



## TAX AND ESTATE PLANNING FOR BUSINESS OWNERS

Kyle Friesen  
KPMG Canada  
Winnipeg

Greg Gillis  
Lawton Partners  
Winnipeg

Aron Grusko  
Fillmore Riley LLP  
Winnipeg

Nick Noonan  
Fillmore Riley LLP  
Winnipeg

# Tax and Estate Planning for Business Owners

Aron W. Grusko and Nick Noonan, Fillmore Riley LLP

Kyle Friesen, KPMG LLP

Greg Gillis, Lawton Partners

## I. Introduction

Tax and estate planning for business owners requires consideration of the Income Tax Act<sup>1</sup> (the "ITA"), corporate law, and commercial feasibility. Owners approaching a sale or transition typically arrive at their advisors' doors, whether accountants, lawyers, or insurance advisors, with incomplete information, pre-existing structures, and constraints - an insurance policy that was set up years ago, a parcel of land that was supposed to be the future expansion site, a son-in-law who is now a co-shareholder. The job of the professional advisor is to optimize the structure based on what is actually on the table.

This paper looks at tax and estate planning for business owners through a set of fact patterns, focusing on how these files arrive on advisors' desks and how they tend to evolve. The discussion moves through common scenarios and unpacks the tax, corporate, insurance, and estate issues that shape both short-term decisions and long-term outcomes. The paper works through situations involving immediate exits and longer-term planning horizons, including businesses that are offside key tax thresholds because of passive assets, owners considering succession to children or key employees, and files where future flexibility matters as much as the immediate tax result. Along the way, the discussion touches on freezes, trusts, beneficiary corporations, shareholder agreements, and the commercial realities that often constrain otherwise clean tax plans. Some of these scenarios involve existing insurance arrangements or advice clients have already received, particularly where liquidity, family dynamics, or post-mortem tax exposure is in play. The focus throughout is on how experienced advisors assess these situations, test assumptions, and integrate the moving pieces into a coherent plan.

This paper is prepared as material to support a panel discussion and is not intended to be an exhaustive analysis of any of the topics covered. All figures in the fact patterns are hypothetical. Readers should not rely on this paper as legal or tax advice in respect of any particular situation. This paper assumes that the reader has basic knowledge of eligibility for purposes of accessing the lifetime capital gains exemption.

The acronym "**FMV**" will be used in this paper to mean fair market value.

---

<sup>1</sup>Income Tax Act, RSC 1985, c 1 (5th Supp) [ITA].

## II. Scenario 1: Immediate Exit - Passive Real Estate and the 90% Test

### A. Facts

James Bradley is the sole shareholder of Bradley Supply Inc. ("**Opco**"), a Manitoba-incorporated company that has operated a wholesale industrial parts distribution business for approximately 20 years. James is 62 and has received an offer from a strategic buyer to acquire all of the issued and outstanding shares of Opco for a purchase price of \$9,600,000 on a cash-free/debt-free basis and James wants to close in approximately 90 days.

James's question: Can he sell his shares and claim the LCGE? If not, what can be done?

Opco's balance sheet and tax attributes currently are as follows:

- Adjusted cost base of James's shares: approximately nil (founder shares issued for nominal consideration)
- No corporately-owned life insurance policies.
- Opco has no loss carry forward balances and nominal CDA, NERDTH, and ERDTH accounts for the purpose of this illustration.
- Opco does have a substantial amount of GRIP due to years of profitability and reinvestment back into the business.
- Fair market value of Opco shares are \$11,000,000, allocated as follows:

	Current State		Original Cost	UCC
	FMV	% of Assets		
<b>Active Business Assets:</b>				
Working capital (inventory, receivables)	\$500,000	4.5%	\$500,000	N/A
Tangible assets (warehouse, equipment)	\$1,000,000	9.1%	\$750,000	\$0
Goodwill & other intangibles	\$8,100,000	73.6%	\$0	\$0
	<b>\$9,600,000</b>	<b>87.3%</b>		
<b>Passive Assets:</b>				
Undeveloped Land	\$1,400,000	12.7%	\$250,000	N/A
	<b>\$11,000,000</b>	<b>100.0%</b>		

James has not previously claimed any portion of his Lifetime Capital Gains Exemption ("**LCGE**").<sup>2</sup> His accountants have confirmed that Opco otherwise qualifies as a "qualified small business corporation" ("**QSBC**") for purposes of the ITA,<sup>3</sup> except for the question of whether the passive real estate causes Opco to fail the "90% test" discussed below. The "50% test" is satisfied regardless.

