

BUSINESS OVERHEAD INSURANCE

Individuals with significant earnings should consider the economic impact of becoming disabled and incapable of continuing to earn income. Where will their monthly cash flow come from to meet their lifestyle needs? Sources of income could include group insurance, savings, or income insurance.

The scenario becomes more complex for professionals and self-employed business owners, who have an additional consideration - how will they fund the monthly expenses of their office/business should the business' gross revenue be interrupted because of a disability?

In the long-term, many business expenses can be cancelled; however, in the short-term, expenses may be established pursuant to a contractual obligation that cannot be cancelled on short notice or without a financial cost. For example, staff payroll, rent, equipment leases, and utilities typically have a notice period or financial penalty. It can take time to assess the potential downtime associated with a disability, so immediate separation from employees or utilities may not be a wise business choice.

Business overhead insurance can be a valuable resource to help mitigate the financial risks from lost revenue when business owners or professionals are unable to work due to disability. Premiums paid for overhead disability insurance are tax deductible to the entity paying the premiums and receiving the coverage. If a claim is made under the policy, the benefit is taxable to the recipient. Since overhead disability insurance reimburses a business's monthly tax-deductible business expenses, it should be tax-neutral because the benefit is recognized as income while the actual expenses are deductible.

The issue of recognizing benefit payments as income was the subject of a Canada Revenue Agency (CRA) re-assessment and subsequent appeal by the taxpayer, a dental surgeon, to the Tax Court of Canada.

The facts of the case are as follows:

- Dr Beliveau purchased disability insurance to cover business overhead expenses in the event of an illness or disability.
- Dr Beliveau did not deduct any of the premiums paid for the insurance as a business expense incurred to earn income.
- During the taxation years of 2009 to 2011, when Dr Beliveau was disabled, she received benefits under the policies.
- The insurance benefits were not reported as income by Dr Beliveau and she continued to deduct the office overhead expenses against other business income.
- Dr Beliveau was reassessed by the CRA, whereby the office overhead benefits received were treated as income in the years received.
- Dr Beliveau explained to the court that the benefit was deposited to her personal bank account and was not used in the business.

The court affirmed the CRA's assessment, which required the taxpayer to include the insurance proceeds associated with the business overhead insurance in her income for the respective years. The court explained that the insurance benefit was reimbursing the taxpayer for a tax-deductible business expense. As such, since the tax-deductible expenses were reimbursed, the taxpayer did not have any net expenses that could be claimed for tax purposes.

In explaining the decision, the judge noted that just because the taxpayer did not deduct the premiums paid for the business overhead insurance, it did not change the nature of the reimbursement when the benefit was received, nor the tax consequences associated with it.

It is in every taxpayer's best interests to review their affairs to ensure that their situation is arranged to pay the least amount of income taxes.