



Canadian life insurance transferred from one non-resident owner to another

People move. Often they will retain the life insurance they purchased while in Canada. At the time they leave Canada, life insurance is excluded from the list of property that is deemed to be disposed of pursuant to subsection 128.1(10) definition of "excluded right or interest". (For more information see Tax Topic entitled "Emigration from Canada: Tax Implications").

What happens when, a now non-resident policyholder wants to dispose of the policy to a non-arm's length party? This was the subject of a question at the CLHIA CRA Roundtable on May 17, 2013 (#2013-0481411C6). The example in this question involved a person who purchased a policy while they were a resident of Canada that had no cash surrender value but who later moved to the U.S. The policyholder then wanted to transfer the policy to an irrevocable life insurance trust (ILIT).

The CRA confirmed that the ILIT would be required to withhold and remit an amount (50%) pursuant to subsection 116(5.3) of the Act based on the fair market value of the policy. There are many instances in which the fair market value may be significant, even for a term insurance policy with no cash values.

This result can be avoided or minimized if the ILIT applies to the CRA for a clearance certificate under subsection 116(5.2) of the Act. The request must be made and clearance certificate issued by CRA prior to 30 days after the month in which the ILIT acquires the property. In order to get the clearance certificate, the ILIT will have to remit 25% of the FMV of the policy or provide adequate security.

From the insurer's point of view, there will be no withholding obligation since the transfer does not involve a disposition covered under subsection 116(5.4). Generally, dispositions like surrenders, receipt of dividends or policy loans, are ones under which the insurer would have to withhold and remit on behalf of the policyholder.

While the existence of the clearance certificate mechanism is helpful, the ILIT trustee will have to know not only that there is a problem (in this case, withholding and remittance of 50% of the FMV of the policy) but also that there is a potential resolution to the problem (putting up security acceptable to the Minister or payment of tax as discussed above and obtaining a clearance certificate).

Other examples of non-arm's length non-resident to non-resident transfers that would be caught in this situation could be simple transfers between spouses when both spouses are now non-residents.

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