canada life™

Transferring a life insurance policy from a shareholder to a corporation

When a shareholder transfers a personally owned life insurance policy to a corporation, the tax consequences to the shareholder are generally dependent upon the policy's cash value, its adjusted cost basis and whether the corporation gives consideration for the policy. The tax consequences to the corporation generally concern the policy's new adjusted cost basis and other factors that might affect the capital dividend account calculation at death.

Why transfer a life insurance policy to a corporation?

Life insurance premiums are generally not tax-deductible. As a result, using corporate dollars that were taxed at a low business rate to pay insurance costs is a significant incentive for business owners to transfer a personally owned policy to their corporation. In addition, a corporation may obtain a credit to its capital dividend account (CDA) as a result of receiving a life insurance death benefit as a policy beneficiary. A corporation's CDA enables it to pay tax-free capital dividends to its Canadian resident shareholders.[i] Depending on the circumstances, the intended end recipient of the insurance death benefit is often left with the same amount of after-tax insurance money compared to the instance when the policy was owned personally.

Considerations for transferring a policy to a corporation is whether, if applicable, any provincially legislated creditor protection is worth losing and whether the policy will need to be transferred at some time in the future.

Tax consequences to the shareholder

Transferring a policy from a shareholder to a corporation is a disposition for tax purposes. These transactions types are typically non-arm's length. Pursuant to this provision, the shareholder's transfer price for tax purposes is deemed to be the greatest of the:

1) Fair market value (FMV) of the consideration given for the policy
2) Policy's cash surrender value (CSV)
3) Policy's adjusted cost basis (ACB).

If the proceeds exceed the policy's ACB, then the excess over the ACB is a taxable policy gain that's treated as ordinary income (in the case of an individual shareholder) or passive income (in the case of a corporate shareholder).

Shareholders can experience a range of potential tax outcomes depending on whether they take back any consideration from the corporation on the transfer. Consideration may take the form of cash, property or a promissory note. A shareholder may want to limit the value of this consideration to an amount equal to the higher of the policy's ACB and CSV to avoid triggering a higher policy gain.

Example

The following table shows the tax consequences where a non arm's length shareholder transfers a life insurance policy with the following attributes to their corporation in exchange for varying amounts of consideration:

Policy FMV: **$60,000**	Policy CSV: **$50,000**	Policy ACB: **$10,000**

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	No consideration	Consideration < CSV	Consideration CSV	Consideration FMV	Consideration > FMV
FMV of consideration given by corporation	Nil	$25,000	$50,000	$60,000	$70,000
Proceeds of the disposition (POD) highest of CSV, ACB or FMV of consideration	$50,000	$50,000	$50,000	$60,000	$70,000
Policy gain (POD less ACB)	$40,000	$40,000	$40,000	$50,000	$60,000
Initial ACB to corporation	$50,000	$50,000	$50,000	$60,000	$70,000
Taxable shareholder benefit	$0	$0	$0	$0	$10,000

The above example is for illustrative purposes only. Situations will vary according to specific circumstances.

Multiple non-arm's length shareholders

A tax issue may arise where a shareholder transfers a policy to a corporation for consideration that's less than its FMV and there are other shareholders of the transferee corporation who are related to the transferor. In these cases, there's a risk that the Canada Revenue Agency (CRA) may consider the shareholder to be conferring a benefit on the other related shareholder(s) pursuant to subsections 56(2) or 246(1) of the Act. The rationale for this view is that the shareholder transferring the policy to the corporation is shifting value from him/herself to a related person pursuant to a transaction that doesn't occur at FMV for tax purposes. The CRA hasn't commented on this scenario.

Tax consequences to the corporation

Adjusted cost basis

The corporate transferee's initial ACB in the policy is generally the shareholder's transfer price for tax purposes (i.e., the deemed proceeds). .

Capital dividend account calculation

Generally, an amount equal to the life insurance death benefit received by a private corporation, less the policy's ACB, may be added to its CDA. As noted, to the extent there's balance in the corporation's CDA, it may pay tax-free capital dividends to its Canadian resident shareholders.

As noted, the initial ACB of the policy to the corporation is equal to the transferor's proceeds as determined by subsection 148(7). This may result in the corporation having a higher policy ACB compared to the shareholder's policy ACB prior to the transfer. In the examples above, the ACB of the policy to the shareholder was $10,000; but after the transfer the ACB of the policy to the corporation increased to at least $50,000. The higher the ACB at the time of the transfer may lower the

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amount that's credited to CDA depending on when death occurs. Consequently, the lower the amount that may be paid out as tax-free capital dividends to Canadian resident shareholders.

If the policy was transferred to the corporation in exchange for consideration after 1999, but before March 22, 2016 , and the death occurs after March 21, 2016, the credit to CDA account is also reduced by the following two amounts:

Fixed grind: The FMV of the consideration given by the corporation for the policy, less the greater of the policy's CSV and ACB immediately before the transfer. This rule is intended to address any consideration that the shareholder received tax-free from the corporation that was in excess of the policy's CSV or ACB on a transfer of the policy.

Declining grind: The amount, if any, by which the lesser of the FMV of the consideration given by the corporation for the policy and the policy's ACB immediately before the transfer exceeds the policy's CSV immediately before the transfer, minus the absolute amount of any negative ACB at the time of death. This rule is intended to address any decrease that occurred in the policy's ACB (i.e., situations where the policy's ACB was higher than its CSV) immediately after a transfer of the policy.

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[i] Generally, the credit to the CDA is the equal to the death benefit less the policy ACB. In most cases the corporate policyowner should also be the beneficiary of the policy to address taxable shareholder benefit issues. If a shareholder is the beneficiary of the policy, the amount of annual premium paid by the corporation would likely be considered a taxable shareholder benefit.

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