A GUIDE FOR BUSINESS OWNERS

Post-Mortem Tax Strategies

Sun Life

Life's brighter under the sun

Post-mortem tax strategies for business owners

Why Sun Life created this guide

Post-mortem tax strategies are essential in helping a business owner reduce tax at death. If no strategies are implemented, a shareholder's estate and/or beneficiaries will face double and even possibly triple taxation. This would mean very little would remain for the shareholder's beneficiaries. Of course, it would be disappointing to see a lifetime of hard work going to taxes when this can be avoided with some tax planning.

We prepared this guide to outline the common post-mortem planning strategies that can be employed for shareholders who die owning private company shares, to reduce a shareholder's taxation at death. We also explain how life insurance is a vital part of a post-mortem plan and how it can augment and provide liquidity to a post-mortem plan.

This guide reflects the tax rules up to May 2021. Tax rates and other information may change as a result of new legislation. Please discuss your needs in confidence with your advisor.[1]

[1] The information presented in this document is for general information only. Sun Life does not provide legal, accounting, taxation or other professional advice to advisors or their Clients. Before you act on any of the information contained in this guide, please obtain advice from qualified professionals. Tax and accounting professionals, along with your advisor, can thoroughly examine your situation and provide you with the best insurance and tax planning option suited to your needs.

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Deemed disposition at death

Immediately before a shareholder's[2] death, there is a deemed disposition of his/her shares at fair market value ("FMV").[3] As a result of the disposition, the deceased shareholder's estate is deemed to receive the shares at a cost equal to the FMV immediately before death.[4] In most cases, the deemed disposition will trigger a capital gain, one-half of which will be included in the shareholder's terminal tax return. If the estate disposes of the shares to the corporation that had issued them, the redemptive distribution of funds from that corporation will be treated as a taxable dividend to the estate. This dividend taxation constitutes a second layer of tax on top of the shareholder's capital gains tax. A third layer of tax can arise if the corporation owns investments that are taxable when disposed of and then must liquidate those investments when the corporation is ultimately wound up. Therefore, double or even triple taxation can arise if private company shares are left to a beneficiary on a non-rollover basis.

Post-mortem planning can help produce a more tax-efficient result by reducing or eliminating this double-taxation. As explained below, corporate-owned life insurance (COLI) can further help to provide the funds to deal with tax liabilities.

The tax impact on death: double taxation on private company shares

As mentioned, the deemed disposition of the shares will result in a capital gain. This capital gain must be reported on the deceased shareholder's terminal return. The beneficiary will have an increased cost base in respect of the shares, but there is no corresponding adjustment at the corporate level. This can potentially result in double and triple tax to the deceased shareholder's estate because the increase in cost base from the deemed disposition at death does not provide shelter from the tax resulting from: (a) tax that results from the corporation redeeming the estate's shares; and (b) later liquidation and distribution of assets from the corporation.

To illustrate, we will consider the case of John, a widower and the sole shareholder of J. Holding Inc. (JHI). Paul passed away in January 2020. His son, Martin is the sole heir and liquidator of the estate. The FMV of the JHI's shares at John's death was $2 million, consisting primarily of securities and term investments. JHI's shares have an adjusted cost base (ACB) and paid-up capital (PUC) of $0.

[2] As a Canadian resident taxpayer.

[3] Paragraph 70(5)(a) of the Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.) (hereinafter referred to as the ITA). Unless otherwise noted, all statutory references will be the ITA.

[4] Paragraph 70(5)(b).

The following tax rates are assumed:

the personal tax rate on taxable capital gains is 26.76% (half of the 53.53% rate on income[5]) and, 47.74% on ordinary (non-eligible) dividends5 after the dividend tax credit.

The deemed disposition of the shares of JHI will result in a capital gain of $2 million. The resulting tax payable on this gain is $535,300 ($2 million x 50% x 53.53%).

Following the liquidation of the estate, Martin will inherit JHI's shares. The ACB of these shares will be equal to the deemed proceeds of disposition of $2 million. If no strategy is in place, and if Martin decides to withdraw all of the money invested in the company by declaring a liquidation dividend of $2 million, this amount will be added to his other income, resulting in a second tax layer of $954,800 (ordinary dividend x tax rate = $2 million X 47.74%).

The total tax burden to John and Martin will be approximately $1,490,100 ($535,300 + $954,800). In other words, the total effective tax rate is **74.51%**. And, this does not include the potential third layer of tax that would apply when JHI disposes of its investments and is eventually wound up.

The chart below summarizes the double tax at death:

Double taxation on death: result of no planning

Provincial worst case scenario

BC	27% + 49% = 76%
AB/SK/YK	(24% + 42% = 66%
MB/PEI	25% + 47% = 72%
ON/NB/NS	27% + 48% = 75%
QC	27% + 46% = 73%
NL	26% + 44% = 70%
NWT	24% + 37% = 61%
NU	22% + 38% = 60%

Post-mortem planning helps to eliminate or reduce the multiple layers of taxation at death. The particular strategies used to eliminate or reduce double taxation will depend on the Client's individual circumstances. The most common strategies (used alone or in combination) are:

1. Loss carry-back strategy

This strategy reduces or eliminates the capital gains tax in the deceased's terminal return from the deemed disposition of corporate shares when the estate receives a deemed dividend on redemption of the shares issued to it by the corporation.

2. Pipeline strategy

This strategy results in a capital gain being reported in the terminal return of the deceased instead a deemed dividend for the estate.

3. Bump strategy

This strategy increases the ACB of certain types of corporate assets up to their FMV to reduce the tax due when corporation disposes of those assets.

