



# DI Premiums

## How the taxation of disability insurance benefits works

**M**any advisors would agree that clients should make sure they have enough disability insurance (DI) before exploring excess life insurance coverage. While it's well-known among both advisors and clients that the proceeds received by a beneficiary of an exempt life insurance policy upon the death of the life-insured person can be received by that beneficiary completely tax-free, the taxation surrounding the benefits paid out under a DI policy is less clear.

The general tax rule is that if the individual pays the premiums under the DI policy, any periodic disability payments received from the insurer will be tax-free. On the other hand, if the individual's employer pays the premiums under the DI policy and does not report them as a taxable employment benefit to the employee, any benefits received in the future under the DI policy will be fully taxable.

A recent tax case (*Béliveau c. La Reine*, 2018 CCI 87), however, shows that what appeared to be tax-free DI benefits to the purchaser of the policy was not seen as tax-free by the Canada Revenue Agency.

The case involved a Sherbrooke, Quebec, dental surgeon who was reassessed by the CRA for her 2009, 2010, and 2011 taxation years. The CRA added \$88,150 to her 2009 income, \$249,417 to her 2010 income, and \$114,116 to her 2011 income to reflect insurance benefits she received under two disability professional overhead protection policies issued by Great-West Life (GWL) insurance company.

The taxpayer testified that she purchased three separate DI policies from GWL. The first policy, entitled "Professional Overhead Protection," was issued in 1991 and provided monthly protection of \$3,000 at a monthly premium cost of \$57. The second policy, entitled "Professional Overhead," was issued in 2007 and provided monthly protection of \$15,000 in

exchange for a monthly premium of \$408. The third policy, entitled "Disability Insurance Plan – Professional," was issued in 2008 for a monthly premium of \$883 and provided monthly protection of \$8,000.

In court, the taxpayer provided evidence that she had paid the premiums for these three policies out of her personal bank account, and that in all the years, she never deducted the premiums she paid as an expense from her taxable income.

In May 2009, the taxpayer became disabled due to illness, but nevertheless continued to operate her clinic from then through July 2011, using other dentists and paying them 50 per cent of their billed revenues.

She began receiving benefits under her three policies, all of which were deposited into a personal bank account (versus her clinic's business account). She did not include them in her professional income for the years in question, believing they were tax-free disability payments.

Following a tax audit, however, the CRA reassessed her and included the disability benefits she received under the two overhead policies in her business income. It did not reassess her for the benefits she received under the third policy since it was a personal DI product whose benefits were not taxable.

The taxpayer's main argument was that DI premiums are considered personal expenses that cannot be deducted in computing the insured's income under the Tax Act and therefore any benefits paid under a DI policy cannot be taxable.

The CRA's position was that the benefits paid under the two overhead policies were a reimbursement of business expenses that were intended to maintain the operation of the practice for 24 months to allow the dentist to reorganize her business if the disability persisted.

For benefits to be paid under the two

overhead policies, the practice had to continue to be operated by the insured during the disability period, and evidence of overhead costs relating to the operation of the clinic had to be presented to GWL monthly. These benefits are intended to replace the dental clinic's operating expenses that were included in the calculation of the net operating income of the clinic and deducted for tax purposes.

This can be contrasted with the third policy where the benefits were non-taxable because the only condition required for payment was that the insured was disabled. Benefits would continue to be paid as long as the insured's disability lasts, whether or not her practice continues.

The judge referred to the principle of substitution (the "surrogatum principle") in which the Supreme Court, in a seminal 2005 decision, concluded that the tax consequences of DI benefits are established on the basis of what the amount was intended to replace. Under this principle, the DI benefits were intended to replace the general operating expenses of a dental clinic. The judge concluded that since the source of the insurance benefits is the taxpayer's dental business, the insurance benefits paid to the taxpayer must be included in the calculation of her business income. **E**

JAMIE GOLOMBEK, CPA, CA, CFP, CLU, TEP, is managing director, tax and estate planning, at CIBC Financial Planning & Advice. He can be reached at [jamie.golombek@cibc.com](mailto:jamie.golombek@cibc.com).

### HOW TO REACH US



On Twitter:  
[@advocis](https://twitter.com/advocis) [@deannegage](https://twitter.com/deannegage)



On Facebook:  
[facebook.com/advocis](https://facebook.com/advocis)



On LinkedIn:  
[linkedin.com/company/advocis](https://linkedin.com/company/advocis)