception found in subsection 12.2(10) relates to life insurance riders added after 1989 to life insurance policies in effect before 1990 in connection with the accrual reporting rules. Similarly, but for purposes of the determination of reserves only, subsections 1408(5) and (6) of the *Income Tax Regulations* provide for the treatment of post-1995 riders added to pre-1996 policies as separate policies. Based on the lack of symmetry between these two subsections, it is arguable that subsection 1408(6) contemplates the addition of a non-cancellable or guaranteed renewable accident and sickness insurance rider to a life insurance policy.

Exempt Policy

In essence, for a life insurance policy to qualify as an exempt policy, the accumulating fund in respect of the policy cannot exceed the total of the accumulating funds in respect of the "exemption test policies" that are deemed to be issued in respect of the policy.

Accumulating Fund

> Issues for discussion:
>
> Do CI or LTC benefits affect the computation of the preliminary term reserve component of the accumulating fund in respect of either a policy that provides both life and CI/LTC insurance benefits or the related exemption test policy?

For this purpose, the accumulating fund of the actual policy is determined under Regulation 307(1)(b)(ii) as the maximum amount of the reserve that the insurer could have claimed pursuant to Regulation 1401(1)(c).[33] These rules for the calculation of allowable reserves for insurers were changed for policies issued after 1995. However, the old rules contained in Regulation 1401 continue to apply to all policies for purposes of the exempt policy provisions.

Regulation 1401(1)(c) provides that the maximum allowable reserve in respect of a life insurance policy is the greater of:

(a) the cash surrender value of the policy, and

(b) the excess of the present value of the future benefits provided by the policy over the present value of any future modified net premiums in respect of the policy. This value is referred to as the preliminary term reserve.

Although not explicitly stated, the reference in Regulation 1401(1)(c) to "the present value of the future benefits" and "the present value of any modified net premiums" would appear to encompass only death benefits and premiums related thereto and not CI or LTC benefits and any future premiums related to such benefits, with the exception of refund of premium on death benefits. This seems to be the only reasonable conclusion that can be drawn in light of Regulation 1403(1) which provides that the amounts determined under Regulation 1401(1)(c) are to be computed based on rates of interest and mortality only. The present value of the CI or LTC benefits is clearly nil, since the rates of morbidity are assumed to be nil. Given that the CI and LTC benefits do not contribute to the present value, it would be both unreasonable and illogical to include the premiums for this benefit in the calculation of modified net premiums.

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[33] While the maximum allowable reserve is determined on a net of policy loans basis, the accumulating funds of the life insurance policy and the exemption test policy are determined without reference to any policy loans, in accordance with Regulation 306(1)(a).

While not necessary to this argument, the conclusion that the present value of future benefits provided by the policy is equal to the present value of the basic death benefit may be reinforced by Regulation 1401(1)(d). This paragraph provides for additional reserves with respect to certain specified ancillary benefits and risks commonly found in life insurance policies. Regulation 1401(1)(d) parallels the exclusions from the definitions of "premium" and "disposition" within subsection 148(9). Similar support can be found in a landmark article on the application of the accrual rules to exempt policies, which states that "the cost of ancillary benefits that do not contribute to the savings accumulation must be removed from the acb."[34] Such a removal logically requires a parallel exclusion from the accumulating fund of any amounts relating to such benefits.

Based on the above analysis, no amount in respect of a CI or LTC benefit would be included in determining the preliminary term reserve portion of the calculation of the accumulating fund in respect of the actual policy. However, if the inclusion of a CI or LTC benefit increases the cash surrender value of a combination policy this may result in an increase in the accumulating fund.

As noted above, the related exemption test policy has the terms specified by Regulation 306(3). It appears from that provision that the exemption test policy is only considered to provide death benefits, in which case the fact that the actual policy provides CI or LTC benefits is clearly irrelevant in determining the accumulating fund in respect of the exemption test policy. Even if the exemption test policy is considered to provide CI or LTC benefits, the conclusion is the same, for the reason given above. In this regard, Regulation 307(1)(c) specifies that the accumulating fund in respect of an exemption test policy is to be computed with reference to Regulation 1401(1)(c)(ii)(A), which refers to "the present value at the end of the year of the future benefits provided by the policy". Since this is the same provision as applies in determining the accumulating fund in respect of the actual policy, the above analysis would be applicable.

Any refund of premium on death benefits would likely be included in the determination of reserves under Regulation 1401(1)(c). However, to the extent that such benefits are ancillary to the associated CI or LTC benefits, the amount that would be included in the determination of the reserve under Regulation 1401(1)(c) would be small. At the same time, such benefits would be reflected in the determination of the accumulating fund of the related exemption test policy. As these elements have small and opposing effects, industry practice has been to treat them as self-cancelling, and therefore they have routinely been excluded from these calculations.

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[34] Alan Macnaughton, "New Income Tax Rules for Holders of Life Insurance Policies and Annuities," *Canadian Tax Journal* 31, 6 (November-December 1983): 921-941.

Adjusted Cost Basis

> Issues for discussion:
>
> Are premiums paid with respect to CI/LTC (including any return of premium benefits) under a combination life and CI/LTC policy included in the acb of the policyholder's interest in the policy?
>
> If premiums paid in respect of different coverages under a combination policy are treated differently for tax purposes, how are premiums paid under an integrated UL policy to be allocated among the various coverages?
>
> Is any refund of premium on death benefit included in the calculation of the net cost of pure insurance (NCPI)?

