Tax implications of a life insurance policy transfer

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Life insurance needs are not static. They evolve over time as family and financial situations change. This is true both for individuals and for the corporations they own. In the case of a life insurance policy transfer, questions often arise as to the tax repercussions of the transaction. What constitutes a disposition? Who is liable for the tax due, if any? Under what circumstances is a tax-free rollover available? What are the tax implications of a transfer between a business corporation and a shareholder or employee?

In certain situations, the transfer of the interest in an existing policy to a new owner may be one solution to consider. Whether during the policyholder's lifetime or at death, or as part of a transaction involving corporations, the tax implications of a transfer of interest are sometimes difficult to assess.

The transfer of the ownership of a life insurance policy raises both legal and tax concerns. These are questions that often arise in a financial planning context, and the answers, of course, will vary depending on the parties involved in the transaction. Whether or not they are dealing at arm’s length can also affect the outcome of the process. This bulletin will address some of the tax issues and will include some concrete examples to help illustrate the tax implications of life insurance policy transfers.

Transfer of a life insurance policy

The owner of the policy may choose to transfer their interest in a life insurance policy to another entity. In Quebec, civil law allows the assignment of an insurance contract to a third party provided the assignee has an insurable interest in the life or health of the insured. If an insurable interest does not exist at the time of the transaction, the insured must consent to the assignment in writing. This rule doesn't apply in any of the other provinces. The insurable interest in other provinces is only necessary at the time that the policy is issued.

General rules for life insurance policy transfers

A life insurance policy transfer is a “disposition” within the meaning of subsection 148(9) of the Income Tax Act (ITA). Subsection 148(1) sets out the general rules that apply to the computation of tax in respect of a disposition. A life insurance policy transfer may trigger a policy gain, which is taxable in the hands of the transferor. The policy gain is equal to the proceeds of disposition minus the adjusted cost basis (ACB) of the interest in the life insurance policy. This gain is fully taxable as ordinary income. It should be noted that life insurance policies do not fall into the tax category of capital property, so a taxpayer who disposes of his interest in a life insurance policy does not realize a capital gain; instead, it is a policy gain. Unlike a capital gain, where only half the gain is included in income, the entire policy gain is included in income. Further, a policy owner will not be able to claim any losses on the disposition of a life insurance policy. On a final note, a life insurance policy can't be transferred from a policy owner to their corporation on a tax-free rollover basis under ITA section 85.

1 Article 2418 of the Civil Code of Quebec.
Specific rules and life insurance policy transfers

Subsection 148(7) ITA contains specific rules that override the general rules discussed above. These rules apply when an interest in a life insurance policy is disposed of by:

- distribution from a corporation;
- gift, either while living or by will;
- transfer by operation of law only; or
- transfer in any manner to any person with whom the transferor is not dealing at arm’s length.

The notion of persons not dealing with each other at arm’s length is broader than the notion of related persons. Generally, the idea of “not at arm’s length” refers to persons who are connected by blood relationship or marriage, for example children, parents, siblings, common-law partners, or by adoption. Such a relationship may also exist between an individual and a corporation, a trust, or two corporations.²

As an example, a corporation and a person who controls the corporation, or a person who is a member of a related group that controls the corporation, are related and are deemed not to deal with each other at arm’s length. Similarly, two corporations controlled by the same person or group of persons are deemed not to deal with each other at arm’s length.

Note that if a shareholder does not control a corporation and does not pay fair market value (FMV) for the policy, the transfer may be deemed to be a non-arm’s length transaction or a corporate distribution, which would be subject to the application of subsection 148(7).

For transfers taking place after March 21, 2016 in a non-arm’s length context, subsection 148(7) ITA states that the proceeds of disposition to the transferor and the new ACB to the transferee will be equal to the highest of the following amounts:

- the “value” of the interest in the policy at the time of the disposition;
- the fair market value (FMV) of any consideration given for the interest in the policy; and
- the ACB to the policyholder of the interest in the policy immediately prior to disposition.

“Value” is defined in subsection 148(9) ITA as the amount the policyholder would be entitled to receive if the policy were surrendered, which is essentially the cash surrender value of the policy minus any unpaid policy loans.

