

Corporate Ownership of Life Insurance

Jean Turcotte, Director, ITS Group

2024



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Life insurance has long been used as a financial and estate planning tool for business owners. Whether it's to help cover a tax liability at death, to ensure adequate funding for a shareholders' agreement, or to put a capitalization program in place for a shareholder's policy, a life insurance policy will often be purchased by a corporation or a group of corporations, or even a trust. In certain situations, there are specific rules around choosing the owner, premium payor and beneficiary of the policy that must be followed to avoid unexpected – and undesired – tax and legal repercussions. With that in mind, the purpose of this document is to outline how life insurance can be used as a financial and estate planning tool for business owners.

Why corporate-owned life insurance?

There are a number of business reasons that might justify corporate ownership of a life insurance policy. Generally, corporate ownership of insurance will, if the applicable rules are followed, produce definite advantages from a financial, tax and legal perspective. These advantages, which we'll look at in more detail later in this document, include the ability to utilize the capital dividend account (CDA), protection for the policy against creditors, streamlined policy management, a more equitable sharing of premium payments, and reduction of the tax cost of the premium.

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2024



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While these are valuable benefits, certain tax rules must be satisfied in order to get the most out of them. In some situations, and specifically where a group of companies is involved, it's important to clearly establish who will be the policy owner, who will be the beneficiary for the death benefit, and who will pay the premium. This step is critical, because if life insurance is not placed in the correct manner, there may be unfavourable financial and tax implications.

Advantages of corporate ownership

One of the most important considerations around life insurance in a business context is determining how ownership of the policy will be structured. In simple terms, the question comes down to whether a shareholder should own his or her life insurance policy personally, or have a corporation own it. To answer this question, the following are some key points to consider with regard to corporate ownership options for life insurance.

Reduced tax cost of life insurance premiums

Whether a life insurance policy is owned personally or through a corporation, the premiums are generally not deductible¹ from the income of the premium payor.² The payor's tax rate will therefore determine the real after-tax cost of the premium. In that context, it may be advantageous for the policy to be owned and the premium paid by a corporation, which will often have a more favourable tax rate than its shareholder.

¹ Pursuant to subsection 248(1), c.f. "personal or living expenses," and paragraph 18(1)(h) of the Income Tax Act (ITA).

² There is only one exception to this rule, and that is where a taxpayer borrows for the purpose of producing income and must assign the insurance policy to a creditor as collateral for the loan. Deduction of the premium will be possible only if all the conditions of paragraph 20(1)(e.2) ITA are satisfied.

Corporate Ownership of Life Insurance

Jean Turcotte, Director, ITS Group
2024



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For example, an insurance premium of \$5,000 per year paid personally by a shareholder with a 50% marginal tax rate will require an outlay of \$10,000³ after tax. By contrast, the same premium paid by a corporation with a tax rate of around 12%⁴ will require an outlay of only \$5,681 after tax.

This means that for the same insurance premium, an annual savings of \$4,219 will be generated where the corporation owns the life insurance policy. As life insurance is usually in place for many years, these savings can add up to a substantial amount over time.

A more equitable distribution of premium payments

Where there is a significant age difference between two shareholders, or a shareholder is rated due to a health issue, personal ownership of a policy puts financial pressure on the individual who has to pay the higher premium. For example, it could come up in a buy-sell agreement where two business owners have agreed to buy each other's shares at death, and therefore need to own life insurance on each other's lives. Over the years, this situation could lead to a sense of unfairness for the shareholder paying the higher premium.

To resolve this, corporate ownership of the policy and payment of the premium makes it possible to share the premium payment to be assumed by each of the shareholders in proportion to their respective interests in the company.

³ The formula for calculating real after-tax cost is as follows: Premium in \$ / (1 - (% marginal tax rate))

⁴ Federal /provincial tax rate for a small business in the primary and manufacturing sector on the first \$500,000 of active business income.

Corporate Ownership of Life Insurance

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Control of premium payments

When life insurance policies are owned personally by shareholders, it may be difficult to determine whether each one is paying the required premium. This problem is magnified when a corporation has a large number of shareholders. The issue often comes to light when a shareholder dies, and it can pose a serious threat to funding for a buy-sell agreement in the event of death.

Corporate ownership eliminates this concern, as each shareholder has access to the corporation's minute books and financial statements, and can regularly validate the status of insurance policies in place.

Streamlined management

In a situation where there are multiple shareholders, there is a significant risk of confusion with regard to their various life insurance policies. For example, in a personal ownership scenario, the number of life insurance policies that would be required for four shareholders would be 12 individual contracts (4 shareholders x 3 contracts). In a corporate ownership scenario, only four life insurance policies would be required (one for each shareholder). In addition, policy fees would be lower with corporate ownership, and a better premium rate might be available given that the face amount of each individual policy would be higher.