4. A combination of the above strategies

[5] This is the Ontario top marginal tax rate as 2023. That rates will differ depending on province of residence.

The Loss Carryback Strategy[6]

The ITA[7] lets the executor (liquidator in Quebec) transfer any net capital losses the estate realizes in its first tax year to the deceased's final return. Thus, all or part of the estate's capital loss from redeeming the deceased's private company shares can be carried back to the deceased's terminal return. The subsection 164(6) Loss Carryback election will offset all or part of the capital gain the deceased realized from the deemed disposition at death, thus eliminating or reducing double taxation. If the final return does not have sufficient capital gains to offset the capital loss, excess losses can be deducted against other income (with some restrictions).

To implement the Loss Carryback Strategy, the executor must meet the requirements of the ITA and file an amended final return for the deceased. This means that the loss must be carried back within the first taxation year of the estate (which is normally within 12 months from the date of the decedent's death). Generally, once the first taxation year of the estate has passed, the Loss Carryback Strategy cannot be used.[8]

Therefore, it is important for the deceased's executor and advisors to review the deceased's assets in a timely manner after death. This process will determine whether any capital losses can be realized from a disposition of assets in the first taxation year of the estate so that the losses can be carried back to the deceased's terminal return to offset capital gains that result from the deemed disposition at death.

The result of implementing the Loss Carryback Strategy is that the double taxation is reduced or eliminated, leaving most or all of the shares' value to be taxed to the estate as a deemed dividend. Generally, since tax will be paid at the higher dividend rates, instead of the lower capital gains rates, the subsection 164(6) election should be considered where the corporation has significant refundable dividend tax on hand (RDTOH) or capital dividend account (CDA) balances available. This will help reduce the dividend taxation that would otherwise apply. In ideal cases, the effective tax rate could fall below the capital gains tax rate.

Using the figures from the example above, John's estate will be taxed on a dividend of $2 million, for a potential tax liability of $954,800 ($2 million x 47.74%). However, the deceased's tax on the capital gain arising from the deemed share disposition would be nil (the capital gains

[6] See the case in Appendix 2.

[7] Subsection 164(6) ITA.

[8] It may be possible for the estate to file the election after the deadline pursuant to subsection 220(3.2) and regulation 600. However, this is within the Minister of National Revenue's discretion.

tax of $535,300 is eliminated). In a nutshell, the estate saves the capital gains tax and the only remaining tax it has to pay is the dividend tax. However, as noted above, there may be a third layer of taxation when JHI ultimately disposes of its assets and winds up.

It is important to note, however that the Loss Carryback Strategy may not be the best alternative.

As noted, the estate must pay tax on dividends (which are taxed significantly higher at 47.74% than capital gains at 26.76%). Also, the Loss Carryback Strategy would not eliminate any tax payable by the holding company on the disposition of its securities in favour of the estate (even though the disposition would have created CDA and RDTOH balances in the company).

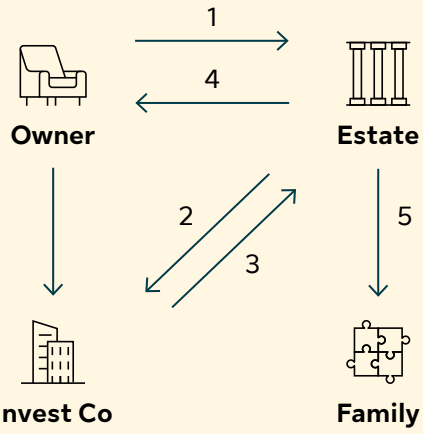
The stop-loss rules

The stop-loss rules[9] need to be considered before disposing of estate assets. The stop-loss rules reduce the capital loss resulting from the deemed dividend. In other words, the stop-loss rules "stop the loss" that would otherwise be used to reduce the capital gain resulting from the deemed disposition on death. The stop-loss rules[10] state that if a taxpayer disposes of a corporation's shares, and the taxpayer is affiliated[11] with the corporation after the disposition, any resulting capital loss is denied and added to the ACB of the taxpayer's shares.

The summary of the Loss Carryback Strategy

Only one tax

Loss carryback simplified



At Death

1. Trigger of capital gains taxes on deemed disposition of shares.

After Death

2. Shares transfer to estate.
3. Share redemption from the estate. Treated as a deemed dividend. Proceeds of disposition are reduced by the deemed dividend, and this creates capital loss.

Loss carryback and distribution

4. If certain conditions are met, the estate can carry back all or some loss in the owner terminal return. This helps to offest the capital gain on his terminal return.
5. The estate distributes the after-tax money to the family and heirs.

Result: One level of tax at dividend level rates

[9] Subsections 40(3.6) and 112(3) ITA may apply in certain circumstances.

[10] Subsection 40(3.6).

[11] Affiliated persons are defined in section 251.1 ITA.

