STEPUP

Sales Tax Estate Planning Underwriting & Product Newsletter

Deemed Retirement Compensation Arrangements

A Retirement Compensation Arrangement ("RCA") is a non-registered retirement savings plan that allows a company to fund retirement and death benefits for participating employees in excess of those that can be funded in a registered pension plan, without affecting the participant's RRSP limits. The employer contributes to a fiduciary to be invested in a Trust with the intention of distributing benefits to former bona fide employees upon retirement, loss of employment or death.

The company makes tax-deductible contributions to the Trustee of the plan, who remits 50% of all RCA contributions to each of the RCA Investment Account and the Canada Revenue Agency ("CRA") Refundable Tax Account, the latter bearing no interest. The trust fund that holds the RCA Investment Account remits 50% of all realized investment income and capital gains to the Refundable Tax Account on an annual basis. CRA reimburses one dollar to the RCA Trust for every two dollars of benefit paid out of the RCA Trust to the RCA participant until the Refundable Tax Account is depleted.

Certain other situations may also deem the RCA rules to apply. Subsection 207.6(2) of the *Income Tax Act* (Canada) provides the following definition:

"...by virtue of a plan or arrangement an employer is obliged to provide benefits that are to be received or enjoyed by any person on, after or in contemplation of any substantial change in the services rendered by a taxpayer, the retirement of a taxpayer..., and where the employer,... person or partnership...acquires an interest in a life insurance policy that may reasonably be considered to be acquired to fund, in whole or in part, those benefits,..."

An employer acquiring an interest in a life insurance policy for the purpose of providing retirement benefits (in whole or in part) to a person, could be deemed the custodian of an RCA and its interest in the policy would be considered property of an RCA. The life insurance policy will then be subject to the above-mentioned RCA rules, with the consequence of having to contribute 50% of the payment of the life insurance premiums to the Refundable Tax Account, bearing no interest, as mentioned above.

At the May 2012 Conference for Advanced Life Underwriting's ("CALU") CRA Roundtable, CRA was asked to provide the factors that would determine the application of subsection 207.6(2) of the *Income Tax Act* (Canada), that might lead to conclude that a life insurance policy

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The Sales, Tax, Estate Planning, Underwriting & Product (STEPUP) team provides internal and broker support, including seminars, education, advanced concept illustrations & Client case technical consultations.

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can "reasonably be considered to be acquired to fund in whole or in part, those benefits". Some of the factors mentioned by CRA are:

- The benefits provided under the plan compared to the life insured;
- The timing of the purchase of the life insurance and the setting up of the plan;
- The value of the benefits vs. the monetary coverage under the life insurance; and
- Reasons for the purchase of the life insurance, i.e. other than setting up an arrangement.

The timing of the purchase of the life insurance and the actual payment of the retirement benefits impact on the deeming RCA rules is a question of fact. CRA seems to apply the rule where the policy is acquired shortly before, or in contemplation of, the provision of retirement benefits. CRA has pointed out that it would be a question of fact whether the deeming rules apply or not, considering all of the circumstances of a particular case.

For example, the Corporate Insured Retirement Strategy is where a corporation purchases a life insurance policy on the life of the shareholder/employee. The tax-free growth of funds within the life insurance policy are typically used to generate retirement income for the shareholder/employee through leveraging the cash surrender value of the policy as collateral against a corporate bank loan, the funds which are used to provide a retirement income for the shareholder. The loan remains outstanding until the shareholder's death. If the two following conditions apply, the arrangement would very likely be deemed an RCA:

- The employer has the obligation to pay the employee retirement benefits and a formal agreement has been drawn up for this purpose;
- The employer acquires an interest in a life insurance policy that may reasonably be considered to be acquired to fully or partially fund the benefits.

If however, the cash surrender value is used as collateral for a personal loan, and the shareholder pays a guarantor fee to the corporation for the use of the corporate asset, the life insurance would not be deemed an RCA.

Considering the above-mentioned cash surrender value comments, if it can be proven, according to the facts of a particular situation, that an arrangement was set up to fund retirement benefits for the shareholder/employee (i.e. when for instance the bank loan comes into effect), CRA will have the ammunition to deem the arrangement as an RCA. This can be true even if the policy was purchased 15 years prior to the leveraging of the cash surrender value.

Another concern raised at the CALU Tax Roundtable was the fact that an annuity contract and a segregated fund policy fall under the definition of a "life insurance policy". Many segregated fund policies provide for annuity payments after a specific maturity date or triggering event, which considers them annuity contracts under the *Income Tax Act* (Canada). CRA has confirmed in the past that the deemed RCA rules can apply to annuity contracts and have reiterated this in their comments at the 2012 CALU roundtable. CRA had not previously considered the RCA deeming rule in the context of segregated fund policies, but agrees that they fall within the scope of the rule.

Consider that a corporation purchases a Guaranteed Withdrawal Benefit Plan on the life of a shareholder/ employee; at his/her age of 60 and the shareholder/ employee decides to retire at age 65, withdrawing the lifetime benefit amount. Given their comments at the 2012 CALU roundtable, CRA would have a good argument deeming the Guaranteed Withdrawal Benefit Plan an RCA from the date of purchase at age 60, with all of the consequences that it entails, specifically, having to contribute 50% of the Guaranteed Withdrawal Benefit Plan deposits to the Refundable Tax Account. Even if the Guaranteed Withdrawal Benefit Plan was purchased when the annuitant was 40 years old, upon reaching the age of 65, CRA could contend that it was acquired to fully or partially fund retirement benefits, dating back to the time the annuitant was 40 years old.

Though the application of this subsection of the *Income Tax Act* (Canada) is nothing new, CRA is confirming the possible application of this subsection to corporate-owned life insurance and segregated fund policies.

Updated April 2019

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