Corporate Ownership of Life Insurance

Jean Turcotte, Director, ITS Group
2024



The Capital Dividend Account

The Capital Dividend Account (CDA)⁵ is part of the system of integration in the Income Tax Act (ITA).⁶

One of the key advantages of corporate ownership of life insurance is the ability for the shareholders to receive tax-free dividends through the CDA, as stated in paragraph (d) of the definition of "capital dividend account" in subsection 89(1) ITA. Under this provision the net proceeds of a life insurance policy will be added to the CDA of a private corporation.

The expression "net proceeds" is defined as the amount of the life insurance policy proceeds received as a consequence of the death of the person insured minus the adjusted cost basis (ACB) of the policy immediately before the death of the person insured.

Example:

A private corporation⁷ is the beneficiary of a life insurance policy with a death benefit of \$1,000,000.00. The ACB of the policy at the time of the insured shareholder's death is \$150,000. The amount that will be credited to the corporation's CDA is \$850,000 (\$1,000,000 - \$150,000). This amount can be paid tax-free to the shareholders of the corporation as a capital dividend. The balance of \$150,000 can be paid to the shareholders as a taxable dividend.

⁵ Subsection 89(1) of the Income Tax Act (ITA) defines various types of property and distributions including the contents of the Capital Dividend Account. In Quebec, paragraph *b* of section 570 of the Taxation Act (TA) refers to the ITA. CRA Interpretation Bulletin IT-66R6 reviews the inclusions in the CDA and the CDA mechanism.

⁶ Refer to the Capital Dividend Account tax guide published by Sun Life Financial for more information on this topic

⁷ CDA is not available for public corporations.

Corporate Ownership of Life Insurance

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2024



Multiple corporations and the CDA

The Canada Revenue Agency (CRA) has consistently taken a position against arrangements designed to unduly exploit the preferential treatment accorded to the CDA where a corporation receives life insurance proceeds.⁸ Certain life insurance ownership structures previously allowed corporations to receive the full death benefit as a credit to their CDA, without a corresponding reduction for the policy's ACB.

This was often accomplished by having a holding company own the policy, but then designating an operating company as the beneficiary of the life insurance proceeds. Because the operating company did not own the policy, it could claim the full death benefit as a CDA credit without a reduction for the ACB of the policy.

The 2016 federal budget ended this practice for deaths occurring on or after March 22, 2016. As a result, the death benefit is now reduced by the ACB for purposes of calculating the CDA credit, regardless of the structure in place for corporate ownership of the life insurance policy.

The 2016 federal budget also proposed the introduction of an information-reporting mechanism that will apply where a corporation or partnership is not a policyholder but is entitled to receive a benefit under the policy. Over the years, the CRA has often expressed opposition to two separate corporations being designated as policyholder and beneficiary solely to benefit from the CDA. The new reporting requirement will enable the CRA to detect this type of situation at the outset, without having to wait until the CDA is calculated at the time of the insured person's death.

⁸ In particular by applying the General Anti-Avoidance Rule (GAAR). See CRA Technical Interpretation 2004-0065461C6, CRA Income Tax - Technical News No. 44 dated April 14, 2011, and CRA Technical Interpretation 2010-0371901C6.

Corporate Ownership of Life Insurance

Jean Turcotte, Director, ITS Group
2024



Creditor protection for the policy

Subject to the exceptions provided for in the Bankruptcy and Insolvency Act and provincial Insurance Acts,⁹ a life insurance policy that has a cash surrender value constitutes an asset that can generally be seized by the policy owner's creditors. For example, a policy owned by a corporation will form part of the corporation's assets, such that the cash surrender value of the policy could be seized by the trustee in the event of bankruptcy. Furthermore, if the insurance was purchased to fund a shareholders' agreement, the death benefit payable to the corporation on the death of one of the shareholders could be subject to the claims of the corporation's creditors. Certain corporate ownership structures can be put in place to guard against this risk.

Where a corporation is the owner of a life insurance policy, the policy is protected from the shareholders' personal creditors or from legal proceedings against one of the shareholders.¹⁰ The insurance policy could also be owned by a holding company that is, in turn, a shareholder of an operating company. Under this policy ownership structure, it is possible for the policy to be protected against the creditors of the operating company, as long as the holding company is not the guarantor of any of the operating company's obligations.

It must be kept in mind that this protection is not total, and it does not apply in all situations. For example, transferring funds into a life insurance policy or choosing a particular corporate ownership structure for a policy does not confer absolute protection against creditors, nor does

⁹ Refer to the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3 (BIA). In Quebec, the relationship between the owner and the beneficiary determines whether or not the policy is protected; see articles 2455, 2456, 2457 and 2458 of the Civil Code of Quebec (CCQ).

¹⁰ Subject to the lifting of the corporate veil and any personal guarantees given by the shareholders to the creditor, if applicable.

