Private companies’ and shareholders’ buy-sell agreements often deal with complex corporate structures that affect operating (OPCO) and holding (HOLDCO) corporation relationships. There are a number of planning issues that clients must consider in determining who will own and be the beneficiary of a life insurance policy, particularly when sophisticated corporate and trust structures are in place. Those involved should consider who will have the cash flow to afford the premium payments and who will need to get the death benefit in a way that provides the most efficient arrangement for the shareholders and their families.

In a corporate environment, a common structure is for the OPCO to own the life insurance policy and pay the premiums while the HOLDCO is the beneficiary of the proceeds.
CRA position from December 1998 to October 2009

In December 1998, CRA released a technical interpretation that said no shareholder benefit would result from the policyholder (OPCO in our example above) paying the premiums due under the policy, and from the beneficiary (HOLDCO) receiving the death benefit. But, CRA also said that structure mentioned above would only work as long as there were “bona fide business reasons” other than wanting to obtain a tax benefit. Otherwise, there could be reasonable grounds to apply the General Anti-Avoidance Rule (GAAR). For example, using this structure without any business reason other than to increase the Capital Dividend Account (CDA) credit could be viewed as an avoidance transaction. Later, in May 2004, the CRA confirmed this position.

CRA position since January 1, 2010

In October 2009 the CRA said that it now believes that where an OPCO owns and pays the insurance premiums, and the death benefit is payable to a HOLDCO, subsection 15(1) of the Income Tax Act (ITA) will apply. CRA will assess a shareholder benefit equal to the premium paid. As a result, the HOLDCO will have to include in income the value of the premiums the OPCO pays, and pay tax on that amount. CRA's position that the GAAR applies if holding of life insurance was structured to increase the value of the CDA credit was also restated.

CRA applied this position since January 1, 2011.

Corporation resident in Québec

For corporations resident in the province of Québec, it should be noted that the Quebec Ministry of Revenue (MRQ) had already indicated their view that such a structure confers a taxable benefit on the HOLDCO.

Different options for clients using corporate owned life insurance structures

In light of the CRA’s change in position in 2010 clients using corporate owned life insurance structures should consult with their tax and legal advisors. They should consider if any changes to their current corporate buy-sell arrangements or any other corporate arrangements may be required. Some possible options to consider are described below.

One option is for the OPCO to declare a tax deductible inter-corporate dividend to the HOLDCO to allow the HOLDCO to pay the life insurance premium. Appropriate corporate resolutions and documents must be in place.

Another option is for OPCO to transfer policy ownership to HOLDCO. This would be a disposition of an interest in a life insurance policy under subsection 148(9) ITA. Consequently OPCO would have to include in its taxable income for the year the portion of the policy’s cash surrender value (CSV) that exceeded its adjusted cost base (ACB). HOLDCO would acquire the policy at its fair market value (FMV). A policy can have a FMV greater than nil even if the policy has no CSV or is a term policy. Consequently such a transfer requires a professional appraisal of the policy usually performed by actuaries. That creates an additional expense for OPCO, compensated by HOLDCO paying the FMV to OPCO as long as HOLDCO has enough cash.

The clients’ tax and legal advisors might also consider a third option - have the OPCO declare an inter-corporate dividend equal to the policy’s FMV and transfer the policy to the HOLDCO as a dividend in kind.

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1 CRA VIEWS E9824645.
2 Using this structure the CDA credit could potentially be increased in this way. At the insured’s death a death benefit would be posted to the HOLDCO’s capital dividend account and paid in full to its shareholders as a tax-free capital dividend. Ordinarily, the capital dividend account credit must be reduced by the amount of the policy’s adjusted cost basis (ACB). However, no reduction for ACB need be made when the HOLDCO does not own the policy, but is only the beneficiary. As a result, the HOLDCO could pay the entire death benefit to its shareholders even if the policy had ACB at the insured’s death.
4 CRA VIEWS 2010-0371901C6.
6 If a promissory note was issued by HOLDCO to OPCO to pay the policy FMV, Sect 15(2) ITA could apply. That results in the amount of the loan being included in HOLDCO taxable income if not fully reimbursed within the appropriate period of time.
Finally, CRA confirmed that a corporate-owned life insurance policy where the corporation is the beneficiary creates a capital dividend account credit for the death benefit less the adjusted cost basis of the policy. CRA confirmed that when a capital dividend election is made, a tax-free distribution can be made to the corporation’s shareholders.7

Tax consequences for clients using corporate owned life insurance structures

There are different structures of corporate ownership to hold a life insurance policy by a company but, before choosing a mode of ownership, it is essential to assess the potential tax consequences.

The following table summarizes the possible consequences according to various structures.

### Summary of different possible structures of corporate ownership of a life insurance policy and tax consequences

<table>
<thead>
<tr>
<th>Owner</th>
<th>Paid by</th>
<th>Beneficiary</th>
<th>Premium repayment by the beneficiary to the payor</th>
<th>Income Tax Act subsection</th>
<th>CRA comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opco</td>
<td>Opco</td>
<td>Holdco</td>
<td>No</td>
<td>15(1)</td>
<td>Taxable benefit for Holdco</td>
</tr>
<tr>
<td>Opco</td>
<td>Opco</td>
<td>Holdco</td>
<td>Yes</td>
<td>9 or 12(1) (x)</td>
<td>May be considered income for opco</td>
</tr>
<tr>
<td>Holdco</td>
<td>Holdco</td>
<td>Opco</td>
<td>No</td>
<td>246(1)</td>
<td>Taxable benefit for Opco</td>
</tr>
<tr>
<td>Holdco</td>
<td>Holdco</td>
<td>Opco</td>
<td>Yes</td>
<td>9 or 12(1) (x)</td>
<td>May be considered income for holdco</td>
</tr>
<tr>
<td>Opco</td>
<td>Opco</td>
<td>Opco</td>
<td>No</td>
<td>nil</td>
<td>nil</td>
</tr>
<tr>
<td>Holdco</td>
<td>Opco</td>
<td>Opco</td>
<td>No</td>
<td>15(1)</td>
<td>Possible taxable benefit for Holdco due to the residual cash access of the policy</td>
</tr>
</tbody>
</table>

Every effort has been made to ensure the accuracy and currency of the information provided. However, 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 the tax and legal situation with their own professional advisors after the facts of the specific case are considered.

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7 CRA VIEWS 2012-0473561E5.

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