Non-residents and Canadian life insurance

Canadians are more mobile now than ever before, so what are the tax implications to your life insurance policy when you move to another country? When are there Canadian tax implications and reporting obligations?

Canada's system of taxation is based on the residency of the taxpayer, a term that's not defined in the *Income Tax Act* (Canada) (the "Act"). The determination of a taxpayer's residency is a question of fact based on established jurisprudence. Canadian residents are taxed on their worldwide income, subject to the application of Canada's bilateral tax treaties. In contrast, non-residents of Canada are subject to Canadian income tax if they're employed in Canada, carrying on a business in Canada, dispose of certain assets or receive passive income (i.e. dividends or royalties) from Canadian sources [i].

Leaving Canada (emigration)

When individuals sever their residential ties to Canada, they are deemed to dispose and reacquire their property at fair market value ("FMV")[ii]. There are several properties exempt[iii] from this rule, including a 'life insurance policy in Canada'. The term 'life insurance policy in Canada' is defined as a life insurance policy, where at the time of issue, was on the life of an individual resident of Canada[iv]. Therefore, if an individual emigrates from Canada, there's no deemed disposition or reacquisition of their interest in a life insurance policy at that time, so long as it meets that definition. While there's no deemed disposition of a Canadian life insurance policy upon becoming a non-resident of Canada, there's a requirement to report all the individual's worldwide properties if the total FMV of those properties is greater than $25,000. The FMV of an individual's life insurance policy is included in this calculation[v].

Consideration should be given on how a Canadian life insurance policy will be taxed in the individual's new country of residence. Consultation with a tax professional in the new country of residence is recommended.

Owning shares of a corporate policyowner

If an individual held shares of a corporation at the time of their emigration, those shares are deemed to be disposed of an amount equal to their FMV. If that corporation owned a life insurance policy, the cash surrender value of the policy is used in determining the FMV of the shares[vi].

Canadian taxation and tax reporting while non-resident

Non-residents of Canada are taxed on policy gains they realize by virtue of owning a Canadian life insurance policy. Policy gains arise where a policy transaction results in a disposition of an interest in the policy and the proceeds of the disposition exceed the policy's adjusted cost basis ("ACB"). A disposition[vii] (including deemed dispositions[viii]) of a life insurance policy includes the following transactions:

- Surrender, either full or partial
- Policy loan
- Policy dividend (where not used to pay a contractual premium, paid-up additions or repay a policy loan)
- Transfer of ownership
- Disposition by operation of law only

A disposition of a policy owned by a non-resident triggers a reporting requirement under the Act. The disposition and policy gain, if any, is reported to the Canada Revenue Agency ("CRA") on form T2062B, "Notice of disposition of a life insurance policy in Canada by a non-resident". This reporting applies to both ownership transfers and internal policy transactions; such as, policy dividends, policy loans, or surrenders, involving the non-resident-owned life insurance policy.

The insurer is deemed to be the purchaser for internal policy transactions, meaning they are responsible for reporting any policy gain to the CRA on form T2062B. However, the insurer isn't deemed to be the purchaser for ownership transfers, therefore, the transferor and transferee are responsible for reporting the disposition on form T2062B and any tax withholding on the transfer[ix].

Any resulting tax liability owed by the policyowner in respect of an internal policy transaction is remitted by the insurer to the CRA with form T2062B. If the non-resident policyowner provides a signed authorization form to us, we withhold taxes at federal graduated non-resident tax rates. We calculate the tax liability by applying the federal graduated non-resident tax rates to the policy gain. In 2018, these rates ranged from 22.2% and climbed to 48.84% for policy gains over $205,842.00. The non-resident may file a non-resident Canadian tax return to report the disposition, any policy gain, and associated tax withheld by the insurer. If the non-resident doesn't provide us with authorization to withhold at federal graduated non-resident tax rates, we would withhold and remit tax calculated as 50% of the proceeds of the disposition.

A transfer or disposition of a Canadian life insurance policy on, after, or as a result of a non-resident owner's death[x] is exempt from filing form T2062B[xi]. Nonetheless, the deemed disposition of the interest in the policy is required to be reported on the deceased's' final Canadian non-resident tax return, along with any resulting tax liability on the policy gain.

If the disposition of a Canadian life insurance policy is not reported to the CRA on form T2062B, the purchaser (insurer or transferee) and the transferor are liable for withholding tax calculated as 50% of the fair market value of the proceeds of the disposition[xii]. This is a punitive measure, in that, if form T2062B was filed, the tax liability would only be the federal non-resident graduated tax rates applied against the policy gain.

Consultation with a cross-border tax professional is recommended to ensure the individual's Canadian reporting obligations are fully met.

Immigration to Canada

Individuals who establish residential ties to Canada are subject to the immigration rules that provide for a deemed disposition in respect of their property[xiii]. However, similar to the emigration rules, a 'life insurance policy in Canada' is exempt from these rules.

Conclusion

The taxation of non-residents can be complex. It's especially important to keep up-to-date on all tax reporting and compliance obligations. Consultation with tax professionals who specialize in cross-border issues is recommended.

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[i] Subsection 2(3) and Part XIII of the Act.
[ii] Subsection 128.1(4) of the Act.
[iii] Subsection 128.1(10) of the Act definition of 'excluded right or interest'.
[iv] Subsection 138(12) of the Act.
[v] Subsections 128.1(9) and (10) of the Act and Form T1161 "List of Properties by an Emigrant of Canada". Exclude any personal-use property valued at less than $10,000.
[vi] Subsection 70(5.3) of the Act.
[vii] Subsection 148(9) of the Act definition of 'disposition'.
[viii] Subsection 148(2) of the Act.
[ix] Subsection 116(5.4) of the Act.
[x] Life insured is different from the policyowner.
[xi] Paragraph 116(5.1)(b) of the Act.
[xii] The Canada Revenue Agency technical interpretation document 2013-0481411C6, May 17, 2013.
[xiii] Subsection 128.1(1) of the Act.