

Accounting for Corporate Life Insurance

When a life insurance policy is acquired by a private corporation, it is important to properly record the purchase, the premium payments and any build up of contract cash surrender value ("CSV") in the books of the corporation.

The International Financial Reporting Standards (IFRS) and Accounting Standards for Private Enterprises are silent as to the financial reporting of corporate owned life insurance. Guidance in respect of accounting for a life insurance policy can be taken from the United States, where the Financial Accounting Standards board has released a statement in this regard. In situations where the International Financial Reporting Standards or the Accounting for Private Enterprises do not specifically address a particular transaction, then the accounting standards used in the U.S. can be deemed to be appropriate reporting for accounting purposes. The following are examples of how to account for corporate owned life insurance policies.

During the Life Time of the Life Insured

There are essentially three components to the accounting treatment during the insured's lifetime:

1. The cash surrender value of the life insurance policy is an asset that is recorded on the balance sheet ("B/S") of the company. The amount recorded varies from year to year as the cash surrender value of the policy increases or decreases.
2. The payment of the policy premium will be reflected on the balance sheet of the company as a reduction in cash.
3. The increase in the cash surrender value and the payment of the policy premium are reflected in the company's income statement ("I/S") on a net basis (see example below). If the premium paid is greater than the increase in cash surrender value for the year, the difference between the two is recorded as an insurance expense on the income statement. If the premium paid is less than the increase in the cash surrender value, the difference is recorded as an insurance gain.

It is important to note that the insurance expense does not generally qualify as a deduction in the calculation of the company's taxable income. Conversely, the amount recorded as an insurance gain on the income statement is not included in the company's income for tax purposes. Any amounts on the company's financial statements ("F/S") that are not taxable or tax deductible will be adjusted for tax purposes when the corporate income tax return is prepared.



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Peter works with independent advisors and other professionals raising awareness on issues and concerns faced by affluent individuals, professionals and business owners. He supports efforts in researching and developing optimal solutions for clients aimed at improving their financial well-being and supporting their personal wishes and lifestyles. He annually provides 100's of workshops, seminars and technical support throughout the country on tax, retirement income and estate planning issues, concepts and strategies to both advisors and consumers. As a Registered Financial Gerontologist, a good deal of his time is spent on building awareness and educating people of all professions who work with or specialize in the needs, expectations and issues of elders. Comprehensive lifestyle planning is an important element of these processes.

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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The following numerical examples illustrate this accounting treatment for a \$1,000,000 corporate owned life insurance policy. There is a \$10,000 annual premium payable for 10 years, after which the policy is paid up.

cash surrender value (CSV)	Year 1	\$3,000
	Year 2	\$8,000
	Year 9	\$98,000
	Year 10	\$110,000
	Year 11	\$115,000

Year 1 accounting entries:

Debit	CSV (B/S)	\$3,000
Debit	Insurance Expense (I/S)	\$7,000
Credit	Bank (B/S)	\$10,000

To record premium payment in year one and recognize yearend cash surrender value of \$3,000.

Year 2 accounting entries:

Debit	CSV (B/S)	\$5,000
Debit	Insurance Expense (I/S)	\$5,000
Credit	Bank (B/S)	\$10,000

To record premium payment in year two and increase in cash surrender value of \$5,000 (\$8,000 less \$3,000). The premium paid is greater than the increase in cash surrender value for the year so the difference between the two is recorded as an insurance expense on the income statement.

Year 10 accounting entries:

Debit	CSV (B/S)	\$12,000
Credit	Insurance Gain (I/S)	\$2,000
Credit	Bank (B/S)	\$10,000

To record premium payment in year ten and increase in cash surrender value of \$12,000 (\$110,000 less \$98,000). The premium paid is less than the increase in the cash surrender value for the year. In this situation, the difference between the two is recorded as an insurance gain on the income statement.

From year eleven onwards, the policy would be paid up and no amount would be drawn on the bank. However, accounting entries could still be made based on the change in cash value over the fiscal period.

In order to enhance the value of information provided by a company's financial statements, notes are usually added to explain significant accounting policies and other information on the financial statements. The actual cash value of the corporate owned life insurance policy as well as the death benefit and other pertinent information could be disclosed in a note to the financial statements. The disclosure should extend to situations such as one where the life insurance policy has been assigned as collateral against a bank indebtedness.

On the Death of the Life Insured

On the death of the life insured, the company receives the proceeds of the life insurance policy. The proceeds received replace the life insurance asset recorded on the B/S. The excess proceeds are recorded as a mortality gain on the I/S. This amount is not included in the calculation of taxable income since insurance proceeds are tax-free.

Example

Year 10 CSV (As recorded on the books of the company)	\$110,000
Life insurance proceeds received	\$1,000,000

The receipt of the life insurance proceeds will create cash in the company equal to the benefit received.

The cash surrender value of the life insurance policy is no longer an asset, so its balance must be removed from the B/S. The entry is balanced by recording a mortality gain on the income statement of the company.

Debit	Bank	\$1,000,000
Credit	Investment in Life Insurance	\$110,000
Credit	Mortality Gain	\$890,000

To record life insurance proceeds received in year of death (year 10).

It should be noted that the mortality gain is not a taxable amount but rather a method by which the accountant can record the difference between life insurance proceeds received and the asset value recorded on the company's books.

When a business like a private corporation owns a life insurance policy, that ownership affects the balance sheet, income statement, retained earnings statement, notes to the financial statement and possibly the eligibility for the small business deduction. On this last point, the cash value of a corporately owned life insurance policy may impact availability of the small business deduction as covered under ss 125(5.1) of the Income Tax Act (Canada). This needs to be kept in mind given the passing of revised federal legislation dealing with passive income in a Canadian Controlled Private Corporation effective 2018.

When a loan is taken out through the insurance company on the cash value of a policy in excess of the adjusted cost basis; or cash is withdrawn from the policy or the policy is partially or fully surrendered, then a taxable disposition may be triggered, resulting in the necessary inclusion of the taxable portion into passive income of the company (s 148 of the Income Tax Act (Canada)). Income from savings in a life insurance policy that is non-exempt will be added to the extent that it is not otherwise already included in adjusted aggregate investment income.

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