The acb of the policyholder's interest in a combination policy is relevant in determining the gain on a disposition of the policy. It is also relevant if the policy is not an exempt policy. In this case, the amount to be included in the policyholder's income under subsection 12.2(1) on an annual basis is the excess of the accumulating fund in respect of the policy over the acb of the policyholder's interest in the policy.

Paragraph B of the definition "adjusted cost basis" in subsection 148(9) adds to the acb the "total of all amounts, each of which is an amount paid before that time by, or on behalf of the policyholder in respect of a premium under the policy." The definition of "premium" in subsection 148(9) is not exhaustive. It provides that a "premium" under a policy includes specified amounts "but does not include" other specified amounts. This definition is meant to exclude from the acb premiums for ancillary benefits that do not contribute to the savings accumulation under the policy.[35]

One of the specified exclusions in calculating the amount of premiums [as defined in subsection 148(9)] to be added to the acb is amounts paid with respect to a "disability benefit". Although an individual might become disabled as a consequence of suffering a critical illness, the payment of the CI benefit is not normally contingent upon the insured's disability. Because of the generally inclusive nature of the definition of premium and the absence of a specific exclusion for premiums for CI benefits, the reasonable conclusion is that such premiums (including any premiums with respect to any return of premium benefits) are included in determining the acb of a life insurance policy.

However, continuing functional disability is exactly the criterion for payment of benefits under LTC coverage. As a result, an explicit premium paid for the LTC benefits provided by a rider attached to a life insurance policy should not be included in calculating the acb of the policyholder's interest in the policy. If such an LTC premium includes an explicit

[35] Ibid.

premium for refund of premium benefits, then that portion of the LTC premium might reasonably be included in the acb of the life insurance policy. But where an explicit premium is not payable with respect to the LTC benefits or any associated refund of premium benefits, as a practical matter, it may be difficult, if not impossible, to determine the portion of the premium that relates to the LTC benefits.

Paragraph L of the definition "adjusted cost basis" in subsection 148(9) provides for a reduction in the acb for the net cost of pure insurance related to the death benefit provided by the policy. This might reasonably also extend to a net cost of pure insurance calculation based on any refund of premium on death under a CI or LTC provision. However, it may not apply because any such refund of premium on death is contingent on the insured not incurring a critical illness. This contingent nature of such refund of premium benefits might argue for exclusion of any associated premiums from the acb of the life insurance policy and any net cost of pure insurance calculation. No comparable reduction is required with respect to any morbidity cost related to the CI or LTC benefits provided by the policy.[36]

CI and LTC Benefits

> Issues for discussion:
>
> Does the receipt of CI or LTC benefits under a combination life and CI and/or LTC policy constitute a disposition of an interest in that policy, and are those benefits included in the income of either the policyholder or the recipient (and if so, under what circumstances)?

For the reasons that follow, it is unclear whether the receipt of CI benefits under a combination policy is a taxable event under current law. It is clear that LTC benefits are received tax-free.

Subsection 148(1) requires an amount to be included in a policyholder's income on the disposition of an interest in a life insurance policy. The amount to be included in income is equal to the excess of the "proceeds of the disposition" of the interest that the policyholder, beneficiary or assignee becomes entitled to receive over the acb to the policyholder of that interest. In this context, the essential question to be answered is whether or not the receipt of a CI or LTC benefit pursuant to the terms and conditions of a life insurance policy constitutes the disposition of a portion of the policyholder's interest in the policy.

"Disposition" is not exhaustively defined for purposes of subsection 148(1). The definition found in subsection 148(9) provides that, in relation to an interest in a life

[36] Some of the further complexities and obsolescences of the exempt test process and acb calculation have been noted in the CLHIA's August 1998 Submission to the Department of Finance, *"Recommendations Regarding Modifications to Exempt Test and Accumulating Fund Calculation For Life Insurance Policies in Canada"* which proposed making this "carve out" of risk costs more reflective of all risk charges associated with a life insurance policy

insurance policy, the term "disposition" includes specified events such as a surrender of the interest in the policy, policy loans made after March 31, 1978 and the dissolution of the interest by virtue of the maturity of the policy. The definition also provides that a disposition does not include other specified events such as a payment under the policy as a disability or accidental death benefit and a payment of a death benefit under an exempt policy. The payment of CI benefits is neither expressly included nor expressly excluded. For combination policies that have been designed so that CI benefits qualify as disability benefits, the exclusion for disability benefits applies to the payment of the CI benefits.[37] The payment of LTC benefits should be excluded, since they are unquestionably disability benefits.

Normally, when one party to a contract pays money to the other pursuant to the terms of the contract, the transaction is not considered to cause a disposition and the capital gains rules would not be considered to apply. Payment of an amount on the redemption of a debt obligation is an exception, but this is because the settlement of a debt is specifically included in the definition of "disposition" in subsection 248(1). The payment of CI benefits is similar to the payment of any other amount pursuant to a contract, and so should not be considered to involve a disposition of the life insurance policy.

Refund of Premium on Death (ROPD) Benefits

> Issues for discussion:
>
> Does the receipt of refund of premium benefits on death with respect to the CI and/or LTC benefit provisions under a combination life and CI and/or LTC policy constitute a disposition of an interest in that policy, and are those benefits included in the income of either the policyholder or the recipient (and if so, under what circumstances)?

