SCOPE:

Please recognize this document and video is not complete guidance to capture the complexities of treatments but to provide loose guidance on what information you need to support your accounting and tax professional (e.g. CPA) with to properly advise you on your own personal circumstances in terms of initially recording the life insurance and maintaining it. Any actions that you take outside of this document should be consulted with your financial team. The carrier that is being covered in this video is specific to Equitable Life Insurance Company of Canada – other carriers may have different terms and procedures.

ACCOUNTING

The first portion we're going to go through is the Life Insurance Information.

At the Fiscal Year End of your Financial Statements –

- You will need your policy anniversary statement, Policy Date, Premiums paid, Cash Surrender Value, Loan Outstanding, Interest Paid (Where applicable), Loan Terms (where applicable – for note disclosure purposes)

Carrier Information:

There are two options for you to gather the above information:

1) **Option 1 -** Request a statement from Equitable – Please note this can only be requested *after* the fiscal year end date of your financial statements. **Please allow a lead time of approximately 3-6 Weeks. The request should be sent to customer-service@equitable.ca or call 1-800-668-4095 (You will need your Policy number)**
   a. Example: If your financial statements are Dec. 31 then you must request it after Dec. 31st. From there you should follow up and it to be sent to you within January – February.
2) **Option 2** – Log into your Equitable Portal and take a screenshot the "Values" tab **On the specific Year End Date of your Financial Statements.**
   a. Example: If your financial statements are Dec. 31st then you must take a screenshot of the portal of the values and save it for supporting documentation for year-end purposes.
   b. A recommended best practice is to put calendar reminders in place to access the screenshot.

As described in the Acknowledgement of Understanding, the responsibility of capturing the necessary information is on the client. Ascendant Financial Client Services may assist on retrieving it for a service fee of $160.

The second portion we're going to go through is the accounting for Life Insurance:

This section is preliminary standard guidance on how to account for Whole Life Insurance in accordance to ASPE for Financial Reporting purposes.

Premiums

This will be paid on a cash basis.

DR Life Insurance Expense

CR Cash

On date of payment the journal entry will be:

Cash Surrender Value

Fiscal Year End Adjustment (True up to match the current values on that date):

DR Cash Surrender Value [Asset - Balance sheet]

CR Insurance Expense

Policy Loan (Financing Source - Insurance Carrier - Equitable)

The interest rate as of July 1, 2020 is annualized at 6.2%. The interest will accrue daily on the loan amount from the effective date of the loan. Equitable Life has the right to change the interest rate at any time. [Other Carriers have different terms]

At each policy anniversary, any interest due on the policy loan is added to the outstanding loan balance (capitalized), and interest is charged on the entire amount owing. Interest is capitalized on full repayment.

Up to 90% of the cash value is used as collateral to borrow money from the loan. The loan balance outstanding as at the fiscal year end should be recorded. [Other Carriers have different terms]

On access of the loan (Principal):

DR Cash

CR Cash Surrender Value [Asset – Balance Sheet]

It's important to also note that when the loan source is from the Insurance Carrier the loan is reported against the Cash Value of the Policy. In other words, the amount that you see on the portal will be the NET Cash Value (after subtracting the policy loan)

DR Interest Expense

CR Cash Surrender Value [Asset – Balance Sheet]

Any additional interest added is accrued onto as a decrease to the Cash Surrender Value.

Fiscal Year End Adjustment (True up to match the current values on that date):

On - Policy Anniversary Date

If Interest has been paid

DR Cash Surrender Value [Asset – Balance sheet]

CR Cash

For an example illustration, see Appendix I below

Interest Paid:

An appropriate method to calculate interest must be done to determine the proportion related to interest and principal. When payments are made to the policy loan, the amount is directed to the principal which therefore will decrease the daily interest calculation.

To properly determine interest paid, it is advised you confirm the amount with Equitable.

Immediate Financing Arrangement (Commercial Lender)

When arrangements are made with a separate commercial lender (instead of the insurance carrier). The typical treatment would be the loan is recorded in the Liabilities of the Balance sheet instead of netted against the Cash Surrender Value Asset.

The terms of the agreement are at the discretion of the lending institution and include:

- Borrowing Limit – Can range from 50-100% of the total cash surrender value
- Type of Loan – variable rate term loan, personal line of credit, etc
- Payment options – interest only or blend of principal plus interest
- Amortization period
- Interest rate
- Policy is assigned to the lender as collateral for the loan

Please contact your lending specialist during the initiation of the loan. Standard ASPE guidelines should be applied when recording the loan.

<u>TAX TREATMENT</u>

Premiums

Premiums paid are generally not deductible as expenses for tax purposes. They will create permanent differences (in other words, they will be added back to accounting income for tax purposes).

Paragraph 20(1)(e.2) of the Income Tax Act provides a limited deduction for premiums in respect of a life insurance policy assigned as collateral security for a loan.

Requirements for deductibility:

In order to be eligible for deductibility under paragraph 20(1)(e.2), the assignment of the life insurance policy must be required by the lender, the lender must be:

1. A restricted financial institution (defined subsection 248(1))
2. The interest payable on the money borrowed must, generally, be deductible in computing the taxpayer's income

Please note – Information contained in this document may change due to changes in regulations and other standards

Restricted means principal business is the lending of money to persons with whom it deals at arm's length with.

When it comes to policy loans depending on your insurance carrier – please discuss with your financial team whether the restricted financial institution criterion will be met. For Immediate Financing Arrangements, this criterion will be met.

Amount deductible:

Paragraph 20(1)(e.2) of the Act provides that the amount deductible in respect of a policy for a taxation year is determined as follows:

The portion of the lessor of:

a) Premiums payable by the taxpayer under the policy in respect of the year, and
b) The net cost of pure insurance ("NCPI") of the policy for the year

When the taxpayer's taxation year does not correspond to the policy year, the premiums payable under the policy and the NCPI should be prorated on a reasonable basis to the taxation year. Insurers are required to calculate NCPI in respect of a life insurance policy at the end of the calendar year.

