



# Life Insurance – Life Interest Trusts

## Summary of CRA Technical Interpretations and Tax Folio S6-F4-C1

### 2006-0174041C6 dated November 2, 2006

Question - spousal testamentary trust – transfer of existing life insurance to trust with premiums to be paid by trust capital. Trust is beneficiary of the policy. Will this “taint” the trust for purposes of subsection 70(6)?

CRA Response - “A duty to fund a life insurance policy out of trust capital or income would, in our view, be one under which a person may obtain the use of the trust capital or trust income. This is because the premium payment is assumed to maintain, for the period covered by the premium, the rights to receive insurance proceeds....

In the circumstances contemplated by your question, as a result of the duty to pay insurance premiums out of trust property, it would appear that persons other than the survivor may, before the survivor’s death, obtain the use of the trust income or capital. Therefore, we are of the view that the trust would not satisfy the conditions of subparagraph 70(6)(b)(ii) of the Act.

As a final comment, whether the trust is one that seeks to satisfy the requirements of paragraph 70(6)(b) of the Act or not, and whether the premiums are paid out of trust income or trust capital, it would appear that the policy beneficiary (including in the circumstances of the trust being named under the policy to receive the insurance proceeds, the trust beneficiaries) would have a benefit, from the trust’s payment of the policy premiums, resulting in section 105 of the Act.”

Note – CRA TI 2008-0301881E5 dated October 9, 2009 (French) confirmed that no benefit under subsection 105(1) arises for the beneficiaries of a trust when the trust owns and is the beneficiary of the policy. “With respect to the second question, we are of the view that the Ontario-based trust would confer no benefit if the payment of premiums is viewed as an investment duty of the trustee under the terms of the trust.” (unofficial translation)

### 2012-0435681C6 dated May 8, 2012

Fact situation – spousal testamentary trust – transfer of existing life insurance to trust with premiums to be paid by trust capital. Trust is beneficiary of the policy.

Q.1 – Who, other than the surviving spouse, is entitled to the capital or income of the trust prior to the death of the surviving spouse? Would placing a positive duty on the trust to retain property (such as corporate shares or rental property) until the death of the spouse taint the trust?

CRA Response – Restates CRA response in TI 2006-0174041C6 and adds “the rights to receive the insurance proceeds by the policy beneficiary – which will never be the surviving spouse”.



The CRA also states “A trustee’s duty to retain and/or maintain certain income producing properties....is not, in our view, analogous to the payment of insurance proceeds by the trustees to receive the insurance proceeds by the policy beneficiary after the death of the spouse. However, with that said, we would caution that it is always a question of fact whether the terms of any trust will meet the requirement of subparagraph 70(6)(b)(ii) of the Act.”

Q. 2 – Can the CRA confirm if there is no “duty” on the trustees to acquire and/or fund life insurance on the lives of the spouses or surviving spouse and where such trust is the beneficiary of any insurance proceeds, that the trust is not tainted.

CRA Response – “The CRA is of the view that the mere possibility of a person other than the surviving spouse receiving or obtaining, before the survivor’s death, use of the trust capital or income is sufficient to disqualify the property transfer from the rollover. This view is consistent, whether the trustee has an *obligation or a mere power* to encroach on the capital of a trust for the benefit of persons other than the surviving spouse or common-law partner.” (italics added).

Q. 3 - Mr. B owns shares in an Opco which are transferred to a testamentary spousal trust. The Opco owns a joint last to die policy on the life of Mr. B and his spouse. Opco B is obligated to maintain the insurance policy until the death of the surviving spouse and pay the insurance proceeds as a dividend to the trust. Will this arrangement taint the trust?

CRA Response – “The CRA is unable to confirm that such a structure would not taint the status of the testamentary trust and also impact the rollover of property under subparagraph 70(6)(b)(ii) of the Act.”

Q. 4 Can the CRA confirm that its response to questions 2/3 will be the same if the policy under consideration has a cash surrender value that is accessible to the trust.

CRA Response - “The CRA is unable to comment on the tax implications in a situation where the trust, or Opco B ... as the owner of the insurance policy makes additional deposits to create a cash reserve accessible on the disposition of the policy or added to the insurance proceeds upon the death of the insured(s).”

## 2012-0435691C6 dated May 8, 2012

Question – Could the CRA comment on the above questions (as submitted in CRA TI 2012-0435681C6 dated May 8, 2012 noted above) in relation to the rollover available on the transfer of property to an alter ego or joint partner trust?