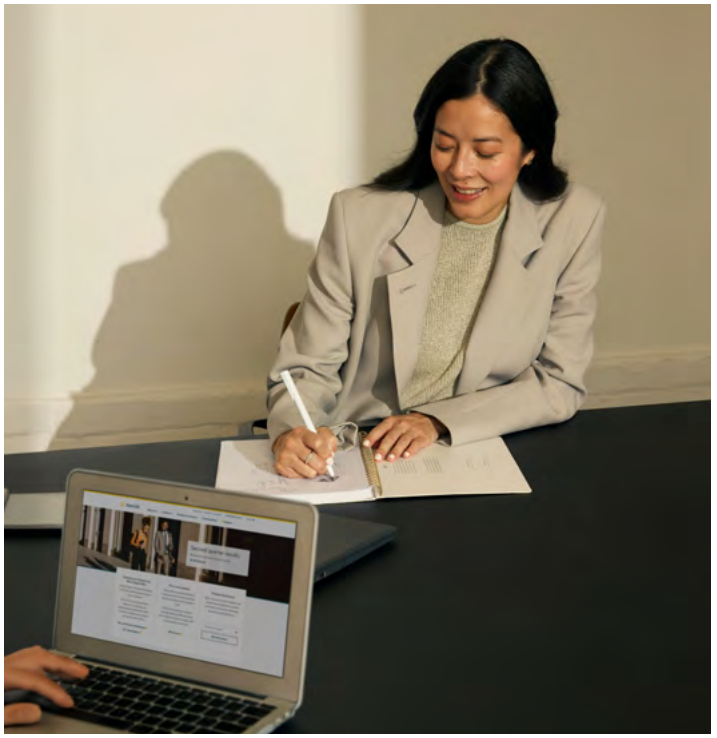
The stop-loss rules contained in the Act are designed to prevent a taxpayer from triggering a loss for tax purposes through a temporary disposition of property or a disposition of property to an "affiliated person". The policy underlying these rules is that a loss from the disposition of property should not be recognized for tax purposes unless the property is effectively out of the control or economic family of the taxpayer.

Essentially, the stop-loss rules allow the estate to carry back losses created by the redemption only to the extent of the non-taxable portion of the capital gain on the disposition of the shares. The end result is an increase of the tax on redemptions from zero to roughly half or more of what the tax would be without a share redemption.

It also means that use of a capital dividend election in excess of this amount could be seen as "wasted" to the extent of the excess. There is an exception to the loss denial where the capital loss is carried back from an estate to a deceased's terminal year under the Loss Carry back Strategy.[12] Consequently, the stop-loss rules will not apply to losses that are carried back from an estate to a deceased's terminal tax return.[13] The exception only applies to a loss carried back from an estate. It does not apply if the loss is carried back from a spousal, alter ego, joint spousal or common law partner trust. Therefore, the Loss Carryback Strategy may be limited where the deceased has used these trusts.

Redeeming shares with life insurance

Other stop-loss rules[14] can apply to reduce the loss from the disposition of shares held as capital property by the amount of tax-free dividends received from the corporation. The denied loss is limited to the extent that previous taxable dividends were paid on the share, and do not permit the denied loss to be added to the ACB of the remaining shares. Consequently, when high ACB shares owned by an estate are redeemed using the CDA, only a maximum of 50% of the amount of the loss will be available to carry back,[15] and the denied loss cannot be added to the ACB of the remaining shares.



It is the loss that is created by the redemption in the estate that these rules grind down or "stop." The amount of the loss that is "stopped" is calculated[16] as:

The lesser of:

1. The capital dividend received by the estate, and
2. The capital loss minus any taxable dividends received by the estate.

Minus 50% of the lesser of:

1. The estate's capital loss, and
2. The deceased's capital gain from the deemed disposition on death.[17]

[12] Subsection 164(6).

[13] Subsection 40(3.6).

[14] Subsections 112(3) to (3.32).

[15] Subparagraph 112(3.3)(a)(iii).

[16] Subsection 112(3) ITA

[17] ITA s. 112(3.2) for loss on a share held by a trust, including a testamentary trust that administers the estate of a deceased shareholder.

Grandfathered shares

Dispositions of shares are grandfathered from the application of the stop loss in two situations:

- where either the disposition occurs pursuant to an agreement in writing made before April 27, 1995, or
- a life insurance policy existed on April 26, 1995 for the purposes of funding the share redemption.

Estates that have COLI but whose shares do not qualify as grandfathered shares will incur capital gains tax on 50% of the capital gain due to the application of the stop-loss rules, if the estate receives the entire capital dividend account (funded by the life insurance) as a deemed divided upon redemption of the estate's shares.

