Shared ownership post 2016

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Moderator: Herb Huck

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Purpose for shared ownership

- Sharing ownership of the distinct components of a life insurance policy (insurers contractually limit splitting of ownership to proportionate interests in all benefits and obligations under the contract)
- Typical split is between a party needing life insurance protection while another is looking for a tax deferred savings vehicle

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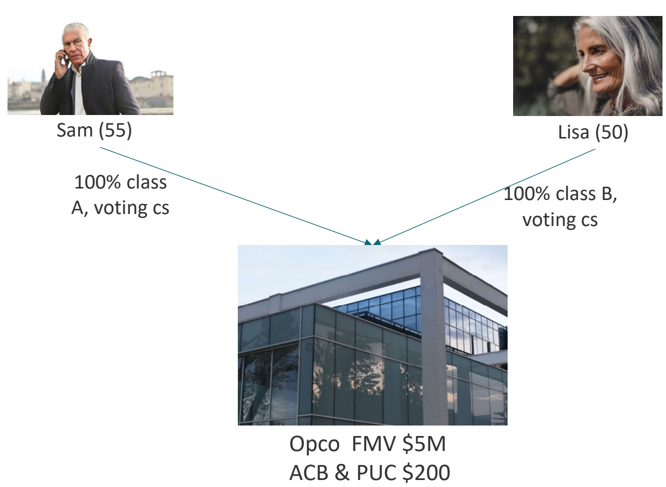
Organization chart



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Insurance needed for buy/sell

- The buy/sell will be a cross purchase between the two parties so they can take advantage of their CGE
- The company has a current FMV of $5M
- Projected growth is 3% each year
- Each interest in 30 years is worth $6M
- Sam and Lisa would also like to personally fund the policy to take advantage of the tax deferred saving available

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Jointly owned insurance policies

Policy on Sam's life

- Universal Life 10 pay LCOI policy
- Face plus fund
- Initial sum insured $6M
- Annual premium $300,000
- Policy crediting rate 4%

Policy on Lisa's life

- Whole Life, guaranteed 10 pay
- Initial sum insured $6M
- Annual premium $320,030
- Policy crediting rate 4.5%

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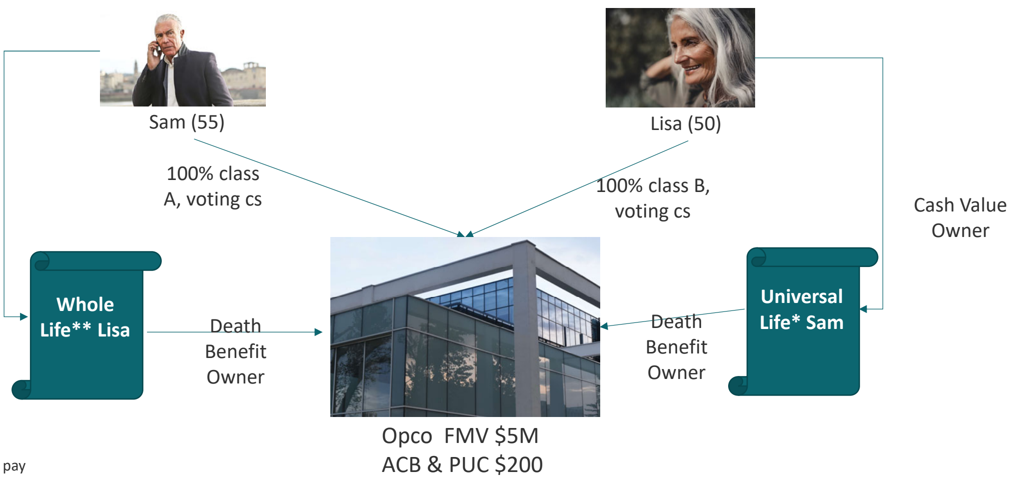
Insurance ownership



- UL 10 pay, LCOI

** WL guaranteed 10 pay

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Shared ownership of insurance – Concept overview

