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Tax Considerations for Corporate Life Insurance & Estate Planning

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Most corporate life insurance is sold on one headline: "tax-free death benefit."

For private corporation shareholders, that is only step one. The real outcome is net-to-estate—what the estate can actually receive after CDA limits, share-valuation tax, and post-mortem sequencing effects are accounted for.

Below are three friction points that warrant serious consideration, as they can materially alter the policy's net-to-estate value and intended utility precisely when liquidity is most critical to avoid the forced liquidation of valuable assets.

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1. ACB Reduces CDA (Tax-Free Extraction Room)

The CDA credit from life insurance is generally the net proceeds of the policy:
CDA credit = proceeds received – adjusted cost basis (ACB)[1, 2]. In general terms, ACB reflects the extent to which cumulative premiums paid exceed the policy's net cost of pure insurance, as determined under the Income Tax Act (Act) and related rules.

The Problem: The CDA is the mechanism that allows insurance proceeds to be distributed as a tax-free capital dividend. If ACB is not near $0 at death, the CDA credit is reduced—meaning part of the proceeds must be extracted as a taxable dividend, reducing net-to-estate value.

The Solution: Design the policy so the ACB profile matches the planning objective (typically life expectancy/target age). This is a deliberate trade-off: the design that maximizes CDA is not always the design that maximizes IRR, but the trade-off must be shown explicitly.

Question to ask: "At life expectancy, what are the projected ACB, CDA credit, and the taxable vs. tax-free split of the distribution?"

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2. Cash Surrender Value Share-Valuation Trap at Death

Cash Surrender value (CSV) can increase terminal share-value tax even when the death benefit is tax-free. On the death of a shareholder, where the corporation owns a policy on the shareholder's life, subsection 70(5.3) of the Act provides that the policy's value immediately before death is its cash surrender value (CSV), determined under the Act's CSV rules (including s. 148(9))[3, 4].

The Problem: CSV sits on the corporate balance sheet as a passive asset. If CSV is positive, it increases the relevant valuation input under 70(5.3) versus a nil-CSV design—increasing the fair market value used to compute the shareholder's deemed disposition of the shares at death, and therefore increasing the capital gain (and tax) on the terminal return, even though the death benefit is received tax-free by the corporation.

The Solution: If cash value is not part of the objective (financing utility, planned access, collateral strategy), design the policy to have nil CSV at life expectancy. Policies engineered to drive CSV toward $0 at the target planning age are often more premium-efficient for pure estate-liquidity planning precisely because you are not paying for a balance-sheet asset you do not plan to use.

Question to ask: "Why am I paying for cash value I don't intend to use, and what does that CSV do to my corporation's death-tax valuation under 70(5.3)?"

3. CDA and Post-Mortem Sequencing / 164(6) Stop-Loss Friction

For corporations with significant investment assets—especially where refundable taxes are relevant and intended to be recovered—post-mortem planning often considers the subsection 164(6) loss carryback framework (capital losses in the estate carried back to offset capital gains on the terminal return)[5, 6].

The Problem: Where the plan relies on a capital loss to neutralize terminal tax, capital dividends paid from the CDA (including CDA created by life insurance proceeds) can trigger stop-loss mechanics that reduce the capital loss available in the sequence. Stated differently, because only 50% of a capital loss is allowable, every $1.00 paid out as a CDA dividend can translate into up to $0.50 less allowable capital loss available to offset the terminal gain[5, 6]. This cost is often missed because it only appears when you model the full post-mortem sequence end-to-end—not when you review the insurance in isolation.

IFA / **Collateral "Gross-vs-Net" Trap:** This risk is amplified in financed/collateral (IFA-style) structures because the gross face amount (and therefore gross proceeds) can be intentionally oversized relative to the *net* liquidity available after debt repayment. In adverse outcomes—particularly longer longevity or higher-than-expected interest—the net amount remaining for the estate can be only a small fraction of gross proceeds.

