



Salary Continuation Plan Disability Insurance

September 2007

Introduction

It can be extremely beneficial for a corporation to fund income replacement policies for the benefit of selected employees under a Salary Continuation Plan. Premiums paid by the corporation do not result in a taxable benefit being conferred on the employees and the premiums are eligible to the corporation as a tax-deductible business expense.

In the event of a disability, payments received by the employee from the disability income company are taxable income. However the tax implications are recognized in the monthly income replacement benefit eligible to be purchased in that such benefit can be higher than the coverage under a policy with premiums paid at the personal level. Premiums for personally funded income replacement insurance are paid from after-tax income and benefits received upon disability are tax-free.

The real impact for the corporation paying premiums under a Health and Welfare plan is the potential tax savings on the premiums paid. To the extent an employee's marginal tax rate differs from the corporation's tax rate, the overall cost may be less than if the employee pays for the insurance personally.

The attached schedule determines the tax savings available if the corporation funds an income replacement policy under a Health and Welfare plan. The section on personally funded income replacement insurance assumes that you would increase your salary sufficiently to pay the annual premium.

From the analysis you will notice that in order to personally pay a premium of \$3,618.00 a year for a monthly benefit of \$7,700.00, it is necessary for you to increase your salary by \$6,750.00 which after payment of personal income tax of \$3,132.00 will net sufficient funds for payment of the premiums. Even though you draw an additional \$3,618.00 from the company, the company's actual cost is reduced by the amount of tax savings it will have as the increased salary is a deductible corporate expense. With a tax savings of \$1,255.50 the actual after-tax cost of personally paying premiums is in fact \$5,494.50.

When your income replacement insurance is paid for by the corporation under a Health and Welfare plan, the monthly benefit can be increased from \$7,700.00 to \$12,600.00 to recognize that benefits received upon disability are taxable. The annual premium of \$5,789.00 is tax-deductible to the corporation, resulting in an after-tax cost of \$4,712.25. The difference translates to savings of \$782.25 in favour of corporate funded income replacement insurance under a Health and Welfare plan.

In order to establish a Health and Welfare plan, a description of the plan or undertaking is to be documented in the corporate minutes together with a resolution by the board of directors. It is most important that at least two employees be included in the plan.



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Exhibit

Gender	Age	Smoking Status	Funding	Monthly Benefit	Annual Premium
Male	45	Non-Smoker	Corporate	\$12,600	\$5,789
			Personal	\$7,700	\$3,618
Corporate Tax Rate:					18.60%
Personal Marginal Tax Rate:					46.40%

Personally Funded Income Replacement Policy – increase salary to provide funds

Required Salary:	\$6,750.00	\$6,750.00
Personal Tax (46.40%):	\$3,132.00	
Net amount needed to pay disability premium:	\$3,618.00	
Tax savings to corporation (salary is a business expense – 18.60%)		<u><u>(-\$1,255.50)</u></u>
Net after-tax cost to corporation		\$5,494.50

Corporate Funded Income Replacement Policy

Annual Premium:	\$5,789.00	\$5,789.00
Tax savings to corporation (18.60%) as a business expense:	\$1,076.75	<u><u>(-\$1,076.75)</u></u>
Net after-tax cost to corporation		\$4,712.25

Conclusion

Annual Savings through Corporate funded:	\$782.25
Savings expressed as a percentage:	16.6%



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