Steven McLeod, LL.B., TEP

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Learning objectives

- Shared ownership and the *Income Tax Act*
- Strategies for shared ownership
- Unique administrative implications
- Life insurance product features and shared ownership
- Tax considerations, including legislative amendments to CDA
- Split beneficiary alternative

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Basis for sharing interests in a policy

- Life insurance contracts generally don't prohibit policyowners from apportioning interests in the contract with others outside of the policy contract
- The federal *Income Tax Act* implies that ownership of a life insurance policy may be split into interests
  - No explicit rules for shared interest policies
- The Canada Revenue Agency acknowledges that rights under a single life insurance contract may be split between more than one owner
- Different than joint ownership

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Shared ownership strategies

	Cash value	Death benefit
Keyperson	Shareholder / employee	Corporation
Executive compensation	Executive	Corporation
Executive compensation	Corporation	Employee
Retirement compensation arrangement	RCA	Corporation
Charitable	Individual	Charity
Buy-sell funding	Holding company / Shareholder/ Trust	Corporation
Tax planning	Shareholder	Corporation

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Administration of shared interest policies

- Insurers track a policy's tax attributes on a whole policy basis
  - Adjusted cost basis, net cost of pure insurance
- Poses challenges for insurers' tax reporting
  - Tax slips issued to policyowner(s) based on insurer's records, either
    - Single – one name on tax slip, or
    - Joint – two names on tax slip
  - Tax slips prepared based on a single ACB
  - Transfers are generally treated as dispositions of the entire policy
- Clients and their advisors must track the tax attributes of each co-owners' interests in the policy and tax report accordingly

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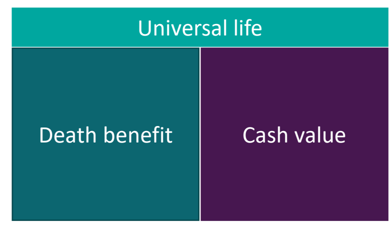
Product selection: UL

- Potentially straight forward split of interests and premium based on death benefit and cash value
- "Coverage plus" death benefit
- Cost of insurance may be anything (level, LP, YRT), but YRT allows for the most over-funding
- Co-owners may split based on alternative bases – i.e., T-10, T-20, T-100, YRT, limited-pay, custom



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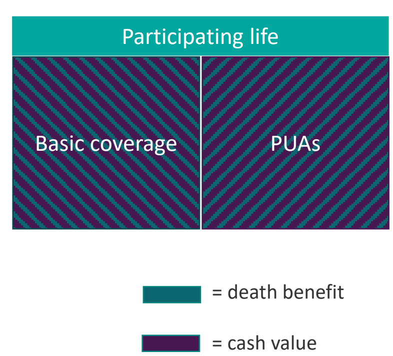
Product selection: Participating life insurance

- More complicated to split interest and premium as death benefit and cash value are entwined for both basic coverage and paid-up additions
- Need to split interests and premium on alternative bases
  - Basic coverage is often the starting point for the one co-owner
  - Each co-owner may own interests in a portion of both the cash value and death benefit, or not
  - Highlights how split dollar can lead to apparently anomalous results



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Tax risks: Shareholder benefit

- Shareholder benefit (taxable) under subsection 15(1) is where:
  - A transaction or a series of transactions gives rise to an *impoverishment* of the corporation and an *enrichment* of the shareholder
- If no impoverishment to corporation then no shareholder benefit?
- CRA on split dollar and subsection 15(1):

  "Where the premium paid by the shareholder is less than that which would be paid for comparable rights available in the market under a separate insurance policy, the corporation may be viewed as having conferred a benefit to the shareholder that could result in a shareholder's benefit for the purpose of subsection 15(1) of the Act."