Policy Interest / Commercial Collateralized Loan Interest

Under paragraph 20(1)(c) a reasonable amount of interest is deductible when it is paid or payable in respect of the year (depending upon the method regularly followed by the tax payer) pursuant to a legal obligation and the borrowed money is used for the purpose of earning income from a business or property, or to acquire property for the purpose of gaining or producing income thereon, or for the purpose of gaining or producing income from a business.

If interest is to be deductible in the context of leveraged life insurance strategies, it is important that the direct use of the borrowed funds is for the purpose of gaining or producing income and not to acquire the life insurance policy.

Please discuss with your financial team on whether your interest can and recommended to be deductible. As further reference, it is important to understand whether the resources to address interest deductibility is worth the tax savings.

CRA Guidance: https://www.canada.ca/en/revenue-agency/services/tax/technical-information/income-tax/income-tax-folios-index/series-3-property-investments-savings-plans/series-3-property-investments-savings-plan-folio-6-interest/income-tax-folio-s3-f6-c1-interest-deductibility.html

Appendix I

Policy Year	Annual premium due during the fiscal year of the corporation	Cash surrender value of the life insurance policy at the year-end of the corporation
1	$10,000	$3,000
2	$10,000	$7,000
3	$10,000	$14,000
4	$10,000	$22,000
…	…	…
11	$10,000	$106,000
12	$10,000	$120,000
13	$10,000	$148,000
14	$10,000	$178,000
15	zero	$180,000

Relevant accounting entries

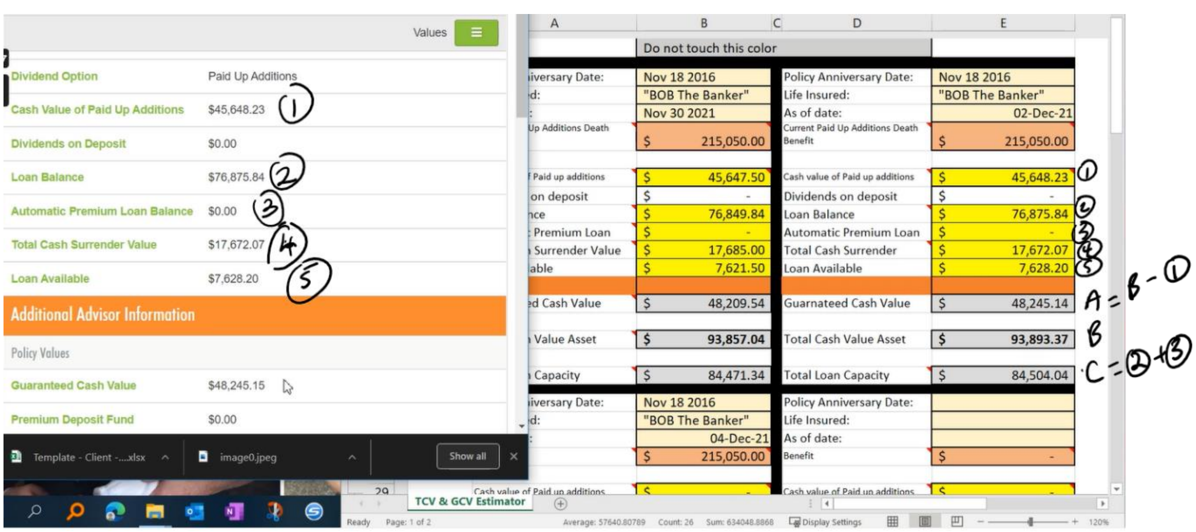
	Date	Account Names	Debit	Credit	Explanation
Each year when the annual premium is paid, the accountant will debit the insurance expense and credit the chequing account. This same entry is made in each of years 1 through 14.		Insurance expense	$10,000		To record the payment of annual insurance premium due
		Chequing account		$10,000	
At Company ABC's year-end, the accountant will write an adjusting entry to reflect the year-over-year increase in the cash surrender value.	Year 1	Cash surrender value	$3,000		To record cash surrender value at the end of the first year
		Insurance expense		$3,000	
	Year 2	Cash surrender value	$3,000		To reflect the year-over-year increase in the cash surrender value
		Insurance expense		$4,000	
In year 12, the increase in the cash value ($14,000) of the life insurance policy is greater	Year 12	Cash surrender value	$14,000		To reflect the year-over-year

than the annual premium ($10,000). This means that on ABC’s income statement, there will be income of $4,000, rather than an expense.		Insurance expense		$14,000	increase in the cash surrender value
In year 15, the company did not pay an annual premium but chose to use the policy’s internal value to fund the cost of insurance. There is still an increase in cash surrender value ($2,000) over the prior year, which needs to be recorded.	Year 15	Cash surrender value	$2,000		To reflect the year-over-year increase in the cash surrender value
		Insurance expense		$2,000	
At the time of Life Insured’s death, ABC will receive a $1-million death benefit. The cash surrender value of the policy at the time of Life Insured’s death is $250,000. So $750,000 will appear on ABC’s income statement for the year.	Year 25	Chequing account	$1,000,000		To record receipt of $1 million of life insurance proceeds and to eliminate the $250,000 of cash surrender value sitting on ABC’s balance sheet
		Cash surrender value		$250,000	
		Other income		$750,000	

Example of the Equitable Portal with the Guaranteed Cash Value Tool.

Please make sure you watch the video in the Ascendant Financial Client Portal

- ➔ Getting Started
- ➔ Tool to Check your Guaranteed Cash Value



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