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Wage Loss Replacement Plan

Insurance advisor guide

RBC Insurance

Contents

Importance of income protection

We all like to think that nothing serious could ever happen to us or become an obstacle to our ability to earn an income. But in reality, no one is safe from adversity. The statistics speak for themselves; a 35-year-old runs a 50% risk of being disabled for 90 days or longer. However, although it seems that this statistic alone clearly highlights the essential need for disability income protection, many individuals remain unprotected.

We often perceive disability as a critical situation that limits us dramatically in a physical way, such as being confined to a wheelchair. However, when thinking about the possibilities of developing a back problem or taking a leave from work due to stress, the risk of becoming disabled seems more real and the need for income protection more important. The statistics for groups of individuals such as employees of a business are even more alarming, as displayed in the chart below.

INCIDENCE AND PERSISTENCE OF A DISABILITY

Probability of at least one disability of more than 90 days before the age of 65[1]

	Number of men in a group		
Age	2	3	4
40	67.3 %	81.3 %	89.3 %
45	62.5 %	77.1 %	86.0 %
50	55.9 %	70.7 %	80.6 %

[1] Commissioners Individual Disability Table A, 1985 (Disability Insurance)

The need for income protection is real. Employees want to maintain their families' lifestyle in the event of a disability. Employees are a corporation's greatest asset and often difficult to attract and retain. A comprehensive benefit package that includes disability income protection is essential in today's marketplace to attract and retain key employees. A Wage Loss Replacement Plan is a tax-effective way to provide income replacement protection for your client's employees.

What is a Wage Loss Replacement Plan (WLRP)?

Wage Loss Replacement Plan, Income Loss Replacement Plan or Salary Continuation Plan are all names for disability income replacement programs set up by an employer for a group of employees. Unlike group insurance solutions, a WLRP comprises individual disability income protection insurance policies grouped together under a common plan. For tax purposes a "grouped arrangement" such as a WLRP is considered to be a group accident or sickness insurance plan.

A WLRP must have two or more employees to qualify as a grouped arrangement, and thus receive the favourable tax treatment accorded to group accident and sickness insurance policies. The employer is typically the owner and pays the premiums for the individual contracts. The employees are the insureds, and benefits are paid to them in the case of disability. Upon termination of employment, the plan may allow for the employees to take the individual disability policies on their life with them subject to the employee picking up future premiums and meeting the insurer's requirements for assignment in such cases. This preserves insurability for the employee and may lock in attractive benefits that were negotiated as part of the plan.

Through an RBC Insurance® WLRP, we transform what would normally be a personal expense for the employee into a tax-deductible business expense for the employer. Details of the tax implications relating to WLRPs are covered in the "Taxation issues" section of this guide.

Advantages of a WLRP

For the employee:

- No premium cost as the employer funds the premiums.
- Premiums paid by the employer are not a taxable benefit.
- Disability benefits are paid to the employee.
- Disability income benefit limits are increased in order to take into account the impact of income tax.
- Disability benefits received constitute income eligible for the purpose of determining RRSP contribution limits. This allows the employee to maintain their retirement plan funding objectives during disability or to create carryforward room for future contributions.
- The insurance policy is guaranteed to remain in force to age 65 as long as premiums are paid when due.
- Ownership of the policy can be transferred to the employee upon termination of employment. This transfer is subject to the limits established by the insurer (see the section, "Assignment of ownership of individual policies" on page 6).
- If 10 or more employees are involved in the arrangement and the average group age is less than 50, it may be possible to issue the case on a Guarantee Standard Issue® (GSI®) basis, thereby eliminating the need for employees to go through the normal underwriting process. (GSI is not available on the Fundamental Series.)