The 50% Solution

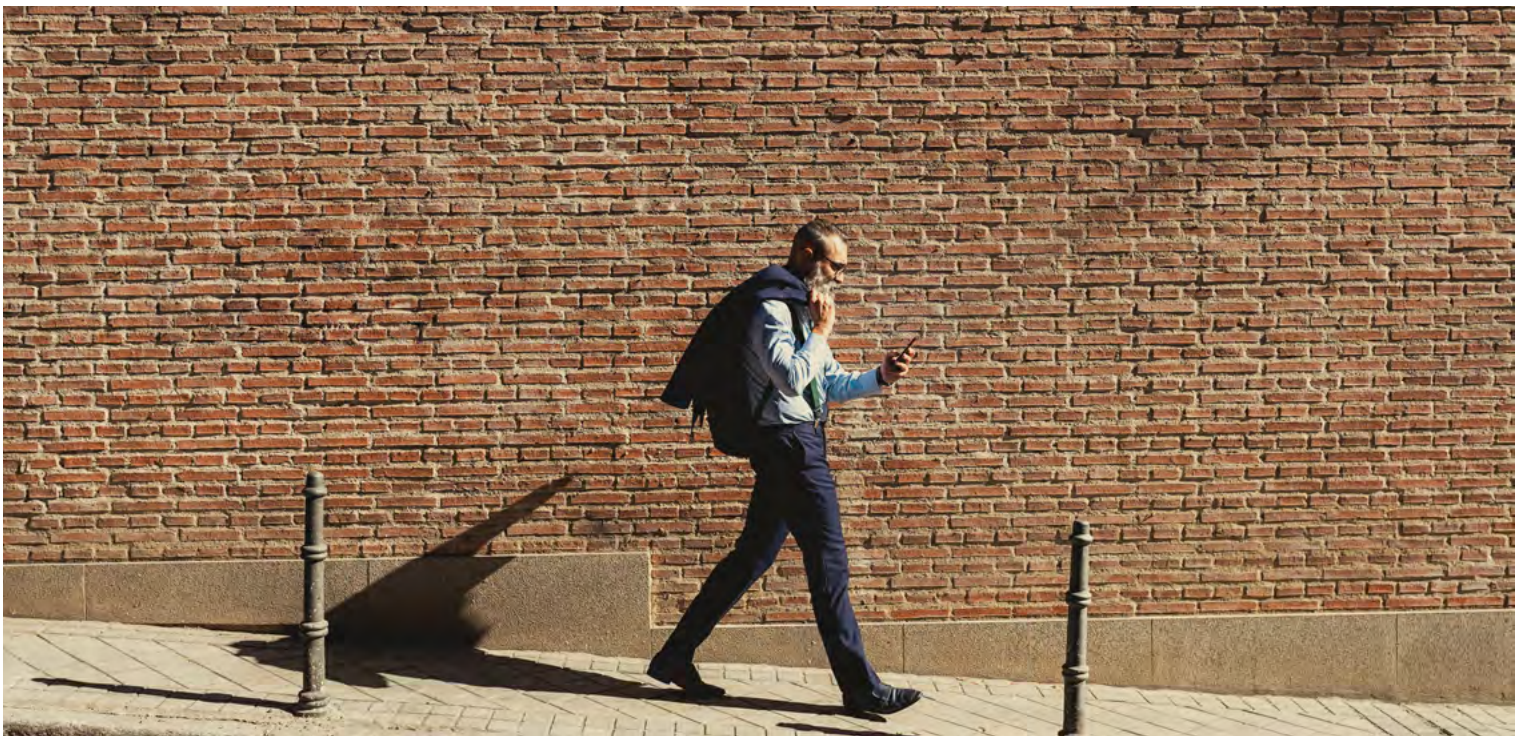
To avoid the denial of the loss, the estate can implement the "50 Percent Solution". With this solution, only 50% of the deemed dividend is paid from the capital dividend account to redeem shares with a high cost base that are held by the estate. The estate takes 50% of the capital dividend account, and incurs regular dividend tax on the other 50% of the proceeds. There will be no reduction of the capital loss realized on the redemption by the estate, so the entire capital loss will be available to offset the capital gain realized in the deceased shareholder's terminal return. The 50 Percent Solution also potentially preserves 50% of the capital dividend account for use by the remaining shareholders; however, there is an additional cost to the estate because capital gains rates are generally lower than regular dividend rates levied on the deemed dividends that are not paid from the capital dividend account. Finally, the stop-loss rules only apply to an estate that is a graduated rate estate (GRE) for 2016 and later taxation years.

A tax-free redemption of shares can happen if the deceased's shares pass via rollover to a spouse or a qualified spouse trust and the shares are redeemed using the capital dividend account. The rollover will not be available if a buy-sell agreement prevents the shares from vesting indefeasibly in a spouse or a spouse trust, unless the buy-sell agreement merely creates a put-call arrangement where the estate or the company may force a sale or repurchase of shares.[18]

The importance of a graduated rate estate

For 2016 and later taxation years, only a graduated rate estate can take advantage of the loss carryback election. An individual can only have one GRE. Therefore, where an individual has multiple wills, only one estate may be designated as a GRE. Business owners may, for example, have one will for their shares (where probate fees will not apply) and another will for other assets (where probate applies). They will need to consider the potential tax impact of the GRE designation so that post-mortem tax planning is not impacted. Business owners may need to forgo probate planning using multiple wills in order to optimize their post-mortem planning. Note that the wills must be drafted to ensure there is clear authority and agreement among executors of different wills to preserve the GRE status and make elections.

[18] See the Buy-Sell Agreements: funding and basic structures guide vol.1 by Sun Life for details.



The Pipeline Strategy[19]

The Pipeline Strategy is another post-mortem strategy that can reduce the double taxation on a deceased shareholder's shares. The CRA has issued a number of rulings and bulletins that are favorable to the strategy.[20] The Pipeline Strategy essentially reduces the tax on the removal of corporate surplus[21] to the capital gains rate applicable on the shareholder's death.

To implement the strategy, the estate incorporates a holding company, then transfers the deceased's private company shares to the holding company in return for a promissory note. The estate then merges the two companies (by amalgamation, winding up, or redeeming the private company shares owned by the holding company and paying its assets to the holding company as proceeds for the redemption). The merged company now has the assets it needs to pay its debt to the estate in satisfaction of the promissory note. The estate will not pay any tax on the repayment of the promissory note and can distribute the acquired assets to the beneficiaries as tax-free capital distributions. This strategy eliminates the dividend tax treatment that would otherwise apply to the distribution of corporate assets. The only tax remaining is the capital gains tax levied on the deceased shareholder due to the deemed disposition at death. The result is that corporate surplus is extracted at lower capital gains tax rates instead of the higher dividend tax rates.

Below is a summary of the steps involved in implementing the pipeline strategy. Again, we'll use the figures from our earlier example.

Step 1:

At John's death, there are deemed disposition of his JHI shares.

Step 2:

Martin in his role of executor incorporates a new company ("Newco"), of which he will be the sole shareholder. Newco then acquires the shares of PHI from the estate, subject to certain conditions, in consideration for one common share and a promissory note payable to Martin in an amount of $2 million (the FMV of the JHI shares at the time of John's death).

[19] See the case in Appendix 2.

[20] See Appendix 1.