The land is a parcel adjacent to Opco's main warehouse that James acquired some years ago with a view to future expansion. It is not used in the active business and is not encumbered. It is capital in nature, and not inventory.

<sup>2</sup>ITA, s. 110.6.

<sup>3</sup>ITA, s. 248(1), definition of "small business corporation"; see also s. 110.6(1), definition of "qualified small business corporation share".

## B. Legal Framework: The QSBC Definition and the 90%/50% Tests

To qualify for the LCGE, the shares disposed of must be "qualified small business corporation shares" as defined in subsection 110.6(1) of the ITA. Among other requirements, at the time of the disposition all or substantially all - generally interpreted by the CRA as 90% or more - of the fair market value of the corporation's assets must be attributable to assets used principally in an active business carried on primarily in Canada, shares of connected small business corporations, or a combination thereof (the "**90% test**").<sup>4</sup>

In addition, throughout the 24-month period immediately preceding the disposition:

- i. the shares must not have been owned by anyone other than the individual or a related person; and
- ii. more than 50% of the fair market value of the corporation's assets must have been attributable to active business assets (the "**50% test**").<sup>5</sup>

The test becomes more complicated where there are "stacked" corporations; this analysis is outside the scope of this paper. Both tests are applied on a fair market value basis.

In Opco's case, the passive real estate has a FMV of \$1,400,000 against total assets of \$11,000,000, making the passive fraction approximately 12.7%. Whether this causes the 90% test to fail is a close question that turns on the precise classification of all assets, and potentially on whether the "all or substantially all" passive threshold is met at the moment of disposition. The analysis is fact-specific. Assume for the purposes of this scenario that it does not pass the 90% test.

## C. Analysis: Planning Options

The central question is whether the real estate can be removed from Opco before closing in a manner that is tax-efficient and timely to satisfy the relevant tests?

### Option 1: Sale of the Real Estate to a Sister Company at FMV

James incorporates a new holding company ("**HoldCo**") and Opco sells the land to HoldCo at FMV. Assume the sale is for cash, funded by a shareholder loan from James to HoldCo.

- Corporate-level gain in Opco: \$1,150,000 capital gain on sale at FMV; taxed at the corporate rate inside Opco

#### **Corporate Tax Cost:**

Permanent Tax	\$115,000
Refundable Tax	\$176,333
	<hr/>
	<b>\$291,333</b>

- No dividend to James; land now sits in HoldCo outside Opco's balance sheet
- HoldCo holds the land; James can deal with it separately post-closing
- Considerations: Opco's 90% test would still not be satisfied – there is excess cash that will need to be paid out as a dividend

---

<sup>4</sup>ITA, s. 110.6(1), definition of "small business corporation" in s. 248(1): "all or substantially all" is generally administered by the CRA as 90% or more on a fair market value basis.

<sup>5</sup>ITA, s. 110.6(1), definition of "qualified small business corporation share", para. (c): throughout the 24-month period immediately before the disposition, more than 50% of the fair market value of the corporation's assets must have been attributable to assets used principally in an active business carried on primarily in Canada, shares of connected small business corporations, or eligible combinations thereof.

	<b>Starting Point</b>		<b>After Land Sale</b>	
	<b>FMV</b>	<b>% of Assets</b>	<b>FMV</b>	<b>% of Assets</b>
<b>Active Business Assets:</b>				
Working capital (inventory, receivables)	\$500,000	4.5%	\$500,000	4.7%
Tangible assets (warehouse, equipment)	\$1,000,000	9.1%	\$1,000,000	9.3%
Goodwill & other intangibles	\$8,100,000	73.6%	\$8,100,000	75.6%
	<b>\$9,600,000</b>	<b>87.3%</b>	<b>\$9,600,000</b>	<b>89.6%</b>
<b>Passive Assets:</b>				
Undeveloped Land	\$1,400,000	12.7%		
Cash (net of taxes)			\$1,108,667	10.4%
	<b>\$11,000,000</b>	<b>100.0%</b>	<b>\$10,708,667</b>	<b>100.0%</b>

### Option 2: Dividend to James / Full Distribution of the Real Estate to Holdco/James

Opco distributes the excess cash directly James as a dividend at fair market value. Opco is deemed to have disposed of the land at FMV, realizing a capital gain of \$1,150,000 inside the corporation. Holdco receives the land at a cost equal to the FMV dividend amount – same as Option #1, except now Opco has distributed the excess cash on hand.

