Using corporate owned life insurance

The Canada Revenue Agency (CRA) has announced changes to its assessment practice for corporate owned life insurance policies.

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.
The CRA’s position from December 1998 to October 2009

In December 1998 the CRA released a technical interpretation saying that 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. However, the CRA also indicated that the 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.

Starting on January 1st, 2010 the CRA will apply a new position

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, and the 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. The CRA’s position that the GAAR will apply if the holding of the life insurance was structured to increase the value of the CDA credit was also restated.

The CRA indicated that they will apply their new assessment practice starting January 1, 2010 for new policies but will delay the application until January 1, 2011 for existing policies.

Corporation resident in Québec

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

Advising clients

In light of the CRA’s change in position, clients using corporate owned life insurance structures should consult with their tax and legal advisors. They should consider whether 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. However this would be a disposition of an interest in a life insurance policy under sect 148(9) ITA. Consequently OPCO would have to include in its taxable income for the year the portion of the policy’s CSV that exceeded its 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

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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.
3 CRA VIEWS 2004-0065461C6
4 APFF Congrès 2008, Table ronde sur la fiscalité provinciale, question 18. p. 47 :50
actuaries. That creates an additional expense for OPCO, though compensated by the fact that HOLDCO has to pay the FMV to OPCO as long as HOLDCO has enough cash.\footnote{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.}

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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