For the employer:

- A WLRP is a significant employee benefit that helps attract and retain key employees.
- Premiums are a tax-deductible business expense.
- RBC Insurance takes on the burden of continuing to make payments to disabled employees.
- A WLRP is an effective method to establish a disability benefit program as it stabilizes costs and eliminates the uncertainty associated with the fluctuation of group insurance rates.
- The employer selects the participants and benefit levels by defining classes of employees.
- The cost for the employer to pay the premiums for a WLRP is lower than the cost to increase the employee's salary in order to allow them to pay the premiums personally.
- Discounts are available when implementing a WLRP for three or more employees.

For the advisor:

- Excellent prospecting tool for access to small and medium-sized business markets.
- Efficient sales opportunity as a single WLRP will result in multiple sales.
- The sale of a WLRP allows for the creation of new sales from cross selling.
- Preferential relationship with new employees.

Eligibility and market for a WLRP

Who is eligible to participate in a WLRP? — Any employee who qualifies for an individual disability income protection policy from an insurer can participate in a WLRP. In the case of partnerships, sole proprietorships or professional corporations, only personnel who are employees of those organizations qualify for a WLRP. The employer designated in the plan must pay the employee's salary or remuneration. A shareholder employee only qualifies by virtue of their employment relationship, not their ownership relationship. As such, only salary income is considered for the purposes of the WLRP. Associations and trade unions are also eligible for WLRPs as they represent groups of employees.

There must be at least two employees — There must be at least two employees covered under the plan at all times for the arrangement to qualify as a grouped arrangement.

If there are 10 or more employees — WLRPs can be structured to take advantage of our unique GSI offering for higher occupation classes (typically 3A and 4A). In these situations the employees need only answer a few simple questions to qualify for coverage instead of going through the full underwriting process. Benefit entitlements vary depending on age and salary levels, with maximums based on group size. A single-page enrolment form along with full census demographic data and a three-year disability insurance (DI) claims history for all participants are all you need to determine if your group qualifies.

There must be an identifiable group — Each identifiable group is called a class. Classes are typically defined based on position, salary range, benefit entitlement or some other common feature. For example, the plan may have separate classes for management and general staff, or differentiate employees based on salary ranges. In a unionized organization there may be separate classes for union employees and non-union employees. If only one class is to be insured under a WLRP, it is essential that the group to be insured be a "logical" group and that the choice of this group, and more importantly the justification for excluding other employees, can be supported in the eyes of the Canada Revenue Agency (CRA). CRA will question the validity of a plan that favours a small group of employees, particularly if that group consists of shareholder employees.

The insurance must be offered to all the employees of the group — The concept of a group arrangement is that everyone in that defined group is included in the plan. Costs and benefits must be in the same proportions for all participants (barring extra premiums or reductions introduced by the insurer). If an employee is not deemed to be insurable by RBC Insurance, that employee can be excluded from the group without violating the concept of the arrangement being offered to everyone in the defined class. In such a situation, it is the insurer who excludes the employee, not the employer or the plan.

Markets for WLRPs — These arrangements are ideally suited for successful small to mid-sized companies. They are often implemented for management classes that the employer has identified as key to the success of the business. In larger organizations, employees are often required to share in a portion of the cost of implementing this type of insurance arrangement, or group insurance programs are put in place instead of WLRPs.

Products and discounts

RBC Insurance offers a variety of individual disability income protection policies suitable for WLRPs. Your clients can select the plan and terms that best meet their benefit objectives.

- The Professional Series® — Fixed premium, non-cancellable product with disability definition based on regular occupation during the entire benefit period.
- The Foundation Series™ — Fixed premium, non-cancellable policy with disability definition of regular occupation for the first 24 months and any occupation thereafter (can be upgraded to regular occupation for the entire benefit period).
- Bridge Series® — Guaranteed renewable policy with disability definition based on regular occupation for the first 24 months and any occupation thereafter (can be upgraded to regular occupation for the entire benefit period).
- The Fundamental Series® — Guaranteed renewable policy with disability definition based on regular occupation for the first 36 months. A simplified offering, that in many instances can provide coverage for individuals who might not otherwise be able to obtain coverage.

More detailed descriptions of our products can be found via the RBC Illustrations software on the Sales Resource Centre, or obtained from our sales representatives.