CI and LTC insurance riders attached to life insurance policies commonly provide for return of premium benefits on death under similar terms and conditions as under stand-alone CI and LTC policies. Combination products typically do not provide refund of premium benefits with respect to either CI or LTC benefit in the event of expiry or surrender, or at specified durations based on no claims having been made.

Where a return of premium benefit is paid as a consequence of the death of the person who is insured under a combination life and CI and/or LTC policy that is either an exempt life insurance policy or is grandfathered with respect to the accrual rules, the payment of such a benefit is explicitly excluded from the definition of "disposition" under subsection 148(9) and is consequently not subject to tax.

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[37] "Disability benefit" is not explicitly defined for the purposes of section 148. In order to provide greater certainty to consumers, some insurers have restricted the design of CI benefits offered in combination with life insurance policies so that those benefits would also satisfy those companies' medical criteria for income replacement disability benefits. These benefits have, however, been marketed as CI benefits, not as disability benefits. It remains a question of fact as to whether such benefits would qualify as disability benefits.

Transfer of an Interest in a Combination Life Insurance and CI and/or LTC Policy

Issues for discussion: What is the tax treatment of a transfer of an ownership interest in a combination policy that includes life insurance benefits and CI and/or LTC benefits?

The tax treatment of the transfer of an ownership interest in a combination policy will be determined by the same rules as apply to the transfer of an interest in a life insurance policy that provides just life insurance coverage. There are no special rules that apply because of the inclusion of CI or LTC benefits under the policy. Subsection 148(1) requires the transferor to include in income the amount by which the proceeds of the disposition exceed the adjusted cost basis of the interest. In many cases, the proceeds of the disposition will be determined by one of subsections 148(7) through 148(8.2).

Except in the most unusual circumstances, such a disposition would not be made in the course of carrying on a business of trading or dealing in life insurance policies or as an adventure or concern in the nature of trade. Accordingly, any proceeds of disposition realized would not constitute income from a business.

Issues for Discussion

This section of the paper summarizes the various issues that are highlighted throughout the foregoing analysis of the application of the current tax legislation to CI and LTC insurance products. We do not make detailed recommendations with regard to legislative or regulatory resolutions to these issues. However, we do provide industry views regarding suggested alternative approaches for discussion and consideration.

Each of the issues discussed would benefit from confirmation, by either the Department of Finance or the Canada Revenue Agency, that the industry's interpretation described herein is consistent with the views of the Department and/or Agency. Such confirmation, and clarification of the Department's and/or Agency's views, is highly desirable for consumers, advisors and insurers.

1.	*Does the current regime for the taxation of life insurance policyholders apply to the holders of all or certain types of stand-alone CI and LTC policies?*	***Ref. pp. 8-12***

Although it might be argued that a CI or LTC policy that includes a return of premium benefit on death is a "life insurance policy," the current regime for the taxation of life insurance policyholders was clearly not intended to apply to the holders of such policies. The application of these special rules to the holders of CI and LTC policies would be extremely difficult and create anomalous and inappropriate results.

The regime for the taxation of life insurance policyholders was designed primarily to deal with the so-called savings component of permanent life insurance policies. CI and LTC policies currently on the market do not include a significant "savings" element. As a result, it would appear reasonable to surmise that, if these products had been available when the current tax regime for life insurance policyholders was introduced, CI and LTC policies would not have been brought within the ambit of that regime. We do not believe that the current product environment justifies the extension of the rules for the taxation of life insurance policyholders to CI and LTC policyholders, nor do we believe that an alternative set of rules for the taxation of CI and LTC policyholders is required.

The industry assumes that it is not the Department's and/or Agency's intention to subject the holders of stand-alone CI and LTC policies to the special tax rules for life insurance policyholders or a parallel or similar regime.

2.	*Are premiums paid for a stand-alone CI or LTC policy a qualified expense for purposes of the medical expense tax credit?*	***Ref. pp. 12-13***

CI and indemnity-style LTC policies of the sort considered in this paper do not qualify as PHSPs. Consequently, premiums paid under them will not qualify for the medical expense tax credit.

A reimbursement-style LTC policy that provides coverage only for expenses listed in subsection 118.2(2) and that does not include a return of premium benefit is clearly a PHSP. As discussed earlier, it is arguable that the inclusion of medical expenses not listed in subsection 118.2(2), or the inclusion of a return of premium benefit, will not necessarily prevent a reimbursement-style LTC policy from qualifying as a PHSP The industry believes that a comprehensive discussion of this point and a review of the Agency's interpretation would be appropriate.

While beyond the immediate scope of this discussion paper, there may be broader social policy rationales for developing a regime under which LTC insurance premiums would be deductible against income, as a means of encouraging Canadians to take greater direct responsibility for the funding of their non-core health care needs in the future. For example, a system that would parallel the existing RRSP model, in which funds accumulate on a tax deferred basis but are taxable upon withdrawal, may merit consideration, particularly if coupled with an offsetting credit for withdrawals that are assigned directly to regulated care providers. In order to discourage use of such a plan for non-care savings, a penalty for withdrawals not supported by a corresponding care expense might also be imposed, similar to the existing surtax on RESP withdrawals other than Education Assistance Payments. The life and health insurance industry looks forward to active consultation with government representatives in order that such alternatives might be explored more fully.

3.	*Are CI or LTC benefits received under a stand-alone policy subject to tax?*	***Ref. p. 14***

Premiums paid with respect to CI and LTC insurance are personal or living expenses, so benefits from such policies are non-taxable.