The consideration given or paid for the FMV of an interest in the policy could be made in cash or with a promissory note or any combination of the above.

² Subsections 251(1) and 251(2) ITA; sections 18 and 19.1 of the Taxation Act (TA).
Lastly, subsection 148(7) ITA does not require that the FMV of the life insurance policy be paid at the time of transfer. A disposition looks instead at the FMV of the consideration paid to acquire the policy when it is transferred. However, the FMV of the policy will have to be taken into consideration for the purpose of benefits under subsection 15(1) ITA, for example, or for valuation of a dividend payable in kind.

**Adjusted cost basis of a life insurance policy**

The concept of adjusted cost basis (ACB) is defined in the ITA.³ The ACB represents the cost of the interest the policyholder has acquired in a life insurance policy. This is the base value from which policy gains will be calculated.

The ACB of a policyholder's interest in a life insurance policy is calculated according to a complex formula set out in the definition of “adjusted cost basis” in subsection 148(9) ITA. This amount may vary depending on the acquisition or issue date of the policy, the nature of the policy (which could be a life insurance policy or an annuity), and any transactions that have taken place with the policy, such as policy loans or the payment of dividends. It is increased by certain factors, such as the amount of premiums paid, and reduced by others, such as the net cost of pure insurance (NCPI).⁴ The amount representing the ACB of the policy may not, however, be negative. In fact, a negative ACB is deemed to be equal to zero. The information about the ACB amount is usually available through the insurer that issued the policy.

**Adjustment to ACB after a life insurance policy transfer**

A strict reading of the definition of “adjusted cost basis” in subsection 148(9) ITA indicates that a taxable benefit must be added to the ACB of the policy acquired by a shareholder or employee from their corporation or employer, to the extent that each has not paid FMV for the policy. Therefore, the ACB of the policy to the transferee would be the cash surrender value (CSV) of the policy plus the value of any taxable benefit included in the transferee's income.⁵

However, the CRA revised its position and indicated that a strict application of this provision could produce an inappropriate outcome for the transferee, in that the ACB may exceed the FMV of the interest in the policy, and as a result, the calculation of the ACB may need to be reviewed. The CRA has indicated that where subsection 148(7) applies and the transferee is required to include an amount in income as a taxable benefit, only the excess of the FMV of the policy over the CSV will have to be added to the ACB of the policy to the transferee.⁶

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³ Subsection 148(9) ITA - “adjusted cost basis;” sections 976 and 976.1 TA.
⁴ Subsection 308(1) Income Tax Regulations.
⁵ Technical interpretation letter no. 9327305.
Taxable shareholder/employee benefit

When a life insurance policy is transferred, it is important to consider whether a taxable benefit will be assessed to a shareholder or employee. The CRA states that a taxable benefit may be conferred on a shareholder under the provisions of subsection 15(1) ITA, or on an employee under the provisions of paragraph 6(1)(a) ITA. The taxable benefit must be added to the transferee’s taxable income when the policy’s FMV exceeds the consideration paid by the shareholder or employee to acquire the policy. To prevent a taxable benefit from being conferred, the shareholder or employee would have to pay the corporation an amount equal to the FMV of the life insurance policy.

Fair market value of a life insurance policy

As we have seen, there are various situations that require determining a life insurance policy’s fair market value (FMV). The CRA has indicated that life insurance policies must be valued at their FMV. We know that this value does not necessarily correspond to the policy’s cash surrender value and that it will depend on several factors. CRA Information Circular 89-3, entitled “Policy Statement on Business Equity Valuations,” outlines certain valuation principles. According to these guidelines, there are a number of factors to be considered in correctly determining the fair market value of a life insurance policy, including:

- the policy’s cash surrender value and face value (i.e. the death benefit amount);
- the state of health and insurability of the insured and his/her life expectancy;
- conversion privileges, riders and other provisions;
- replacement value and the type of policy involved.

Valuation of a policy’s fair market value should always be carried out by an independent professional. Life insurance companies do not provide this service.

Taxes payable by policyholder on transfer

The insurer is required to indicate on a T4A or T5 slip the taxable amount the initial policyholder (transferor) has to include in income for the taxation year in which the disposition took place. Under tax legislation, when a policyholder disposes of an interest in a life insurance policy in a given taxation year, he must include in their taxable income for that year the taxable portion of the proceeds from the disposition of the policy. The policyholder must include the full amount of the taxable portion on their income tax return.

