February 4, 2009

Mr. Brian Ernewein
General Director
Department of Finance
L'Esplanade Laurier
140 O'Connor Street
Ottawa, ON K1A 0G5

Dear Mr. Ernewein:

Re: Capital Dividend Account on Trust Distributions of Life Insurance to a Corporate Beneficiary

I am writing on behalf of the Conference for Advanced Life Underwriting (CALU) and the Financial Advisors Association of Canada, which operates under the name of Advocis™, to recommend that trust distributions of life insurance to a corporate beneficiary be able to added to the corporation's capital dividend account.

Advocis traces its roots to the formation of the Life Underwriters Association of Canada in 1906. It is the largest voluntary professional membership association of financial advisors in Canada, representing more than 10,000 financial advisors across Canada. Advocis members provide comprehensive financial and retirement planning, wealth management, estate and tax planning, risk management and employee benefits planning products and advice to millions of Canadians.

CALU was formed in 1991 with the mandate to address advanced applications of life insurance and financial services. CALU has established a reputation for expertise in the areas of corporate uses of life insurance, estate, retirement and investment planning, and employee benefits and pensions.

Introduction

The capital dividend account is used by corporations to pay tax-free capital dividends pursuant to subsection 83(2) of the Income Tax Act (the "Act").

Since 1971 and prior to 2001, the capital dividend account for a given period was calculated as:

(a) the excess of the non-taxable portion of capital gains over the non-deductible portion of capital losses incurred by the corporation;
(b) the aggregate of capital dividends received by the corporation;

(c) the non-taxable portion of gains resulting from the disposition of eligible capital property;
(d) the net proceeds of a life insurance policy received after May 23, 1985 by the corporation and such proceeds received after 1971 and before May 24, 1985 where the corporation was a beneficiary under the policy prior to June 29, 1982; and
(e) the balance, if any, in the corporation's life insurance capital dividend account immediately before May 24, 1985,

exceeds the aggregate of all capital dividends that became payable by the corporation in the period.

Recent Amendments

The 2001 technical bill (Bill C-22) added paragraphs (f) and (g) to the definition of "capital dividend account" in subsection 89(1) of the Act to enable the receipt by private corporations of capital dividends where such dividends flowed out of a trust to a private corporation. Paragraph (f) provides for the inclusion in the corporation's capital dividend account the amount in respect of the non-taxable portion of capital gains distributed by a trust to the corporation and paragraph (g) relates to capital dividends arising from capital dividends received on shares held by the trust.

CRA Administrative Practice

It is also CRA's administrative position, that a credit to the CDA is available when a corporate partner of a partnership is allocated life insurance proceeds from the partnership pursuant to the terms of the partnership agreement. CRA's position is documented in Advance Income Tax Ruling 2001-0114863 and Technical Interpretation 5-3164.

Request

There are situations in which trusts will receive the proceeds of a life insurance policy on the death of an individual and where the trust is required to distribute the proceeds of life insurance to a private corporation. We are writing to request that the Department of Finance extend the same type of capital dividend account character to life insurance death benefits received by a trust and distributed to a private corporation as has been done in respect of non-taxable portion of capital gains and capital dividends received by a trust.

Example

The following is an example of a situation in which the suggested amendment would be very helpful in practically implementing a solution for this common circumstance:

Operating company (Opco) has 5 shareholders, three of whom are individuals and two are Canadian controlled private corporations (CCPCs). The shareholders have entered into an agreement that requires a buy out of the shares on the death of a shareholder (or principal shareholder of the CCPC). It is contemplated that Opco acquire the shares of a deceased shareholder/principal from the estate or CCPC, as applicable.

However, for a variety of reasons including ease of administration and creditor protection of the insurance policies, it is desired that the insurance policies be owned and funded by a trust of which Opco is the beneficiary. It is critical to this planning that Opco benefit from a credit to its capital dividend account for the insurance proceeds received by the insurance trust. Such credit should be calculated in the same way as if Opco were the owner, payor and beneficiary of the policies.

Conclusion

Life insurance is a useful tool in planning for business continuation. Enabling a capital dividend account credit in respect of life insurance proceeds received by a trust and distributed to a CCPC beneficiary would enable greater flexibility in facilitating the orderly transition of businesses and at the same time would be accorded the same tax results of similar distributions in other contexts.

We would appreciate the opportunity of discussing the proposed amendment further with you or your staff. You may contact the undersigned by either phone or e-mail, as listed above.

Yours very truly,

ORIGINAL ON LETTERHEAD SIGNED BY

A.E. (Ted) Ballantyne, BBA, LLM, CMA, TEP
Director, Advanced Tax Policy