4.	*To what extent is a taxpayer prevented from claiming the medical expense tax credit in respect of eligible expenses, if the taxpayer receives benefits under a CI or LTC policy?*	***Ref. pp. 14-15***

The analysis provided earlier in this document indicated that an inappropriate result occurs for a reimbursement-style LTC policy that does not qualify as a PHSP. The policyholder is not permitted to claim the premium paid for the LTC policy in determining qualified expenses for the medical expense tax credit, nor are they permitted to claim medical expenses that have been reimbursed. The industry requests that corrective action be taken so that it is possible for the policyholder to claim either a portion of the premiums paid or the amount of medical expenses reimbursed under the plan as a qualified medical expense for the purposes of the medical expense tax credit.

5.	*Are Refund of Premium benefits received under a CI or LTC policy included in income in whole or in part:* *(a) in all circumstances, or* *(b) depending upon the nature of the triggering event?* *If included in income, how is that portion determined*?	***Ref. pp. 15-17***

For the reasons given earlier in this document we believe that the benefits currently offered are not taxable.

While we recognize that this may be viewed as providing a limited tax preference to consumers, we do not believe that this preference is sufficiently material to merit the application or introduction of a potentially complex or cumbersome regime to eliminate this preference. Recognizing that this view may not be shared by regulators, we have considered a range of methods that could limit such benefits in order to limit the untaxed investment element.

One possible approach would be to specify that if a policy that never permits the total of all benefits other than the basic CI or LTC benefit to exceed the total premiums paid for the policy such benefits are not taxable.

If the policy would ever permit a death benefit that exceeds the premiums paid for the policy then it would be treated as a life insurance policy with the associated tax regime.

If the policy would not permit death benefits to exceed total premiums but refund of premium benefits for any other events could ever produce a cumulative benefit in excess of the premiums paid for the policy then it should be specified that subsection 16(1) would apply to it.

6.	*What is the tax treatment of a transfer of ownership rights under a CI or LTC policy?*	***Ref. p. 18***

The transfer of an interest in a CI or LTC policy should not normally be a taxable event, since any proceeds from such a transfer would not normally constitute income from a business or income from property, nor would the transfer give rise to a capital gain.

7.	*How is a CI or an LTC benefit attached to a life insurance policy treated for income tax purposes?*	***Ref. pp. 19-25***

In order to assist consumers in understanding what are inherently complex contracts, the applicable tax regimes for CI and LTC benefits should be relatively straight-forward and applicable as universally as possible. In accordance with the principles of clarity,

simplicity and consistency identified above, where a CI or LTC rider attached to a life insurance policy could stand alone as a separately sustainable insurance policy and would then be treated as an accident and sickness contract, then that rider should be treated so as to produce the same tax result as would be obtained under a separate accident and sickness contract.

Similarly, where the CI or LTC coverage is so integrated into the life insurance policy that it cannot be logically separated, the CI or LTC coverage should be treated as part of a single, integrated, and indivisible life insurance policy for income tax purposes.

In order to harmonize the taxation of CI and LTC benefits flowing from these two scenarios, the life insurance taxation provisions of the Act should be amended to provide treatment for CI and LTC benefits that is parallel to that currently afforded disability benefits under life insurance policies (i.e., CI and LTC premiums should be excluded from the adjusted cost basis of the life insurance policy, and CI and LTC benefits paid should be excluded from "proceeds of the disposition" of a life insurance policy.)

8.	*Do CI and/or LTC benefits affect the computation of the preliminary term reserve component of the accumulating fund in respect of a policy that provides life and either or both CI and LTC insurance benefits or the related exemption test policy?*	***Ref. pp. 20-21***

The analyses above conclude that CI and LTC benefits are accident and sickness benefits, and as such, should not be reflected in the determination of the accumulating fund in respect of a life insurance policy, or in respect of any associated exemption test policy.

9.	*Are premiums paid with respect to CI or LTC benefits (and any related return of premium benefits) under a combination life and CI, life and LTC, or life, CI and LTC policy included in the acb of the policyholder's interest in the policy?* *If premiums paid in respect of different coverages under a combination policy are treated differently for tax purposes, how are premiums paid under a UL policy to be allocated among the various coverages?* *Is any refund of premium on death benefit included in the calculation of the Net Cost of Pure Insurance?*	***Ref. pp. 22-23***

Generally, premiums should not be included in the acb with the possible exception of premiums paid for return of premium due to death of the life insured (ROPD). It may be

appropriate to modify the definition of "premium" in subsection 148(9) to add CI, LTC and return of premium (other than ROPD) costs to the list of items that are not included in that definition. This would be consistent with the original tax policy and with proposals regarding a simplification of the acb calculation that were included in the CLHIA's August 1998 submission to the Department of Finance regarding modifications to the exempt test.

If premiums paid in respect of different coverages under a combination policy are to be treated differently for tax purposes, then a method of allocating the premiums subject to the taxation rules for life insurance policies separately from all other premiums must be developed. If required, any such allocation model must reflect the fundamental principles of clarity, simplicity and consistency.

There should be consistency between the treatment of premiums for a refund of premium on death benefit and the treatment of the benefit for purposes of determining the NCPI. If premiums for the benefit are excluded in computing the acb, then the benefit should be excluded in the computation of the net amount at risk for purposes of determining the NCPI. Depending on the intended treatment, it may be appropriate to modify Regulation 308 to provide clarity.