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8. The CRA has stated that the valuation principles for a life insurance policy as set out in sections 40 and 41 of Information Circular 89-3 apply in all circumstances, and not only with respect to valuation in the context of a corporation.
9. Paragraph 56(1)(j) ITA.
Transfers between individuals

Under Quebec’s civil law, an insurance policy can be assigned to a third party provided the assignee has an insurable interest in the life or health of the insured. If an insurable interest does not exist at the time of the assignment, the life insured must consent in writing.\textsuperscript{10} There is no corresponding requirement in the common law provinces and territories.

There are many transactions in which individuals may be involved. A popular but mistaken belief is that a taxable disposition at death can be prevented by appointing a contingent owner on the policy. It is important to remember that transferring ownership to an individual, whether during the policyholder’s lifetime or at death, constitutes a disposition by operation of law.\textsuperscript{11} The transfer will take place on a tax-free basis only if the contingent owner qualifies under the terms of the Income Tax Act as someone who is deemed to acquire the policy for an amount equal to its ACB.

Tax-free transfers

Under the Income Tax Act, a life insurance policy can be transferred on a tax-free basis in certain situations. In that context, the transferor is deemed to have disposed of the policy in exchange for proceeds of disposition equal to the policy’s ACB, and the transferee is deemed to have acquired the interest in the policy at a cost equal to those proceeds (ACB). The ITA allows tax-free policy transfers in the follow situations:

a) Transfer to a spouse

Transfer to spouse during policyholder’s lifetime

Under subsection 148(8.1) ITA, a tax-free policy transfer is allowed when a policy is transferred during the policyholder’s lifetime to the policyholder’s spouse or common-law partner, or former spouse or common-law partner when the transfer is made to settle rights arising out of the marriage or common-law partnership. An additional requirement for avoiding a tax impact is that the policyholder and spouse must be residents of Canada at the time of the transfer.

The policyholder may elect not to take advantage of a tax-free transfer. In that case, subsection 148(7) ITA would apply, and the proceeds of disposition would be equal to the highest of the following amounts: the policy’s cash surrender value, the FMV of the consideration paid for the policy, and the policy’s ACB.

However, even though a transfer to a spouse will not have any immediate tax implications for the transferor, it’s important to remember that during the policyholder’s lifetime, if the spouse-beneficiary accesses the cash surrender value via a policy loan, withdrawal or otherwise, it may

\textsuperscript{10} Article 2418 of the Civil Code of Quebec.
\textsuperscript{11} Subsection 248(8) ITA; sections 7.1 and 7.2 TA.
cause the attribution rules to be applied to the income generated, unless the person is a former spouse. 12

**Transfer to spouse at policyholder's death**

Under subsection 148(8.2) ITA, a policy transfer at the policyholder's death to the policyholder’s married spouse or common-law partner is tax-free.

In order for there to be no tax impact, the policyholder and spouse must be residents of Canada at the time of the transfer. There are certain situations that call for special attention. Firstly, common-law partners who qualify as such under the Income Tax Act cannot be each other’s heirs unless this is specifically provided for in a will or by means of a beneficiary designation in a life insurance policy.

The executor or estate liquidator may elect not to take advantage of a tax-free transfer. In that case, subsection 148(7) ITA would apply and the proceeds of disposition would be equal to the highest of the following amounts: the policy's cash surrender value, the FMV of the consideration paid for the policy, and the policy's ACB.

Lastly, it should be noted that the right of survivorship that applies to joint owners of an asset under common law 13 does not exist in the Civil Code of Quebec. Consequently, in Quebec, the proportion of the interest in a life insurance policy held by one of the owners will automatically form part of that person’s estate, even if the other owner is the spouse. The spouses therefore have to appoint each other to be the contingent owners of their interests in the policy, or ensure that there is a provision in their wills to address this situation.

b) **Transfer to a child**

Subsection 148(8) ITA allows for a tax-free rollover to a child when the following two conditions are met:

1. the policy is transferred to the policyholder’s child for no consideration, and
2. the life insured is a child of the policyholder or a child of the transferee.

