Estate Planning in the 21st Century - Life Insurance: Exploring the Corporate Edge - Part I*

By David Louis, J.D., C.A., Tax Partner, Minden Gross
and Michael Goldberg, Associate, Minden Gross

*(*This release is based on an article published in Tax Notes, May 2004, CCH Canadian Limited)*

In our first group of articles in this series, we focused on *post-mortem* planning. We now shift our focus to a closely-related area, estate planning and life insurance. The next two articles in this series will deal with structuring of life insurance in order to arrive at an optimal estate planning structure – i.e., steps to be taken prior to death.[1]

In order to facilitate discussion, we assume that we are dealing with a hypothetical owner-manager, Harry[2], whose incorporated business is worth in excess of $1,000,000. Although the value may fluctuate, it is assumed that Harry's value has been locked-in at $1,000,000 as a result of the previous implementation of an estate freeze.[3] Based on current Ontario capital gains tax rates of 23.2%, if Harry were to die, his death tax exposure in respect of his frozen shares would be $232,000 without any other planning. It is also assumed that Harry (aged 50) and his wife of twenty-five years, Bryna (aged 45), are Ontario residents, and that Harry's will bequeaths all of his shares in the corporation to Bryna[4] in order to provide the opportunity to defer the death tax should he predecease her.

To insure their death tax exposure, Harry is trying to determine the quantum of the death benefit of a permanent life insurance policy that will be most tax efficient. Harry intends to take out a life insurance policy that will be payable on the last to die of himself and Bryna. Since he expects his death tax to be $232,000 he is considering a death benefit of $232,000. He is open to other suggestions.[5] Harry has also heard that it is generally considered to be more tax efficient to have his corporation as both the policyholder and the beneficiary of the life insurance policy but would like an explanation as to why this is usually the case.

Corporate Held Life insurance

There are two potential benefits to corporate ownership of life insurance which are most often mentioned (however, there are at least two other less obvious benefits, one of which we will deal with later in this article and the other in the second part of this article).

Corporate Level Funding of Premiums

The first rationale for corporate ownership is that the premiums can be funded at the corporate level, rather than having to make distributions to the owner-manager in order to defray the cost of premiums.[6] In other words, instead of the owner manager having to pay the premiums out of after-tax dollars from salary or bonuses (e.g., at rates of about 46% as is the case in Ontario[7]) the corporation would pay the premiums with funds taxed at rates of between 19% and 36% (in Ontario).[8]

Death Tax Minimization

The Old Rules

The second rationale for corporate ownership of life insurance is that it decreases the death tax itself. Insurance proceeds will be added to a corporation's CDA to the extent that the insurance proceeds received on death by a corporation exceed the recipient corporation's "adjusted cost basis" of the policy, as that term is defined in subsection 148(9).[9] It is assumed that the policies discussed below have no adjusted cost basis.

Prior to changes to the Act almost 10 years ago[10], if the corporation had held the $232,000 life insurance policy, all of the proceeds could have been distributed to the estate tax free as a partial redemption of the freeze shares. Assuming the redemption was done within the first year of the estate, an equal ($232,000) capital loss on the redeemed shares would have been triggered in the estate of the last to die of Harry and Bryna, which could have been used to reduce their ultimate death tax. Consequently, based on current rates, their death tax would have been approximately $178,000 on a net capital gain of $768,000 leaving the estate with $54,000 of excess cash. Based on this example, the effective overall tax rate for the estate, the deceased and the corporation would be about 17.8%.