Where the policy is collaterally assigned, and the debtor remains entitled as beneficiary/policyholder, proceeds may be treated as constructively received and included in the corporation's CDA even if paid directly to the creditor[7]. The result is a mathematical trap: CDA (and therefore the 50% loss denial) can remain driven by gross proceeds, while usable estate liquidity is driven by net proceeds.

Where interest is collateralized/accumulated, the gross-vs-net gap can become so large that the CDA-driven stop-loss grind can materially erode—and in some cases meaningfully undermine—the net-to-estate value of the proceeds[5, 7].

The Solution: Any policy integrated into post-mortem planning—especially financed/collateral strategies—must be reviewed on a single reconciled schedule that shows: **gross proceeds → ACB → CDA credit → loan repayment → dividends paid (taxable vs. capital) → stop-loss impact → net estate liquidity**, with the post-mortem sequence explicitly reflected, and stress-tested for adverse outcomes—longer longevity and higher interest rates—modelled both with and without the assumed interest deductibility/tax credits on interest (i.e., do not rely on a single "best-case" after-tax borrowing rate)[5, 6, 7, 8].

Question to ask: "In the assumed post-mortem plan (including any 164(6) loss carryback), how much 164(6) capital loss is ground by paying capital dividends from the policy's CDA, and what is the resulting net-to-estate liquidity after that sequencing impact is reflected (and, if financed, after repayment of any creditor claim/loan)?"

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Bottom Line (Net-to-Estate Calculation)

Evalua*te corporate insurance by the net-to-estate result, not the headline death benefit. A defensible analysis should reconcile the full sequence in one schedule:*

Gross death benefit proceeds
 → **Less ACB** (determines CDA credit)[1, 2]
 → **Capital dividends** paid from insurance-generated CDA[1, 2]
 → **Stop-loss impact** of CDA (including the 50% capital loss denial impact)[5, 6]
 → **CDA credit** and the resulting tax-free dividend vs. taxable dividend requirement[1, 2]
 → **CSV impact** on share valuation under ITA 70(5.3), where applicable[3, 4]
 → **Less loan repayment, if any** (principal + accumulated interest)[7]
 = **Net estate liquidity** (what the estate can actually use)

Additionally, in the case of an IFA, this analysis should be stress-tested for adverse outcomes—longer longevity and higher interest rates—and modelled both with and without the assumed interest deductibility/tax credits on interest. If the results do not hold under these scenarios, the insurance is not functioning as reliable estate liquidity.

References

1. Income Tax Act (RSC 1985, c. 1 (5th Supp.)), s. 89(1), definition of "capital dividend account," para. (d) (life insurance proceeds included to the extent they exceed the corporation's ACB immediately before death).

2. CRA Interpretation Bulletin IT-430R3 (archived), "Life Insurance Proceeds—Capital Dividend Account (CDA)" (net proceeds concept: proceeds minus ACB added to CDA).

3. Income Tax Act (RSC 1985, c. 1 (5th Supp.)), s. 70(5.3) (valuation of shares on death where corporation owns life insurance).

4. CRA Interpretation Bulletin IT-416R3 (archived), "Fair Market Value of Corporate Shares and Life Insurance" (application of s. 70(5.3) and reference to CSV determination under s. 148(9)).

5. Income Tax Act (RSC 1985, c. 1 (5th Supp.)), s. 112(3)(b)(ii)–(iii) (stop-loss reduction of a capital loss on shares by dividends received, including capital dividends and "life insurance capital dividends"; see also s. 38(b) for the one-half inclusion rate mechanics underlying the "50%" effect).

6. Income Tax Act (RSC 1985, c. 1 (5th Supp.)), s. 164(6) (estate loss carryback framework).

7. CRA Interpretation Bulletin IT-430R3 (archived), "Life Insurance Proceeds—Capital Dividend Account (CDA)," paras. 6–8 (policy assigned as collateral security; proceeds can be included in the debtor corporation's CDA even if paid directly to the creditor).