Corporate Ownership of Life Insurance

Jean Turcotte, Director, ITS Group
2024



it automatically make the policy exempt from seizure if the trustee is able to prove that the purpose of the transaction was to defeat the claims of creditors.¹¹

When in doubt as to the legal risks relating to corporate ownership of life insurance, consult a legal advisor.

The concept of taxable benefit in the context of corporate-owned life insurance

The manner in which a life insurance policy is held can take a variety of forms, depending on the needs and circumstances of the particular situation. For example, there may be situations where it is preferable to have one corporation in a group as policyholder and another corporation as beneficiary of the policy. This would be the case, for example, in the context of financing a shareholder agreement with permanent policies in order to avoid the tax consequences of a possible transfer of ownership of the policy, or to avoid an unfair allocation of the premium. The CRA has ruled on a number of occasions regarding the tax consequences of different policy holding structures.

When setting up an ownership structure for life insurance within a group of corporations, where there are various possible combinations of policy owner, beneficiary and premium payor, the result could be taxable benefits or income inclusions for one or more of the corporations involved, depending on the particular structure.

¹¹ See the decision of the Supreme Court of Canada in *Royal Bank of Canada v. North American Life Assurance Company and Balvir Singh Ramgotra*, [1996] 1 SCR 325.

Corporate Ownership of Life Insurance

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2024



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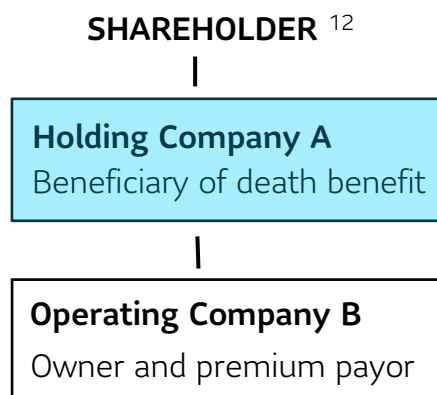
Structuring corporate ownership of life insurance – a few examples

To better understand the scope of the tax provisions discussed above, it might be helpful to take a look at various options for structuring corporate ownership of life insurance in order to analyze the potential tax implications. The examples on the pages that follow illustrate some different ownership structures and their related tax outcomes.

Ownership structure 1

Holding Company A: beneficiary

Operating Company B: owner and payor



This structure would trigger the application of subsection 15(1) ITA. Holding Company A would have to report a taxable benefit equal to the amount of the premium if it does not include that amount in its taxable income. In addition, owning a life insurance policy with substantial cash values could result in another tax disadvantage for Operating Company B, specifically, the potential loss of the capital gains deduction to the shareholder on the sale of qualified small business corporation (QSBC) shares.

¹² For all of the structures presented here, the shareholder owns 100% of the voting and participating shares of Holding Company A and the Holdco owns 100% of the voting and participating shares of Operating Company B.

Corporate Ownership of Life Insurance

Jean Turcotte, Director, ITS Group
2024

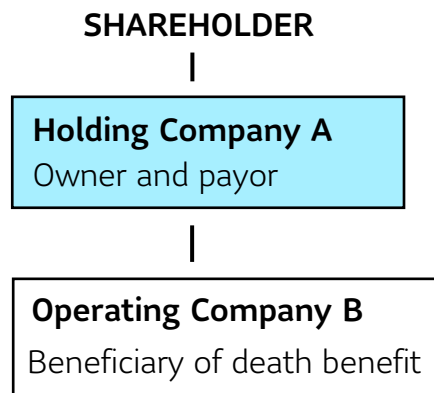


Further, if Operating Company B were sold and the insurance policy were transferred, that would trigger a disposition and possible taxable policy gain for the corporation. This ownership structure might also result in some risk to the policy's cash values in the event of a lawsuit against Operating Company B or that corporation's bankruptcy.

Ownership structure 2

Holding Company A: owner and payor

Operating Company B: beneficiary



Under this structure, Operating Company B is the beneficiary of the death benefit, while Holding Company A is the policy owner and payor. In this case, subsection 15(1) ITA would not apply.

Corporate Ownership of Life Insurance

Jean Turcotte, Director, ITS Group
2024



a) If Operating Company B reimburses the premiums to Holding Company A

If Operating Company B reimburses the premiums to Holding Company A, section 9 and paragraph 12(1)(x) ITA would have to be analyzed to determine whether Holding Company A would be required to include in its income an amount equal to the premium reimbursement by Operating Company B.

Section 9 ITA states that a taxpayer's income for a taxation year from a business or property is the taxpayer's profit from that business or property for that year. Consequently, if Holding Company A receives each year the exact amount of the premiums paid to the insurer, barring a gain arising on surrender of the policy, no income will be generated, and section 9 ITA would not apply to that structure.