Interestingly, even though the estate would still own $768,000 of freeze shares with a high cost base and no paid-up capital, by creating a "pipeline"[11] with proper structuring it will usually be possible to extract the remaining $768,000 of value in favour of the estate without giving rise to additional tax in the estate. Since the life insurance policy proceeds were limited to $232,000, other funds will need to be found to extract the remaining value. However, the extraction need not happen immediately and can be effected over time.[12]

If a $500,000 policy had been taken out, then the death tax would have been approximately $116,000 on a net capital gain of $500,000, leaving the estate with $384,000 of excess cash. Based on this example, the effective overall tax rate for the estate, the deceased and the corporation would have been about 11.6%. Once again, it should be possible to create a pipeline to extract the remaining $500,000 reflected by the freeze shares on a tax neutral basis. In fact, in all of the other examples described below, it should be possible to create a pipeline.

If a $1,000,000 life insurance policy had been taken out then it would have been possible to totally eliminate the death tax and the estate would have an extra $1,000,000.

The tax treatment described above should still be available where arrangements for the redemptions of shares that are funded by life insurance policies which satisfy the grandfathering rules that were enacted in connection with the "stop-loss rules" in subsection 112(3.2).[13]

Stop-Loss Rules

Pursuant to subsection 112(3.2), losses in an estate are restricted to the extent that the lesser of:

1) capital dividends received on the shares, and

2) the amount of the capital loss otherwise determined less taxable dividends received by the estate

exceeds 50 % of the lesser of:

3) amount of the capital loss otherwise determined, and

4) the deceased's capital gain.

Based on these rules, assuming the same facts as set out above, the capital loss of $232,000 otherwise realized by the estate would be limited to $116,000 (i.e., the capital loss of $232,000 less the amount by which the lesser of (1) $232,000 and (2) $232,000 (i.e. $232,000 capital loss less $0 of taxable dividends) exceeds the lesser of (3) $116,000 (i.e., 50% of $232,000) and (4) $116,000 (i.e., 50% of $232,000)). Consequently, their death tax would be approximately $205,000 on a net capital gain of $884,000 leaving the estate with $27,000 of excess cash. Based on this example, the effective overall tax rate for the estate would be about 20.5%.

If a $500,000 policy is taken out, then their death tax would be approximately $174,000 on a net capital gain of $750,000 leaving the estate with $326,000 of excess cash. Based on this example, the effective overall tax rate for the estate, the deceased and the corporation would be about 17.4%.

If a $1,000,000 policy is taken out then their death tax would be approximately $116,000 on a net capital gain of $500,000 leaving the estate with $884,000 of excess cash. Based on this example, the effective overall tax rate for the estate, the deceased and the corporation would be about 11.6%.

As will be seen below this effective tax rate is less than the effective tax rate that can be generated using the "50% solution." However, by merely allowing the stop-loss rules to apply, the ability to efficiently employ ½ of the CDA generated by the receipt of the proceeds of the life insurance policy will essentially be reduced, whereas the 50% solution makes it possible for the full benefit of the CDA to ultimately be enjoyed.

The "50% solution" – in context

To the extent that the stop-loss rules apply in respect of any particular share, it may be advisable to generate a taxable dividend in respect of the share in an amount that is equal to the capital dividend. This is the so-called "50% solution". In reality, though, this is more like the 1/3 solution since, depending on the province, the maximum reduction of the effective tax rate resulting from this approach is about 1/3 less than the tax on capital gains in the terminal period (in Ontario, the effective rate is 15.6%, compared to the 23.2% that would otherwise be payable). The reason this solution is only able to reduce the effective tax rate by 1/3 is because used efficiently it converts terminal period capital gains taxed at 23.2% into an equal amount of dividends, ½ of which

will be non-taxable CDA dividends and the other ½ which will be taxable dividends at a rate of approximately 31%.

However, because subsection 112(3.2) applies to each share separately and because subsection 83(2) requires that an election be "in respect of the full amount of [a particular] dividend," generating a separate taxable dividend will require jumping some technical hurdles. For example, if the objective is to create a taxable dividend equal in amount to the capital dividend, the correct results will not be obtained simply by redeeming a certain number of shares and treating the resulting deemed dividend as a capital dividend and then redeeming an equal number of shares and treating the resulting deemed dividend as a taxable dividend. This is because of the fact that the stop-loss rule will apply to the first-noted group of shares without regard to the taxable dividend resulting from the redemption of the second-noted group of shares.

