



August 10, 2021

Shawn Porter
Associate Assistant Deputy Minister (Legislation)
Department of Finance
90 Elgin St
Ottawa, ON K1A 0G5

SENT VIA EMAIL

Dear Mr. Porter

Re: Comfort letter relating to the definition of the capital dividend account

On behalf of the Conference for Advanced Life Underwriting (CALU), we are writing to seek a comfort letter with respect to amending the definition “capital dividend account” in subsection 89(1) of the *Income Tax Act* (Canada). The background and specific request are outlined in this letter. We would be pleased to engage in further discussions and answer questions you may have with respect to this request.

Background

In Budget 2016 the definition “capital dividend account” (CDA) was amended to prevent certain planning which could potentially increase the CDA credit where the death benefit under a corporate owned policy was payable to a different corporate beneficiary.¹ The amended definition ensures that the adjusted cost basis (ACB) of a “policyholder’s interest in a policy” immediately before death will reduce the credit to the CDA of a corporate beneficiary, even where the corporate beneficiary was not the owner of the policy. This change is effective for deaths occurring after March 21, 2016, and therefore has application to beneficiary designations made before that date, provided the life insured has not died before March 22, 2016.

The revised CDA definition did not contemplate how the ACB of the policy would be apportioned where there is more than one beneficiary under the policy and at least one is a corporation, or situations where the life insurance policy is jointly owned and at least one of the owners/beneficiaries is a corporation.

¹ The specific amendment added clause (B) to (d)(iii) of the definition “capital dividend account” as it applies to amounts each of which is the proceeds of a life insurance policy of which the corporation was a beneficiary in consequence of the death of any person.





The Canada Revenue Agency was subsequently asked to provide its views on the application of the revised legislation where there were multiple corporate beneficiaries or multiple owners of a life insurance policy with one of the owners being a corporation. In both scenarios the CRA confirmed that the full ACB of the policy would need to be included in the calculation of the credit to the CDA of the corporate beneficiary.² In other words, the revised wording in the definition of CDA does not provide for prorating the policy's ACB in these scenarios. In certain circumstances this can result in a significant and unintended reduction in the credit to a corporation's CDA in comparison to situations where there is only one beneficiary under the policy. This is of particular concern for insurance arrangements entered into prior to Budget 2016 as any attempts to modify such arrangements to avoid this result could have adverse tax consequences and other negative impacts on estate/corporate planning arrangements.

CALU is aware of several situations where an individual shareholder has died after March 21, 2016, and there were multiple corporate beneficiaries of a life insurance policy on the deceased's life. As discussed above, this resulted in the full ACB of the policy reducing the credit to the CDA of each corporate beneficiary, and in turn the ability to pay tax-free capital dividends from those insurance proceeds. We anticipate this will impact a growing number of situations involving corporate beneficiaries, particularly where the insurance arrangements were put in place prior to Budget 2016.

CALU has considered various options that would permit a reasonable prorating of the ACB of the policy between corporate beneficiaries based on different scenarios. We have also reviewed these options to ensure they would not create unnecessary drafting complexity, would be easy to administer by insurance companies and audited by the CRA, and not result in the ability of taxpayers to engage in tax avoidance transactions.

Requested Amendment

CALU is requesting that the CDA definition be amended to avoid the above-noted reduction in the CDA credit in situations involving multiple beneficiaries under a life insurance policy. One approach which we believe arrives at a reasonable result would be to allocate the ACB of the policy to each corporate beneficiary based on its pro rata interest in the proceeds of the life insurance policy for purposes of determining the credit to the corporation's CDA, for deaths occurring after March 21, 2016.

We also request that this change have retrospective effect, permitting corporations that have already received life insurance death benefits arising from deaths occurring after March 21, 2016, to re-determine the credit to their CDA based on the revised rule, with any CDA addition taking effect as of the date of the comfort letter.

The following example illustrates the issue with the current CDA definition where there is more than one corporate beneficiary, and CALU's suggested approach to apportioning the ACB of a policy between corporate beneficiaries to address this concern.

² CRA Technical Interpretations 2017-0690311C6 (dated May 18, 2017) and 2018-0745811C6 (dated May 8, 2018) which are attached to this letter.





Example

Holdco is the owner and premium payor for a \$1 million life insurance policy (the Policy) on the life of A, who is the majority shareholder of Holdco. The ACB of the Policy is currently \$100,000.

Holdco owns all the shares of Opco A and Opco B. Opco A and B are beneficiaries under the Policy, Opco A for 60% of the death benefit and Opco B for 40% of the death benefit.

Assume A dies. If Holdco were the only beneficiary of the policy, the credit to its CDA would be \$900,000 (\$1,000,000 - \$100,000). However, under the revised CDA definition, Opco A would have a \$500,000 (\$600,000 - \$100,000) credit to its CDA and Opco B would have a \$300,000 (\$400,000 - \$100,000) CDA credit. The total CDA credit arising from the payment of the life insurance proceeds would be \$800,000, \$100,000 less than would be the case if Holdco or one Opco was the sole beneficiary.