10. Does the receipt of CI or LTC benefits under a combination life and CI, life and LTC, or life, CI and LTC policy result in a disposition of an interest in that policy, and are those benefits included in the income of either the policyholder or the recipient (and if so, under what circumstances)?	***Ref. pp. 23-24***

From a policy perspective, to be consistent with the treatment of benefits received pursuant to a stand-alone CI or LTC policy, a CI or LTC benefit, including a return of premium benefit, received pursuant to a combination life and CI and/or LTC policy should also not be subject to tax. It would be inappropriate for the tax treatment of CI or LTC benefits to be altered merely as a result of "packaging" of such benefits with a life insurance policy

For greater clarity, the definition of "disposition" in subsection 148(9) should be modified to expressly exclude the payment of benefits that are in the nature of CI and LTC benefits.

11.	*Does the receipt of refund of premium benefits on death with respect to the CI and/or LTC benefit provisions under a combination life and CI and/ or LTC policy constitute a disposition of an interest in that policy, and are those benefits included in the income of either the policyholder or the recipient (and if so, under what circumstances)?*	***Ref. p. 24***

Where a return of premium benefit is paid as a consequence of the death of the person who is insured under a combination life and CI and/or LTC policy, the payment of such a benefit is explicitly excluded from the definition of "disposition" under subsection 148(9) and is consequently not subject to tax.

12.	*What is the tax treatment of a transfer of an ownership interest in a combination policy that includes life insurance benefits and CI and/or LTC benefits?*	***Ref. p. 25***

The same tax rules apply to the transfer of an ownership interest in a combination policy as to the transfer of an interest in a life insurance policy that does not include CI or LTC benefits. There do not appear to be any concerns in the application of those rules to combination policies.

Appendices

Appendix A

Definitions (as taken from the Ontario *Insurance Act*)

"life insurance" means an undertaking by an insurer to pay insurance money,
a) on death,
b) on the happening of an event or contingency dependent on human life,
c) at a fixed or determinable future time, or
d) for a term dependent on human life,

and without restricting the generality of the foregoing, includes,

e) accidental death insurance but not accident insurance,
f) disability insurance, and
g) an undertaking entered into by an insurer to provide an annuity or what would be an annuity except that the periodic payments may be unequal in amount and such an undertaking shall be deemed always to have been life insurance.

"accident insurance" means insurance by which the insurer undertakes, otherwise than incidentally to some other class of insurance defined by or under this Act, to pay insurance money in the event of accident to the person or persons insured, but does not include insurance by which the insurer undertakes to pay insurance money both in the event of death by accident and in the event of death from any other cause;

"disability insurance" means insurance undertaken by an insurer as part of a contract of life insurance whereby the insurer undertakes to pay insurance money or to provide other benefits in the event that the person whose life is insured becomes disabled as a result of bodily injury or disease.

"sickness insurance" means insurance by which the insurer undertakes to pay insurance money in the event of sickness of the person or persons insured, but does not include disability insurance.

Appendix B

CCIR Classes of Insurance and Definitions

Primary sources for these definitions are noted in parentheses after each definition.

Accident & Sickness
"accident and sickness insurance" means
(a) in the case of accident
- (i) insurance against loss resulting from bodily injury to, or the death of, a person caused by an accident, or
- (ii) insurance whereby an insurer undertakes to pay a certain sum or sums of insurance money in the event of bodily injury to, or the death of, a person caused by an accident,

and
(b) in the case of sickness
- (i) insurance against loss resulting from the sickness or disability of a person other than loss resulting from an accident or death,
- (ii) insurance whereby an insurer undertakes to pay a certain sum or sums of insurance money in the event of the sickness or disability of a person other than as a result of an accident, or
- (iii) insurance whereby an insurer undertakes to pay a certain sum or sums of insurance money to reimburse expenses incurred for the health care, including the dental care and the preventative care of a person other than as a result of an accident.

[Federal (with revisions)]

…

Life
"life insurance" means insurance that is payable
(a) on the death of a person;
(b) on the happening of an event or contingency dependent on human life;
(c) at a fixed or determinable future time; or
(d) for a term dependent on human life;
and, without restricting the generality of the foregoing, includes
(e) insurance whereby an insurer, as part of a contract of life insurance, undertakes to pay an additional amount of insurance money in the event of the death by accident of the person whose life is insured; and
(f) insurance whereby an insurer, as part of a contract of life insurance, undertakes to pay insurance money or to provide other benefits in the event that the person whose life is insured becomes disabled as a result of bodily injury or disease.

The provinces will include the following additional clause in their life insurance definition. This clause will not form part of the federal definition; the ability of a life insurance company to issue annuities is currently provided for separately in the federal Insurance Companies Act.

(g) an undertaking to provide an annuity, or what would be an annuity except that the periodic payments may be unequal in amount, for a term dependent solely or partly on a human life, and such an undertaking shall be deemed always to have been life insurance.

An additional piece will be included in that part of the provincial insurance acts dealing with life insurance contracts to ensure deposit-taking institutions are not captured under life insurance contract law.

For the purposes of this Part, an undertaking entered into by an insurer to provide an annuity, or what would be an annuity except that the periodic payments may be unequal in amount, shall be deemed to be and always to have been life insurance whether the annuity is for
(a) a term certain, or
(b) a term dependent solely or partly on the happening of an event not related to a human life.
[Revised compilation (See Note 1)]

Notes:

1. For Quebec, the definition of “life insurance” will not be modified at this time.
2. Wordings for the definitions to be adopted in Quebec may vary slightly from the wordings in the above definitions.

