

# COMMENT

Edition 314 - Mar/Apr 2019

---

## BUSINESS OVERHEAD INSURANCE

Individuals with significant earnings should consider the economic impact of becoming disabled and incapable of continuing to earn income. Where will their monthly cash flow come from to meet their lifestyle needs? Sources of income could include group insurance, savings, or income insurance.

The scenario becomes more complex for professionals and self-employed business owners, who have an additional consideration - how will they fund the monthly expenses of their office/business should the business' gross revenue be interrupted because of a disability?

In the long-term, many business expenses can be cancelled; however, in the short-term, expenses may be established pursuant to a contractual obligation that cannot be cancelled on short notice or without a financial cost. For example, staff payroll, rent, equipment leases, and utilities typically have a notice period or financial penalty. It can take time to assess the potential downtime associated with a disability, so immediate separation from employees or utilities may not be a wise business choice.

Business overhead insurance can be a valuable resource to help mitigate the financial risks from lost revenue when business owners or professionals are unable to work due to disability. Premiums paid for overhead disability insurance are tax deductible to the entity paying the premiums and receiving the coverage. If a claim is made under the policy, the benefit is taxable to the recipient. Since overhead disability insurance reimburses a business's monthly tax-deductible business expenses, it should be tax-neutral because the benefit is recognized as income while the actual expenses are deductible.

The issue of recognizing benefit payments as income was the subject of a Canada Revenue Agency (CRA) re-assessment and subsequent appeal by the taxpayer, a dental surgeon, to the Tax Court of Canada.

The facts of the case are as follows:

- Dr Beliveau purchased disability insurance to cover business overhead expenses in the event of an illness or disability.
- Dr Beliveau did not deduct any of the premiums paid for the insurance as a business expense incurred to earn income.
- During the taxation years of 2009 to 2011, when Dr Beliveau was disabled, she received benefits under the policies.
- The insurance benefits were not reported as income by Dr Beliveau and she continued to deduct the office overhead expenses against other business income.
- Dr Beliveau was reassessed by the CRA, whereby the office overhead benefits received were treated as income in the years received.
- Dr Beliveau explained to the court that the benefit was deposited to her personal bank account and was not used in the business.

The court affirmed the CRA's assessment, which required the taxpayer to include the insurance proceeds associated with the business overhead insurance in her income for the respective years. The court explained that the insurance benefit was reimbursing the taxpayer for a tax-deductible business expense. As such, since the tax-deductible expenses were reimbursed, the taxpayer did not have any net expenses that could be claimed for tax purposes.

In explaining the decision, the judge noted that just because the taxpayer did not deduct the premiums paid for the business overhead insurance, it did not change the nature of the reimbursement when the benefit was received, nor the tax consequences associated with it.

It is in every taxpayer's best interests to review their affairs to ensure that their situation is arranged to pay the least amount of income taxes.

## COMMENT

### BEWARE OF RRSP OVER-CONTRIBUTIONS

When individuals contribute amounts into their registered retirement savings plan (RRSP) that exceed the plan's deduction limit, an excess contribution can occur. While the concept appears simple, taxpayers can find it difficult to ascertain their available limits.

A taxpayer's notice of assessment includes a statement with details about the taxpayer's available contribution room as shown in the table below. The form depicts the

calculation for arriving at the taxpayer's RRSP deduction limit for the year (see row H). However, after the current year's limit is calculated, there is a subsequent line that highlights unused RRSP contributions (see row I). Unused contributions reduce a taxpayer's available contribution room for the current year and, if unused contributions exceed the taxpayer's deduction limit, the taxpayer may have over contributed to his or her RRSP.

	Description	Donna	Ken
		\$ Amount	\$ Amount
A	RRSP deduction limit 2018	75,000	10,000
B	Minus: Employer's PRPP contribution for 2018	0	0
C	Minus: Allowable RRSP/PRPP contributions deducted for 2018	50,000	30,000
D	Plus: 18% of 2018 earned income, up to a maximum of \$26,500	26,500	20,000
E	Minus: 2018 pension adjustment	10,000	0
F	Minus: 2019 net past service adjustment	0	0
G	Plus: 2018 pension adjustment reversal	0	0
H	<b>EQUALS: RRSP/PRPP deduction limit for 2019</b>	41,500	0
I	<b>MINUS: Unused RRSP/PRPP contributions previously reported and available to deduct for 2019</b>	0	12,000
J	<b>EQUALS: Available contribution room for 2019</b>	41,500	(12,000)

**Notes:** The term PRPP refers to a pooled registered pension plan. This is a new type of retirement savings plan designed for employees and self-employed individuals who are not covered by workplace pension plans.