CRA Response – “...a duty to fund a life insurance policy out of trust capital or trust income would be one under which a person may obtain the use of trust capital or trust income....and this view would equally apply for purposes of the rollover provisions in subsection 73(1) of the Act.

Further, as noted in our response [in the above noted CRA TI] this view applies consistently whether the trustee has an obligation or a mere power to encroach on the capital of a trust for the benefit of persons other than the surviving spouse or common-law partner.”



## 2012-0453121C6-T dated October 5, 2012 (Unofficial Translation)

Question – there are joint last to die exempt policies where the cost of insurance ceases on the first death. Such a policy remains in force without premium being payable and the benefit is payable on the second death of the spouses. Assume the owner of such policy dies and there is a specific bequest or the testamentary spousal trust is named as contingent owner. Can the CRA confirm this does not taint the testamentary spousal trust.

CRA Response – “Assuming that the ownership of the insurance contract, following the death of the testator who is the policyholder, has been legally transferred to this trust and that this trust (or its trustees) does not have to disburse any amount from the income or capital of the trust in order to maintain the policy in force and that no other person other than the surviving spouse or common-law partner, can, prior to the death of the spouse or common-law partner, receive or obtain any part, if any, of the income or cash surrender value of the policy, it appears that the condition of subparagraph 70(6)(b)(ii) ITA would be met.”

## 2014-0529361E5 dated November 15, 2015

Question – Scenario provided where income or capital from a proposed spousal trust will be used to pay life insurance premiums on spouse’s life. Will this disqualify the trust from being eligible for the rollover of property upon the creation of the trust. [Note this question was submitted in a similar format as an Advance Tax Ruling by CALU in April 2014]

CRA Comments – “...while we agree with your comments that the relevant legislation does not contain a requirement that the spouse “benefit” from the trust while alive, the concern remains that no one other than the spouse obtains the use of trust capital or income. The distinction must be made from the examples provided in your situation whether a trustee in his/her fiduciary duty takes action to preserve or increase the capital of a trust or invests in an asset providing income to the trust. In this regard we are still of the view that a trustee’s duty to maintain certain income producing or capital appreciating properties which may potentially benefit a spouse during their lifetime, is not, in our view, analogous to the payment of insurance premiums by the trustee to maintain rights to receive the insurance proceeds by the policy beneficiary on the death of the spouse.... we consider the payment of premiums by the trust to be property used to establish the residual beneficiaries’ rights to funds from the policy that will be realized after the death of the spouse.

## 2016-0632631C6 dated May 3, 2016

Question – Is paragraph 8 of IT-305R4 (archived) still valid? This provision provides that once a trust qualifies as a spouse trust under the terms of subsection 70(6), it remains a spouse trust and remains subject to the provisions affecting such trusts even if the terms are varied by agreement, legal action or breach of trust. [Note that section 1.68 of Tax Folio S6-F4-C1 Testamentary Spouse or Common-Law Partner Trusts limits these comments specifically to subparagraph 104(4)(a)(i)].

CRA Comments – “The wording of subparagraph 104(4)(a)(i) clearly provides for a deemed disposition date that is based on the terms of the trust “at the time it was created”. Accordingly, even if the terms of the trust are varied by agreement, legal action or breach – it is the terms of the trust upon creation that would determine the application of subsection 104(4).” [Note – the rollover in subsections 70(6) does not contain the wording “at



the time it was created” but it is difficult to see how a subsequent act outside the terms of the will or trust documents could override the rollover rules for a transfer that took place when the trust was compliant with the requirements. Subsection 73(1) seems to be clearer that the conditions have to be met at the time the property is transferred.]

## 2018-0761511C6-T dated October 5, 2018 (Unofficial Translation)

Question – Mr. A dies and under his will the residue of his property transfers to a testamentary spousal trust. Among his assets transferred to the spousal trust are policies Mr. B owned on the lives of his two children. The policies have a cash surrender value and premiums are still payable. Does the transfer of these policies taint the spousal trust?

CRA Comments – “Assuming the trust is the revocable beneficiary of a life insurance policy and that ownership of the policy has been legally transferred to the Trust following the death of a testator, the fact that the insured is the residual beneficiary of the Trust and that the insurance proceeds could benefit the surviving spouse or common-law partner in the event that the insured children predecease the surviving spouse or common-law partner does not generally change the CRA’s position in the above mentioned documents.” [i.e., the CRA’s TIs discussed above].