Under the ITA, the term “child” is broadly defined. It includes grandchildren, great-grandchildren, the married spouse or common-law partner of a child, a child of the taxpayer’s married spouse or common-law partner, or an adopted child. 14 The child to whom the policy is transferred does not necessarily have to be the person insured under the policy. Thus, a grandfather who owns a policy

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12 Subsection 74.1(1) ITA; section 462.1 TA.

13 Generally, the right of survivorship is a right where, at death, the interest of the deceased joint owner is transferred to the surviving joint owner(s) by operation of law. For spouses residing outside Quebec, it is important to note that insurance policies should expressly stipulate that the right of survivorship applies.

14 The definition of “child” in this specific case is the definition found in subsection 148(9) ITA, which itself refers to the definition in subsection 70(10) ITA. An extended definition of “child” can be found in subsection 252(1) ITA.
under which his grandson is insured may transfer that policy to his son (i.e. his grandchild’s parent) with no tax implications.

If the conditions are satisfied, a life insurance policy can be transferred on a tax-free basis. There are no restrictions as to the timing of the transfer. This can be a very effective strategy for helping with the intergeneration transfer of wealth.

The policy must be transferred to the child directly. It cannot be transferred to a trust, even if the beneficiary under the trust is a child who would otherwise qualify for a rollover. Also, the CRA has stated that a rollover is not allowed if the policy is transferred to the policy owner’s child and the owner is the insured under the policy.

At first glance, it would appear that these rollover situations are easily applied. However, subsection 148(8) ITA, which allows tax-free rollovers, does not apply to an insurance policy transferred from parent to child by means of the policyholder’s will. Thus, upon the policyholder’s death, the policy will first be transferred to the estate, and then to the child. This situation will result in the disposition of the policy by the deceased policyholder, and any gain realized on the policy will have to be included in the final tax return for the deceased.

The only way around this is to name a contingent owner in the policy who is the insured child or a child of whom the insured is a child. The CRA has confirmed that a rollover would be allowed where the insured child is named the contingent owner, as the policy will then not form part of the deceased owner’s estate but will instead be transferred directly to the child named as contingent owner. It should be noted that a transfer to a child should not be made unless the child is at least 16 years of age, which is when a child is deemed able to deal with a contract of insurance (age 18 in Quebec).

Transfer from a corporation to a shareholder or employee

Corporations often own insurance policies on the lives of their shareholders and employees. In many cases, it is advantageous for the shareholder or employee to receive the policy after the corporation is sold or wound up, or after employment is terminated. The tax implications, however, will be different depending on whether the parties are dealing at arm’s length.

Using the following information, let’s look at the impact of various types of life insurance policy transfers.

15 Technical interpretation letter no. 9826715.
16 Technical interpretation letter no. 2001-0098185.
18 Technical interpretation letter no. 9618075.
Universal life insurance policy

Insurance amount: $1,000,000

Cash surrender value: $150,000

ACB of policy: $75,000

FMV of policy: $500,000

Example 1: Transfer from a corporation to a shareholder

A corporation owns a life insurance policy on a shareholder. When the shareholder leaves, the corporation will probably no longer need to have insurance on the shareholder. However, the shareholder may want to own the policy. The corporation may therefore wish to transfer ownership of the policy to the departing shareholder.

As we have seen, the transfer would be a disposition for tax purposes. Since the transfer is between parties not dealing at arm’s length, subsection 148(7) ITA will apply. Under this subsection, the transaction is subject to the following tax rules:

- The proceeds of disposition for the corporation will be the highest of the value of the policy (i.e., the cash surrender value), the FMV of the consideration paid by the shareholder to acquire the policy, and the ACB of the policy.
- The new ACB to the shareholder is deemed to be equal to the same amount of the proceeds of disposition.
- If they had a difference between the FMV of the policy and the amount paid as consideration for the transfer, this amount will be considered a taxable benefit to the shareholder.

Let’s look at the potential tax impact of this transaction in various scenarios.

Scenario 1: The corporation transfers the life insurance policy to the shareholder for no consideration.

