

## Asset Protection

Using critical illness insurance with the return of premium on cancellation or expiry benefit



Life's brighter under the sun



## CLIENTS

John and Susan are 45 years old. They own their own home plus a diversified portfolio of registered and non-registered investments to which they contribute every year. John has his own successful business, while Susan works at home. John earns \$150,000 per year. He also owns enough life and disability insurance to protect his family from the financial consequences of premature death or disability. Their accumulated wealth (\$1 million split equally between registered and non-registered investments) represents most of their financial security, and they want to protect it.

## Asset Protection

Using critical illness insurance with the return of premium on cancellation or expiry benefit



Life's brighter under the sun

## SITUATION

John and Susan are concerned that if John has a critical illness they would have to borrow, sell assets or withdraw money from their accumulated savings. They recognize that many of the costs of a critical illness would not be covered by their provincial health insurance plan, and not fully by the benefits plan John has established through his company.

## STRATEGY

John and Susan determine that a critical illness could result in a nine-month recovery period for John. They assume that his recovery would cost \$20,000 for health care and \$20,000 for home care, in 2020 dollars. Assuming 5% inflation in medical costs, that works out to a \$423,740 need if John has a critical illness by age 65.<sup>1</sup> John's business does not offer critical illness insurance (CI) as an employee benefit, so John buys a \$425,000 Term to age 75 CI policy with the Return of Premium on cancellation or expiry (ROPC/E) benefit. John's annual premiums are \$10,079.<sup>2</sup> At John's income level, this represents about 6.7% of his pre-tax income.

As long as John continues to pay premiums, CI coverage will remain in force until the policy anniversary nearest his 75th birthday, or until cancellation. He may cancel coverage at any time, but if he maintains his policy until at least the 15th policy anniversary he can cancel coverage and receive an ROPC/E benefit.

John and Susan expect that if they have a critical illness after age 75 it will more likely result in their needing long-term care. They decide to cover that need with separate long-term care insurance policies.

John pays his CI premiums using money they would otherwise contribute to their non-registered savings plans. Growth in their savings plans is less, but the rest of their wealth is protected from the financial consequences of a critical illness to the extent of their coverage.

---

<sup>1</sup> Needs analysis assumes a 9-month recovery, 2% annual increases in John's salary, and 5% annual increases in the cost of health and home care.

<sup>2</sup> Based on rates effective November 14, 2021 for a male, non-smoker, age 45, at standard rates.