8. Practitioner commentary: Miller Thomson LLP, article on post-mortem planning and subsection 164(6) loss carryback (for applied sequencing examples).

Disclaimer: This article is for informational purposes only and does not constitute financial, legal, or tax advice. All performance figures and rates are illustrative and are not guarantees of future results. Please consult with your qualified professional advisors before making any financial decisions.

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Appendix

Illustrative Client Presentation

The following client presentation is included to illustrate the mechanics of the net-to-estate reconciliation referenced above and to show the tax-equivalent internal rate of return for comparison purposes.

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Corporate Estate Liquidity Strategy

The proposal is a **Level Tax-Free Sum Insured Universal Life policy** with a face amount of **$15,416,486**, funded by **five annual premiums of $1.7 million**, designed for a 70-year-old standard-health non-smoker.

At life expectancy (age 85), the corporation receives **$15.4 million** of tax-free insurance proceeds. These proceeds generate a Capital Dividend Account (CDA) credit of approximately **$11.2 million** attributable to the policy, which is used to maximize the estate's net value, with the remaining balance distributed as a taxable dividend.

Note: Assuming post-mortem planning under subsection 164(6), an amount economically equivalent to approximately 25% of the policy-generated CDA is subject to tax at the corporate marginal rate of 53.53%, reflecting the denial of 50% of the terminal capital loss. This tax cost has been reflected in the amounts distributable from the policy-generated CDA.

The resulting distribution is efficient and transparent:

- **Total Death Benefit:** $15,416,486
- **Tax-Free CDA Dividend:** $11,221,416
    – Tax arising due to denial of ½ of capital loss: $1,501,695
- **Taxable Dividend:** $4,195,070
    – Tax at 39.34%: $1,650,341
- **Cash Surrender Value:** nil

This results in a **total net benefit to the estate of $12,264,451**.

To achieve the same outcome by allocating the same five annual deposits of $1.7 million into passive corporate investments, the corporation would need to grow a portfolio to **$16,920,006** by age 85. This requires sustaining an **11% annual return** every year for the next 15 years. Only at this level—after corporate tax, dividend distribution, and RDTOH recovery—would the estate net an equivalent **$12.26 million**.

Sincerely,
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Universal Life (Level) - Policy Summary

Yr	Age	Deposit	Cash Value	Face Value	CDA	Net to Estate [1]	Hurdle Rate [2]
1	71	$1,700,000	–	$15,416,486	$13,790,793	$12,931,399	1664.0%
2	72	1,700,000	1,221,292	15,416,486	12,202,835	12,192,327	311.2%
3	73	1,700,000	2,540,614	15,416,486	10,641,803	11,434,007	129.6%
4	74	1,700,000	4,243,962	15,416,486	9,103,007	10,578,675	65.3%
5	75	1,700,000	5,707,732	15,416,486	7,582,107	9,792,110	34.3%
6	76	–	5,795,487	15,416,486	7,794,599	9,823,781	25.9%
7	77	–	5,506,311	15,416,486	8,043,255	9,965,723	21.2%
8	78	–	5,786,986	15,416,486	8,331,296	9,965,370	17.7%
9	79	–	5,354,198	15,416,486	8,662,125	10,167,080	15.6%
10	**80**	**–**	**4,834,332**	**15,416,486**	**9,032,919**	**10,402,470**	**14.1%**
11	81	–	4,199,474	15,416,486	9,442,286	10,678,650	13.0%
12	82	–	3,426,805	15,416,486	9,884,650	11,000,281	12.2%
13	83	–	2,496,891	15,416,486	10,347,587	11,369,338	11.6%
14	84	–	1,370,978	15,416,486	10,807,811	11,790,149	11.2%
15	**85**	**–**	**–**	**15,416,486**	**11,221,416**	**12,264,451**	**10.9%**
16	86	–	–	15,416,486	11,507,630	12,338,745	10.2%
17	87	–	–	15,416,486	11,803,299	12,415,494	9.5%
18	88	–	–	15,416,486	12,107,949	12,494,573	9.0%
19	89	–	–	15,416,486	12,421,018	12,575,839	8.5%
20	**90**	**–**	**–**	**15,416,486**	**12,741,902**	**12,659,132**	**8.1%**
21	91	–	–	15,416,486	13,069,982	12,744,294	7.8%
22	92	–	–	15,416,486	13,404,571	12,831,145	7.4%
23	93	–	–	15,416,486	13,744,926	12,919,493	7.1%
24	94	–	–	15,416,486	14,090,265	13,009,135	6.8%
25	95	–	–	15,416,486	14,439,688	13,099,837	6.6%
26	96	–	–	15,416,486	14,792,201	13,191,341	6.4%
27	97	–	–	15,416,486	15,146,572	13,283,327	6.2%
28	98	–	–	15,416,486	15,416,486	13,353,390	6.0%
29	99	–	–	15,416,486	15,416,486	13,353,390	5.7%
30	**100**	**–**	**–**	**15,416,486**	**15,416,486**	**13,353,390**	**5.5%**