It has been suggested that one way to overcome this problem is to file an election to treat a portion of the dividend as an excessive dividend in accordance with subsection 184(3). However, the statutory language only appears to support such a strategy to the extent that the dividend exceeds the corporation's CDA.[14] As a result, where the amount of CDA exceeds the amount necessary to achieve the goals of the 50% solution, it may be necessary to remove the excess CDA, for example, by paying dividends on other classes of shares of the corporation prior to redeeming the freeze shares.[15]

Using the same examples, if a $232,000 policy is purchased, keeping in mind the issues discussed immediately above, $464,000 worth of shares would be redeemed (half of the proceeds would come from the life insurance and the other half would be satisfied with a note) in a manner that will give rise to a taxable dividend and a capital dividend of $232,000. The stop loss rules would not apply (i.e., the capital loss of $464,000 less the amount by which the lesser of (1) $232,000 and (2) $232,000 (i.e., $464,000 capital loss less $232,000 of taxable dividends) exceeds the lesser of (3) $232,000 (i.e., 50% of $464,000) and (4) $232,000 (i.e., 50% of $464,000)). Consequently, their death tax would be approximately $197,000 comprised of the $232,000 taxable dividend and a net capital gain of $536,000 leaving the estate with $35,000 of excess cash. Based on this example, the effective overall tax rate for the estate, the deceased and the corporation would be about 19.7%.

This strategy is more efficient where the amount of life insurance is set at ½ the value of the freeze shares (i.e., $500,000). Under this scenario a $500,000 capital dividend and a $500,000 taxable dividend would be paid, in order to eliminate the entire taxable capital gain. Tax of $156,500 would be payable by the estate in connection with the taxable dividend, leaving the estate with $343,500 of excess cash and the effective overall tax rate for the estate, the deceased and the corporation would be about 15.6%.

Since the freeze value is only $1,000,000, it will not be possible to return more than that amount to the estate. Consequently, to the extent that insurance proceeds exceed $500,000 they will have no impact on the death tax liability if the 50% solution is used. On the other hand, any excess amount of insurance proceeds will give rise to an equal amount of additional CDA remaining in the corporation (i.e., in this case, $500,000) to benefit future generations.

Summary – Effective tax rate on 164(6)-type procedure at different levels of life insurance: Ontario Resident (capital gains tax rate = 23.2%)

Policy Level	Stop-loss	"50% solution"	Grandfathered
$232,000	20.5	19.7	17.8
$500,000	17.4	15.6	11.6
$1,000,000	11.6	15.6	Nil

Conclusion

As illustrated above, the use of corporate held life insurance will nearly always provide opportunities to reduce the effective death tax rate from 23.2% to some lesser effective rate. Assuming that the grandfathering rules to subsection 112(3.2) are not applicable, the 50% solution is generally more tax efficient to the estate than simply allowing the stop loss rules to apply – but not always.

Moreover, if the interests of continuing shareholders are taken into account then the 50% solution may still be more tax efficient overall, even in situations where the initial tax savings may be less than that which would have been achieved if the stop-loss rules applied. For example, if it was assumed that a $1,000,000 policy had been in place on the lives of Harry and Bryna and after their death their surviving children want to remove an additional $500,000 from the corporation then if the 50% solution is employed they could do so free of tax using the

unused CDA so that the total tax paid by the children, the estate and the deceased would still aggregate $156,500. If the stop-loss rules are allowed to apply and there is no other CDA available[16] then the children would have to pay additional tax on the distribution of $156,500.[17] Since the deceased will have already paid $116,000, the aggregate tax payable at all levels will be $116,000 more than under the 50% solution as a result of the application of the stop-loss rules.[18]

The calculation of all of the figures described above are set-out in Schedules I, II and III attached to the end of this article.