“Indeed, the payment of a life insurance premium is presumed to maintain, for the period covered by the premium, the rights of the policy beneficiary to receive the insurance proceeds. In this case, the beneficiary could at any time be a person other than the surviving spouse or common-law partner.”

## Income Tax Folio S6-F4-C1

This Chapter, which may be referenced as S6-F4-C1, is effective February 3, 2022 and replaces and cancels Interpretation Bulletin IT-305R4, Testamentary Spouse Trust.

## Requirements regarding the income and capital of a spouse trust

**1.19** As indicated in ¶1.11, to qualify as a spouse trust, the spouse or common-law partner must be entitled to receive all the income of the trust arising before the spouse’s or common-law partner’s death. Further, no one but the spouse or common-law partner may receive or otherwise obtain the use of any of the income or capital of the trust before the spouse’s or common-law partner’s death.

**1.20** For this purpose, subsection 108(3) provides that the income of the trust is its income calculated under the rules of trust law rather than under calculation provisions in the Act, minus certain dividend amounts. The dividends deducted from the trust’s income are those dividends:

- that are, by reason of section 83, not included in computing the trust’s income for other purposes of the Act;
- that are described in subsection 131(1); or
- to which subsection 131(1) applies by reason of subsection 130(2).



**1.21** Consequently, a trust will not be precluded from qualifying as a spouse trust because under its terms, such dividends are not paid or payable to the spouse or common-law partner.

**1.22** Also, amounts such as taxable capital gains (that are not in the nature of income under trust rules) which were neither paid nor payable to the spouse or common-law partner under the terms of the trust, nor included in the spouse's or common-law partner's income under a preferred beneficiary election, are necessarily taxed in the trust. This is because during the spouse's or common-law partner's lifetime no one but the spouse or common-law partner may receive anything out of a spouse trust or make a preferred beneficiary election in connection with the trust's income.

**1.23** A discretionary power granted to the trustee to distinguish income and capital items cannot change the nature of an amount of income or deductible expense into a capital receipt or expenditure and vice versa. The CRA does not accept that a trustee can, at their discretion, determine what is income and what is capital.

**1.24** Under subsection 108(4), a trust is not prevented from qualifying as a spouse trust solely because it is charged with the payment of:

- any estate, legacy, succession, or inheritance duty payable, in consequence of the death of the taxpayer, or a spouse or common-law partner of the taxpayer who is a beneficiary under the trust, in respect of any property of, or interest in, the trust; or
- any income or profits tax on any of its income computed in accordance with the Act.

**1.25** Additionally, for tax years beginning after 2016, a trust is not prevented from qualifying as a spouse trust solely because the deceased's child, spouse or common-law partner, or former spouse or common-law partner, inhabits a housing unit that is, or is in respect of, property that is owned at that time by the trust. This exception is applicable provided that the housing unit is a property described in the definition of "principal residence" in section 54 in respect of the trust. For more information on what constitutes a housing unit see ¶2.7 of [Income Tax Folio S1-F3-C2](#).

**1.26** The mere existence of a power to encroach on the capital or income of the trust for the benefit of persons other than the spouse or common-law partner, prior to the spouse's or common-law partner's death, is sufficient to disqualify a trust from being a spouse trust. Disqualification would also occur if the trustee of a trust were given discretion to allocate the trust's income and/or capital among members of the deceased taxpayer's family during the life of the spouse or common-law partner.

**1.27** It is the CRA's view that the phrase "entitled to receive all of the income of the trust" in subparagraph 70(6)(b)(i) means to have a legal right to enforce payment of that income. In order for a spouse or common-law partner to have a legal right to enforce payment of the income of the trust, any discretion in respect of the distribution of all or part of the income of the trust must be solely in the hands of the spouse or common-law partner.

**1.28** Even if the terms of the trust make it clear that the spouse or common-law partner is to receive all income of the trust, it may happen that the spouse or common-law partner indicates to the trustee in writing that they do not wish to receive such income for a particular year. The fact that such income is retained by the trust, at the spouse's or common-law partner's direction, and added to the capital of the trust will not, by itself, disqualify the trust from being a spouse trust.