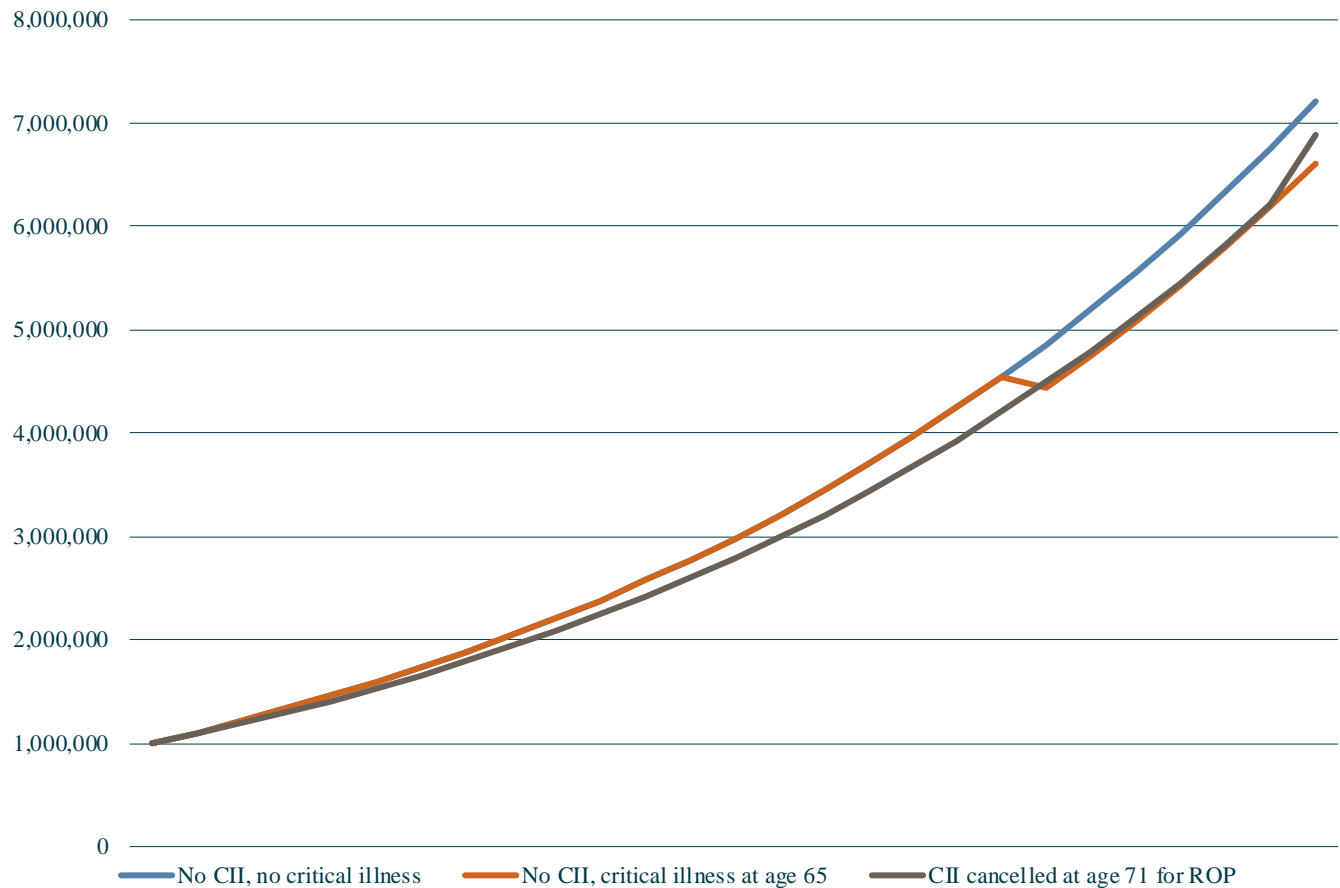
## Asset Protection

Using critical illness insurance with the return of premium on cancellation or expiry benefit



Life's brighter under the sun

## THREE POSSIBLE OUTCOMES



The chart above shows three possible outcomes John and Susan could face:<sup>3</sup>

<sup>3</sup> The blue line assumes \$1 million at John and Susan's age 45, split between registered and non-registered assets, annual RRSP contributions of \$25,000 and annual non-registered contributions of \$20,000, growing at an assumed 5% per year (after-tax growth is less for their non-registered investments). The assumed 5% growth rate is less than the 5, 10 and 20-year returns for the S&P/TSX Composite Index (9.3%, 5.8% and 6.2% respectively, calculated as of December 31, 2020). Source: Taxtips.ca: Historical Investment Returns on Stocks, Bonds, T-Bills:

## Asset Protection

Using critical illness insurance with the return of premium on cancellation or expiry benefit



Life's brighter under the sun

## STRATEGY

If John doesn't buy CII, and doesn't have a critical illness, their savings could grow to over \$7.2 million by age 71, not considering taxes on the non-registered portfolio. But if John were to have a critical illness at age 65, and did not have CII, John and Susan anticipate having to spend almost \$425,000 for care, which they would have to take from their investments. As a result, they will have less than \$6.6 million at age 71, almost \$603,000 less..

There is a cost to owning CII, but the ROPC/E feature helps reduce the impact of that cost on their net worth by returning all their premiums paid when coverage is cancelled or expires (except premiums paid for the long-term care insurance conversion benefit, and any premiums unpaid at the time of cancellation or expiry). In this case, we show John cancelling coverage at age 71 (though he does not have to do so before the policy anniversary nearest his 75th birthday). John and Susan's net worth at age 71, almost \$6.89 million, is \$324,000 less at age 71 than if John had not bought CII. This compares to potential losses from an uninsured critical illness that could be much more costly.

## TAX AND LEGAL ISSUES

The Income Tax Act<sup>4</sup> (ITA) does not specifically discuss CII policies, and the Canada Revenue Agency (CRA) has offered little guidance on their taxation. What follows is a general discussion. Further details on the tax treatment of CII policies are available in the Canadian Health Insurance Tax Guide.<sup>5</sup>

**Premiums paid by individuals for their own or their family's coverage are not deductible.** The ITA defines insurance premiums as "personal or living expenses" if the

---

<https://www.taxtips.ca/stocksandbonds/investmentreturns.htm>. Illustrated rates of return are for information and illustrative purposes only, and are not guaranteed. Actual rates of return will vary. The grey line is the same as the blue line except \$10,079 is diverted each year from non-registered contributions to pay for CII premiums, until coverage is cancelled at age 71 and all premiums are returned. The orange line shows the impact on their savings from John having an uninsured critical illness at age 65.

<sup>4</sup> Income Tax Act, R.S.C., 1985, c. 1 (5th Supp.), referred to herein as the ITA.

<sup>5</sup> Available at [www.sunlife.ca/advisor/HealthTaxGuide](http://www.sunlife.ca/advisor/HealthTaxGuide).