Deductibility of Premiums

There is a third benefit of corporate ownership of life insurance that, while potentially available to any taxpayer, will often only be available when life insurance is corporately held. In certain defined circumstances, any taxpayer (individuals, corporations etc.) may be able to claim a tax deduction in respect of premiums paid. The most common basis for a deduction in a business context occurs where life insurance is required by a restricted financial institution in respect of borrowing to earn income from a business or property, in accordance with paragraph 20(1)(e.2).[19]

Such deductions are limited to the lesser of the premium payable in the year by the taxpayer and the net cost of pure insurance ("NCPI") in respect of the policy for the year provided that the premiums can reasonably be considered to relate to the amount owing by the taxpayer as a result of the borrowing.[20] Accordingly, if the premiums on the policy are payable by an individual, but the borrowing is by a corporation, the premiums will not be deductible.

Consequently, if Harry were to hold the policy personally and assuming he does not carry on any business himself he will not be able to claim any deduction for the premiums he pays on the policy – even if his bankers require the policy in respect of the corporation's borrowings. As a result, if Harry were to transfer the policy to the corporation or, if the corporation had acquired the policy in the first instance, corporate ownership of the policy could give rise to the additional benefit: namely enabling the corporation to claim a deduction of at least a portion of the life insurance premiums it pays.

SCHEDULE I

	Grandfathered	Stop-Loss	No Stop-Loss
Deceased Assets			
Freeze Shares	$1,000,000.00		
ACB	$0.00		
Amount of Insurance	$232,000.00	$232,000.00	$232,000.00
Deceased Tax			
Capital Gain - s.70(5)(a)	$1,000,000.00	$1,000,000.00	$1,000,000.00
Estate's Capital Loss Applied - s.164(6)	$232,000.00	$116,000.00	$464,000.00
Net Capital Gain	$768,000.00	$884,000.00	$536,000.00
Capital Gains Tax	$178,176.00	$205,088.00	$124,352.00
Estate Tax (Redemption of Freeze shares)			
Insurance CDA Available	$232,000.00	$232,000.00	$232,000.00
Insurance CDA Claimed	$232,000.00	$232,000.00	$232,000.00
Taxable Dividend (to avoid 112(3.2) stop-loss)	$0.00	$0.00	$232,000.00
Estate Tax On Dividends	$0.00	$0.00	$72,616.00
ACB of Freeze Shares - s.70(5)(b)	$1,000,000.00	$1,000,000.00	$1,000,000.00
FMV of Freeze Shares Post-Redemption	$768,000.00	$768,000.00	$536,000.00
Capital Loss Otherwise Determined	$232,000.00	$232,000.00	$464,000.00
Capital Loss Denied - s. 112(3.2)	0	$116,000.00	$0.00
Adjusted Capital Loss (applied by deceased - s.164(6))	$232,000.00	$116,000.00	$464,000.00

Total Tax Payable	$178,176.00	$205,088.00	$196,968.00
Effective Tax Rate	17.82%	20.51%	19.70%
Unused CDA			
Unused CDA	$0.00	$0.00	$0.00
Additional Dividend to Pay Out Unused CDA (applied to all scenarios so total distributions are equal)	$0.00	$0.00	$0.00
Tax on Additional Dividend	$0.00	$0.00	$0.00
Total Tax Payable	$178,176.00	$205,088.00	$196,968.00
Effective Tax Rate	17.82%	20.51%	19.70%
Capital Loss Denied - s. 112(3.2)			
Lesser of:			
Insurance CDA (paid as tax free dividend)	n/a	$232,000.00	$232,000.00
Capital Loss Otherwise Determined Less Taxable Dividends	n/a	$232,000.00	$232,000.00
In Excess of:			
50% of Capital Loss Otherwise Determined	n/a	$116,000.00	$232,000.00
50% of Deceased's Capital Gain	n/a	$116,000.00	$232,000.00
Dividend Tax Rate	31.30%		
Capital Gain Rate	23.20%		