Appendix C

Benefit Criteria for Critical Illness

The evolving and competitive nature of insurance product design means that there is no standardized set of illnesses or conditions that are used as triggering events within Critical Illness policies. Even where the general condition (e.g., stroke) is common, the details of trigger criteria vary between insurers' contracts. In addition the definitions change and over time, reflecting evolving medical diagnoses and diagnostic testing methods, as well as the extent of the risk that each insurance company is prepared to accept, and has reflected in the pricing of its product. The following is meant to be representative of criteria used, but is not exhaustive or universally accepted.

Many contracts do not provide the breadth of benefits listed below.

Critical Illness shall mean the presence of one or more of the following:

- Alzheimer's Disease – diagnosis by a certified neurologist or a certified psychiatrist of Alzheimer's Disease, a progressive degenerative disease, as evidenced by loss of intellectual capacity resulting in impairment of memory and judgement requiring permanent daily supervision of the activities of daily living, and excluding any other dementing organic brain disorders and psychiatric illnesses,
- Blindness – diagnosis by a certified ophthalmologist of the permanent and uncorrectable reduction in either visual acuity to worse than 20/200 or field of vision to less than 20 degrees in both eyes,
- Coma – diagnosis by a certified neurologist of a state of unconsciousness from which the insured cannot be aroused and in whom external stimulation produces no more than primitive avoidance reflexes, and that has persisted for at least 96 hours,
- Coronary bypass surgery – surgical correction, on the advice of a certified cardiologist, of the narrowing or blockage of one or more coronary arteries with bypass grafts, but excluding no-surgical techniques such as balloon angioplasty, laser relief of an obstruction and other inter-arterial procedures,
- Deafness – diagnosis by a certified otolaryngologist of the permanent loss of hearing in both ears, with an auditory threshold of more than 90 decibels in each ear,
- Heart attack – diagnosis by a doctor of death of a portion of the heart muscle as a result of inadequate blood supply to that portion of the heart, as evidenced by both new electrocardiographic changes consistent with heart attack and elevation of cardiac enzymes,
- Human Immunodeficiency Virus – diagnosis by a doctor, more than 3 months and less than 6 months after such event, of HIV inflection arising either from accident of injury in Canada in the course of the insured's normal occupation that exposed the insured to HIV contaminated blood or bodily fluids, such accident or injury having been reported to the insurer within 14 days of occurrence, reported, investigated and

documented in accordance with established procedures for the relevant occupation and where an HIV blood test within 14 days of the occurrence determines that the insured was HIV negative at that time,

- Kidney failure – diagnosis by a doctor of end stage renal disease (i.e., chronic irreversible failure of both kidneys) requiring regular dialysis,
- Life-threatening cancer – diagnosis by a doctor of a malignant neoplasm, characterized by uncontrolled growth and spread of malignant cells and the invasion of tissue that is not any of the following: stage A prostate cancer, non-invasive cancer in situ, pre-malignant lesions, benign tumours or polyps, any tumour in the presence of any human immunodeficiency virus (HIV), or any skin cancer other than invasive malignant melanoma extending into the dermis or deeper,
- Loss of speech – diagnosis by an appropriately certified doctor of the total, permanent and irreversible loss of the ability to speak as a result of physical injury or physical disease that has persisted for at least 365 days,
- Multiple Sclerosis – unequivocal diagnosis by a neurologist of multiple sclerosis based on at least two episodes of well defined neurological abnormalities with objective evidence of lesions at more than one site within the central nervous system, supported by modern investigative techniques,
- Organ failure requiring transplant – enrolment in a recognized organ or bone marrow transplant program or completion of surgery for irreversible failure of one or more of the insured's liver, bone marrow, both lungs, both kidney or entire heart such that transplantation is medically necessary,
- Paralysis – diagnosis by a doctor of complete and permanent loss of function of two or more limbs as a result of physical paralysis that has persisted for at least 180 days,
- Parkinson's Disease – diagnosis by a certified neurologist of primary idiopathic Parkinson's Disease characterized by at least two of the following clinical manifestations: tremor, muscle rigidity and akinesia,
- Severe burns – diagnosis by a plastic surgeon of third degree burns to at least 20% of the surface area of the body,
- Stroke – diagnosis by a doctor of a cerebrovascular incident, excluding any transient ischemic attack (TIA), that was caused by haemorrhage or by infarction of brain tissue due to thrombosis or embolization, and evidenced by measurable, persistent and permanent neurological deficit that has existed for at least 30 days,

Appendix D

Definition of Disability

The evolving and competitive nature of insurance product design means that there is no standardized set of functional competencies for which the inability to complete such tasks is used as a basis of qualification for benefits within disability policies. Historically, where disability policies have qualified claimants in terms of the ability to perform a particular set of employment tasks, there may have been greater consistency of definition and interpretation. The following is meant to be representative of criteria used, but is not exhaustive or universally accepted

Many contracts do not provide the breadth of definitions listed below.

A Life Insured shall be deemed to be disabled if diagnosed by a medical practitioner licensed and practicing in Canada as exhibiting all relevant symptoms of one or more of the following conditions, and if that diagnosis has been made at least 90 days prior to any application for disability benefits under this policy:

I. diagnosis of a state of incapacity resulting from bodily injury, illness or disease which wholly prevents the Life Insured from performing his or her own occupation.

