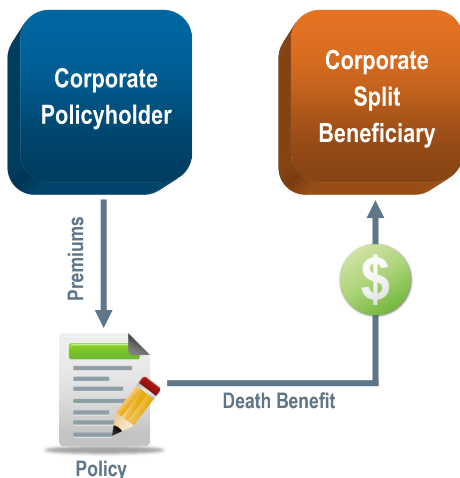
WESTWARD ADVISORS

CORPORATE SPLIT BENEFICIARY: CDA ISSUE



THE ISSUE

A "corporate split beneficiary" may receive a larger credit to the capital dividend account (CDA) upon receipt of the death benefit than the policyholder would if the policyholder were the beneficiary.

CRA frequently cautions taxpayers that the credit to a corporate split beneficiary's CDA may result in the application of the general anti-avoidance rule (GAAR) to deny the additional CDA benefit that results[1].

This Viewpoint examines CRA's position on CDA for corporate split beneficiaries, and the non-tax reasons for corporate split beneficiaries.

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WESTWARD'S VIEWPOINT

A corporation may credit its CDA when it receives proceeds of a life insurance policy as a consequence of the death of any person. The credit to the CDA equals the proceeds received less *the corporation's* adjusted cost basis (ACB) in the policy immediately before the death of the person[2].

The *policyholder* has an ACB in the policy that is generally the cumulative premiums paid under the policy less the cumulative net cost of pure insurance under the policy[3].

A corporate split beneficiary refers to a corporate beneficiary that is not the same as the corporate policyholder. A corporate split beneficiary does not have any ACB in the policy because it is not the policyholder, and so it does not suffer an ACB reduction when computing the credit to its CDA upon receipt of the life insurance proceeds.

At the May 1996 Conference for Advanced Life Underwriting (CALU), CRA confirmed this tax result but noted that they had referred it to the Department of Finance for consideration and commented that it may be subject to the general anti-avoidance rule (GAAR)[4]. We are not aware of any reassessments since then, nor has the Department of Finance proposed any changes to the Income Tax Act to apply an ACB reduction to a corporate split beneficiary's CDA computation upon receipt of life insurance proceeds.

A corporate split beneficiary should be able to avoid a GAAR challenge to its CDA computation if there is a *bona fide* purpose to establishing a corporate split beneficiary other than to obtain the CDA tax benefit[5]. The following two-step planning process leads to corporate split beneficiaries established primarily for *bona fide* purposes other than to obtain the CDA tax benefit:

1. First, the corporate beneficiary requires the insurance proceeds to fund a loss or obligation as a consequence of the death of the life insured. Examples of such requirements are (1) buy-sell obligations, (2) key-man business losses, and (3) funding the capital gains tax obligations of the deceased shareholder on the share value of the corporate split beneficiary.
2. Second, the corporate beneficiary should not or cannot be the policyholder for non-tax reasons. Examples of such non-tax reasons are (1) the policy should not be exposed to the corporate beneficiary's creditors, (2) the corporate beneficiary may be sold in the future and therefore should not hold the policy, and (3) a creditor may not permit the policy to be owned by the corporate beneficiary.

This two-step process should be documented to justify the *bona fide* non-tax purpose of the corporate split beneficiary.

1 See for example CRA Documents 2010-0359421C6, 7M12851, and Income Tax Technical News #44.
2 See 89(1)(d) of the *Income Tax Act*..
3 See 148(9).
4 See CRA Document 7M12851.
5 GAAR can only be applied to a tax benefit arising from an "avoidance transaction". A transaction that may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit is not an avoidance transaction. See 245(2) and (3).

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