## Asset Protection

Using critical illness insurance with the return of premium on cancellation or expiry benefit



Life's brighter under the sun

proceeds of the policy or contract are paid to or for the benefit of the taxpayer or to a person connected with the taxpayer by blood relationship, marriage or common-law partnership, or adoption.<sup>6</sup> Personal or living expenses are not deductible.<sup>7</sup>

**The CII base benefit is paid tax-free.** If a CII policy meets the definition of health insurance under provincial or territorial law, the CRA treats it as a sickness or accident insurance policy (SAIP). Most CII policies sold in Canada meet the provincial and territorial definitions of health insurance. According to CRA guidance, the base benefits from a CII policy are paid tax-free.<sup>8</sup>

**The ROPC/E benefit is paid tax-free.** The CRA has said that a return of premium at cancellation or expiry (ROPC/E) benefit from a CII policy is tax-free when none of the premiums paid (including the premiums paid for the ROPC/E benefit) have been deducted, and represent no more than the total premiums paid.<sup>9</sup> The CRA's guidance considered policies owned by one person or entity.

**You may not count CII premiums towards a claim for the medical expense tax credit (METC).** According to CRA guidance, one of the requirements for counting insurance premiums towards a claim for the METC under ITA paragraph 118.2(2)(q) is that all or substantially all of the benefits paid under the policy relate to medical expenses that are

---

<sup>6</sup> ITA subsection 248(1). See paragraph (b) of the definition, "personal or living expenses".

<sup>7</sup> ITA paragraph 18(1)(h).

<sup>8</sup> There are no sections in the ITA that tax CII benefits. The CRA has said that a CII policy should be viewed as a "sickness" policy, and that the disposition (i.e. payment of the base benefit) from a CII policy is not taxable: CRA Document 2003-0004265, June 18, 2003. See also CRA Document 2003-0054571E5, December 24, 2004. The CRA's guidance contained in its interpretation bulletins, responses to taxpayer inquiries and advance tax rulings is the CRA's interpretation of the law on a given subject and can help taxpayers plan their affairs in order to comply with the law. However, the CRA is not bound by what it says in its interpretation bulletins or by its responses to taxpayer inquiries. The CRA is bound by the Income Tax Act and Regulations, and by judicial decisions, all of which have the force of law. It is also bound by the Advance Tax Rulings (ATR) it issues, but only to the individual taxpayer who requested the ruling, and only as long as the circumstances outlined in the request for the ATR remain unchanged. The CRA is free to take a different position on a same or similar question or ruling request from a different taxpayer.

<sup>9</sup> CRA Documents 2002-0117495 and 2003-0054571E5, March 4, 2002 and December 24, 2004. CRA Document 2002-00117495 discussed a disability income insurance plan, but the CRA's comments should also apply to CII policies.

## Asset Protection

Using critical illness insurance with the return of premium on cancellation or expiry benefit



Life's brighter under the sun

eligible for the METC (the CRA considers "all or substantially all" to mean at least 90%).<sup>10</sup> Because CII policies pay benefits with no restriction on how you may use them, the benefits do not relate to medical expenses, and the premiums do not count towards a claim for the METC.<sup>11</sup> See our article, "The Medical Expense Tax Credit" for more details.

**Medical expenses may be claimed even if paid from tax-free insurance benefits.** If the insured person has a covered critical illness, and uses the CII benefit to pay hospital or medical expenses, the policy owner may be able to count those expenses towards a claim for the METC. It will not matter that the source of the money used to pay those expenses was a tax-free insurance benefit.

**CII offered through an employee benefit plan is treated differently for tax purposes.** We discuss the tax treatment of CII offered as an employee benefit in our articles, "Employee Life and Health Trusts" and "Group Sickness or Accident Insurance Plans".

## CONCLUSION

John and Susan discuss this strategy with their tax advisor, and decide that personally owned CII needs to be part of their financial plan. The CII benefit, if needed, will help protect their savings from depletion if John has a critical illness. The ROPC/E benefit will help replenish part of the savings they used to pay premiums if no claim is made and the policy expires or is cancelled after 15 years.

**Author: Stuart L. Dollar, M.A., LL.B., CFP®, CLU®, ChFC®, TEP, Director Insurance Tax Solutions.** First published August 2012. Last revised September 2021.

---

<sup>10</sup> CRA Document 2015-0610751C6, November 24, 2015. See additional CRA commentary at [www.cra-arc.gc.ca/whtsnw/tms/phsp-rpam-eng.html](http://www.cra-arc.gc.ca/whtsnw/tms/phsp-rpam-eng.html).

<sup>11</sup> 10 CRA Document 9711505, June 2, 1997.

## **Asset Protection**

Using critical illness insurance with the return of premium on cancellation or expiry benefit



Life's brighter under the sun

**This case study is intended to provide general information only. Sun Life Assurance Company of Canada does not provide legal, accounting or taxation advice to advisors or clients. Before a client acts on any of the information contained in this case study, or before you recommend any course of action, make sure that the client seeks advice from a qualified professional, including a thorough examination of their specific legal, accounting and tax situation. Any examples or illustrations used in this case study have been included only to help clarify the information presented in this case study, and should not be relied on by you or the client in any transaction.**