- Corporate-level gain on land: \$1,150,000 capital gain; 50% inclusion; taxed at Opco's applicable corporate rate
- Dividend to James of excess cash:

Capital Dividend	\$575,000	
Non-eligible Dividend	\$460,000	(to recover NERDTH)
Eligible Dividend	\$250,000	
<b>Total Dividend</b>	<b>\$1,285,000</b>	
James' Tax Liability	(\$309,132)	
<b>Net Cash Received</b>	<b>\$975,868</b>	

- Result: land (and excess cash) are removed from Opco, 90% test likely satisfied, but tax cost arises at both the corporate and personal level.

#### Tax Cost:

Corporate Tax	\$115,000	(net of dividend refund)
Personal Tax	\$309,132	
	<b>\$424,132</b>	

- Considerations: Does the Undeveloped land or the impact of removing the land increase/reduce the share sale price dollar-for-dollar or is there a negotiation point with the buyer?

	<b>Do Nothing</b>	<b>OPTION #1 Sale Land to Holdco</b>	<b>OPTION #2 Sale Land to Holdco Distribute Cash</b>
<b>Adjusted Share Consideration:</b>			
Base Purchase Price (Offer)	\$9,600,000	\$9,600,000	\$9,600,000
Adjustments:			
Cash on hand/Shareholder Loan	\$0	\$1,400,000	\$365,000
Corporate Tax Liability (net of refund)	\$0	(\$291,333)	(\$115,000)
Undeveloped Land	\$1,400,000	Removed	Removed
<b>Adjusted Share Price</b>	<b>\$11,000,000</b>	<b>\$10,708,667</b>	<b>\$9,850,000</b>

### Option 3: Asset Sale and Wind-Up

As an alternative to a share sale, the buyer purchases Opco's active business assets (excluding the land) and Opco is subsequently wound up (at a future date), with the land and after-tax proceeds distributed to James.

- No LCGE available on an asset sale (the LCGE applies to share dispositions by individuals or trusts [where the gain is allocated to individuals] only)
- Opco pays corporate tax on gains realized on the sale of goodwill and other assets, and any applicable recapture:

Active Business Assets:	FMV	Original Cost	UCC	Business Income	Capital Gain	
Working capital (inventory, receivables)	\$500,000	\$500,000	N/A	\$0	N/A	
Tangible assets (warehouse, equipment)	\$1,000,000	\$750,000	\$0	\$750,000	\$250,000	
Goodwill & other intangibles	\$8,100,000	\$0	\$0	\$0	\$8,100,000	
	<b>\$9,600,000</b>	<b>\$1,250,000</b>	<b>\$0</b>	<b>\$750,000</b>	<b>\$8,350,000</b>	
				↓	↓	
				Permanent Tax	\$202,500	\$1,037,500
				Redundable Tax	N/A	\$1,280,333
					<b>\$202,500</b>	<b>\$2,317,833</b>
					27%	25.33%

- After-tax proceeds may be distributed to James as a dividend or remain in Opco and distributed to James on future wind-up<sup>6</sup>. As a matter of best practice, distributions should be made to James to the extent any shareholder loans can be repaid or dividends can be declared from Opco capital dividend account. Further distributions should be discussed on a case-by-case basis based on the immediate and long-term need for personal cash, which can help preserve a layer of tax deferral for James.

#### Deferred Tax Liability (paid on distribution/wind-up):

Dividend refund	\$1,280,333
James tax on non-eligible dividend	(\$1,558,778)
James tax on eligible dividend	(\$395,745)
	<b>(\$674,190)</b>

- Land remains in Opco until wind-up; distributed to James at that time (deemed dividend at FMV)

#### Deferred Tax Liability (paid on distribution/wind-up):

Opco Corporate Tax (net of refund)	(\$115,000)
James tax on non-eligible dividend	(\$214,682)
James tax on eligible dividend	(\$94,450)
	<b>(\$424,132)</b>

- Generally an asset sale is less tax-efficient than a share sale with LCGE, but may be the buyer's preference and may allow for an increase in purchase price to be negotiated (i.e. CCA Tax Shield value, simplicity of an asset deal, etc.) One of the underlying benefits of an asset deal is that it defers the accrued tax on any redundant assets held by the corporation, which can be substantial.
- Integrating the Asset Sale results with the Share Sale (with purification) results clearly yields a drastic difference. This difference is brought on by key elements of income tax rate integration between the personal and corporate environment:

<sup>6</sup>ITA, s. 84(2) (deemed dividend on distribution on winding-up, discontinuance or reorganization of business).