In addition to the broad individual disability income protection product portfolio, RBC Insurance also offers discounts for situations involving three or more insured employees working for the same employer. Please contact your RBC Insurance sales representative for more information on applicable discounts.

Individual disability income protection options

There are four options for funding individual disability income protection:

1. Personal — Personally owned and funded with after-tax dollars.
2. Shared cost — Personally owned, paid for by the employer and treated as a taxable benefit.
3. WLRP — Employer owned and funded WLRP.
4. Increased salary — Personally owned and funded with increased salary from the employer.

A WLRP is often the most cost- and tax-effective solution for providing disability income protection to employees. The following example* and chart display the four alternatives and the advantages of WLRPs.

Assumptions:

Male non-smoker	Age 44	Annual income: $145,000	Class 4A
Elimination period	90 days	Benefits to age 65 (including COLA and $1,500 FIO)	
Tax rates	Employee marginal 45.00%	Employee average 35.09%	Employer 34.00%

Policy premium and benefit	Monthly benefit	Annual premium
Disability income benefit is non-taxable	$5,550	$3,051
Disability income benefit is taxable	$8,550	$4,577

Description	Option 1 Personal	Option 2 Shared cost	Option 3 WLRP	Option 4 Increased salary
COSTS				
Employee				
Premium	$3,051	$0	$0	$3,051
Additional compensation[1]	$0	$0	$0	($5,547)
Tax cost[2]	$0	$1,373	$0	$2,496
Total employee costs	$3,051	$1,373	$0	$0
Employer				
Additional compensation	$0	$0	$0	$5,547
Employee taxable benefit[3]	$0	$3,051	$0	$0
Premium	$0	$0	$4,577	$0
Tax savings[4]	$0	($1,037)	($1,556)	($1,886)
Total employer costs	$0	$2,014	$3,021	$3,661
Combined after-tax costs	$3,051	$3,387	$3,021	$3,661
BENEFITS				
DI monthly benefit	$5,550	$5,550	$8,550	$5,550
Tax[5]	$0	$0	($3,000)	$0
Net after-tax benefit	$5,550	$5,550	$5,550**	$5,550

[1] This is the total increase in compensation that XYZ Corporation has to pay to all employees in this class to offset their cost (including taxation) of acquiring personal disability income policies.
[2] Taxes payable by all employees under this class based on each employee's marginal tax rate times the increase in compensation.
[3] Disability insurance premiums paid by the employer and reported as a taxable benefit to the employee.
[4] XYZ Corporation's tax savings from deductions for amounts paid to fund the program times the corporation's tax rate.
[5] Tax on potential benefits from the insurer for all employees in the class based on their taxable monthly indemnity times their average tax rate.

* This example is based on the specific tax rate assumptions listed, and results will vary if other rates apply to the client's situation.

** Assumes there are no other sources of income during disability. The grossed up WLRP benefit may increase the employee's marginal tax rate. In some cases, the overall after-tax income of the employee from all sources could be lower using a WLRP. This example is for illustration purposes only.

For the two alternatives where the employer picks up all the costs (Options 3 and 4), the WLRP is $640 less costly, resulting in a savings of 21%. The employer will have to determine how to share the costs of providing disability income protection. The choices range from the employee footing the whole bill to the employee not incurring any costs. As the chart on page 4 displays, as we move from Option 1 — Personal to Option 4 — Increased salary, the employee costs decrease but the employer costs increase. Depending on the employer's desire for the plan design and available budget, they can select the alternative that best suits their objectives.

Comparison of a WLRP and group disability plans

WLRPs are often compared to group disability plans when an organization is looking at options for providing income replacement benefits for employees. These two types of arrangements are very different and often target different employee groups. WLRPs are typically designed for smaller groups of senior management personnel, whereas group plans are designed for larger groups providing affordable basic protection. The chart below summarizes some of the differences between the two types of arrangements.