Using CALU's ACB prorating approach, the ACB of the Policy would be allocated 60% to Opco A (\$60,000) and 40% to Opco B (\$40,000). Thus, upon the payment of the death benefit, Opco A would receive a credit to its CDA of \$540,000 (\$600,000 - \$60,000) and Opco B would receive a credit to its CDA of \$360,000 (\$400,000 - \$40,000). The aggregate CDA credit of \$900,000 would be equal to the CDA credit had Holdco or one Opco been the beneficiary of the insurance policy.

We believe this prorating formula provides the appropriate overall result and it should be relatively easy for the CRA to audit the applicable prorated CDA credit as all relevant information would be available from the life insurance company.

We would be pleased to engage in further discussions and respond to any questions you may have related to this request for a comfort letter.

Yours truly,

Guy Legault
President & CEO

cc: Trevor McGowan, Department of Finance
Pascale Dugre-Sasseville, Department of Finance
Kevin Wark, tax advisor, CALU

encl.



SUMMARY: CLHIA 2017—Q1 CDA—ITA-89(1)“capital dividend account”—CLHIA CRA Roundtable—May 2017—Question 1—Capital dividend account—Where there are two corporate beneficiaries, each designated for 50% of the death benefit under a life insurance policy held by a third corporation, whether the increase to the capital dividend account will be reduced by the full adjusted cost basis of the policyholder’s interest in the policy for each beneficiary. ... Please note that the following document, although believed to be correct at the time of issue, may not represent the current position of the CRA. ... Prenez note que ce document, bien qu’exact au moment émis, peut ne pas

2017-0690311C6-- CLHIA 2017—Q1 CDA

Date: May 18, 2017

Reference: 89(1)“capital dividend account”;

Référence : 89(1)«compte de dividendes en capital»

SUMMARY: CLHIA 2017—Q1 CDA—ITA-89(1)“capital dividend account”—CLHIA CRA Roundtable—May 2017—Question 1—Capital dividend account—Where there are two corporate beneficiaries, each designated for 50% of the death benefit under a life insurance policy held by a third corporation, whether the increase to the capital dividend account will be reduced by the full adjusted cost basis of the policyholder’s interest in the policy for each beneficiary.

Please note that the following document, although believed to be correct at the time of issue, may not represent the current position of the CRA.

Prenez note que ce document, bien qu’exact au moment émis, peut ne pas représenter la position actuelle de l’ARC.

PRINCIPAL ISSUES: Where there are two corporate beneficiaries, each designated for 50% of the death benefit under a life insurance policy held by a third corporation, will the increase to the capital dividend account be reduced by the full adjusted cost basis of the policyholder’s interest in the policy for each beneficiary?

POSITION: Yes.

REASONS: Paragraph (d) of the definition of “capital dividend account” in subsection 89(1).

CLHIA CRA Roundtable—May 2017

Question 1—Capital Dividend Account

Background

Paragraph (d) of the definition of capital dividend account (CDA) in subsection 89(1) of the Act was amended in 2016 by Bill C-29 (enacted December 15, 2016) to generally provide for an addition to the CDA of a corporation equal to the amount by which the proceeds of a life insurance policy of which a corporation was a beneficiary in consequence of the death of any person after March 21, 2016, exceed the adjusted cost basis (ACB) immediately before the death, of a policyholder’s interest in the policy.

Scenario

Assume the following fact situation: Corporation A is the sole owner and premium payor for a life insurance policy with a death benefit of \$1 million on the life of Mr. A. Corporation B and Corporation C are each designated as beneficiaries for 50% of the death benefit under this policy. Mr. A dies after March 21, 2016 at a time when the ACB of the policy to Corporation A is \$200,000.

Question

Can the CRA please confirm that the amount added to the CDA of each of Corporation B and Corporation C is

\$400,000?

CRA Response

As amended by Bill C-29, paragraph (d) of the definition of CDA in subsection 89(1) of the Act includes in a corporation's CDA the amount by which the proceeds of a life insurance policy received as a consequence of the death of a person (death benefit) exceed the total of all amounts described in subparagraphs (d)(iii) to (vi). For deaths occurring after March 21, 2016, subparagraph (d)(iii) refers to the ACB, immediately before the death, of a policyholder's interest in the life insurance policy (regardless of whether the recipient of the death benefit is a policyholder of the policy).

Where there are multiple corporate beneficiaries designated under a policy, it is our view that each beneficiary must apply paragraph (d) of the definition of CDA independently. That is, for the purposes of determining the addition to each beneficiary's CDA, the portion of the death benefit received by each beneficiary must be reduced by the full ACB of a policyholder's interest in the policy. The wording of subparagraph (d)(iii) does not provide for a proration of the ACB in cases of multiple corporate beneficiaries.

In the scenario provided above, the net addition to the CDA of each of Corporation B and Corporation C with respect to the death benefit is \$300,000 (\$500,000 received by each beneficiary as a consequence of Mr. A's death reduced by the ACB of the policy to Corporation A of \$200,000).