Option #2 - After-tax Net Consideration **\$8,503,118**

Asset Sale Inefficiencies:

Dividend vs. Capital Gain on Corporate Cost Base:	(\$188,700)
Recapture of CCA (corporate level)	(\$126,107)
Loss of CGE deduction on capital gain	(\$358,333)
Capital Gain Integration Inefficiency (Corp vs Personal)	(\$246,133)
	(\$919,274)

Option #3 - After-tax Net Consideration **\$7,583,844**

- Considerations: Rather than winding-up, Opco can continue as an investment corporation (holding the land and investing the purchase proceeds), and dividends can be paid out over time as cash is needed (delaying the tax liability).

	<b>Opco</b>	<b>James</b>	<b>TOTAL</b>
Asset Sale Proceeds (cash)	\$9,600,000		\$9,600,000
Corporate Tax Liability	(\$2,317,833)		(\$2,317,833)
Net Cash Available in Corporation	\$7,282,167		\$7,282,167
Capital Dividend	(\$4,175,000)	\$4,175,000	\$0
Cash on Hand	\$3,107,167	\$4,175,000	\$7,282,167
Undeveloped Land	\$1,400,000	\$0	\$1,400,000
<b>Total Assets Available</b>	<b>\$4,507,167</b>	<b>\$4,175,000</b>	<b>\$8,682,167</b>
Deferred Tax on Distribution:			
Corporate Cash	\$1,280,333	(\$1,954,524)	(\$674,190)
Undeveloped Land	(\$115,000)	(\$309,132)	(\$424,132)
	<b>\$1,165,333</b>	<b>(\$2,263,656)</b>	<b>(\$1,098,322)</b>
		<b>Net Fully Distributed Proceeds</b>	<b>\$7,583,844</b>

At this stage, we would normally present James with a summary of the different Options we discussed above so that we can work through the pros and cons of each from an objectives perspective, but also numerically compare the options:

	Do Nothing	OPTION #1 Sale Land to Holdco	OPTION #2 Sale Land to Holdco Distribute Cash	OPTION #3 Asset Sale Delayed Distribution
<b>Consideration:</b>				
<b>Adjusted Share Consideration:</b>				
Base Purchase Price (Offer)	\$9,600,000	\$9,600,000	\$9,600,000	N/A
Adjustments:				
Cash on hand/Shareholder Loan	\$0	\$1,400,000	\$365,000	N/A
Corporate Tax Liability (net of refund)	\$0	(\$291,333)	(\$115,000)	
Undeveloped Land	\$1,400,000	Removed	Removed	N/A
<b>Adjusted Share Price</b>	<b>\$11,000,000</b>	<b>\$10,708,667</b>	<b>\$9,850,000</b>	<b>\$0</b>
Shareholder Transactions:				
Shareholder Loan (Holdco)		(\$1,400,000)	(\$1,400,000)	N/A
Capital Dividend			\$575,000	\$4,175,000
Taxable Dividend (non-eligible)			\$460,000	
Taxable Dividend (eligible)				
	\$0	(\$1,400,000)	(\$365,000)	\$4,175,000
Undeveloped Land	Sold with Shares	\$1,400,000	\$1,400,000	\$1,400,000
Business Asset Proceeds (net of tax)	N/A	N/A	N/A	\$3,107,167
<b>Total Consideration Received</b>	<b>\$11,000,000</b>	<b>\$10,708,667</b>	<b>\$10,885,000</b>	<b>\$8,682,167</b>
<b>Personal Tax<sup>(See below)</sup>:</b>				
Share Proceeds (cash)	(\$2,772,000)	(\$2,698,584)	(\$2,167,200)	\$0
Taxable dividends (cash)	\$0	\$0	(\$214,682)	\$0
	<b>(\$2,772,000)</b>	<b>(\$2,698,584)</b>	<b>(\$2,381,882)</b>	<b>\$0</b>
<b>After-tax Net Consideration:</b>				
Cash (after-tax)	\$8,228,000	\$6,610,083	\$7,103,118	\$7,282,167
Undeveloped Land	Sold with Shares	\$1,400,000	\$1,400,000	\$1,400,000
	\$8,228,000	\$8,010,083	\$8,503,118	\$8,682,167
Deferred tax on future corporate distribution	N/A	\$0	\$0	(\$1,098,322)
	<b>\$8,228,000</b>	<b>\$8,010,083</b>	<b>\$8,503,118</b>	<b>\$7,583,844</b>
<b>Personal tax on Capital Gain:</b>				
Estimated Capital Gain:	\$11,000,000	\$10,708,667	\$9,850,000	\$0
Less: capital gains exemption	Not Eligible	Not Eligible	(\$1,250,000)	Not Eligible
Net Capital Gain	\$11,000,000	\$10,708,667	\$8,600,000	\$0
Tax rate	25.20%	25.20%	25.20%	25.20%
<b>Estimated Tax Liability</b>	<b>\$2,772,000</b>	<b>\$2,698,584</b>	<b>\$2,167,200</b>	<b>\$0</b>

