

# R<sup>C</sup>F News

ISSUE 5

## *Life Insurance in the Retirement Compensation Arrangement*

*By Roy W. Craik*

Some pension commentators have said that the Retirement Compensation Arrangement (RCA) is a flawed pension plan in that earnings in an RCA do not compound tax free as is the case with a Registered Retirement Savings Plan (RRSP) or a Registered Pension Plan (RPP). As a result, the performance of an RCA cannot equal that of a RRSP or RPP, at least, in theory. In practice, there is a funding option that can dramatically improve the performance of an RCA – the use of an exempt life insurance policy.

### *Funding an RCA with an Exempt Life Insurance Policy*

Subsection 207.6(2) of the *Income Tax Act* sets out special rules that apply when an interest in a life insurance policy is acquired to meet an obligation of an employer to provide RCA benefits.

Pursuant to subsection 207.6(2) the person who acquires the interest in the policy is considered to be the custodian of an RCA and the interest in the life insurance policy is deemed to be the "Subject Property" of the arrangement. Twice the amount of premiums paid under the policy is treated as a contribution to the arrangement.

The employer is required to withhold and remit the special refundable tax from any payment towards the policy and file the required returns. Payments under the policy, including policy loans, and refunds of refundable tax distributed to the employer (not as custodian) or the employee are treated as distributions by the arrangement.

Because of this deeming provision, the RCA should first be established under Section 207.5(1) of the Act if life insurance is acquired to fund such benefits.

The fact that the amount of RCA earnings is calculated under Part I of the *Income Tax Act* has

certain implications for life insurance. **With an exempt life insurance policy there is no taxation of earnings until there is a policy gain as the result of a disposition.**

### *Tax Sheltered Earnings in the Policy*

**PENSIONPlus™**, designed by R<sup>C</sup>F uses a specially configured universal life insurance plan as the RCA funding vehicle. The earnings within the policy are tax sheltered. There is no requirement to transfer 1/2 of the policy accumulation to the Refundable Tax Account. And **PENSIONPlus™** offers several additional advantages not available from a conventional RCA.

### *Survivor Benefits*

Survivor Benefits are allowed under the Generally Accepted Guidelines since they are included in virtually all defined benefit pension plans and are mandated now in some provinces. If they were to be added to a conventional RCA, the cost of funding the RCA would increase. If a pre-retirement death benefit were added, this would also increase the cost of funding a conventional RCA.

With most life insurance policies used in RCAs, the minimum cost of insurance makes the cost of using the policy more expensive than a conventional RCA. **PENSIONPlus™**, uses the minimum premium to provide the survivor benefits. The premium deposited in excess of the minimum premium grows over time to provide enough cash to pay the primary retirement benefits. If no survivor benefits are indicated, the cost of funding the RCA is reduced.

The additional insurance used to keep **PENSIONPlus™** from attracting accrual taxation up to retirement is used to provide the pre-retirement death benefit. At retirement, any excess insurance not required to keep the policy exempt or to provide survivor benefits is reduced

## Treatment of Policy Death Benefits

Policy proceeds received as a consequence of the employee's death are tax free to the RCA trust. The distribution of these funds to the beneficiaries of the RCA trust produces refunds of the refundable tax account until all such tax has been refunded to the trustee. In the event that a Corporate Owned Life Insurance contract is deemed to be an RCA trust, proceeds on death cannot be distributed through the Capital Dividend Account. Great care therefore must be taken as to the purpose of Corporate Owned Life Insurance, particularly if maximum funded.

## Additional Benefits

While the RCA provides significant benefits, it can be time consuming and expensive to set up and administer. This can deter an advisor from recommending an RCA, even when it may be the most appropriate solution for the client.

R<sup>CF</sup> provides a fully supported RCA program with the **RRSPWrap™** and **PENSIONPlus™**. The concerns most likely to prevent an advisor from recommending an RCA to his or her client are removed.

## Pension Entitlement Calculation

In establishing an RCA, the pension entitlement calculations are very important. Failure to follow the Generally Accepted Guidelines increases the risk that CRA could deem the RCA to be a Salary Deferral Arrangement (SDA) with substantial tax and interest payable. Usually an actuary must be retained to make these calculations. R<sup>CF</sup> provides this service as part of the **RRSPWrap™** program using a custom designed actuarial software program, so the client does not have to pay actuarial consulting fees.

## Integration with the Refundable Tax Account

The RCA Investment Account and the Refundable Tax Account must be integrated and an annual filing must be made to the CRA.

With **RRSPWrap™** and **PENSIONPlus™** the plans are fully integrated with the RTA and the Trustee makes the annual filing.

## RCA Plan Document and Trust Document

With all RCAs there is a requirement for an RCA Plan document and related documents which must be drawn up by a lawyer. In addition trust agreements must be completed. An R<sup>CF</sup> lawyer provides the client's lawyer with a full documentation package as part of the **RRSPWrap™** and **PENSIONPlus™** programs.

## Reduced Trustee Fees

The **PENSIONPlus™** program provides a Corporate Trustee arrangement through BMO Trust Company for a \$250 set up fee. Annual trustee fees are \$1,000, plus \$250 for the preparation of the annual trust return. Of course, the client would pay any legal or accounting fees charged by their own advisors.

**Roy W. Craik, President**  
Retirement Compensation Funding

R<sup>CF</sup> is the creator of the **RRSPWrap™**, **IPPWrap™**, **MPPPWrap™** and **PENSIONPlus™**. RCA trust services are provided by BMO Trust Company.

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**Retirement Compensation Funding Inc**  
416.364.6444 | info@rcf.ca | www.rcf.ca

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