Armstrong
Financial Services

Impact of Bill C-59 on Immediate Financing Arrangements (IFAs)

Bill C-59, which received Royal Assent on June 20, 2024, significantly expands GAAR, increasing CRA's ability to challenge tax deductions and recharacterize transactions. IFAs, which rely on interest deductibility and collateral loans, now face a high risk of CRA reassessment, retroactive taxation, and penalties.

Key Risks to IFAs Under the New GAAR Rules

- **Interest Deductibility at Risk** – Under the revised definition of an "avoidance transaction" in subsection 245(3) of the Income Tax Act, CRA now has broad authority to assess whether a loan would exist independently of the insurance policy. Bill C-59 lowers the threshold for GAAR application—if one of the loan's main purposes is to obtain a tax benefit, CRA can deny interest deductibility, even if the loan has some business purpose. Since IFAs depend significantly on tax deductions, the strategy cannot survive without them. If CRA denies deductibility, the IFA collapses, leaving the policyholder with long-term debt and no tax relief.

- **Loan Recharacterization & 25% GAAR Penalty** – Under subsection 245(3), CRA has expanded authority to recharacterize collateral loans as taxable policy loans if they lack economic substance. If CRA determines the loan would not exist without the policy, it may recharacterize it as a policy loan, making proceeds retroactively taxable at the highest rates. Bill C-59 further imposes a 25% punitive penalty on GAAR transactions, compounding the financial impact of a reassessment.

CRA shut down the 10-8 leveraged life insurance strategy in 2013 on similar grounds—IFAs now face the same risk. With CRA's expanded power to deny deductions and recharacterize loans, the strategy collapses without tax benefits, leaving policyholders exposed to long-term debt and unexpected tax liabilities. Given rising CRA scrutiny, anyone considering an IFA should seek written expert advice or a formal CRA opinion before exposing themselves to severe tax consequences.

Sincerely,
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