[21] To the extent permitted by section 84.1.

Step 3:

JHI, which owns highly liquid securities only, continues to operate. As per the CRA's requirements,[22] JHI adopts a structured investment policy with diversified investments, so that its status is not simply that of a "cash corporation". In addition, the CRA requires the new investment policy to remain in place for a minimum of one year[23]. After maintaining the investment policy in place for at least one year, Martin (the estate executor) is able to initiate the process of amalgamating Newco with JHI to form a single corporation.

Step 4:

Following the amalgamation, the ACB of the JHI investments held at the time of John's death will be increased to their FMV (as at the date of death), thus reducing the tax arising on the sale of the investments held by JHI (more on this in the "Bump Strategy" section, below). The new corporation created by the merger uses the sale of the investments to repay the $2 million note issued to the estate. The note must be paid back gradually to the estate over a period of time (and not all at once). In one specific case, the CRA gave it's blessing for a repayment made in four quarterly instalments of 25% each following the amalgamation or in a lump sum one year after the amalgamation. However, each Client should obtain a ruling from the CRA to ensure that his/her scenario meets CRA requirements.

As mentioned, the corporations in the strategy must wait at least one year before they merge (or wind up). The CRA has also stated in previous rulings that the repayment of the promissory note to the estate must take place over at least an additional year.

It is also very important that the new corporation continue to operate (including in the case of a holding company as regards its investment policy).

The goal is to avoid liquidating the corporation's investments after the shareholder's death and ending up with a "cash corporation", in compliance with the CRA's rules around the pipeline technique.

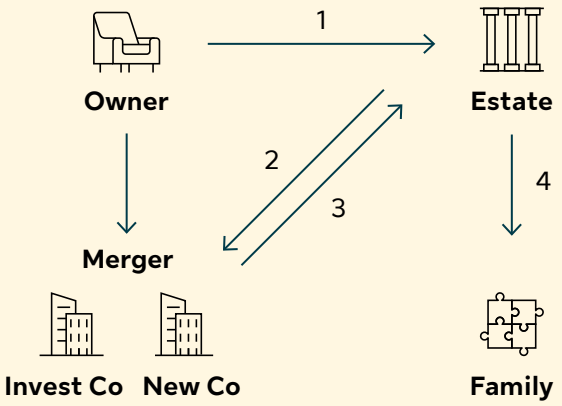
[22] See advance ruling 2014-0526431R3 and CRA documents 2011-0401861C6, 2018-0748381C6.

[23] See CRA documents mentioned in the note 21

The summary of the Pipeline Strategy

Only one tax

Pipeline planning simplified



1. At Death

- Trigger of Capital Gains taxes
- Shares transfer to the estate

2. After Death

- Estate creates a new company (New Co)
- New Co created in exchange for promissory note

3. Merger & Repayment

- Hold Co & New Co become one
- Repay promissory note (via assets from Invest Co)

4. Distribute to family and heirs

Result: One level of tax at capital gain

Anti-avoidance rules and the Pipeline Strategy

Section 84.1 is an anti-avoidance rule designed to eliminate surplus[24] stripping by extracting corporate surplus at capital gains rates rather than as dividends. The section deems the shareholder to have received a dividend to the extent that the sale proceeds exceed the ACB of the shares. For these purposes, the cost base of the shares is adjusted to eliminate V-day value[25] and the cost resulting from any previous use of the lifetime capital gains exemption[26].

The cost resulting from capital gains realized on the deemed disposition at death is recognized for the purposes of section 84.1 unless it is sheltered by the capital gains exemption.

Note that it is possible that a deemed dividend could arise[27] when the Pipeline Strategy Strategy is implemented. Subsection 84(2) applies where funds or property of a corporation have been distributed or otherwise appropriated to or for the benefit of the shareholders. The application of subsection 84(2) to a pipeline transaction would result in the payment of the promissory note being recharacterized as a deemed dividend paid by the corporation to the estate. This result would essentially deny the tax benefits of implementing the pipeline planning.

However, the CRA has held that subsection 84(2) will not apply if the following conditions are met:

1. Opco's business or investment activities will continue for at least one year following the implementation of the Pipeline strategy;
2. Opco will not be amalgamated or wound-up into Holdco for at least one year; and
3. Opco's assets will not be distributed to its shareholders for at least one year after the amalgamation or winding-up, followed by a gradual distribution of assets over an additional period of time.

[24] Corporate surplus or retained earnings represent accumulated undistributed income net of any losses, miscellaneous charges and dividend payments.

[25] In the case of non-depreciable property, the cost of such property is determined by the V day value rules described in section 26 of ITAR. Generally, the cost of non-depreciable property is the median of 3 values (i.e. neither the greatest nor the least): (i) the historical cost of the property; (ii) the fair market value of the property on V-day; and (iii) the proceeds of disposition of the property, or if the property has not been sold, its fair market value as of the date cost is being determined. If any of the above values are the same, the cost is that value.

[26] The lifetime capital gains exemption on small business income is $892,218 in 2021, indexed to inflation.

[27] Under section 84(2) ITA.

The Bump Strategy

The Bump Strategy has the same mechanics as the Pipeline Strategy, so the two are often used in combination. The Bump Strategy[28] can be used to avoid or reduce double taxation on private company shares by removing capital property that has appreciated in value from the company following the death of the controlling shareholder. The effect is to increase the cost base of non-depreciable corporate owned assets. The estate can then transfer high cost base shares of PHI (Opco) to a new Holdco as part of the Pipeline Strategy.

