



Tax Planning and Insurance

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The benefits of life insurance are well known. Its uses range from family protection in the event of an unexpected death, to liquidity for funding taxes owing on death, through to being a simple and tax-effective investment and philanthropic vehicle. While the rules related to insurance under the *Income Tax Act* are very complex, there is one rule in particular that provides for a relatively straight-forward tax efficient plan.

Generally, when assets are transferred between non-arm's length persons, the person disposing of the asset is deemed to have transferred the asset at its fair market value. Tax would be owing by the transferor on the transfer of the asset to the extent that the fair market value exceeded the cost base thereof. In the context of life insurance, however, a policy transferred by an individual to a non-arm's length person (including a corporation) will be deemed to have been transferred at its "cash surrender value," and not its fair market value, even if it may have been transferred for fair market value consideration.

Where a policy has grown in value since its acquisition (e.g., due to a change in the insured's ability to get insurance or because the insurance was purchased when the insured was much younger) while its cash surrender value has remained nominal, no gain will be deemed to have incurred on the transfer. As a result, in the case of a transfer of life insurance to a corporation, funds from the corporation in an amount equal to the fair market value of the policy can be extracted from the corporation without tax.

Say, for example, that Mr. Jackson obtained a policy in the face amount of \$1 million twenty years ago. If Mr. Jackson went out into the market today and tried to obtain a similar policy, the cost of the policy would be significantly higher than at the time it was acquired – thus creating a fair market value for the policy. In this case, let's assume that the policy's fair market value is \$500,000 and its cash surrender value is nominal.

If Mr. Jackson sold his policy to his corporation, BoCo, he could receive a promissory note

back from BoCo in the amount \$500,000. Mr. Jackson will not have a gain on the disposition (as he will be deemed to have disposed of the policy at its cash surrender value), but the repayment of the promissory note by BoCo would be without the incurrence of any tax to Mr. Jackson. Without this strategy, a withdrawal of \$500,000 from BoCo as a regular dividend would normally incur income tax well in excess of \$150,000. On Mr. Jackson's death, \$1 million insurance proceeds will be paid to BoCo (which, having purchased the policy, will have changed the designated beneficiary of the policy to itself), and assuming the cash surrender value of the policy remains nominal until his death, the full \$1 million can generally be paid out to Mr. Jackson's estate tax-free by way of a capital dividend.

Mr. Jackson was so thrilled with the tax savings, he decided to explore some charitable options, including gifting all or a portion of the tax savings (which would result in a charitable receipt that could be used to offset his personal income) or causing BoCo to donate the policy itself (which would result in an even more significant charitable receipt that could be used to offset BoCo's income). In fact, as a result of the transaction, the fair market value of the policy will have already been established for the purposes of determining the amount of the charitable receipt available to BoCo.

The Jewish Foundation would be happy to help implement a charitable plan similar to that of our fictional Mr. Jackson.

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