In the table above, Donna has a RRSP deduction limit of \$41,500 (line H) and \$41,500 of contribution room (line J) available for 2019. In Ken's scenario, the calculation results in no RRSP deduction room for 2019 (line H) and ultimately a \$12,000 over contribution (line J). Taxpayers are permitted \$2,000 of over contributions without penalty, so Ken will be subject to tax on \$10,000 of excess contributions.

Taxpayers should look at row J to ascertain available contribution room. An important hint that a taxpayer

may be in an overcontribution position is a negative number (depicted by brackets) on line J.

The form for calculating the tax (form T1-OVP) is very complicated. In simple terms, tax on the excess contributions is set at one percent per month for every month the excess contributions remain in the plan.

Paying careful attention to available contribution room will reduce the risk of overcontributing, which comes with a significant financial penalty.

## RIGHTS OR THINGS

In the year of death, a taxpayer will often have several different types of income, such as regular earned income to the date of death, income from the deemed disposition of capital property, and income from the realization of any registered plans. Some income items fall into the definition of a right or thing and may enjoy favourable income tax treatment.

In general terms, a right or thing is a receivable amount that has been earned before the date of death but has not yet been received. Examples of rights or things include dividends that have been declared but are unpaid, matured uncashed bond coupons, and amounts that are payable to an employee at the time of death but that have not yet been paid (for example, salary accrued to the end of the most recent pay period, unpaid commissions or bonuses, and unused vacation pay credits). For individuals on the cash basis of accounting (e.g., farmers and fishers), rights or things will also include harvested crops, livestock, account receivable, supplies on hand, and inventory.

It is important to distinguish a right or thing from other types of income that may be paid on a periodic basis. For instance, a right or thing does not generally include accrued interest because, while it has been earned by the date of death, it is not receivable until the next due date. For employment-related rights or things, the deceased must have had, on the date of death, an enforceable claim to an amount that related to a pay period ending prior to that date. As such, an employee might have accrued employment income as of the date of death, but if the amount would not have been receivable until a later pay day, it is not a right or thing. Capital property, eligible capital property, and income from a registered plan, such as a registered retirement savings plan or registered retirement income fund, are also not considered to be rights or things.

Several options are available to the executor for reporting the deceased's rights or things, and the

executor can use the option that is most advantageous. Rights or things can be:

- transferred to a beneficiary who reports the income on his or her return;
- included in an optional tax return on which only the rights or things are reported; or,
- reported on the deceased's final income tax return.

The executor may distribute some, or all, of the rights and things to one or more beneficiaries of the estate. The beneficiary would have to report the income on his or her own tax return and would be liable for any associated income tax. This transfer removes the reporting of those rights or things from the deceased's final tax return and the separate rights or things tax return. For such a transfer to take place, the beneficiary must be entitled to the right or thing and the value thereof as a distribution from the estate. This means that the executor must follow the testator's wishes with respect to the distribution of assets when determining how best to minimize income taxes through a distribution of rights or things.

Rights or things not allocated to beneficiaries may be reported on the deceased taxpayer's final return or a separate rights or things tax return in the year of death. The advantage of using a separate tax return is that it is possible to claim a number of personal tax credits on that return as well as on the deceased's final return. In addition, any taxable income on the separate tax return is subject to its own set of marginal tax rates. If, however, the executor elects to file a separate tax return for rights or things, then all of the rights or things not allocated to beneficiaries must be reported on that separate return.

Planning involves minimizing the overall taxation of rights or things by determining which items and amounts to allocate to beneficiaries and whether to file a separate tax return for the remaining rights or things.

## EMPLOYEE DEATH BENEFIT

The most ideal tax result occurs when a payment is deductible by the party making the payment and non-taxable to the receiving party. The first \$10,000 of the payment of an employee death benefit is one example of this. A death benefit is an amount paid after an individual's death in respect of that person's

employment service. The amount would generally be reported by the employer on a T4A tax slip.