When personal capital gains tax rates are lower than dividend rates, the Bump Strategy may produce a better tax result. If there is a change of control as a consequence of death, the shares of the corporation held at the time of death can be transferred by the estate to a new corporation for a promissory note, and the existing corporation can be merged into the new corporation by way of a winding up and in the course of that transaction.

Consequently, the ACB of the non-depreciable capital property of the existing corporation can be increased or "bumped" to its fair market value at the time of the death of the controlling shareholder. These assets can then be (liquidated and) used to pay down the promissory note owing to the estate. Note that because the "bumped" assets have no impact on the deceased's deemed disposition, there is still that capital gain on death that continues to exist.

There are several limitations to the bump strategy, which may affect the type of planning chosen in a particular Client's circumstances. The rules are complex[29] and only certain capital property can be bumped.

[28] Paragraph 88(1)(d).

[29] See advance rulings 2001-0093363 and 2002-0127013 issued by the CRA.

Choosing between the Loss Carryback Strategy and the Pipeline Strategy

Based on current tax rates, the Pipeline Strategy may yield a better tax result because the capital gains tax rate is more favourable than the dividend tax rate. However, if the Pipeline Strategy is used without careful consideration, the capital dividend account (CDA), refundable dividend tax on hand (RDTOH) and general rate income pool (GRIP) will be lost.

The Loss Carryback Strategy may be more advantageous if the corporation has CDA and a RDTOH balance. To that end, it will be necessary to determine whether it will be possible to declare, on the one hand, a taxable dividend of 2.61 times the RDTOH amount in order to recover that account and, on the other, a dividend to recover the CDA balance. Without this, the RDTOH or CDA will be lost.

The Loss Carryback Strategy could also be more beneficial if the company has life insurance policies because the latter will be able to pay a non-taxable dividend to the estate from the CDA[30]. In the end, Clients should consult with their own tax experts to ensure that they choose an optimal solution for their specific situation.

On the next page is a chart comparing the Loss Carryback Strategy and the Pipeline Strategy:

[30] The death benefit will only go to the CDA to the extent it exceeds the policy's ACB

The final decison

Side by side

Loss carry back versus Pipeline planning

Loss Carryback Planning		**Pipeline Planning**	
Pros	Cons	Pros	Cons
• One tax only • ITA approved • Tax pools maximizedaa (RDTOH, GRIP, CDA)	• Higher tax dividend rates • Has to be done in the firts year of the GRE estate • Stop-loss rules may reduce CG loss	• One tax only at capital gain tax rates • No deadlines	• Might not be allowed in future by the CRA/ITA • More complicared • Time-merger cannot happen for 1 year and promissory note repayment progressive • Tax pools can be lost (RDTOH, GRIP, CDA)

Post-mortem planning choice is dependent on the following factors:

1. Tax attributes of corporation at time of death;
2. Nature of corporate assets;
3. Intention of beneficiaries;
4. Timing; and
5. Other considerations.

How life insurance can help provide liquidity

The primary goal of post-mortem planning is to minimize the tax burden at death. When an individual owns shares in a private corporation, post-mortem planning can reduce or eliminate the double or triple taxation that can result from: (a) the deemed disposition of the shares at death; and (b) the tax liability on the final distribution of the assets out of the corporation.

For taxpayers with a Canadian-controlled private corporation, life insurance can help minimize double taxation and help maximize cash flow to the estate.

Loss carryback

In the Loss Carryback post-mortem strategy, the shareholder still faces a deemed disposition of the corporation shares, with disposition proceeds of those shares valued at their FMV immediately before the shareholder's death. At the same time, the estate is deemed to acquire those corporation shares at an ACB equal to the shareholder's deemed proceeds of disposition. Where the shareholder was insured by a corporation-owned policy, the corporation can then use proceeds from corporate-owned life insurance to redeem (i.e. buy-back) its shares from that deceased shareholder's estate.

Pipeline planning

In the post-mwortem Pipeline strategy, the estate incorporates a new corporation ("NewCo"), which transfers the estate's OpCo shares using a non-interest bearing promissory note that is equal to the FMV of the shares at the time of the shareholder's death. This share acquisition by NewCo does not constitute a deemed dividend, and there is no capital gain on the transfer because the estate acquired the OpCo shares at an ACB equal to the shareholder's deemed proceeds of disposition. NewCo then merges with OpCo and can thereby access the latter company's former assets; where the shareholder was insured by an OpCo-owned policy, the accessed assets can include proceeds from that corporate-owned life insurance.

The following are some more considerations when choosing the optimal post-mortem strategy:

1. If dividends cannot be paid on a tax-efficient basis, particularly if the corporation has assets with nominal gains – consider the Pipeline Strategy
2. If winding up with RDTOH or CDA – consider the Loss Carryback Strategy
3. If non-depreciable capital assets exist – consider the Bump Strategy
4. Hybrid strategy – a combination of strategies

