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Split-Dollar & Shared Ownership RCAs

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There seems to be some confusion in the field as to how Split-Dollar / Shared Ownership RCAs actually work and should be illustrated.

What is the Difference?

A split-dollar arrangement separates the mortality of the policy from the cash value for the life of the contract (ie. until the insured dies). A Shared Ownership arrangement separates mortality from the cash value for a period of time, usually the retirement of the life insured.

Use in RCA

Mathematically, a split-dollar arrangement does not work in an RCA. The reason is that in post-retirement, the premiums the insured is required to pay exceeds the death benefit received. Only Shared Ownership can be used in an RCA and then only on a pre-retirement basis, if the Insured RCA is to provide more benefits then the Non-Insured RCA.

Corporate RCA

Under no circumstances will RCF be involved in a Shared Ownership RCA with a corporation. The tax risks are too high and if mitigated, not only offer no tax advantages to the corporation (over just buying the coverage separately for the corporation's own account) but, also expose both the insured and advisor to liability over valuation issues.

For example, if a corporation was contributing $100,000 annually to an RCA, half would go to the RTA and half would go to the RCAIA that can be paid to the Insurer – requiring X amount of insurance for the insurance contract to remain exempt. If done properly, the insurance funded RCA will provide greater benefits than conventional funding.

Now, enter the corporation with a split-ownership offer to the RCA to buy the mortality portion to retirement, ostensibly because the corporation has a key person risk on the RCA plan member. Some would argue that the tax risks of the arrangement can be mitigated if the corporation continues (i) to pay the $100,000 full RCA contribution and (ii) separately pay the RCA the term costs for the insurance (5, 10, 20 or Term to 65) to retirement. There is no cost advantage to the corporation (they could buy the insurance separately at the same price and after tax cost) but the advisor, insured, and corporation are now exposed to two risk factors:

- The mitigation attempt might not succeed and the face value of the insurance paid to the corporation could still be deemed by CRA as a distribution from an RCA.
- The RCA is losing very substantial pre-retirement death benefits against the extra CSV they receive relative to the re-investment back into the policy of the payment for the pure mortality received from the corporation. Since the insured exempt policy is already providing greater benefits (if properly illustrated) then the non-insured version, there is the risk of a lawsuit from the surviving spouse or beneficiaries of the RCA if the mortality proceeds do not find their way through the corporation to them. That is why professional corporate trustees will not touch Shared Ownership RCAs.

An insurer's desire to obtain premium and an advisor's desire to receive commissions are often in conflict with the best interests of the client. Ignorance of how an RCA can and should be used, is no defense.

Individual RCA

If a Shared Ownership RCA is going to be considered it should only be between the RCA and the plan member, spouse or other 3rd party or corporation other than the OpCo. that establishes the RCA. If the spouse is not the beneficiary of the mortality portion of the contract, it would be wise to obtain a release from her for the pre-retirement benefits lost under the RCA plan document.

Why Shared Ownership?

Since there is no cost advantage to the individual or corporation buying the mortality portion of a policy (compared to buying separately), why do it?

Sadly, the primary reason is that most insurance contracts are designed inefficiently for use in an RCA. The only way a sale can be made is to remove the inefficiency through the use of a Shared Ownership arrangement. Providing the contract is properly designed for use in the RCA in the first place, there are only two valid reasons for Shared Ownership between an RCA and an individual:

- Provides greater pre-retirement survivor benefits particularly in low tax jurisdictions like Alberta.
- Resolves capacity problems for large RCAs if there is a need for both personal insurance and a large face amount to maintain the exempt status of the policy in the RCA.

Why do we not promote individual Shared Ownership?

RcF has developed the software to properly illustrate them but have concerns that inexperienced advisors and insurers are using them to reduce the corporate cost of funding the RCA . As such, expose the client to the risk that the insurance proceeds might be deemed by CRA to be a distribution from an RCA trust as they have stated they would treat Shared Ownership arrangements between a corporation and the individual.

We have sought a Technical Interpretation from CRA and feel that it is prudent to wait until it has been received.

Conclusion

Due to the uncertainty associated with Shared Ownership, we strongly recommend that clients seek independent tax and legal advice.

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RcF is the creator of the PENSION***Wrap***™ (RRSP***Wrap***™/ IPP***Wrap***™/ MPPP***Wrap***™) and PENSION***Plus***™. RCA trust services are provided by BMO Trust Company.

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