

STEPUP

Sales Tax Estate Planning Underwriting & Product Newsletter

Understanding life insurance (tracking) shares

(tracking) shares

Life insurance shares are often discussed as an estate planning tool for shareholders of private Canadian corporations. Uncertainty as to what these shares are, the advantages they provide as well as the related tax issues may make it hard for advisors to identify which clients to recommend them to.

The present newsletter gives a detailed review of life insurance shares providing the reader with a fuller comprehensive understanding of what these shares are and how they work. For readers who wish to see a case study on how these shares could be used, we invite you to consult our Case In Point "Estate Equalization for Farming Families".

What are they?

Life insurance shares are a way for a corporation to direct the benefits associated with a corporately owned life insurance policy (cash surrender values and/or death benefit) to a specific shareholder.

More specifically, they are preferred shares which generally have the following rights and conditions:

Rights and conditions	Explanation of the right or condition
Non-voting	The share does not carry a vote in the normal running of the corporation.
Non-Participating	The share does not participate in the remaining property of the corporation if is dissolved. In other words, the shares of the shareholder will not increase in value as the corporation's value increases.



Alex Papale,
Tax Retirement &
Estate Planning
Services

Alex is a well-regarded Tax and Estate Planning specialist with a sought-after ability to analyze and articulate complex matters. He completed graduate studies in tax law which allows him to provide integrative advice and comprehensive solutions to problems faced by Canadian residents and business owners. Before joining Empire Life, Alex worked for renowned accounting and legal firms, where he regularly advised clients on various tax and estate planning matters.

Alex can be reached at
alex.papale@empire.ca



Understanding life insurance (tracking) shares

Rights and conditions	Explanation of the right or condition
Redeemable at any time before death of the life insured by the holder for an amount corresponding to the cash surrender value (CSV) of the policy at time of payment (net of the corporation's tax liability resulting from the withdrawal of the CSV)	<p>Before death of the life insured, the shareholder is entitled to demand that the life insurance share be redeemed by the corporation.</p> <p>The amount to be paid by the corporation would be equal to the CSV of an identified life insurance policy at time of payment less the tax liability to be paid by the corporation as the result of the CSV withdrawal.</p> <p>The corporation can then either choose to withdraw the CSV of the life insurance policy to have the necessary funds to make the payment or, if it has the funds to pay for the share without withdrawing the life insurance policy, it can keep the policy in force.</p> <p>For the shareholder, this redemption of the life insurance share should result in a deemed taxable dividend with the associated tax liability.</p>
Redeemable at any time after death of the life insured at the request of the corporation or the holder for an amount corresponding to the death benefit	<p>After death of the life insured, the shareholder or the corporation are entitled to demand that the life insurance share be redeemed by the corporation.</p> <p>The amount to be paid by the corporation would be equal to the death benefit from an identified life insurance policy at time of payment.</p> <p>The corporation should make the necessary choices and designations so that the deemed dividend resulting from the repurchase of the life insurance share be designated, at least in part, as a capital dividend.</p> <p>For the shareholder, this redemption of the life insurance share should result in a deemed dividend which could be a taxable dividend, a capital dividend or a combination of both.</p>

Tax issues

Shareholder benefit

When the use of a life insurance share is considered, the timing of issuance of such share is important. More specifically, the timing of issuance of a life insurance share may have different tax consequences whether the share is issued before or after the relevant life insurance policy is in force.

In situations where a corporation is owner of an already in force life insurance policy, a consideration of an amount equal to the fair market value of the policy should be paid by the shareholder to whom the life insurance share is issued to the corporation. If no consideration is paid by the shareholder, a shareholder benefit under subsection 15(1) ITA would arise and would lead to an income inclusion for the shareholder.

Considering the above, it may be simpler and more tax efficient to issue the life insurance share prior to the life insurance policy being in force. For instance, the shareholder could pay the corporation \$1 in return for the life insurance share. Once the life insurance share is issued, the corporation applies for the life insurance policy that will be tracked by the life insurance share. With this sequence of steps, the shareholder receiving the life insurance share may not incur a shareholder benefit under subsection 15(1) ITA.

Impact of CSV on value of shares at time of death

Subsection 70(5) ITA establishes a deemed disposition at death of an individual of each capital property of the individual at their fair market value. For many clients, their capital properties include shares of a private corporation.

When determining the value of these shares at time of death, subsection 70(5.3) ITA provides that the fair market value of a corporately owned life insurance policy should generally be equal to the policy's CSV.

However, the Income Tax Act does not establish how the fair market value of a corporately owned life insurance policy should be distributed on the shares issued and outstanding of the corporation. This could result in tax uncertainty in situations where a person owns all the common shares of a private corporation and is also the

Understanding life insurance (tracking) shares

life insured under a life insurance policy owned by the corporation while another person owns the life insurance share. In such situations, the Income Tax Act does not provide the value of which shares (the common shares or the life insurance share) the CSV of the corporately owned life insurance policy will impact.

The Canada Revenue Agency (CRA) has provided some guidance on that matter. CRA's general position is that it would be reasonable to distribute the CSV of a life insurance policy between the different categories of shares based on the rights and conditions attached to them. CRA was also asked to comment on a situation where a life insurance share was redeemable at the shareholder's request at any moment before the life insured's death for an amount corresponding to the CSV of the policy. In such a situation, CRA's position was that "it would not be unreasonable to allocate the amount of the policy's cash surrender value to the insurance share, immediately prior to death. Therefore, the value of the common shares held by the taxpayer in the situation, would not take into account the cash surrender value of the life insurance policy on the taxpayer's life."

If the CSV of the corporately owned life insurance policy does not impact the value of the common shares held by the deceased, the CSV would not increase the tax liability at death of the holder of the common shares.

How we can help

Our tax and estate planning team can assist you and your clients in matters of tax and estate planning involving identifying clients for whom life insurance shares may be relevant and how it might work for them. Contact your sales team to see how the team can help you and your clients.

FOR ADVISOR USE ONLY

Updated, Oct. 2022

This document reflects the views of Empire Life as of the date published. The information in this document is for general information purposes only and is not to be construed as providing legal, tax, financial or professional advice. The Empire Life Insurance Company assumes no responsibility for any reliance on or misuse or omissions of the information contained in this document. Information obtained from and based on third party sources are believed to be reliable, but accuracy cannot be guaranteed. Please seek professional advice before making any decisions.

A description of the key features of the individual variable insurance contract is contained in the Information Folder for the product being considered.

Any amount that is allocated to a Segregated Fund is invested at the risk of the contract owner and may increase or decrease in value.

® Registered trademark of **The Empire Life Insurance Company**. Policies are issued by The Empire Life Insurance Company.

The Empire Life Insurance Company

259 King Street East, Kingston, ON K7L 3A8

Insurance & Investments – Simple. Fast. Easy.®

empire.ca info@empire.ca 1 877 548-1881