Appendix 1

Canada Revenue Agency (CRA) Post- latest Mortem Rulings as at August 26, 2020

CRA Document Number	Title	Date	ITA Sections	Summary of Ruling
2020-0842241C6	Post-mortem pipeline: Gradual repayment of note	July 8, 2020	84(2)	When asked if it is permissible for the estate to borrow funds from the pipeline corporation in order to pay its liabilities (e.g., for taxes) during the period in which the note is being repaid following the amalgamation of the pipeline corporation, CRA noted that as "an example," this can occur in a hybrid pipeline transaction in which there is a preliminary redemption of shares of the estate for a note (subject to s. 84(3)) with a resulting carryback of a loss under s. 164(6).
2020-0839401R3	Post-mortem pipeline	January 1, 2020	84.1, 84(2), 245	Favorable rulings on the following questions: Does paragraph 84.1(1)(b) deem a dividend in the Proposed Transactions? 2. Does subsection 84(2) apply to the Proposed Transactions? 3. Does the GAAR apply to the Proposed Transactions?
2020-0838951R3 (F)	Post-mortem pipeline	January 1, 2020	84.1, 84(2), 245	Favorable ruling on pipeline implemented by beneficiaries and not the estate.
2020-0839401R3	Post-mortem pipeline	January 1, 2020	84.1, 84(2), 245	Favorable rulings on the following questions: Does paragraph 84.1(1)(b) deem a dividend in the Proposed Transactions? 2. Does subsection 84(2) apply to the Proposed Transactions? 3. Does the GAAR apply to the Proposed Transactions?
2020-0838951R3 (F)	Post-mortem pipeline	January 1, 2020	84.1, 84(2), 245	Favorable ruling on pipeline implemented by beneficiaries and not the estate.
2019-0824211R3 (F)	Post-mortem Hybrid Pipeline	January 1, 2020	84.1, 84(2), 245(2)	Favorable rulings on these questions: 1) Whether section 84.1 applies to deem the Estate to have received a dividend on the disposition of shares to the new corporation or to reduce the PUC of the shares of the new corporation received as consideration for the disposition of the shares. 2) Whether subsection 84(2) applies to the proposed transactions. 3) Whether subsection 245(2) applies to the proposed transactions.
2019-0822951R3 (F)	Post-mortem Hybrid Pipeline	January 1, 2019	84.1, 84(2), 245(2)	CRA provided standard rulings for a pipeline transaction respecting a CCPC, with portfolio of public company shares and other marketable securities, whose common shares were stepped up to their fair market value on the death of the deceased.

CRA Document Number	Title	Date	ITA Sections	Summary of Ruling
2019-0819191R3	Post-mortem planning - pipeline	January 1, 2020	84.1, 84(2), 245	Favorable rulings provided.
2019-0793281R3 (F)	Post-mortem Hybrid Pipeline	January 1, 2019	84.1, 84(2), 245	Favorable rulings provided.
2018-0789911R3 (F)	Post-mortem pipeline	January 1, 2019	20(1)(c), 84(2), 84.1, 245(2)	CRA relaxed its longstanding position and accepted that, upon the sale of shares that had been stepped up on death under s. 70(5) to a Newco in a pipeline transaction, the estate could immediately receive cash derived from the surpluses of the company that had been indirectly held by the deceased taxpayer in order to fund the taxes payable under s. 70(5). Thus, it was not necessary to wait a year before accessing such cash derived from such surpluses. CRA also provided an interest deduction ruling on a transaction in which Opco pays a preferred stock dividend on its common shares whose amount does not exceed its accumulated profits, and then uses a bank loan to redeem such preferred shares (which is described as entailing the replacement of the capital represented by the preferred shares by the bank loan).
2018-0777441R3F	Post-mortem planning - pipeline	January 1, 2018	84(2), 84.1 , 245(2)	Favorable rulings provided.

Other Post-mortem pipeline favourable rulings issued:

- CRA Views; Conference 2011 – 0401861C6– Post-mortem planning
- CRA Views, Conference – 2011 – 0426371C6– Post-mortem planning
- CRA Views Ruling – 2002–0154223 – Post-mortem planning
- CRA View Ruling 2005 – 0142111R3 – Post-mortem planning
- CRA Views Ruling 2010–0389551R3 – Post-mortem planning withdrawal ruling;
- CRA Views, Ruling – 2011 – 0403031R3 – Post- mortem planning;
- CRA Views, Ruling – 2012 – 0435131R3 – Post-mortem planning;
- CRA Views, Ruling – 2014 – 0545531R3 – Post-mortem planning;
- CRA Views, Ruling – 2015 – 0604851R3 – Post-mortem pipeline;
- CRA Views, Ruling – 2016 – 0646891R3 – Pipeline and subsequent butterfly; and
- CRA Views Ruling – 2019–0793281R3 – Post-mortem hybrid pipeline.

Appendix 2

The Case Study

Paul is a 73-year-old widower living in Canada, and is the sole shareholder of PHL Investments Inc. (PHL). He recently passed away. He incorporated his business 25 years ago and paid $100 for 100 Class A common shares. Paul's adjusted cost base (ACB) and paid-up capital (PUC) are both $100.

PHL Investment is a holding company valued at $5 million with no accrued gains. Paul's two children are the beneficiaries, and want their cash portions of the estate.

For simplicity, we assume the company's capital dividend account (CDA), refundable dividend tax on hand (RDTOH) and general rate income pool (GRIP) are nil.

Terminal tax

The Income Tax Act (ITA) deems the taxpayer to have disposed of all their capital property at FMV immediately before death.

Consequently, on his terminal tax return, Paul's deemed disposition of shares amounts to the difference between a FMV of $5 million and an ACB of $100, of which 50% is a taxable capital gain.

As shown in Table 1, Paul's personal tax due at death is approximately $1.3 million.

Table 1:
Paul's terminal tax

Deemed proceeds from shares	$5,000,000
Shares' ACB	($100)
Capital gain	$4,999,900
Taxable capital gain (50%)	$2,499,950
Personal tax (using top marginal tax rate of 53.53%)	**$ 1,338,223**

Corporate tax

Ordinarily, corporate tax would be payable if the company held an investment portfolio with accrued gains and then disposed of those investments. Half of the capital gain would be subject to tax at the corporation's investment tax rate (not its small business tax rate). An amount equal to the non-taxable portion of the capital gain could be paid as tax-free dividends to the shareholder (the estate in this case) from the CDA.