Scenario 2: The corporation transfers the life insurance policy to the shareholder, who pays the corporation consideration equal to the cash surrender value of the policy ($150,000).

Scenario 3: The corporation transfers the life insurance policy to the shareholder, who pays the corporation consideration equal to the fair market value of the policy ($500,000).
Transferor: Corporation Inc.

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<thead>
<tr>
<th>Scenario</th>
<th>Proceeds from deemed disposition (148(7))</th>
<th>ACB</th>
<th>Policy gain</th>
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<tbody>
<tr>
<td>Scenario 1</td>
<td>$150,000</td>
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<td>$75,000</td>
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<tr>
<td>Scenario 2</td>
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<td>$75,000</td>
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<tr>
<td>Scenario 3</td>
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Transferee: Shareholder

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<th>Consideration paid</th>
<th>Taxable benefit</th>
<th>New ACB</th>
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<tr>
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<td>$500,000</td>
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In scenarios 1 and 2, the result would be a taxable benefit equal to the amount by which the policy's FMV exceeds its cash surrender value or the consideration paid, and this would have to be added to the transferee shareholder's taxable income pursuant to the provisions of subsection 15(1) ITA or paragraph 6(1)(a) ITA. To prevent a taxable benefit from being conferred, the shareholder would have to pay to the corporation an amount equal to the FMV of the life insurance policy. The assessment of a taxable benefit can be reduced or eliminated if the life insurance is transferred as a dividend payable in kind to the shareholder. The dividend amount would be equal to the fair market value of the policy.

In scenarios 1 and 2, the existence of a taxable benefit means there would have to be an adjustment to the policy's ACB to reflect the amount by which the policy's FMV exceeds its CSV. This amount would have to be added to the policy's ACB. The ACB adjustment has been confirmed by various CRA technical interpretations.

Example 2: Transfer from an operating company to a holding company

Corporate restructuring or the sale of an operating company will often lead to a change in the ownership structure of any life insurance involved. One common arrangement is for an operating company (OpCo) that is owned by a holding company (HoldCo) to transfer ownership of a life insurance policy to the holding company. In this situation, subsection 148(7) ITA will apply, as the transfer is a non-arm's length transfer.

As a result, the proceeds of disposition for the operating company will be the highest of the following amounts: the value of the policy (i.e., the cash surrender value), the FMV of the consideration paid by the holding company, and the ACB of the policy. The new ACB to the holding company is deemed to be equal to the proceeds of disposition.

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Lastly, the difference between the FMV of the policy and the amount paid as consideration for the transfer will be considered a taxable benefit to the transferee (holding company) pursuant to subsection 15(1) ITA.

Let’s look at the potential tax impact of this transaction in various scenarios.

**Scenario 1:** OpCo transfers the life insurance policy to HoldCo for no consideration.
**Scenario 2:** OpCo transfers the life insurance policy to HoldCo, which pays OpCo consideration equal to the cash surrender value of the policy ($150,000).
**Scenario 3:** OpCo transfers the life insurance policy to HoldCo, which pays OpCo consideration equal to the fair market value of the policy ($500,000).
**Scenario 4:** OpCo declares a dividend payable in kind to HoldCo in an amount equal to the fair market value of the policy ($500,000).

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<tr>
<th>Transferor: OpCo Inc.</th>
<th>Scenario 1</th>
<th>Scenario 2</th>
<th>Scenario 3</th>
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<td>Proceeds from deemed disposition (148(7))</td>
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<td>$75,000</td>
<td>$425,000</td>
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<tr>
<th>Transferee: HoldCo Inc.</th>
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<tr>
<td>Consideration paid</td>
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<tr>
<td>Taxable shareholder benefit</td>
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<tr>
<td>New ACB</td>
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</table>
In scenarios 1 and 2, the taxable benefit that arises for HoldCo cannot be deducted by the transferor corporation, OpCo. A taxable benefit should therefore be avoided if possible. The assessment of a taxable benefit could, however, be reduced or eliminated if the life insurance policy is transferred as a dividend payable in kind. The amount of the dividend would be equal to the FMV of the policy, i.e., $500,000. The dividend could then be treated as a tax-free intercorporate dividend in kind.