Features	WLRP	Group plan
Individual non-cancellable or guaranteed renewable policies with terms and conditions locked in at issue	Yes	No
Possibility to lock in future pricing at issue	Yes	No
Insurance portable upon termination	Yes	Maybe
Availability of optional benefits such as partial and residual benefits, cost of living, etc.	Yes	Maybe
Disability definitions broad and comprehensive	Yes	Standard
Individual underwriting required resulting in possible exclusions from coverage or employees declined	Yes	No
Cost of insurance protection typically	Higher	Lower
Employment insurance payor status	1st payor	2nd payor

As you can see from the above comparison, WLRPs tend to have more comprehensive benefit definitions, are portable and introduce some cost stability, while group plans are typically less costly arrangements, providing basic benefits during employment only.

Implementation of a WLRP

1. Determine the class or classes of employees to be insured. Document the logical relationship that defines each class.
2. Establish eligible insurable income levels for each plan participant based on their T4 income from employment in prior years. The following information will help you determine the sources of income that qualify for establishing WLRP benefits:
   - Annual remuneration or salary.
   - Bonuses, if they are regular (two-year history) and the amount is predictable within a reasonable range.
   - Contributions to a retirement plan or deferred profit sharing plan for the employee made by the employer from company funds.

   A business owner should avoid including the following amounts that typically qualify for non-WLRP applications as they relate to their status as a shareholder instead of as an employee:
   - Salary paid to a spouse if the income is split.
   - Net before-tax operating income from the employer multiplied by the percentage of ownership (for example, 50% ownership, 100% ownership).
3. Determine the benefit entitlement for each class including:
   - The appropriate monthly benefit (see 2 for eligible insurable income levels).
   - The elimination period.
   - The duration of the benefit period.
   - The other optional benefits to be integrated (riders).

4. Prepare the appropriate documentation to support the WLRP. CRA does not specify what type of documentation is required to support the contention that individual DI policies should be treated as a grouped arrangement. Typically, a board resolution and a plan document are used. Please note that the employer's legal counsel must determine the appropriate form of documentation for the WLRP, and that RBC Insurance is not a party to these documents or the preparation of them. We can, however, provide you with a set of draft documents intended to be used by the client's legal counsel to assist in the preparation of the appropriate documentation. Sample documents available are listed at the back of the guide (draft legal documents must not be used in their current form).
5. Fill out an application for each employee to be insured. The employer must be the owner on the application, the employee is the insured and disability benefits are to be paid directly to the insured. Fill out the section Wage Loss Replacement Plan in the application, making sure that a company director signs as the "policyholder" and the employee signs as the "person to be insured." When this section is completed, RBC Insurance will attach an amendment to the policy specifying what would happen to the policy should the WLRP terminate, or should a member of the plan cease to participate in the WLRP.

   Employment Insurance is the second payor when a disability benefit is paid through a WLRP. Because of this, the policies do not require the usual Employment Insurance exclusion. However, the plan must respect the rules set out in the Employment Insurance Regulations. More details on Employment Insurance can be found at www.servicecanada.gc.ca.
6. Have the final plan approved by management and the Board of Directors as appropriate.

Assignment of ownership of individual policies

One of the advantages of a WLRP is the fact that individual policies are issued and they may be portable depending on the employer's plan design. Events occurring after the WLRP has been put into effect may result in the employee no longer being able to participate in the plan. Here are a few examples:

- The employer terminates or ceases to fund the WLRP.
- The employment relationship is terminated.
- CRA rules the plan no longer qualifies as a WLRP.

As the employer is the payor and plan designer of the WLRP, it is their decision whether the individual insurance policies will lapse or if the ownership of the contract will be assigned to the employee when participation is no longer possible. This decision is typically reflected in the plan document pertaining to the WLRP.

If the employer opts to assign ownership of the policy to the employee in the above circumstances, they must then request that the insurer process the ownership transfer. The insurer will typically specify the conditions attached to such an assignment, and all those conditions would have to be satisfied before any transfer could take place.