Corporate tax can be reduced through the corporation's RDTOH account when a taxable dividend is paid. This requirement can potentially be met when the corporation is wound up or through a share redemption, which deems the redemption proceeds to be paid as a dividend to the estate.

In the current case, there are no accrued corporate gains, and consequently corporate tax is nil.

Estate tax

The estate is deemed to have acquired the shares in PHL at FMV immediately after the deceased's deemed disposition. As a result, the estate's ACB in the shares equals the FMV of those shares immediately after Paul's death - $5 million.

To realize a distribution of estate proceeds, the executor will arrange for the company to purchase (redeem) the shares from the estate. This triggers subsection 84(2) of the ITA, deeming the estate to receive a dividend equal to the shares' value in excess of PUC upon disposition of the shares (see table 2) - $4,999,900.

The ITA says that because PHL is paying $5 million to redeem the shares, but is receiving nothing of value in return, Paul's estate therefore sustains a capital loss to the extent the deemed dividend exceeds Paul's PUC in those shares ($100). The capital loss is therefore $4,999,900 (see table 3).

The capital loss can be carried back to Paul's terminal tax return to help eliminate the capital gain Paul had on his deemed disposition of PHL shares when he died. In this case, all but $100 of Paul's capital gain can be eliminated, provided the windup is done in the estate's first taxation year, as per ITA subsection 164(6).

Table 2:
Paul's estate tax on corporation's windup

Deemed proceeds from shares	$5,000,000
Shares' ACB	($100)
Capital gain	$4,999,900
Taxable capital gain (50%)	$2,499,950
Personal tax (using top marginal tax rate of 53.53%)	$ 1,338,223
Dividend tax (using top marginal tax rate for non-eligible dividends—47.74%)	**$ 2,386,952**

Table 3:
Creating the capital loss available for carryback to the terminal return under ITA subsection 164(6)

Share proceeds	$5,000,000
Deemed dividend	($4,999,900)
Adjusted proceeds	$100
ACB	($5,000,000); deemed acquisition of the shares immediately after death
Capital loss (available for carryback)	**($4,999,900)**

Consequently, with no tax planning, the total tax burden would exceed 74% taxation (see table 4). PHL Investment's value would have been taxed twice: once to the deceased on the capital gain arising from the deemed disposition of the shares, and again to the estate as a non-eligible dividend from the company having redeemed the shares from the estate.

Table 4:
Paul's tax summary

Terminal tax	**$1,338,223**
Corporate tax	None
Estate tax	**$2,386,952**
Total tax	**$3,725,175**
Total proceeds	$5,000,000
Effective tax rate	**74.5%**

The Pipeline Strategy

The Pipeline Strategy reduces the tax on the removal of corporate surplus from the higher dividend rate (that would result from using the Loss Carryback strategy) to the lower capital gains rate that is applicable on the shareholder's death.

At Paul's death his shares are deemed to have been acquired by his estate for FMV, $5 million in this case. The $5 million amount also becomes the estate's adjusted cost base in the shares. Following this strategy, the estate incorporates a new company (Newco). The estate then transfers its PHL Investments shares to Newco, usually by electing under subsection 85(1) of the ITA. In exchange for the shares, the estate takes back a promissory note equal to the elected amount, which is usually the shares' adjusted cost base. Since the estate has transferred shares with an FMV and ACB of $5 million in exchange for a promissory note for $5 million, there is no capital gain on the transfer, and no tax payable.

Newco now owes the estate $5 million, reducing the combined values of the Newco and PHL to nil. The key feature in a pipeline strategy is that Newco can pay off its debt to the estate without the repayment being treated as a taxable dividend – loan repayments are tax-free to the lender. To accomplish this process, the CRA requires the operating company to continue for at least one year. After that year has passed, the estate amalgamates Newco and PHL into a new company, "FusionCo". FusionCo now has PHL's assets, which it uses over the following year to gradually repay NewCo's debt to the estate. After FusionCo repays the note it will have no value, having used its value, $5 million, to repay a $5 million debt.

Following the note repayment, FusionCo will be wound up. Since it won't be worth anything, its being wound up will generate no taxable dividend (see table 5) or taxable gain (see table 6).

Table 5:
FusionCo windup with the Pipeline Strategy

Proceeds	$100
PUC	($100)
Deemed dividend	None
Capital dividend (tax-free)	None
Non-eligible dividend	None
Dividend taxes	**None**

Table 6:
Deemed disposition of FusionCo shares

Proceeds	$100
Deemed dividend	None
Adjusted proceeds	$100
ACB	($100)
Capital loss available	**None**

As shown below (in Table 7), the dividend tax is avoided by the estate due to the conversion of the high cost basis on the shares to non-share consideration, reducing the effective tax rate from over 74% to approximately 27%.

Table 7:
Tax summary with post-mortem pipeline strategy

Terminal tax	**$1,338,223**
Corporate tax	None
Estate tax	None
Total tax	**$1,338,223**
Total proceeds	$5,000,000
Effective tax rate	**27%**

The post-mortem pipeline could be a timely and costly process. However, the tax savings may more than offset those costs by eliminating a layer of tax and accessing favourable tax rates.

Finally, advisors should encourage their Clients to speak with their tax specialist to help with different tax solutions that meet the Client's needs.

What advisors can do

As part of your fact-finding efforts with Clients, Post-Mortem planning opportunities are important considerations in developing plans, both during the Client's lifetime and for periods following death.

Any examples presented in this article are for illustration purposes only. No one should act upon these examples or information without a thorough examination of their tax and legal situation with their own professional advisors after the facts of the specific case are considered.

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