II. the inability of a Life Insured to perform any one or more of the following activities of daily living
   a) perceiving, thinking or remembering, or
   b) independently feeding or dressing themselves, or
   c) speaking so as to be understood in a quiet setting, by another person familiar with the Life Insured, or
   d) hearing, so as to understand in a quiet setting, another person with whom the Life Insured is familiar, or
   e) eliminating (bladder and bowel functions), and
   f) walking

   even with therapy and/or the use of any device(s) or medication, all or substantially all, of the time.

III. a terminal medical condition which reduces the life expectancy of a Life Insured to a period of 24 months or less;

IV. the permanent, entire and irrecoverable loss of a Life Insured's
   a) sight in both eyes, or
   b) hearing in both ears, or
   c) speech, or
   d) use of both arms, both legs or an arm and a leg;

V. any one of the following conditions in a Life Insured
   a) Alzheimer's Disease,
   b) Muscular Dystrophy,
   c) Coma,

d) Third degree burns to at least 20% of the body of the Life Insured,
e) Cancer
f) Stroke or CVA excluding any Temporary Ischemic Attack,
g) Heart Attack,
h) Coronary Artery Disease,
i) Renal Failure,
j) Receipt by transplant of a vital organ,
k) Paralysis, or
l) Multiple Sclerosis.

(Note: Definitions of the existence of any of the conditions noted in Section V above are consistent with the descriptions of those conditions in Appendix C.

Appendix E

Long-term Care Benefit Provisions

The evolving and competitive nature of insurance product design means that there is no standardized set of illnesses or conditions that are used as triggering events within Long-Term Care policies. Even where the general condition giving rise to the Long-Term Care need is common, the details of trigger criteria vary between insurers' contracts and over time, reflecting evolving medical diagnoses and diagnostic testing methods, as well as the extent of the risk that each insurance company is prepared to accept, and has reflected in the pricing of its product. The following is meant to be representative of criteria used, but is not exhaustive or universally accepted.

Many contracts do not provide the breadth of benefits listed below.

Core Benefits

Qualification
injury or sickness, or inability to perform 2 Activities of Daily Living (ADLs), or cognitive impairment, or medical necessity due to chronic illness. ADLs[38] include:

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[38] Recent product development trends in the United States introduce a second set of benefit triggers that is classified as an inability to perform a set number of "**Instrumental [or Incidental] Activities of Daily Living," or "IADLs."** These are common signs that an individual needs help with tasks that wouldn't necessarily qualify as "Activities of Daily Living." While not yet incorporated into the set of claim triggers used by most policies, some insurance companies may evaluate "IADLs" when discussing potential Plans of Care and claims. It remains to be seen whether companies liberalize or tighten their definitions to go "on claim" for Long-Term Care.

"IADLs" include:

- Shopping,
- Cooking and Meal Preparation,
- Housekeeping,
- Laundry,
- Bill Paying and Managing Finances,
- Using the telephone and television, and
- Taking medications.

- Bathing,
- Eating,
- Dressing,
- Toileting,
- Maintaining continence,
- Transferring,
- Leaving the house, and
- Walking.

All benefits must arise from sickness or injury, and Long-Term Care must be recommended (as medically necessary?) by a physician as part of a written Plan of Care.

Elimination Period
Optionally 0 to 730 days, but typically 90 days, with no recommencement if mode of care changes or if otherwise requalified to receive benefits within 180 days of ceasing to receive benefits. Some plans may measure only days in which care is provided, rather than total elapsed time from diagnosis or onset.

LTC Facility Care
is confinement due to sickness or injury in a Long-Term Care facility operated by law as a convalescent nursing facility, a skilled nursing facility, a convalescent hospital, a convalescent unit of a hospital, an intermediate care facility or a custodial care facility that:

- is primarily engaged in providing, in addition to room & board accommodations, continuous
  - extended care (requiring the training and skills of an RN as prescribed by a physician that may not be provided by a lesser trained person),
  - intermediate care (providing a planned continuous program of nursing care that is preventative or rehabilitative in nature), and/or
  - personal care (hands-on services to assist with ADLs),
- is located within Canada, the United States or Mexico,
- maintains a daily record of each patient ,
- administers a planned program of observation and treatment by a physician other than the proprietor in accordance with existing standards of medical practice for the injury or sickness causing the confinement,
- is not a rehabilitation centre, any part of a facility used primarily for rest care, training, or education, care of the aged, treatment of alcoholism, chemical dependency, neurosis, psychoneurosis, psychopathy, psychosis, or mental or emotional disease or disorder, and
- may provide bed reservation if hospitalized temporarily from an LTC care facility (maximum 14 days annually).

Home Care
provided by a Home Support Agency or a Home Health Care Agency, mainly for the purpose of meeting ADLs. Services need not be rendered by professionals, but must be supervised, and include

- ambulation and exercise
- self-administered medications
- reporting changes in conditions/needs
- completing appropriate records
- personal care
- home management services
- home health aide services
- services to maintain/improve functional ability

Home Health Care
a program of physician-supervised and medically-necessary services that are primarily medical, therapeutic or personal care services, provided in home or in a home for the retired or aged or a place that provides residential care, by a professional, paraprofessional or skilled care worker through an appropriately licensed and certified Home Health Care Agency, including:

- nursing services provided by an RN, RNA, LPN, or equivalent
- physical therapy
- speech therapy
- respiratory therapy
- occupational therapy
- services of home health aides, social workers or clinical psychologists
- home-based Hospice/Palliative Care.