  - 2012 CALU CRA Roundtable — Question 7

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Tax risks: Benefit conferral

- Subsection 246(1) is a risk for aggressive premium splits which may not be considered a shareholder benefit (15(1)):
  - Applies where a person confers a benefit, directly or indirectly, or by any other means whatever, on a taxpayer and the amount of the benefit would have been included in the taxpayer's income if the amount were a payment made directly by the person to the taxpayer
- Other tax issues
  - General anti-avoidance rule
  - Policy treated as two separate polices for tax purposes

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Post March 21, 2016 ACB/CDA implications

- Amendments to definition of CDA, for deaths after March 21, 2016
  - A death benefit received by a corporation less the ACB of “a policyholder's interest in a policy” generally increases its capital dividend account (CDA)
- CRA’s interpretation of this amendment in the shared ownership context creates one ACB for the purposes of calculating CDA and another for dispositions

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Post March 21, 2016 ACB/CDA implications

- For calculating a corporation’s CDA credit from receiving a death benefit, the ACB of the entire policy grinds the CDA credit
  - Full ACB grind to CDA applies to each corporate co-owner: 2018 CALU CRA Roundtable, 2018-0745811C6
  - Same result in the split-beneficiary context: 2017 CLHIA CRA Roundtable, 2017-0690311C6
  - Finance is aware of this issue and CALU has sought a comfort letter for legislative changes that would allow for prorating the ACB amongst death benefit recipients
- For calculating a policy gain on a disposition of an interest in the policy
  - Death benefit owner ACB was determined by using the premium allocation for their share minus 100% of the NCPI. The saving benefit owner retained full ACB for their premiums

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Shared beneficiary – An alternative?

- Shared beneficiary arrangement is a limited alternative
- One policyowner with two or more beneficiaries
- Limitations
  - Limited to death benefits
  - Policyowner may change beneficiary designation unless irrevocable
  - Corporate context
    - Shareholder beneficiary: subs. 15(1)
    - Subsidiary (non-arm's length) beneficiary: subs. 246(1)
  - Reimbursement from beneficiary: subss. 9(1) or 12(1)(x)

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Shared ownership of insurance – Legal considerations

William Fowlis, KC, FCPA, FCA, TEP, FEA

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Learning objectives

- How does the Shared Ownership Agreement work?
- Parties and impacted Persons
- Important matters to address in the Shared Ownership Agreement

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How does a Shared Ownership Agreement work?

- Insurance policy is a contract between the policy holder (Owner) and the life insurance company (Insurer)
- Shared Ownership Agreement (SOA) sets out and documents the joint ownership of the insurance policy by the policy holders
- Documents that the insurance policy is jointly owned
- Establishes the rights and obligations of the joint owners

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Parties and impacted persons

- Joint owners are the parties to the SOA
- Other persons contemplated by the agreement might include:
  - Trustee who holds the policy for the joint owners
  - Attorney if the contract contemplates granting of a Power of Attorney
- Other persons impacted by the SOA might include:
  - Insurer
  - Beneficiary
  - Lender
  - Canada Revenue Agency

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Important matters to address in the Shared Ownership Agreement

- Interest of each party in the underlying policy
  - Often one party has a specific interest and the other party has residual interest
- Definitions of various terms
- Obligations with respect to payment of premiums
- Addressing procedures should a party default on their obligations
- Designation and change in beneficiaries
- Procedures for dealing with the Insurer, providing of instructions related to decisions on policy investments, beneficiary designations, etc.

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Important Matters to address in the SOA (cont'd)

- Rights or limitations respecting financial transactions related to the policy, such as collateral loans, cash withdrawals or policy loans
- Assignment/Transferability of interest in policy/the SOA itself
- Resolution of conflicts under the SOA
- Termination of the SOA
- General Contractual Provisions

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Potential challenges and problems regarding SOA

- Verbal rather than written agreements
- Timing issues – when did the shared ownership happen?
- Changes in ownership – a disposition and acquisition for income tax purposes

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Best practices – Do's and Don'ts

- Document shared ownership as soon as possible
- Use a written agreement to evidence shared ownership
- Use a form of agreement that arm's length parties would use
- Actions of parties should be consistent with terms of the SOA
- Don't:
  - Rely on a verbal agreement
  - Ignore or not follow the terms of the SOA

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Shared ownership of insurance – Valuation issues

