



Understanding Taxation of Disability Insurance

Tax Status of Disability Insurance Benefits – Overview

	Premiums				Insurance Benefits		Refunds	
	Owner	Payor	Deductible?	Note	Payee	Tax Status	Payee	Tax Status
Income Replacement (Proguard Series, Venture Series)								
Individual	insured	insured	No		insured	tax-free	owner	tax-free
Corporate payor (not grouped) ¹	insured employer	employer employer	Yes Yes	taxable benefit to employee	Insured insured	tax-free tax-free	owner owner	tax-free taxable
ILRP ²	employer ³	employer	Yes	IT 428	insured	taxable	owner	taxable
Key Person ⁴	employer	employer	No		employer	tax-free	owner	tax-free
Retirement Savings Protection (Pensioinguard Rider)								
Individual	insured	insured	No		non-registered RSP	tax-free	owner	tax-free
Corporate payor (not grouped) ¹	insured employer	employer employer	Yes Yes	taxable benefit to employee	non-registered RSP non-registered RSP	tax-free tax-free	owner owner	tax-free taxable
ILRP ²	employer	employer	Yes	IT 428	non-registered RSP ⁵	taxable	owner	taxable
Key Person	not available							
Office Overhead (ExpenseComp)								
Overhead	business	business	Yes	IT 223	business	taxable, but offset by deduction for expense	owner	taxable
Disability Buy-Out (Buy-Sell Plus)								
Cross purchase	insureds	insureds	No		healthy insureds	tax-free, but the sale of business is a taxable event	not available	
Corporate redemption	business	business	No		business	tax-free, but the redemption of shares is a taxable event	not available	

¹ For the plan to qualify to pay non-taxable benefits, CRA rulings stress that the employees must be legally obligated to pay all premiums. The employer must be paying the premiums on the employees' behalf, for example, through payroll deductions.

² An Income Loss Replacement Plan (ILRP), also known as a Wage Loss Replacement Plan, is an employee benefit. Where the insured(s) are also shareholders, there are circumstances where the CRA might view the plan as a shareholder benefit. The tax consequences would then be different. Partners are not eligible for an ILRP.

³ An alternative to employer ownership is ownership of the individual policies that are part of an ILRP by the individual employees who are part of the group.

⁴ The employer can use the money to meet various business needs, such as recruiting and training a replacement. This ownership structure may also be used to provide DI benefits when the insured is a shareholder – the business in turn pays out DI benefits in the form of a dividend, subject to regular taxation of the dividend.

⁵ Benefits from an ILRP are earned income. Therefore, the client might wish to use some of the non-registered funds to make a contribution to a designated RRSP.