Adult Day Care
The insured must attend a program of social and health related services provided during the day in a community group (6 or more) setting, intended to support frail or impaired elderly or other disabled adults who can benefit from care in a group setting outside the home. Such services include:

- nursing care under an RN's supervision
- planned therapeutic, social and educational activities,
- necessary assistance in ADLs, physical and restorative therapy, and nutritional services and counseling,
- written records of services to each patient.

Home-Based Hospice/Palliative Care
Care within a coordinated program of services primarily concerned with pain and symptom control of people who are terminally ill, and death is expected by a physician to occur within 6 months. (maximum benefit period = 6 months)

Respite Care
Short-term care providing temporary relief from care-giving duties to a member of the insured's immediate family. The insured must be receiving home care, home health care or adult day care to be eligible. Annual limit 14 days.

Medical Equipment
Up to $5,000 for the rental (or purchase if judged to be less expensive) of durable medical equipment designed and used to treat sickness or injury, for use in a person's home. The insured must be receiving home care, home health care or adult day care to be eligible.

Emergency Response System
Up to $40 installation and $35 monthly for a household communication system (other than a home security system) used to call for assistance in the event of a medical emergency. The insured must be receiving home care, home health care or adult day care to be eligible.

Substitute Services
May be provided in lieu of more expensive contractually available services upon mutual agreement of the insured, his or her physician, care coordinator, and the insurer.

Non-Core Benefits

Waiver of Premium
Premiums waived after 90 consecutive days of confinement to a Long-Term Care facility. No supplemental premium.

Indexation
Optional 2-5% simple or compound or CPI-based increase in daily benefit amount and maximum benefit for 20 years, or to a maximum of 50-100% of the initial daily benefit amount and maximum benefit or without limit. The benefit level will not be indexed after a claim has been incurred.

Refund of Premium
Optional at issue, all premiums will be refunded, upon death while coverage is in-force or upon expiry of coverage, grading from 10% after 10 complete years to 100% after 20 years, less any benefits paid. Optional interest component based on fixed or variable rates.

Appendix F

Summary of Related CRA Technical Interpretations

Accident and Sickness Insurance

The CRA has issued several interpretation letters dealing with various aspects of "A&S" policies. Relevant interpretations are summarized below:

RID No. 9206365, May 4, 1992 – Partners Group Benefits, Employee Benefits

Disability Insurance

The CRA has issued a large number of interpretation letters dealing with various aspects of Disability Insurance policies. Relevant documents are summarized below:

RID No. 9238025, February 08, 1993 – Assignment of Disability Policies to Employees.

RID No. 9411015, July 24, 1994 - Removal of a Disability Policy from Employer Plan.

Critical Illness

The CRA has issued several interpretation letters dealing with various aspects of CI policies. These are summarized below:

RID No. 9214825, March 9, 1993 – Independent treatment of disability income rider attached to life insurance policy.

RID No. 9613915, May 28, 1996 – Negotiated salary decrease in exchange for employer funded long-term disability insurance benefits do not give rise to income inclusion.

RID No. 7M12851, May 10, 1996 – Periodic disability income payments are not taxable as annuity income.

RID No. 9711505, June 2, 1997 – Taxability of employer-paid premiums under paragraph 6(1)(a), lump-sum benefits under 6(1)(f), eligibility of premiums for medical expense tax credit under paragraph 118.2(2)(q) and deductibility of premiums by employer are questions of fact and law, and cannot be determined without reference to specific arrangement.

RID No. 9730255, February 9. 1998 – Unable to comment on taxation of CI plans pending issue of an audit memorandum or an advance tax ruling with respect to a given product.

RID No. 9908430, June 30, 1999 – Unable to comment on taxation of CI plans pending issue of an audit memorandum or an advance tax ruling with respect to a given product.

RID No. 1999-0013605, January 28, 2000 – Employer-paid premiums are likely to be taxable employee benefits.

RID No. 2001-0072757, May 8, 2001, – Critical Illness and Split Dollar Insurance.

RID No. 2001-0113597, May 24, 2002, - Assurance contre les maladies graves.

RID No. 2002-0160155, April 3, 2003, – Critical Illness whether a tax benefit.

RID No. 2003-0004265, June 18, 2003 – Update of CRA position on issues raised by CALU re Critical Illness Insurance

RID No. 2003-0034505, December 9, 2003 – Critical Illness Insurance - Treatment of Employer-Paid Premiums and Lump-Sum Benefits

RID No. 2003-0026385, December 10, 2003 - Critical Illness Insurance status as sickness insurance not dependent on premium paying period

RID No. 2003-0182875, June 30, 2003 – Transfer of Insurance Policy

Long-Term Care

The CRA has also issued several interpretation letters dealing with various aspects of LTC policies. These are summarized below:

RID No. 9327215, October 19, 1993 – Criteria for fees paid to nursing homes to be treated as medical expenses.

RID No. 9528625, November 23, 1995 – Update of above.

RID No. 9705895, July 14, 1997 – Availability of medical expense credit for fees paid for accommodation in an assisted living facility.

RID No. 9818715, July 31, 1998 – Determination of whether an LTC policy is a PHSP is only possible based on the facts of a given policy.

RID No. 1999-0015885, February 24, 2000 – Benefit levels within an LTC policy exceed those permitted for PHSPs.

RID No. 2000-0018375, dated May 29, 2000, -PHSP – Insurance for care of disabled individuals.

RID No. 2001-0072855, dated, May 31, 2001, - CALU; Medical Expenses

RID No. 2001-0082757, dated July 12, 2001, - Premium – Medical Expense.

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