The tax treatment applied to dividends in kind is discussed in Interpretation Bulletin IT-67R3, Taxable dividends from corporations resident in Canada. According to this Interpretation Bulletin, the dividend would be equal to the life insurance policy's FMV even though the proceeds of disposition and the new ACB may be a different amount. Thus, a professional evaluator will be needed to provide a FMV for the policy.

Despite this possibility, it should be noted that subsection 55(2) ITA could apply to recharacterize the intercorporate dividend in kind as a capital gain. The 2015 federal budget expanded the application of subsection 55(2) to a number of common situations involving the payment of a dividend between related companies, including the payment of a dividend in kind in the context of transferring a life insurance policy between two related companies.

To prevent the application of subsection 55(2) ITA and allow the transfer of the policy to the holding company without triggering a capital gain, there must be sufficient safe income (taxed retained earnings) attributable to the class of the operating company’s shares used to pay the dividend in kind. As the provisions of subsection 55(2) ITA are relatively complex, the best course of action is to consult a tax professional before proceeding with this type of transaction.
Example 3: Transfer between sister corporations

In a context of corporate restructuring, it might make sense to transfer a life insurance policy from one sister corporation to another. Sister corporations are corporations that are related in the sense that they are controlled by the same person or entity, but neither sister company owns any part of the other. As the transfer is a non-arm’s length transfer, it will also be subject to the provisions of subsection 148(7) ITA. Similar to the preceding examples, the proceeds of disposition for the transferor corporation will be the highest of the following amounts:

- the value of the policy (i.e., the cash surrender value),
- the FMV of the consideration paid by the transferee corporation, and
- the ACB of the policy.

The new ACB to the transferee is deemed to be equal to the proceeds of disposition.

Let’s look at a situation where SIS A.Inc. owns an insurance policy on the life of a shareholder who is also a shareholder of SIS B. Inc. Following a restructuring of the business, SIS A. Inc. wishes to transfer this policy to SIS B. Inc.

Let’s look at the potential tax impact of this transaction in various scenarios.

**Scenario 1:** SIS A. Inc. transfers the life insurance policy to SIS B. Inc. for no consideration.

**Scenario 2:** SIS A. Inc. transfers the life insurance policy to SIS B. Inc., which pays SIS A. Inc. an amount equal to the cash surrender value of the policy ($150,000).

**Scenario 3:** SIS A. Inc. transfers the life insurance policy to SIS B.Inc., which pays SIS A. Inc. an amount equal to the fair market value of the policy ($500,000).

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<th>Transferor: SIS A. Inc.</th>
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<th>Transferee: SIS B. Inc.</th>
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<td>Consideration paid</td>
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<tr>
<td>Taxable benefit</td>
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In the above example, the two corporations are not shareholders of one another. As a result, there can be no taxable benefit for the transferee corporation pursuant to subsection 15(1) ITA. However, in the CRA’s view, the transfer between sister corporations may result in a taxable benefit to the shareholder of the transferee corporation. This conclusion stems from comments made by the CRA,\textsuperscript{22} which applied a test for determining whether there was a shareholder benefit under subsection 15(1) ITA. If the transferor corporation is impoverished and the sole shareholder of the transferee corporation is enriched, a taxable benefit could be assessed to the shareholder.

A transfer between sister corporations could also be deemed an indirect payment to the shareholder of the transferee corporation pursuant to subsection 56(2) ITA. If any of these tax provisions apply, the taxable benefit to the shareholder would be equal to the amount by which the FMV of the policy exceeds the consideration paid, if any, by the sister corporation to acquire the policy.

Example 4: Transfer from a shareholder to a corporation

For estate planning purposes, or as a result of corporate restructuring, a shareholder may wish to transfer his life insurance policy to a corporation that he controls. In such a case, the shareholder and his corporation would not be dealing at arm’s length, meaning that subsection 148(7) ITA will apply.

Under this subsection, both the proceeds of disposition to the transferor and the ACB to the transferee are deemed to be the highest of:

\begin{itemize}
  \item the “value” (i.e., cash surrender value or, if there is no CSV, a nil value);
  \item the FMV of the consideration paid for the transfer;
  \item the adjusted cost basis (ACB) immediately prior to the transfer.
\end{itemize}

Let’s look at the potential tax impact of this transaction in various scenarios.