The other provision that could be invoked by the CRA is paragraph 12(1)(x) ITA, which is broader and more general in scope than section 9 ITA. It states that amounts received (including in the form of a premium) from another person who earns income from a business or property must be included in computing the taxpayer's income.

In that context, if the holding company has to include in its income a premium that is not otherwise deductible, the result would be double taxation. The risk relating to this provision would apply more specifically where a portion of the premium is deductible.¹³

It may be possible to prevent the potential application of paragraph 12(1)(x) ITA by paying a dividend which would have to be declared annually by Operating Company B to Holding Company A.

¹³ See paragraph 20(1)(e.2) ITA.

Corporate Ownership of Life Insurance

Jean Turcotte, Director, ITS Group

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b) If Operating Company B does not reimburse the premiums to Holding Company A

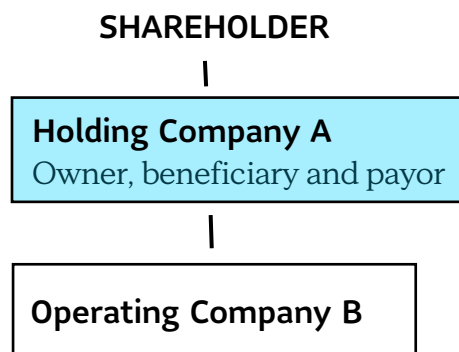
If Operating Company B does not reimburse the premiums to Holding Company A, subsection 246(1) ITA could potentially apply, given that payment of the premium confers a benefit on Operating Company B.

The value of the benefit would have to be included in Operating Company B's taxable income.

Ownership structure 3

Holding Company A: owner, payor and beneficiary

Operating Company B: Nil



This life insurance ownership structure does not result in a taxable benefit for corporations A and B, nor does it carry with it any particular risk in terms of creditor protection – Holding Company A does not deal with the public or with any of the business' trade creditors. With

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Jean Turcotte, Director, ITS Group
2024

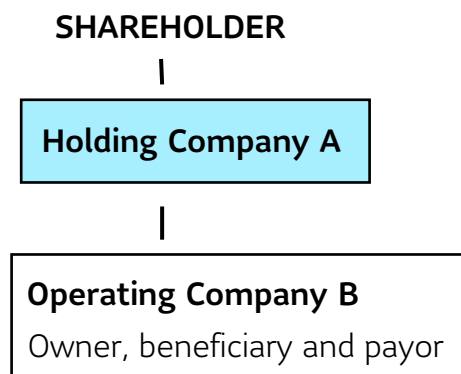


Holding Company A as the owner of the life insurance policy, a policy transfer can be avoided in the event Operating Company B is sold.

Ownership structure 4

Holding Company A: nil

Operating Company B: owner, payor and beneficiary



This life insurance ownership structure does not result in a taxable benefit for corporations A and B. However, if the policy has a savings component, it may become an asset that taints the QSBC status of the shares for purposes of the capital gains deduction on the sale of the shares.¹⁴

In addition, the transfer of the ownership of the life insurance policy from Operating Company B to Holding Company A could give rise to tax consequences like a possible taxable policy gain for Operating Company B. This ownership structure might also carry with it some risk in terms

¹⁴ According to the definition of "qualified small business corporation share" in subsection 110.6(1) ITA.

Corporate Ownership of Life Insurance

Jean Turcotte, Director, ITS Group
2024



of creditors, who could seize the policy's cash values in the event of a lawsuit against Operating Company B or the corporation's bankruptcy.

Corporate ownership of life insurance policy and possible tax issues

As stated, the CRA has published some views regarding life insurance policy arrangements.¹⁵ Each of these documents describes a situation where one private corporation, Opco, is the sole owner and premium payor of a life insurance policy, and another corporation, Holdco, the sole shareholder of Opco, is the beneficiary of the policy. The CRA stated that Opco was impoverished by paying the life insurance premiums under the policy, and Holdco was enriched by being the named beneficiary. As a result, subsection 15(1) ITA would apply, such that Holdco, in computing its income for the year, would have to include the amount of the benefit conferred on it by Opco.

In another document¹⁶ which considered the tax consequences arising from different insurance ownership and beneficiary arrangements involving a Holdco and a Opco. In the first situation described, Holdco is the sole owner and premium payor of the policy, and Opco is designated as the revocable beneficiary of the policy. The CRA stated that this arrangement did not result in a taxable shareholder benefit to Holdco under subsection 15(1) ITA of the Act. However, the CRA did state that subsection 246(1) ITA could apply to Opco.