## Takeaway

Immediate exits with passive assets require consideration of a few questions, namely:

- 1) Does the passive asset definitively cause the 90% test to fail, or is it arguable on the numbers (and if arguable, what is the client's risk tolerance);
- 2) Is there a cost-effective way to remove passive assets before closing;
- 3) Does the buyer care about the structure (often, a buyer prefers an asset sale anyway); and
- 4) Does the seller want to retain the passive asset / does the buyer want to buy the passive asset?

The math on purification - including the gain triggered on purification and any personal tax cost – are to be weighed against the value of the LCGE. On the right facts, purification is clearly worthwhile. On others, the cost of purifying may approach or exceed the LCGE benefit.

### III. Scenario 2: Immediate Exit - Corporate-Owned Life Insurance

#### A. Facts

Michael and Helena Taylor are married co-shareholders of Taylor Mechanical Ltd. ("**Opco**"), a Manitoba-incorporated company operating a commercial HVAC service and installation business. They each own 50% of the common shares. They own "dividend sprinkling" shares of different classes. They have received an offer from a private equity buyer to acquire 100% of the shares for \$6,000,000. Michael is the insured key person in the business and wants to retain his life insurance policy personally after the sale.

Opco holds a permanent whole life insurance policy on Michael's life with the following attributes:

- Current Death Benefit: \$5,000,000 (will increase from policy dividends each future year)
- Annual premium: \$200,000
- Adjusted cost basis ("**ACB**") of the policy: \$700,000
- Cash surrender value ("**CSV**"): \$1,200,000
- Fair market value ("**FMV**"): \$2,225,000

For this scenario, assume that with the policy at CSV, Opco fails the 90% test (i.e., the policy's CSV causes passive assets to exceed 10% of total asset FMV<sup>7</sup>), but Opco does not fail the 50% test on a 24-month look-back basis. This means the policy must be dealt with on or before closing, but the two-year hold-period planning contemplated in Scenario 3 is not required.

If the policy were a term policy, which typically will have no CSV or FMV (as discussed in Section C. below), the simplest approach would be to cancel it or transfer it to Michael for nominal consideration. This scenario uses a permanent whole life policy because it presents the more complex and common planning issue.

#### B. Legal Framework: Taxation of Non-Arm's Length Dispositions of Life Insurance Policies

We are grateful to Kevin Wark (author) and Glenn Stephens (editor), of *The Essential Canadian Guide to Life Insurance Transfers*, 1st ed (2021), for writing the treatise on this issue. We have relied on this publication extensively in preparing these materials.

On a disposition of a life insurance policy, the policyholder (Opco) realizes a policy gain equal to the proceeds of disposition less the ACB of the policy.<sup>8</sup> The policy gain is fully included in Opco's income from property (it is not active business income nor a capital gain).<sup>9</sup>

---

<sup>7</sup> ITA, s. 110.6(15)(a)(i) deems FMV of the life insurance policy shall, at any time before the death of the insured, be deemed to be its CSV (within the meaning assigned by subsection 148(9)) at that time.

<sup>8</sup> ITA, s. 148(1) (amounts included in computing policyholder's income). The policy gain on a disposition is generally the proceeds of disposition less the adjusted cost basis of the policy as defined in s. 148(9).

<sup>9</sup> ITA, s. 39(1)(a)(iii) (meaning of capital gain and capital loss). The gain on the disposition of insurance policies is not a capital gain, unless it is in respect of a segregated fund.

Subsection 148(7) of the ITA (as modified by the 2016 Federal Budget) governs the tax treatment of non-arm's length dispositions of life insurance policies. On such a disposition, the proceeds of disposition to the transferor are **deemed** to equal the greatest of:

- i. the value of the policy at the time of disposition (generally, the cash surrender value – “CSV”);
- ii. the FMV of any consideration given for the policy; and
- iii. the ACB of the policy.

