

Tax reference guide for ownership transfers of a critical illness policy

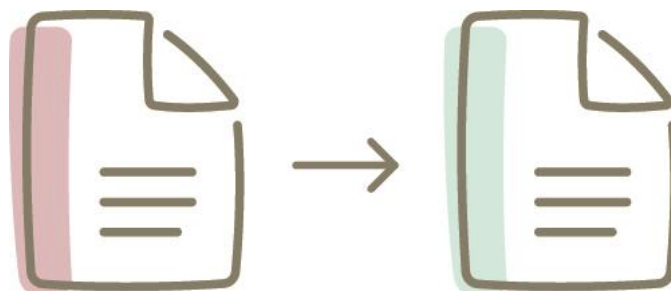
What happens if your circumstances change and you need to transfer ownership of your critical illness insurance policy? What are the tax implications of a change in ownership?

Generally, transferring property results in a disposition for tax purposes. The *Income Tax Act* (Canada) (the “Act”) contains rules governing the tax consequences arising from transferring many types of properties in different situations. The Canada Revenue Agency (“CRA”) confirmed that a gain or loss realized on the disposition of a critical illness policy is capital in nature. However, a critical illness policy is an insurance policy and an exception in the Act provides there’s no capital gain or loss on the disposition of an insurance policyⁱ. Consequently, in all cases, transferring a critical illness policy doesn’t result in any tax consequences for the transferor. Thus, transferring a critical illness policy between individuals is straightforward as there are generally no tax consequences.ⁱⁱ However, this isn’t the case when business entities are involved as the tax consequences become more complex depending on who receives the policy and whether consideration is paid.

This guide will help you understand the tax consequences of common ownership transfers of a critical insurance policy within each of these categories;

1 Individuals

2 Business entities (including corporations and partnerships)



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1 Individuals (arm's length and non-arms length)

Existing owner	New owner	Tax consequences	Tips & considerations
Transfer between individuals			
Individual (transferor)	Individual (transferee)	There are no tax consequences to the transferor or the transferee.	The premiums are not deductible as they are considered a personal or living expense.

2 Business entities (including corporations and partnerships)

Existing owner	New owner	Tax consequences	Tips & considerations
Transfer from an individual to a corporation			
Individual	Corporation	There are no tax consequences to the individual or the corporation.	<p>The individual may take back consideration from the corporation equal to the fair market value ("FMV") of the policy.</p> <p>Consider changing the beneficiary to the corporate policyowner to avoid taxable shareholder benefits based on premiums paid or receipt of a CI benefit.</p> <p>The premiums are not deductible as a business expense.</p> <p>A benefit paid under the policy doesn't credit the corporation's capital dividend account.</p>
Transfer from a corporation to an individual shareholder			
Corporation	Individual shareholder	There are no tax consequences to the corporation. The shareholder may have a shareholder benefit equal to the FMV of the policy, less any consideration paid.	The premiums are not deductible as they are considered a personal or living expense.

Existing owner	New owner	Tax consequences	Tips & considerations
Transfer between an employer and an employee (arm's length)			
Corporation	Employee	<p>There are no tax consequences to the corporation; however, the corporation (the employer) may deduct as a business expense for tax purposes the amount equal to the FMV of the policy less any consideration paid by the employee.</p> <p>The employee may have a taxable employee benefit equal to the FMV of the policy, less any consideration paid.</p>	<p>The premiums are not deductible as they are considered a personal or living expense.</p>
Transfer from a corporation to a corporate shareholder			
Corporation (transferor)	Corporate shareholder	<p>There are no tax consequences to the transferor. The shareholder may have a taxable shareholder benefit equal to the FMV of the policy, less any consideration paid (unless the policy is transferred as a dividend in kind).</p>	<p>The transfer could be structured as a dividend-in-kind so that its treated as a tax-free intercorporate dividend to the shareholder, if the corporations are connected.</p> <p>The shareholder's tax professional should consider the application of 55(2) of the Act in respect of the tax-free intercorporate dividend.</p> <p>The premiums are not deductible as a business expense.</p>
Transfer between sister corporations			
Corporation (transferor)	Sister corporation (transferee)	<p>There are no tax consequences to either the transferor or the transferee corporations.</p> <p>The shareholder may have a taxable shareholder benefitⁱⁱⁱ equal to the FMV of the policy, less any consideration given by the transferee corporation.</p>	<p>To avoid a taxable benefit for the shareholder, the transfer may be structured as a sale paid with cash, a promissory note or shares issued by the transferee corporation, or pursuant to a share redemption where the policy is transferred as payment of the share redemption price (latter requires a corporate reorganization).</p>

Existing owner	New owner	Tax consequences	Tips & considerations
Wind-ups and amalgamations			
Corporation (Opco)	Corporate shareholder (≥90% “Holdco”), as part of a wind-up ^{iv}	The policy is deemed to be disposed of and acquired at its cost ^v .	Applies in situations where the Holdco owns at least 90% of the issued shares of each class of the Opco.
Corporation (Opco)	Individual shareholder/ Corporate shareholder (<90% “Holdco”) ^{vi}	Although property is deemed to be disposed of at its FMV, there are no tax consequences to the transferor of the policy ^{vii} . In each case where either an individual or a corporate shareholder receives the policy, for tax purposes, they’re deemed to receive a dividend equal to the FMV of the policy.	Applies in situations where either the Holdco owns less than 90% of the issued shares of each class of the Opco or the wind-up is to an individual shareholder.
Corporation	Corporate shareholder or sister corporation, as part of an amalgamation ^{viii}	Since the new corporation is deemed to be a continuation of each predecessor corporation, there is no disposition of the policy and as such; no tax consequences ^{ix} .	Technically, an amalgamation doesn’t result in a transfer of ownership.

The fair market value of a critical illness policy

Where either there's a potential for a taxable benefit or when receiving consideration from a corporation for a policy, obtaining a valuation of the critical illness insurance policy is recommended to support the reported amounts. If the policy has a return-of-premium option, it's FMV will be higher (so the income inclusion will be more as well). If the insured has health issues or is uninsurable, the FMV of the policy will also increase as a result.

ⁱ Canada Revenue Agency technical interpretation 2015-0588941C6 and subparagraph 39(1)(a)(iii) of the Act

ⁱⁱ The CRA confirmed a critical illness policy is not a 'life insurance policy', but rather an 'sickness' policy technical interpretation 2003-0004265

ⁱⁱⁱ Subsections 15(1), 56(2), 246(1) of the ITA.

^{iv} Subsection 88(1) of the Income Tax Act (Canada) ("ITA").

^v Canada Revenue Agency technical interpretation 9211260. Currently, this tax attribute of a CI policy is irrelevant for tax purposes.

^{vi} Subsections 88(2) and 69(5) of the ITA.

^{vii} Canada Revenue Agency technical interpretations 9211260 and 2015-0573841C6.

^{viii} Subsection 87(1) of the ITA.

^{ix} Canada Revenue Agency technical interpretation 9211260.