SCHEDULE II

	Grandfathered	Stop-Loss	No Stop-Loss
Deceased Assets			
Freeze Shares	$1,000,000.00		
ACB	$0.00		
Amount of Insurance	$500,000.00	$500,000.00	$500,000.00
Deceased Tax			
Capital Gain - s.70(5)(a)	$1,000,000.00	$1,000,000.00	$1,000,000.00
Estate's Capital Loss Applied - s.164(6)	$500,000.00	$250,000.00	$1,000,000.00
Net Capital Gain	$500,000.00	$750,000.00	$0.00
Capital Gains Tax	$116,000.00	$174,000.00	$0.00
Estate Tax (Redemption of Freeze shares)			
Insurance CDA Available	$500,000.00	$500,000.00	$500,000.00
Insurance CDA Claimed	$500,000.00	$500,000.00	$500,000.00
Taxable Dividend (to avoid 112(3.2) stop-loss)	$0.00	$0.00	$500,000.00
Estate Tax On Dividends	$0.00	$0.00	$156,500.00
ACB of Freeze Shares - s.70(5)(b)	$1,000,000.00	$1,000,000.00	$1,000,000.00
FMV of Freeze Shares Post-Redemption	$500,000.00	$500,000.00	$0.00
Capital Loss Otherwise Determined	$500,000.00	$500,000.00	$1,000,000.00
Capital Loss Denied - s. 112(3.2)	0	$250,000.00	$0.00
Adjusted Capital Loss (applied by deceased - s.164(6))	$500,000.00	$250,000.00	$1,000,000.00

Total Tax Payable	$116,000.00	$174,000.00	$156,500.00
Effective Tax Rate	11.60%	17.40%	15.65%
Unused CDA			
Unused CDA	$0.00	$0.00	$0.00
Additional Dividend to Pay Out Unused CDA (applied to all scenarios so total distributions are equal)	$0.00	$0.00	$0.00
Tax on Additional Dividend	$0.00	$0.00	$0.00
Total Tax Payable	$116,000.00	$174,000.00	$156,500.00
Effective Tax Rate	11.60%	17.40%	15.65%
Capital Loss Denied - s. 112(3.2)			
Lesser of:			
Insurance CDA (paid as tax free dividend)	n/a	$500,000.00	$500,000.00
Capital Loss Otherwise Determined Less Taxable Dividends	n/a	$500,000.00	$500,000.00
In Excess of:			
50% of Capital Loss Otherwise Determined	n/a	$250,000.00	$500,000.00
50% of Deceased's Capital Gain	n/a	$250,000.00	$500,000.00
Dividend Tax Rate	31.30%		
Capital Gain Rate	23.20%		

SCHEDULE III

	Grandfathered	Stop-Loss	No Stop-Loss
Deceased Assets			
Freeze Shares	$1,000,000.00		
ACB	$0.00		
Amount of Insurance	$1,000,000.00	$1,000,000.00	$1,000,000.00
Deceased Tax			
Capital Gain - s.70(5)(a)	$1,000,000.00	$1,000,000.00	$1,000,000.00
Estate's Capital Loss Applied - s.164(6)	$1,000,000.00	$500,000.00	$1,000,000.00
Net Capital Gain	$0.00	$500,000.00	$0.00
Capital Gains Tax	$0.00	$116,000.00	$0.00
Estate Tax (Redemption of Freeze shares)			
Insurance CDA Available	$1,000,000.00	$1,000,000.00	$1,000,000.00
Insurance CDA Claimed	$1,000,000.00	$1,000,000.00	$500,000.00
Taxable Dividend (to avoid 112(3.2) stop-loss)	$0.00	$0.00	$500,000.00
Estate Tax On Dividends	$0.00	$0.00	$156,500.00
ACB of Freeze Shares - s.70(5)(b)	$1,000,000.00	$1,000,000.00	$1,000,000.00
FMV of Freeze Shares Post-Redemption	$0.00	$0.00	$0.00
Capital Loss Otherwise Determined	$1,000,000.00	$1,000,000.00	$1,000,000.00
Capital Loss Denied - s. 112(3.2)	0	$500,000.00	$0.00
Adjusted Capital Loss (applied by deceased - s.164(6))	$1,000,000.00	$500,000.00	$1,000,000.00
Total Tax Payable	$0.00	$116,000.00	$156,500.00