RBC Insurance attaches an amendment to all the policies issued pursuant to a WLRP. That amendment allows us to reduce the taxable benefits in order to take into account the amount of insurance the insured would be entitled to according to the non-taxable underwriting limits in force on the date on which the insured stopped participating in the WLRP. We will not adjust the non-taxable benefits to an amount lower than the amount the insured would have been entitled to on the date the policy was issued.

Taxation issues

TAX RULES APPLICABLE TO DISABILITY INSURANCE

The taxation issues relating to DI will largely depend upon the owner of the plan, the payor of the premiums, the payee of the benefits and any special insurance features.

Individually Owned Disability Insurance

Similar to most insurance contracts, premiums for individually owned disability insurance policies are generally not deductible from an individual's income as they are considered a personal living expense that is paid with after-tax dollars. Conversely, the insurance benefits are not of an income nature for tax purposes, and thus the benefits are not subject to tax; no deduction, not taxable. The return of premium feature is subject to the same logic.

Type of plan	Premiums paid by	Taxation of premium	Taxation of benefits
Individually owned	Employee	Non-deductible	Non-taxable

Corporate Disability Arrangements

Disability income protection in the corporate context generally fits into two categories: corporate income protection and employee benefit. The comments that follow are with respect to disability arrangements providing income protection for employees only.

Non-Grouped Individual Plans

The employer may pay the premium on a disability policy on behalf of an employee but not as part of a group employee benefit plan or WLRP. In this situation, either the employer or the employee can own the policy, but disability benefits are payable to the employee. If the plan is not considered a group plan, any payment of premiums by the employer for insurance that provides protection to an employee is considered a taxable benefit. If the employee is subject to a taxable benefit, the disability policy is treated the same way as an individually owned and funded disability policy. As such, any disability benefits received as a result of a claim are not taxable.

Type of plan	Premiums paid by	Taxation of premium	Taxation of benefit
Individual or corporate-owned	Employer, deductible	Taxable benefit to employee	Non-taxable to employee

Grouped Individual Plans — WLRP

A WLRP is a grouped arrangement that allows an employer to group together individual disability income protection policies to provide income replacement for their employees. The individual policies are owned and paid for by the employer, but the benefit is payable to the employee. At least two employees are required for a plan to qualify as a "grouped arrangement" such as a WLRP. Partners and sole proprietors are not eligible for coverage under a WLRP, but may be eligible for individual disability income protection insurance. Shareholders may be included, but only to the extent that they are active employees of the company. Premium payments are not considered taxable benefits, and any benefits received by the employee are taxable.

Type of plan	Premiums paid by	Taxation of premium	Taxation of benefit
WLRP	Employer, deductible	Not a taxable benefit	Taxable to employee

TAX BACKGROUND NOTES AND REFERENCES

- Interpretation Bulletin IT-428 — Wage Loss Replacement Plans
- IMP. 43-1/R1 — Income Insurance Plan
- Technical Interpretation 2000-0055145 — Accident and Sickness Insurance, dated January 9, 2001
- Technical Interpretation 9126876 — Group Sickness or Accident Insurance Plan, dated December 11, 1991

  The Canada Revenue Agency (CRA) confirmed in a technical interpretation (9126876), dated December 11, 1991, that individual contracts of insurance issued to an employer in respect of certain employees could constitute a group sickness or accident plan for tax purposes.

- CRA's response to a question of whether benefits are received by virtue of employment or shareholding, provided at the 1999 annual meeting of the Conference for Advanced Life Underwriting (CALU):

  "In examining a particular case, a negative answer to one or more of the following queries would suggest that the benefits are provided to the recipient in his or her capacity as a shareholder:

  (a) Is participation in the plan made available to all employees, including those who are neither a shareholder nor related to a shareholder? If not, is there a logical reason to exclude some employees?

  (b) Are the benefits available under the plan the same for all employees of the business, in their nature, quantum and cost-sharing ratio?