The gross amount of a death benefit is the amount received by a taxpayer, on or after the death of an employee, in recognition of that employee's service. In order to be deductible by the employer, the payments

## COMMENT

must be reasonable, taking into consideration the employee's position in the company and length of service. The amount could be paid as a lump sum or as a series of payments continued for an extended period of time, as long as the employer's requirement to pay the benefit is evidenced by an explicit statement in the employee benefit plan or the employee's contract of employment.

The payment may also include the employee's unused sick leave, where there is a requirement for the employer to make such a payment. The employer making the payment is obligated to withhold and remit taxes on the payment to the beneficiary.

Certain types of payments made by an employer are not considered to be an employee death benefit. Such non-qualifying payments include: payments from the company pension plan, payments in respect of accumulated vacation pay, payments under the Canada/Quebec pension plan, payments under a deferred income plan, and payments for overtime earned prior to death.

The first \$10,000 of the gross amount of a death benefit is tax-free to the recipient, and the excess is taxable. The \$10,000 exemption cannot be multiplied by naming multiple beneficiaries or by having the money paid over several years.

Where multiple beneficiaries receive portions of the gross death benefit payment, the surviving spouse or common-law partner of the employee has priority to receive the first \$10,000 tax-free regardless of timing or structure. Where the death benefit is paid to multiple beneficiaries, none of whom is a surviving spouse, the tax-free entitlement is prorated among them based on each beneficiary's entitlement to the total amount of the death benefit. Below are a number of examples that illustrate the general rules.

### Example One

Assume that \$18,000 is paid equally to the employee's surviving spouse and child. The spouse would be entitled to receive \$9,000 tax-free, and the child

would be entitled to receive \$1,000 of the \$9,000 payment tax-free.

### Example Two

Assume that \$24,000 is paid equally to the employee's surviving spouse and child over two years (i.e., \$6,000 each per year for two years). In year one, the spouse would receive \$6,000 tax-free, and the child would receive \$4,000 of his/her \$6,000 payment tax-free.

In year two, the spouse would receive \$4,000 of the \$6,000 payment tax-free, and the child would be fully taxable on the second \$6,000 payment. In addition, the child's non-taxable portion for year one would be reassessed, and the child would be required to include the \$4,000 in income for that year.

In the situation where there is a subsequent payment that will be made to a spouse that falls within the \$10,000 tax-free limit, the child could avoid the reassessment by not claiming any portion of the first-year payment as a tax-free amount.

### Example Three

Assume that \$20,000 is paid to the employee's two surviving children, \$12,000 (i.e. 60%) to one and \$8,000 (i.e. 40%) to the other. The first child would be entitled to receive \$6,000 of the \$12,000 payment tax-free based on the proration of the exemption. The second child would be entitled to receive \$4,000 of the \$8,000 payment tax-free.

### Example Four

Assume that \$12,000 is paid from each of two employers to the same beneficiary because of the death of the same person. Regardless of the number of sources, the beneficiary is entitled to receive only \$10,000 tax-free as a result of the death of the single person.

The employee death benefit can be significant because of the substantial tax benefits that can be generated. Planning for the payment of the employee death benefit can involve amendments to employee benefits plans or contracts of employment.

---

### Authors:

**James W. Kraft**, CPA, CA, MTAX, TEP, CFP, FEA, CLU  
**Deborah Kraft**, MTAX, LLM, TEP, CFP, CLU

### Published by:

#### The Institute

10 Lower Spadina Ave suite 600  
Toronto, ON M5V 2Z2  
T: 416.444.5251 or 1.800.563.5822  
F: 416.444.8031

[www.iafe.ca](http://www.iafe.ca) • [info@iafe.ca](mailto:info@iafe.ca)

---

This commentary is published by The Institute in consultation with an editorial board comprised of recognized authorities in the fields of law, life insurance and estate administration. The Institute is the professional organization that administers and promotes the CLU® and CHS® designations in Canada.

The articles in Comment are not intended to provide legal, accounting or other advice in individual circumstances. Seek professional assistance before acting upon information included in this publication.

Publication Agreement # 40069004

Advocis®, The Institute for Advanced Financial Education™ (The Institute™), CLU®, CHS®, CH.F.C.\* and APA® are trademarks of The Financial Advisors Association of Canada (TFAAC). The Institute is a wholly owned subsidiary of Advocis®. Copyright © 2019 TFAAC. All rights reserved. Unauthorized reproduction of any images or content without permission is prohibited.

Copyright 2019 ISSN 0382-7038 All Rights Reserved