



Determining the value of corporate-owned life insurance for purposes of the capital gains exemption

CRA technical interpretation (#2013-047298) dated March 14, 2013, involved a corporation that holds a life insurance policy on the life of its shareholder - Mr. X. Mr. X is terminally ill. The facts state that the policy's cost (presumably, this means the policy's adjusted cost basis) is zero, the cash surrender value is \$50,000 and the fair market value (FMV) as determined by an actuary is \$500,000. The corporation is the owner and beneficiary and pays the premium for the policy.

For the shareholder to qualify for the capital gains exemption in respect of a disposition of his shares, the corporation must meet certain asset tests, in this case in the definition of "qualified small business corporation share" in subsection 110.6(1) of the Act. (For more information see the Tax Topic on [The Capital Gains Exemption](#)). For purposes of these tests, the CRA was asked the following question (unofficial English translation):

... which of the cash surrender value or the FMV of the life insurance policy should be used in calculating the FMV of the assets used in the active corporation, based on the assumption that the Insured holds: 1) all of the issued shares of the Corporation's capital stock; 2) 1% of the issued shares in all of the classes of the Corporation's capital stock; 3) preferred shares of the Corporation without voting rights; 4) issued preferred shares, without voting rights, of the capital stock of another corporation..., which holds more than 10% of the issued shares of the Corporation's capital stock.

Although the CRA did not specifically reference each of the scenarios of share ownership described above, it did confirm that the proper value would be the policy's cash surrender value in this situation. It confirmed that paragraph 110.6(15)(a) would apply (provided all the other requirements of the paragraph are met). This paragraph states that the FMV of the life insurance policy at a given time prior to death of the shareholder is deemed to be the cash surrender value of the policy at that time.

This makes sense. Life insurance is generally considered a passive asset and could throw off meeting these asset tests. Inflating the value of insurance because of, in this case an individual's terminal illness, would be harsh. Hence the deeming rule in paragraph 110.6(15)(a).

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