Effective Tax Rate	0.00%	11.60%	15.65%
Unused CDA			
Unused CDA	$0.00	$0.00	$500,000.00
Additional Dividend to Pay Out Unused CDA	$500,000.00	$500,000.00	$500,000.00
(applied to all scenarios so total distributions are equal)			
Tax on Additional Dividend	$156,500.00	$156,500.00	$0.00
Total Tax Payable	$156,500.00	$272,500.00	$156,500.00
Effective Tax Rate	10.43%	18.17%	10.43%
Capital Loss Denied - s. 112(3.2)			
Lesser of:			
Insurance CDA (paid as tax free dividend)	n/a	$1,000,000.00	$500,000.00
Capital Loss Otherwise Determined Less Taxable Dividends	n/a	$1,000,000.00	$500,000.00
In Excess of:			
50% of Capital Loss Otherwise Determined	n/a	$500,000.00	$500,000.00
50% of Deceased's Capital Gain	n/a	$500,000.00	$500,000.00
Dividend Tax Rate	31.30%		
Capital Gain Rate	23.20%		

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[1] Although the focus of the articles is pre-mortem planning, the nature of planning using life insurance is such that it requires one to take into account post-mortem issues (i.e., the effect of taxes after death) to arrive at an optimal pre-mortem plan (i.e., the quantum of an individual's life insurance needs, determining where the life insurance is held etc.).

This article assumes that the reader is familiar with a number of provisions of the *Income Tax Act* (Canada) ("Act"), including matters dealt with in earlier instalments of the **Estate Planning in the 21st Century** series. Unless otherwise indicated all statutory references are to the Act.

[2] Any references to persons living or dead are strictly coincidental.

[3] It is assumed that Harry's freeze shares have a nominal adjusted cost base and that Harry's capital gains exemption is not available to him. In addition, it is assumed that the corporation has no preexisting tax pools (i.e., no capital dividend account ("CDA") balance and no refundable dividend tax on hand account balance). The existence of such balances could significantly impact on the analysis set out in the discussion that follows.

[4] Either outright or in a spouse trust; as noted in earlier articles, *post mortem* methodology may differ in each case.

[5] The discussion relating to quantum of life insurance will focus on Canadian income tax consequences. In reality a number of factors other than tax should be considered when determining the correct amount of life insurance for an individual including, the cost of premiums, the perception of life insurance as an investment, the need for liquidity for other purposes, insurability maximums etc.

[6] Of course, if premiums are not deductible to the corporation and the owner-manager is receiving bonuses to reduce corporate income to the small business limit in any event, the owner may have sufficient income to pay the premiums without the need to distribute additional income for this purpose.

[7] Ignoring EHT.

[8] Subject to the Ontario claw-back rules, which can effectively increase the rate to about 41% at certain income levels. At the higher end of the spectrum, this benefit would have even been more dramatic if the new Ontario provincial government hadn't cancelled planned corporate tax rate reductions proposed by the last government that would have reduced corporate rates to nearly 30%.

[9] The concept of "adjusted cost basis" will be discussed in Part II of this article. ***[later in the article – if one Part used]***

[10] The changes are discussed below under the heading "Stop-Loss Rules."