Scenario 1: The shareholder transfers the life insurance policy to the corporation for no consideration.

Scenario 2: The shareholder transfers the life insurance policy to the corporation, which pays the shareholder an amount equal to the cash surrender value of the policy ($150,000).

Scenario 3: The shareholder transfers the life insurance policy to the corporation, which pays the shareholder an amount equal to the fair market value of the policy ($500,000).

\textsuperscript{22} “Round Table - Taxation of Financial Strategies and Instruments,” 2006 APFF Convention, Montreal, October 2006, Question 15; Tax Window Files, October 6, 2006, number 2006-0197211C6.
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<td>$75,000</td>
</tr>
<tr>
<td>Policy gain</td>
<td>$75,000</td>
<td>$75,000</td>
<td>$425,000</td>
</tr>
<tr>
<td>Consideration paid</td>
<td>0</td>
<td>$150,000</td>
<td>$500,000</td>
</tr>
<tr>
<td>Taxable benefit</td>
<td>N/ A</td>
<td>N/ A</td>
<td>N/ A</td>
</tr>
<tr>
<td>New ACB</td>
<td>$150,000</td>
<td>$150,000</td>
<td>$500,000</td>
</tr>
</tbody>
</table>

Notwithstanding the March 2016 federal budget, which significantly reduced the tax advantages of this type of transaction, transferring a life insurance policy from a shareholder to a corporation may still be a good idea. For example, it may be advantageous from a tax perspective to pay the premiums on the policy with corporate dollars, which are generally taxed at a lower rate.

Shareholders interested in this type of strategy would be well advised to accept consideration that is at least equal to the higher of the cash surrender value and the ACB of the policy, as applicable. The shareholder in our example should therefore receive consideration in the amount of $150,000, as that value will have no additional impact on the policy gain indicated. As a result of this transaction, the new ACB to the transferee corporation will be the highest of the following amounts: the value of the policy (i.e., the cash surrender value), the FMV of the consideration paid by the transferee corporation, and the ACB of the policy.

Before transferring a policy to a corporation under their control, shareholders should also give some thought to the implications of the transaction. Factors to consider with this type of transfer include:

- The risk in terms of exposure to the creditors of the corporation, if any.
- If the life insurance policy has a substantial cash surrender value, this could impact the eligibility of the corporation’s shares for the capital gains deduction to the shareholder.
- Care must be taken to avoid triggering an undesirable taxable benefit. To that end, the corporation should be designated as the beneficiary of the policy.
- The risk of double taxation at death if the policy has a substantial cash surrender value.
Impact of the transfer of an interest in a life insurance policy in the context of amalgamation

In a case where two or more corporations are amalgamating and the provisions of section 87 ITA apply, the new corporation, in respect of each of the amalgamated corporations, is deemed to be the same corporation. As a result, the tax characteristics of the initial life insurance policy will continue to apply. It would appear that such a transaction would not constitute a disposition of an interest in a life insurance policy, given the continuation of the two amalgamated corporations.

Impact of the transfer of an interest in a life insurance policy in the context of winding up a corporation

In a case where a corporation is being wound up and a subsidiary is being absorbed by the parent corporation, the parent corporation, in respect of each subsidiary, is deemed to be the same corporation and a continuation of it, pursuant to subsection 88(1) ITA. Therefore, if the applicable rules are followed, the initial life insurance policy could be transferred tax-free and vested rights would be protected for the policies owned by the subsidiary that are transferred to the parent corporation at the time of the winding-up.

Conclusion

The tax implications of transactions performed on life insurance policies are often difficult to assess. Consequently, some situations will require you to seek the advice of an independent actuary and taxation specialists to ensure that the client is not leaving themselves open to an unexpected tax assessment. When in doubt, it is always best to have the transaction validated by these specialists before proceeding with a transfer.

While we have made every possible effort to ensure that the information presented in this document is accurate and up-to-date, please note that the examples and information provided are for illustrative purposes only. No one should act upon the information presented here without first seeking the professional services of a personal advisor and having a thorough analysis of his/her specific legal or tax situation performed by an independent professional in those fields.

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Sun Life Financial

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