In the second situation described in the document, Holdco is the sole owner and premium payor of a life insurance policy, and Opco is designated as the irrevocable beneficiary. Opco reimburses Holdco for the insurance premiums paid by Holdco that represent the charge or

¹⁵ See CRA technical interpretations 2009-0347291C6 and 2009-0329911C6

¹⁶ See CRA technical interpretation 2010-0359421C6

Corporate Ownership of Life Insurance

Jean Turcotte, Director, ITS Group
2024



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amount that should be paid by Opco. The CRA commented that subsection 15(1) ITA would not generally be applicable to Holdco in this situation if the reimbursement is included in Holdco's income. In a recent document¹⁷, the CRA stated on whether section 9, subsection 246(1) or paragraph 12(1)(x) ITA apply to the following Holdco/Opco arrangements:

Two brothers resident in Canada each own a holding corporation. Each holding corporation owns 50% of an operating corporation. In order to fund a share redemption agreement upon a brother's death, each holding company has purchased insurance on the life of its sole shareholder. Opco is the revocable beneficiary of both insurance policies. The Holdco pay the insurance premiums out of their accumulated after-tax profits, and opco does not reimburse the holding companies for anything.

Questions to the CRA

- a) Could the CRA comment on whether it is of the view that subsection 246(1) of the ITA would apply in this case given the non-arm's length relationship between the holding companies and opco?
- b) If the two business partners were dealing at arm's length, would the CRA still be of the view that subsection 246(1) of the ITA would apply?
- c) If Opco reimbursed the premiums to the holding companies based on the cost of the coverage that opco would receive, and Opco was designated as irrevocable beneficiary, would the payments received by the holding companies be taxable under section 9 or paragraph 12(1)(x) of the ITA or any other provision of the Income Tax Act?
- d) Would your answer to question (c) be different if the beneficiary designation were revocable?
- e) If the reimbursement of premiums were taxable to the holding companies, would they be entitled to deduct a portion of the life insurance premiums paid?

¹⁷ CRA 2022-0936281C6 — 2022 APFF - Q2 - police d'assurance-vie & avantage

Corporate Ownership of Life Insurance

Jean Turcotte, Director, ITS Group
2024



CRA response - preliminary remarks

Given the broad scope of section 9, paragraph 12(1)(x), and subsections 15(1) and 246(1) of the ITA, it would be necessary to conduct a review of all the facts and circumstances in respect of a particular given situation to determine whether any of these provisions may apply. Such a review would normally be done as part of the compliance process for the arrangement or the relevant transactions or, where an arrangement involves proposed transactions, as part of a request for advance rulings submitted in the manner set out in Information Circular IC70-6R12 (footnote 4). However, we are able to provide the following general comments.

The determination of whether section 9, subsections 15(1) or 246(1), or paragraph 12(1)(x) of the ITA may apply to a particular situation is made independently of the tax consequences resulting from the 2016 legislative amendments to paragraph (d) of the definition of CDA in subsection 89(1) of the ITA and must take into account the facts of each situation.

However, it has been our long-standing position that a benefit is generally conferred on a shareholder under subsection 15(1) of the ITA where a corporation pays the premiums for a life insurance policy under which the shareholder or a person related to the shareholder is the beneficiary. The amount of the benefit that would be required to be included in computing the shareholder's income in a particular taxation year is generally equal to the amount of insurance premiums paid by the corporation for that year. However, a review of all the facts relevant to a particular situation is necessary to determine the value of the benefit conferred.

Corporate Ownership of Life Insurance

Jean Turcotte, Director, ITS Group
2024



This position is consistent with the recent decision in *Harding v. The Queen*.¹⁸ In that case, the Tax Court of Canada found that a shareholder benefit had been conferred under subsection 15(1) of the ITA by a corporation that paid the premiums on insurance policies on the life of its sole shareholder and the shareholder's wife, the beneficiaries of which were the shareholder's wife and stepchildren. The positions set out in Technical Interpretations 2009-0347291C6, 2009-0329911C6 and 2010-0359421C6 continue to represent the CRA's position on this issue.

CRA response to question A

The application of subsection 246(1) of the ITA is based on an examination of the specific facts of a particular situation. However, in light of the above and in accordance with the position set out in Technical Interpretation 2010-0359421C6, it is our view that subsection 246(1) of the ITA may apply in the situation where a parent corporation holds and pays the premiums on a life insurance policy and its subsidiary is designated as beneficiary.

Thus, in the situation describe, we are of the view that the provisions of subsection 246(1) of the ITA may apply in respect of Opco, subject to a review of the specific facts of the particular situation.

¹⁸ 2022, TCC3 (Harding)

Corporate Ownership of Life Insurance

Jean Turcotte, Director, ITS Group
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CRA response to question B

Assuming that the two sole shareholders of the Holdcos are dealing with each other at arm's length, one of the issues to be determined is whether the transaction that would otherwise give rise to a benefit is a bona fide transaction and not a transaction entered into pursuant to, or as part of, any other transaction, or not to effect the payment, in whole or in part, of any existing or future obligation, since the exception provided for in subsection 246(2) of the ITA is only applicable where all of the conditions set out in that provision

are met. These are questions of fact that can only be resolved after a review of all the relevant facts and circumstances. In addition, it is important to note that, pursuant to paragraph 251(1)(c) of the ITA, it is a question of fact whether persons not related to each other are dealing at arm's length with each other at any particular time. Unrelated persons may not be dealing with each other at arm's length depending on the circumstances. If such a non-arm's length relationship were demonstrated, subsection 246(2) of the ITA would be inapplicable, since one of the conditions for its application would not be met.