  (c) When all participating employees are also shareholders, is the benefit coverage similar to coverage given to non-shareholder employee groups for similar size businesses who perform similar services and have similar responsibilities?"

TAXATION OF INDIVIDUAL DISABILITY INSURANCE (DI) PREMIUMS AND BENEFITS

RBC Insurance Disability	Insurance		Premiums and tax	Benefits and tax		Refunds and tax	
Type of insurance	Owner	Payor	Deductibility	Payee	Tax status	Payee	Tax status
PERSONAL PROTECTION							
WLRP	Insured	Insured	No (personal expense)	Insured	Tax-free	Owner	Tax-free
	Insured	Employer	Yes (taxable benefit)	Insured	Tax-free	Owner	Tax-free
	Employer	Employer[1]	Yes (taxable benefit)	Insured	Tax-free	Owner	Taxable
	Employer	Employer	Yes (no tax benefit)	Insured	Taxable[2]	Owner	Taxable
RETIREMENT PROTECTION[3]							
WLRP	Insured	Insured	No (personal expense)	Trustee	Tax-free	Owner	Tax-free
	Insured	Employer	Yes (taxable benefit)	Trustee	Tax-free	Owner	Tax-free
	Employer	Employer[1]	Yes (taxable benefit)	Trustee	Tax-free	Owner	Taxable
	Employer	Employer	Yes (no tax benefit)	Trustee	Taxable[2]	Owner	Taxable
KEY PERSON PROTECTION[4]							
	Employer	Employer	No (capital outlay)	Employer	Tax-free	Owner	Tax-free
DISABILITY BUY SELL							
Cross purchase[5]	Individual	Individual	No (capital outlay)	Individual	Tax-free	Owner	Tax-free
Redemption — entity purchase[5]	Business	Business	No (capital outlay)	Business	Tax-free	Owner	Tax-free
OFFICE APPLICATIONS							
Overhead expense	Business	Business	Yes (business expense)	Business	Taxable	Owner	Taxable
Loan protection	Business	Business	No (capital outlay)	Business	Tax-free	Owner	Tax-free

1 The employees must be obligated to pay all premiums, and therefore any payments will be on the employee's behalf.
2 Benefits from a WLRP are considered earned income for tax purposes.
3 Retirement protection coverage provides for the payment of a monthly benefit to a non-registered account if the insured becomes disabled. This account accumulates and invests the benefits up to age 65 when it pays out a lump sum amount to provide for the insured's retirement. Benefits paid under a WLRP application to a non-registered plan are considered earned income eligible for RRSP calculations. Income earned on the investments in the non-registered account is also taxable on an annual basis.
4 In the case of key person protection coverage, the employer may require funds to meet immediate cash needs to find a replacement during the period of disability. This structure may also be used to provide disability benefits when the insured is a shareholder. The business receives the tax-free benefit and in turn can pay out the benefit in the form of a dividend, which is subject to regular taxation as a dividend to a shareholder.
5 For both the cross purchase and the corporate redemption, the proceeds are of a capital nature and are tax-free. The sale or corporate redemption of the business interest is a taxable transaction.

Sample documents

RBC Insurance has a number of sample documents to assist you in explaining the concept of WLRPs and also to facilitate the implementation of such arrangements. These documents can be obtained online from the Sales Resource Centre or from your RBC Insurance sales representative. A list of available documents is provided below:

- Pre-approach letter
- Employer marketing brochure (83658)
- WLRP proposal
- Taxation of individual disability insurance (DI) premiums and benefits chart (83660)
- Draft legal documents — employer-administered arrangements
  - Board of Directors resolution
  - Plan document

Note: These sample documents are solely provided for general information, and clients should not rely on their contents to obtain specific legal, financial or tax advice. Clients should consult their independent accountant, or legal, financial and tax consultants, regarding their specific needs.

RBC Insurance

This insurance advisor guide is a summary only. Actual policy language will prevail. For additional information on the Wage Loss Replacement Plan, call your regional sales office.

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