Sylvie Danis

2017-069031

May 18, 2017

SUMMARY: CALU 2018 Q2—CDA credit—joint ownership—ITA-89(1)“capital dividend account”—CALU Roundtable—May 2018—Question 2—Capital dividend account credit—Corporate joint/co-ownership of insurance—Where there are two corporate beneficiaries and two joint owners in a life insurance policy, whether the addition to each corporation’s capital dividend account is reduced by the total adjusted cost basis of the policy when the policyholders’ interests are reflected by ownership as tenants in common. ... Please note that the following document, although believed to be correct at the time of issue, may not represent the current position of the CRA. ... Prenez note

2018-0745811C6 -- CALU 2018 Q2—CDA credit—joint ownership

Date: May 8, 2018

Reference: 89(1)“capital dividend account”;

Référence : 89(1)«compte de dividendes en capital»

SUMMARY: CALU 2018 Q2—CDA credit—joint ownership—ITA-89(1)“capital dividend account”—CALU Roundtable—May 2018—Question 2—Capital dividend account credit—Corporate joint/co-ownership of insurance—Where there are two corporate beneficiaries and two joint owners in a life insurance policy, whether the addition to each corporation’s capital dividend account is reduced by the total adjusted cost basis of the policy when the policyholders’ interests are reflected by ownership as tenants in common.

Please note that the following document, although believed to be correct at the time of issue, may not represent the current position of the CRA.

Prenez note que ce document, bien qu’exact au moment émis, peut ne pas représenter la position actuelle de l’ARC.

PRINCIPAL ISSUES: Where there are two corporate beneficiaries and two joint owners in a life insurance policy, will the addition to each corporation’s capital dividend account be reduced by the total adjusted cost basis of the policy when the policyholders’ interests are reflected by ownership as tenants in common?

POSITION: Yes.

REASONS: Paragraph (d) of the definition of “capital dividend account” in subsection 89(1).

CALU Roundtable—May 2018

Question 2—CDA Credit—Corporate joint/co-ownership of insurance

Background

The CRA has commented previously (# [2017-0690311C6](#) dated May 18, 2017 CLHIA Roundtable Q1) that where the beneficiary corporations are different from the owner of the policy, clause (d)(iii)(B) of the definition of “capital dividend account” in subsection 89(1) would reduce the CDA inclusion to each beneficiary corporation by the total “adjusted cost basis” (ACB) of the policy.

Consider the following fact pattern:

- Opco is owned 50/50 by Holdco A and Holdco B.
- Mr A holds 100% of the shares of Holdco A; Mr. B holds 100% of the shares of Holdco B.
- Holdco A and Opco jointly own an exempt life insurance policy on the life of Mr. A (Policy A).
- Holdco B and Opco jointly own an exempt life insurance policy on the life of Mr. B (Policy B).
- Opco requires \$1 million of death benefit coverage under each policy in order to redeem the shares of

Holdco A or Holdco B on the death of Mr. A or Mr. B, respectively.

- Opco pays the premium relating to \$1 million of death benefit coverage in each case.
- Holdco A and Holdco B make additional deposits on an annual basis into the respective policies under which they are joint owners.
- The beneficiary designation in respect of each policy names Opco as the beneficiary for \$1 million, and to the extent that there is any excess death benefit under each policy, the beneficiaries are Holdco A with respect to Policy A and Holdco B with respect to Policy B.
- Mr. A dies. At the time of death, the total death benefit to be paid under Policy A is \$1.2 million and the ACB of Policy A is \$150,000.

Question

What will be the addition to Opco's and Holdco A's CDA with respect to the total death benefit paid under Policy A? Will the addition to the CDA to each corporation be reduced by the total ACB of all of the policyholders' interests in the life insurance policy even where their respective interests are reflected by ownership in the policy as tenants in common?

CRA Response

Paragraph (d) of the definition of "capital dividend account" (CDA) in subsection 89(1) of the Act includes in a corporation's CDA the amount by which the proceeds of a life insurance policy received as a consequence of the death of an insured person (death benefit) exceeds the total of all amounts described in subparagraphs (d)(iii) to (vi). For deaths occurring after March 21, 2016, subparagraph (d)(iii) refers to the ACB of a policyholder's interest in the life insurance policy immediately before the death (regardless of whether the recipient of the death benefit is a policyholder of the policy).

As we noted in [2017-0690311C6](#), where there are multiple corporate beneficiaries designated under a policy, it is our view that each beneficiary must apply paragraph (d) of the definition of CDA independently. For the purposes of determining the addition to each beneficiary's CDA, the portion of the death benefit received by each beneficiary must be reduced by the total of all amounts each of which is a policyholder's ACB. In other words, the addition to each beneficiary's CDA should be reduced by the total ACB of the life insurance policy.

In the scenario described above, the addition to the CDA of Holdco A with respect to the death benefit would be \$50,000 (\$200,000 death benefit received by Holdco A reduced by the total ACB of the policy which is \$150,000). The addition to the CDA of Opco with respect to the death benefit is \$850,000 (\$1,000,000 death benefit received by Opco reduced by the total ACB of the policy which is \$150,000).

Sylvie Danis

2018-074581

May 8, 2018