CRA response to questions C and D

In the situation where Opco, as beneficiary (revocable or irrevocable) of the life insurance policies, reimburses the Holdcos, the policyholders, for the related premiums, it would be necessary to examine all the facts and relevant documentation to be able to determine whether the reimbursement should be included in the incomes of the Holdcos under section 9 or paragraph 12(1)(x) of the ITA.

Corporate Ownership of Life Insurance

Jean Turcotte, Director, ITS Group
2024



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CRA response to question E

Generally, premiums paid under a life insurance policy are not deductible in computing a taxpayer's business income because they are personal or living expenses which are not deductible under paragraph 18(1)(b) of the ITA. Paragraph 20(1)(e.2) of the ITA does, however, provide an exception under which such premiums may be deductible under certain specified conditions. Paragraph 20(1)(e.2) of the ITA requires, among other things, that the acquisition of the life insurance policy be required by a financial institution as a collateral for a borrowing. These conditions do not appear to be applicable in the situation described. Thus, we are of the view that the premiums paid by the Holdcos would not be deductible, even if the reimbursement of the premiums received from Opco were included in their income.

The CRA views expressed previously remain unchanged. It should be noted that, in the recent decision,¹⁹ the Tax Court of Canada found that a benefit under subsection 15(1) ITA of the Act was conferred when a corporation paid the premiums on corporate-owned life insurance policies insuring the lives of the corporation's sole shareholder and his spouse, and all of which named the spouse or the shareholder's stepchildren as beneficiaries.

The CRA stated that with Holdco/Opco situations described above any determination of whether section 9, paragraph 12(1)(x) ITA, subsections 56(2) ITA or 246(1) ITA apply to a particular Holdco/Opco arrangement involving life insurance policies can only be ascertained, on a case-by-case basis, after a comprehensive review and analysis of the relevant facts and agreements amongst the parties (including any valuation considerations, as applicable).

¹⁹ *Harding v. The Queen* (2022 TCC 3)

Corporate Ownership of Life Insurance

Jean Turcotte, Director, ITS Group
2024



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The Gestion M.A. Roy Case

In Gestion M.-A. Roy case²⁰, the Tax Court of Canada had occasion to determine whether subsections 15(1) and/or 246(1) of the ITA applied where a corporation held a life insurance policy, but designated another (related) corporation as beneficiary.

Generally, when a Holdco is a shareholder of an operating company, it is generally easy to change the beneficiary designation when the structure changes. In such a structure, it is often the case that the Opco pays a tax-free inter-company dividend to the management company to fund the bonus. However, this approach may not be practical if the Opco has several shareholders, as it may require it to pay dividends to all of them.

In Gestion M.-A. Roy, the Opco company could have paid a non-taxable inter-corporate dividend to the Holdco company, but for various reasons, it did not. As a result, the parties were taxed based on what the Opco did, not on what it could have done.

In this decision, the Tax Court of Canada analyzed the scope of subsection 246(1) of the ITA, which, in addition to dealing with direct benefits, also deals with indirect benefits.

The key points in this decision are as follows. First, if the upstream corporation (or person) is a shareholder, subsection 15(1) of the ITA will apply. However, if the upstream corporation (or person) is a related party, but not a shareholder, subsection 246(1) of the ITA may apply. If the Opco has paid the cost of the contracts held by the Holdco, there will be a benefit to the shareholder. Moreover, if the Holdco pays the premium and the Opco reimburses it, other tax consequences could also arise. Thus, even if there is no benefit to the shareholder, the repayment could be considered as property income or a taxable repayment. If the Opco pays

²⁰ Gestion M.-A. Roy inc. c. The King, 2022 CCI 144 TCC)

Corporate Ownership of Life Insurance

Jean Turcotte, Director, ITS Group
2024



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a dividend to the Holdco, the question arises as to whether the beneficiary designation in favor of the Opco (downstream) could create a taxable benefit.

In the downstream scenario, it cannot be categorically stated that the payment would have been taxable had it been made directly to the subsidiary, as a parent company can inject capital and make loans to its subsidiary without suffering any tax consequences. Consequently, the essential condition of subsection 246(1) of the ITA would not be met, namely that the payment would have been taxable had it been made directly to the subsidiary.