[11]For a detailed discussion of the "pipeline" see "Post-Mortem Tax Planning in Connection with Shares of Canadian Private Corporations - More on the Pipeline" by Michael Atlas, Tax Topics No. 1635. Essentially, the structure involves a sale by the estate of its remaining freeze shares of the corporation to a new holding company in exchange for a promissory note that can be paid back without additional tax to the estate. The freeze shares held by the holding company would normally be capable of being redeemed on a tax neutral basis. As with any tax planning structure, a qualified tax professional should be consulted prior to taking steps to implement the structure as there are technical issues that will need to be considered.

[12] For tax purposes the "value" of the life insurance policy on death will be determined under subsection 70(5.3), which is discussed in more detail in Part II of this article. In this case, the value of the insurance policy should be irrelevant since the shares Harry owns are freeze shares.

[13] Bill C-28, *Income Tax Amendments Act, 1997*, SC 1998, c. 19, given Royal Assent on June 18, 1998. A discussion of the "grandfathering rules" is beyond the scope of this article. See, for example the discussion by the Tax and Estate Planning Group Manulife Financial, *Canadian Taxation of Life Insurance*, 2nd edition (Thomson Carswell, 2002) at pages 191-193.

[14] See question 2 of the CALU Conference May 1999, as reproduced in Canada Revenue Agency ("CRA") document no. 9908430 dated June 30, 1999, where the CRA confirmed that it is not possible to file an election except to the extent that the amount exceeds the CDA.

[15] There are other ways to split the dividends, including strategies to realize taxable dividends by increasing the paid up capital of shares held by the estate prior to the redemption. When using such strategies care will need to be taken to avoid paid-up capital averaging among other technical issues. For additional discussion of such strategies see *Canadian Taxation of Life Insurance* at pages 194-195. See also the discussion of planning using subsection 107(2.001) in "Post-mortem Tax Planning Using Subsection 164(6) in Connection with Shares of Canadian Private Corporations" by Michael Atlas, Tax Topics No. 1582, which, in certain circumstances could allow a convenient mechanism to be used for creating the optimal amounts of capital dividends and taxable dividends (i.e. increases of paid-up capital of all shares of the class) followed by the realization of the desired capital loss by the transfer of such shares to the beneficiaries.

[16] In some circumstances it may be possible to take steps to create CDA. A discussion of such steps is beyond the scope of this article.

[17] In a case where the grandfathering rules to subsection 112(3.2) are applicable the additional dividend would also have been taxable.

[18] For purposes of the discussion in this article it is assumed that any excess CDA is to be immediately withdrawn from the corporation. In a real life situation, this well may not be the case and the analysis would need to be reconsidered.

[19] Deductions are possible in other limited circumstances. Some examples include deductions for premiums paid by employers for group insurance policies, deductions of premiums for certain corporate charitable gifts of life insurance and limited deductions for premiums paid under a life insurance policy that has been registered as an RRSP. For more information on this topic see the detailed requirements for deductibility as set out in paragraph 20(1)(e.2) and CRA *Interpretation Bulletin IT-309R2*.

[20] Consistent with the foregoing, in CRA document #9220255 dated September 23, 1992, the CRA indicated that it is irrelevant how premiums are ultimately paid (i.e., directly by a taxpayer, by a surrender of policy dividends or paid-up policy additions or withdrawal from the investment account of a universal life policy), so long as they are payable by a taxpayer. However, this position appears to have been restricted by CRA Document #9901875 dated April 30, 1999, in which the CRA indicated that they would deny the deduction of monthly amounts transferred from an accumulating fund representing an over-funding of premiums paid in prior years, no portion of which was treated as a prepaid premium by the insurer, because the amounts transferred from the accumulating fund were not premiums payable in the year by the taxpayer. Consequently, when over-funding a policy care should be taken to ensure that the policy is designed in a manner that, at the very least, ensures the taxpayer is deemed to be paying the NCPI to support the policy each year.