Corporate Income (Hurdle Rate) @ 10.9%

		Deposit	Fund BOY	Income	Income Tax	Fund EOY	RDTOH
		a	*b*	*c*	*d*	*e*	*f*
			$a + e\_(y-1)$	$b \times 10.87\%$	$c \times 50.17\%$	$b + c + d$	$\Sigma c \times 30.67\%$
1	71	\$ 1,700,000	\$ 1,700,000	\$ 184,765	\$ (92,697)	\$ 1,792,069	\$ 56,661
2	72	1,700,000	3,492,069	379,537	(190,414)	3,681,192	173,053
3	73	1,700,000	5,381,192	584,858	(293,423)	5,672,627	352,409
4	74	1,700,000	7,372,627	801,298	(402,011)	7,771,913	598,141
5	75	1,700,000	9,471,913	1,029,460	(516,480)	9,984,893	913,842
6	76	–	9,984,893	1,085,213	(544,452)	10,525,655	1,246,640
7	77	–	10,525,655	1,143,986	(573,938)	11,095,704	1,597,463
8	78	–	11,095,704	1,205,942	(605,021)	11,696,625	1,967,285
9	79	–	11,696,625	1,271,254	(637,788)	12,330,090	2,357,136
10	80	–	12,330,090	1,340,102	(672,329)	12,997,863	2,768,101
11	81	–	12,997,863	1,412,680	(708,741)	13,701,802	3,201,323
12	82	–	13,701,802	1,489,188	(747,125)	14,443,864	3,658,007
13	83	–	14,443,864	1,569,839	(787,588)	15,226,115	4,139,424
14	84	–	15,226,115	1,654,858	(830,242)	16,050,731	4,646,914
15	**85**	**–**	**16,050,731**	**1,744,482**	**(875,207)**	**16,920,006**	**5,181,889**

A) Corporate Income / Year 15

Total Taxable Dividend Distribution Declared: $22,101,895 (e + f)

Distribution	Type	Amount	Tax Rate	Taxes	Net to Estate
Dividend	Eligible	8,500,000	39.34%	(3,343,900)	5,156,100
Dividend	Non-Eligible	13,601,895	47.74%	(6,493,545)	7,108,350
				Total Net	**12,264,451**

B) Life Insurance / Year 15

Total Corporate Policy Proceeds Distributed: $15,416,486

Distribution	Type	Amount	Tax Rate	Taxes	Net to Estate
Dividend	CDA	11,221,416	*See Note (1)*	(1,501,695)	9,719,721
Dividend	Eligible	4,195,070	39.34%	(1,650,341)	2,544,730
				Total Net	**12,264,451**

Note (1): Under subsection 164(6), only 50% of the capital loss is available to offset taxable income. The denied portion is taxed at the corporate marginal rate of 53.53%, producing a tax cost economically equivalent to approximately 25% of the CDA (i.e., 50% loss denial × 53.53% tax rate), as reflected above.