CRA clarifies that subsection 246(1) of the ITA may apply where a parent owns and pays for a life insurance policy and designates a subsidiary as beneficiary. According to CRA, this arrangement could result in a taxable benefit to the subsidiary, which contrasts with the tax issue raised in *Gestion M.-A. Roy*. In that case, the benefit was conferred by an operating company to a management company, while the CRA argues that the paragraph could apply in the opposite direction, from a management company to a subsidiary. Indeed, the *Gestion M.-A. Roy* case may present additional arguments against the application of subsection 246(1) of the ITA in the usual scenario where it is the management company and not the operating company that pays the premium. In *Gestion M.-A. Roy*, the Tax Court of Canada rejected implicit arguments that the beneficiary designation itself conferred quasi-property rights on the beneficiary corporation.

Finally, subsection 246(1) of the ITA cannot apply to the death benefit, since the payment is not taxable.

In January 2024, the Federal Court of Appeal (FCA)²¹ dismissed the appeals of the two Holdcos regarding corporate-owned life insurance and shareholder benefits. In 2022, the Tax Court of Canada ruled that there are shareholder benefits for Holdco 1 under subsection 15(1) of the ITA and for Holdco 2 under subsection 246(1) when an Opco pays the premiums on life

²¹ *Gestion M.-A. Roy inc. v. The Queen* (2024 FCA 16)

Corporate Ownership of Life Insurance

Jean Turcotte, Director, ITS Group
2024



insurance policies held by the Holdco. On January 18, 2024, the FCA agreed with the Tax Court of Canada.

The main conclusion to be drawn from *Gestion M.-A. Roy* is that, where a Holdco is the policyholder and the Opco is the beneficiary and payer of an insurance contract, CRA may apply subsections 15(1) and/or 246(1) to conclude that there is a tax on the Holdco. CRA may include the benefit in the Holdco's income and tax it as ordinary income. Consequently, it would be preferable for the Opco not to pay the premiums on a contract held by the Holdco.

CRA has also stated that it may apply section 9 and paragraph 12(1)(x) of the ITA if the Opco reimburses the Holdco to pay the premium on a contract held by the Holdco. CRA will not question structures where a corporation is the owner, payer and beneficiary of a contract.

Corporate Ownership of Life Insurance

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Summary table of ownership structures and potential tax impacts

OWNER	PAYOR	BENEFICIARY	REIMBURSEMENT OF PREMIUMS TO PAYOR	APPLICABLE SECTIONS (ITA)	CRA TAX POLICY
Opco	Opco	Holdco	No	15(1)	Benefit for Holdco
Holdco	Holdco	Opco	Yes	9 or 12(1)(x)	Possible income inclusion for Holdco
Holdco	Holdco	Opco	No	246(1)	Benefit for Opco
Holdco	Holdco	Holdco	N/A	None	None
Opco	Opco	Opco	N/A	None	None

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Grandfathering and stop-loss rules

The CRA confirmed at a CALU roundtable²² that if a change in ownership or a change in beneficiary designation on an insurance policy is made so as to prevent a shareholder benefit, it will not result in the loss of grandfathered status where those changes were made after April 26, 1995.²³ As a result, if insurance ownership criteria²⁴ are met, once shares are grandfathered, they remain grandfathered. In addition, if shares are grandfathered according to criteria in a shareholders' agreement, a change to the agreement could cause grandfathering to be lost.

Corporate-Owned Life Insurance and Share Valuation Issues

A corporation may own a policy which has an impact on the value of the corporate shares. There are a number of circumstances when a fair market valuation (FMV) involving corporate-owned life insurance is required.

Deemed Disposition at Death under Subsection 70(5) and corporate-owned life insurance

Subsection 70(5) of the Act provides that a deceased Canadian resident taxpayer is deemed to have disposed of each capital property for proceeds equal to the FMV of the property immediately before death except for limited exceptions (e.g., spousal rollover).

²² CRA Roundtable in CALU Reports, July 2010.

²³ See subsections 112(3) to 112(3.32) ITA.

²⁴ See CRA Technical Interpretation 2010-0359431C6, May 4, 2010.

Corporate Ownership of Life Insurance

Jean Turcotte, Director, ITS Group
2024



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The FMV of a deceased's shares of a private corporation must be determined for purposes of the subsection 70(5) deemed disposition rules on the death of a taxpayer. If a shareholders' agreement exists, the terms of the agreement should be determinative of the FMV of the shares held by the deceased shareholder for purposes of 70(5) if certain conditions are satisfied.

Paragraph 28 of IC 89-3 published by the CRA must be considered determinative of value pursuant to subsection 70(5), it must meet all the following requirements:

- (a) The agreement must obligate the estate to sell the shares at death either under a mandatory sales and purchase agreement or at the option of a designated purchaser.
- (b) The agreement must restrict the shareholder's right to dispose of his/her shares at any price during his/her lifetime.
- (c) The agreement must fix a price for the shares or set out a method for determining the price on a current basis.
- (d) The agreement must represent a bona fide business arrangement and not a device to pass the decedent's shares to his/her heirs for less than an adequate and full consideration.