**1.29** In addition, notwithstanding any direction by the spouse for a particular tax year to retain the income in the trust, the trust income for that year would still become payable to the spouse within the meaning of subsection 104(24). Consequently, such income would be included in computing the income of the spouse for that year regardless of whether the income was paid to the spouse, unless the trust made an election under subsection 104(13.1) for the year in question (subject to the limitation in subsection 104(13.3)).

**1.30** The terms of the trust might permit the trustee to restrict the payment to the spouse or common-law partner of any portion of the trust's income. If so, it is the CRA's view that the spouse or common-law partner is not entitled to receive all the income of the trust. This means that the trust does not qualify as a spouse trust.

**1.31** A trust under which the income beneficiary's entitlement to the income of the trust would be limited to a certain percentage of the value of the trust property could not qualify as a spouse trust since the income beneficiary would not be entitled to receive all of the income of the trust.

**1.32** In interpreting the requirement that the spouse or common-law partner must be entitled to receive all of the income of the trust that arises before their death, the doctrine of constructive receipt is applied. Consider a situation in which there is a payment of trust income according to the will (or a provision in the will for the payment) to a person other than the spouse or common-law partner, on the condition that it be used solely for the benefit of the spouse or common-law partner. Under the doctrine of constructive receipt, this does not disqualify an otherwise qualifying spouse trust.

**1.33** *The terms of the trust might permit the trustee to fund a life insurance policy held by the spouse trust on the life of the spouse or common-law partner out of the trust capital or trust income. If so, this would be a situation in which a person other than the spouse or common-law partner may obtain the use of trust capital or trust income contrary to subparagraph 70(6)(b)(ii). This is because for the period covered, the premium payment ensures that the policy beneficiary maintains a right to receive insurance proceeds. Since the policy beneficiary will never be the spouse or common-law partner, it is the CRA's view that the trust would not satisfy the conditions of subparagraph 70(6)(b)(ii).*

**1.34** Subparagraph 70(6)(b)(ii) specifies that before the death of the spouse or common-law partner, no other person may receive or otherwise obtain the use of any of the income or capital of the spouse trust. The renting of real estate at market value or the lending of money on commercial terms (including market rates of interest, appropriate securities, and a reasonable repayment schedule), does not generally mean that the person renting the real estate or borrowing the money has received or obtained the use of that property as the expression is used in this requirement.

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## Death of the taxpayer's spouse or common-law partner

**1.65** For 2016 and subsequent tax years, if the individual whose death is the death determined in respect of a particular trust under paragraph 104(4)(a), (a.1) or (a.4), paragraph 104(13.4)(a) deems the trust's tax year to end at the end of the day of the death. A new tax year of the trust is deemed to begin immediately after that day.



**1.66** At the end of the day on which the spouse or common-law partner dies, a spouse trust is deemed to have disposed of each property of the trust (other than exempt property) that was capital property (other than depreciable property) or land included in the inventory of a business of the trust. The disposition is deemed to be for proceeds equal to the property's FMV at the end of that day (determined with reference to subsection 70(5.3)). The spouse trust is deemed to have reacquired the property immediately after that day for an amount equal to that FMV. Subsections 104(5) and (5.2) apply in a similar manner to depreciable property and resource property (other than exempt property).

**1.67** Exempt property is defined as property the income or gain from a taxpayer's disposition of which is exempt from Canadian taxation for the taxpayer either because the taxpayer is not resident in Canada or because of a tax treaty.

**1.68** *It is the terms of the trust upon creation that determine the application of subsection 104(4), even if the terms of the trust are varied by agreement, legal action, or breach. For example, the wording of subparagraph 104(4)(a)(i) clearly provides for a deemed disposition date that is based on the terms of the trust at the time it was created.*

**1.69** Paragraph 104(13.4)(b.1), permits the trust and the legal representative administering the deceased beneficiary's graduated rate estate to file a joint election to report all of the trust's income arising from the application of subsections 104(4) to (5.2) or subsection 12(10.2) on the deceased beneficiary's final T1 Return. The joint election is possible if all of the following conditions are met:

- Immediately before death, the beneficiary was a resident of Canada.
- The trust is, immediately before the death, a testamentary trust that is a post-1971 spousal or common-law partner trust and was created by the will of a taxpayer who died before 2017.
- A copy of the joint election is filed with both the final T1 Return of the beneficiary and the T3 Trust Income Tax and Information Return for the tax year of the trust to which the deemed year end applies.

Where the election is made, the trust may deduct the corresponding amount from its income. For information on filing a deceased person's income tax return, see [Guide T4011](#).