Navaz Cassam, FCIA, FSA, CERA

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Learning objectives

- Understand the valuation process for shared ownership insurance arrangements
- Review the methodology for share ownership

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Valuation considerations

- Member data
  - i.e., date of birth, smoker/non-smoker, health rating (typically use the insurance company rating)
- Policy details
  - Whole Life, Universal Life, etc.
  - Premiums, Cash Value Projections, Death Benefit
  - Premium payment timing
- Who owns what?
- Important to setup the split from the onset of the policy

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Ownership arrangement

- Ownership split has one defined amount
  - In valuing the policy, one of the parties has a fixed* entitlement and the other party has a varying entitlement dependent on the policy structure
- Clearly define which party owns what benefit in the life insurance policy
  - Examples:
    - Shareholder owns cash value, Company owns death benefit less the cash value
    - Company owns base death benefit, shareholder owns paid up additions
    - Company owns death benefit, investment account is owned by the RCA

*not necessarily a fixed $ amount, but rather one of benefits paid are clearly outlined (i.e., cash value)

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Types of policies

- Most common shared ownership are:
  - Universal Life (UL)
  - Whole Life (WL)
- UL
  - Simpler structure for shared ownership
    - One party owns the death benefit
    - The other party owns the investment account
- WL
  - More complicated than UL
    - One party owns the cash value, the other party owns the death benefit less the cash value
    - One party owns a flat death benefit, the other party owns the paid up additions

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Premium payment terms

- Things to consider
  - Will the premiums be paid for the full payment term under the policy
    - i.e., 10 pay, 20 pay, life
  - Will the client utilize premium offset?
  - Will the client utilize ADOs?
  - Payment terms should be decided from the beginning

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Methodology considerations for premium split

- Who owns what
- Payment terms of split
  - If payment term changes, it could change how much of the premium should be paid by each co-owner.
- Premium offsets
- Discount rates

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Methodology for premium split

- Simple split: UL Policy: Face Value owned by Company, IA owned by shareholder
  - Minimum premiums paid by the company
  - Excess premiums paid by the shareholder
- Simple split: Party A owns 75% of DB and CV, Party B owns 25% of DB and CV
  - Party A's portion: 75% of the premium
  - Party B's portion: 25% of the premium
  - Considerations
    - Not common on new setups for shared ownership
    - Could just setup 2 policies

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Adjusted Cost Basis (ACB)

- Each co-owner will have their own ACB calculated independently of the other's
  - Not reasonable to just apportion the insurer calculated ACB
- Co-owner's ACB needs to account for the premiums they've paid and the NCPI charges calculated based only on their interest in the policy.
  - Can use the insurer's calculated NCPI and apportion each year's NCPI charge based on each co-owner's NAAR for that year.
  - Policy loans, partial withdrawals, and any other taxable dispositions also need to be taken into account
- The sum of each co-owner's ACB may exceed the total ACB calculated by the insurer
  - Occurs when one co-owner has a negative ACB (equals $0 for tax purposes) and the other has a positive ACB

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Transferring a policy

- Calculate the Fair Market Value (FMV) for the specified co-owner and their portion being transferred
- Would need to calculate the ACB for that component

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Example 1: Universal Life (UL)

- UL 10 pay policy
  - Male Age 55
  - Base DB - $6M + Account Value (AV)
    - Company owns Base DB plus portion of CSV for pre funding
    - Shareholder owns AV
  - Annual Premiums - $300k for 10 years

- Split
  - Company pays 82% of the premium – approx: $245k
  - Shareholder pays 18% of the premium – approx: $ 55k

- Actuarial valuation important in case CRA challenges valuation

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Example 2: Participating Whole Life (WL)

- PAR WL 10 pay policy
  - Female Age 50
  - Base DB + Paid-up Additions - $6M + Additions
    - Company owns base DB ($6M)
    - Shareholder owns CV/paid up additions
  - Annual Premiums - $320k for 10 years

- Split
  - Company pays 55% of the premium – approx: $175k
  - Shareholder pays 45% of the premium – approx: $145k

- Actuarial valuation important in case CRA challenges valuation

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Questions?

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