Between *non-arm's length parties*, paragraph 29 of the IC-89-3 requires the following three additional conditions to be satisfied :

- (a) It is a bona fide business arrangement.
- (b) The stipulated price or formula price in the agreement provides full and adequate consideration, and represents the fair market value of shares determined without reference to the agreement at the time it is executed.

Corporate Ownership of Life Insurance

Jean Turcotte, Director, ITS Group
2024



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(c) It is a legal and binding contract.

In the context of a deemed disposition under subsections 70(5) and 70(5.3) ITA, to determine the fair market value of shares held by a deceased shareholder where a life insurance policy is owned by the corporation on the shareholder's life (or on the life of a particular individual who was not dealing at arm's length with the shareholder when the policy was issued), the cash surrender value of the policy is considered to be its fair market value.

Valuation of a life insurance policy owned by a corporation on the life of a deceased shareholder or a non-arm's length person will therefore be based on the policy's cash surrender value. Lastly, a life insurance policy owned by a corporation on the life of a person dealing at arm's length with the deceased shareholder must be valued according to normal valuation methods as stated in Information Circular 89-3.

Trust ownership of life insurance

In cases involving a group of companies, it's not uncommon to find a trust as part of the shareholders' corporate structure. Trusts, which are considered a separate patrimony, are often used as a tax planning tool. Also, trusts can be useful if the goal is to provide protection for the policy, reduce probate fees at death, or to ensure effective tracking and management of funds generated by a corporation.

A trust can purchase and be the owner of a life insurance policy where permitted by the trust deed. Upon the death of the insured person, the death benefit will be paid to the trust as beneficiary of the policy, and distributed in accordance with the trust deed.

One of the tax advantages of owning a life insurance policy through a trust is the fact that a life insurance policy is not eligible capital property under the ITA, and consequently, policies held by a trust are not affected by the deemed disposition of the trust property every 21 years.

Corporate Ownership of Life Insurance

Jean Turcotte, Director, ITS Group
2024



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In addition, like any other trust property, a life insurance policy can be transferred to the beneficiaries of the trust capital with no tax impact, if the conditions of subsection 107(2) ITA are satisfied.²⁵ By contrast, a tax-free rollover of a life insurance policy owned by a corporation to a trust is not possible, as a life insurance policy is not eligible capital property within the meaning of section 73 ITA. Such a transfer would constitute a disposition under subsection 148(7) ITA and could trigger tax consequences.

Lastly, if a trust is the direct beneficiary of a death benefit, it cannot utilize the capital dividend account (CDA) mechanism, which is available solely to private corporations that are life insurance beneficiaries. Similarly, the CRA has clarified that life insurance proceeds received by a trust and then paid to a private corporation designated as a trust beneficiary cannot be included in the corporation's CDA.²⁶

Documenting life insurance policy ownership

The choice of a corporate ownership structure for a life insurance policy should be carefully documented and recorded in the form of a resolution in the corporation's minute books. The documentation should clearly state the business reasons²⁷ that support the particular ownership structure selected. That way, in the event of a tax audit, there will be little risk of a diverging interpretation that could lead to undesirable tax repercussions.

²⁵ See CRA Technical Interpretation 2011-0391781E5. According to the CRA, this subsection takes precedence over subsection 148(7) ITA.

²⁶ See CRA Technical Interpretation 2011-0399771C6.

²⁷ Examples of business reasons: funding a shareholders' agreement, asset purification to ensure shares qualify for the CGD, desire to keep the policy following sale of the corporation, creditor protection, etc.

Corporate Ownership of Life Insurance

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2024



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Conclusion

Benefits and drawbacks of a corporate owned Life Insurance policy

The main benefits and drawbacks for corporate owned life insurance include:

Benefits	Drawbacks
Ability to direct funds to meet stated goals (e.g. key person coverage, liquidity for shareholder buy-out, estate planning)	Cash surrender value (CSV) is a passive asset for the corporation and may affect tax planning opportunities
Premiums often paid with cheaper after-tax corporate dollars	Transferring the policy at a later time is a taxable disposition and may result in taxes owing
Growth within the policy generally occurs tax deferred (up to exempt limits)	Provincial creditor protection for protected class beneficiaries is not available, so the policy and death benefit are subject to claims of creditors
Entire death benefit received tax-free. Net proceeds can flow out to shareholders tax free using the capital dividend account	Taxable benefits can arise without proper planning

Corporate Ownership of Life Insurance

Jean Turcotte, Director, ITS Group
2024



As there is no one-size-fits-all solution, it's important that you evaluate clients' needs and situation in order to identify the most appropriate corporate ownership structure. It's important also to encourage clients to consult their legal and tax advisors before settling on a specific ownership structure, especially in situations of greater complexity.

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