A taxable policy gain arises to the extent deemed proceeds exceed the ACB of the policy. The cost of the policy to the transferee is equal to the same deemed proceeds under paragraph 148(7)(b) of the ITA<sup>10</sup>.

The mode of transfer affects the tax analysis:<sup>11</sup>

- **Transfer/gift to an individual shareholder for no consideration:**  
A shareholder benefit under subsection 15(1) of the ITA will generally be assessed to the transferee shareholder. The shareholder benefit will be equal to the FMV of the policy. The deemed proceeds to Opco are the greatest of CSV, nil (no consideration), and ACB.
- **Dividend in-kind to an individual shareholder:**  
The distribution is treated as a dividend to the shareholder, with dividend tax to be paid, and the amount of the dividend being equal to the FMV of the policy. The dividend can only be paid if corporate solvency tests are met.<sup>12</sup> The deemed proceeds to Opco are the greatest of CSV, nil (no consideration), and ACB.
- **Dividend in-kind to a parent corporation:**  
The same treatment as above, except that an inter-corporate dividend is generally tax-free,<sup>13</sup> unless the payor corporation has insufficient safe income (which may be the case if the policy has a large FMV); in which case, a capital gain will be assessed to the recipient corporation under section 55(2) of the ITA.
- **Transfer as redemption proceeds:**  
Where the policy is transferred as proceeds for the redemption of shares, consideration is deemed to be paid equal to the FMV of the shares redeemed. The deemed proceeds to Opco are the greatest of CSV, FMV of the policy (assuming the value of the shares redeemed equals the FMV of the policy), and ACB.

A practical issue/trap arises on the inter-Corporate dividend in-kind and redemption scenarios: the transfer of the insurance policy moves refundable dividend tax on hand up to the parent company on the payment (or, on redemption, deemed payment) of the dividend, without the corresponding cash to fund future dividends for the parent to receive the refund. This issue can be further compounded when there is no sufficient safe-income that contributes to the gain on the shares held by the Corporate Parents and the dividend proceeds are deemed to be a capital gain, causing a substantial corporate tax liability with no cash on hand available to remit.

---

<sup>10</sup> ITA, s. 148(7)(b) (disposition at non-arm's length and similar cases). The person that acquires the interest in the policy because of the non-arm's length disposition is deemed to acquire it at a cost equal to the deemed proceeds of dispositions.

<sup>11</sup> See: CRA TI 9327305, CRA TI 2003-0004275, CRA TI 2016-0671731E5, CRA TI 2017-0690331C6, and CRA TI 2018-0761521C6.

<sup>12</sup> Section 40 of *The Corporations Act* (Manitoba) states: “A corporation shall not declare or pay a dividend if there are reasonable grounds for believing that (a) the corporation is, or would after the payment be, unable to pay its liabilities as they become due; or (b) the realizable value of the corporation's assets would thereby be less than the aggregate of its liabilities and stated capital of all classes.”

<sup>13</sup> ITA, s. 112(1) (deduction of taxable dividends received by corporation from another corporation). Dividend is included in corporate recipient's income, with an offsetting deduction.

## C. Legal Framework: Valuation of Life Insurance Policies

### 1. Term vs. Permanent Policies - Basic Concepts

#### **Term Insurance:**

- Death benefit set at policy issue.
- Temporary coverage for a set term of (typically) 10, 15, 20, or 30 years.
- Guaranteed premium for the duration of the term, after which the premium increases to a contractual renewal amount for another term of the same duration.
- Renewals continue until a set age such as 80 or 85, at which time coverage ceases.
- Typically, term policies can be converted to permanent coverage up to a certain age such as 70.
- Renewals and the option to convert to permanent are contractually provided with no new underwriting requirements.

#### **Permanent Insurance:**

Insurance that will not expire as long as contractual premiums are remitted or sufficient cash values exist to keep the policy in force.

Two general types:

1. Whole Life, also called participating or “par”, and
2. Term-to-100 and Universal Life.

#### Whole Life/Par:

- Breakdown of insurance costs and savings components are not separately disclosed.
- “Participates” in the profits of the insurance company from the entire Par block of business through policy dividends paid each year.
- Par policies are issued with minimum guaranteed death benefit amounts and guaranteed future cash values. Policy dividends paid each year can be used to purchase additional “paid up” amounts of death benefit (typical), or can be left in the policy to build cash values or be used to offset future premium requirements, or can be paid out to the policyholder each year (rare).
- Dividend scales are not guaranteed, but the life insurance companies strive not change dividend levels significantly from year to year.
- Par policies have higher premiums for a given level of guaranteed death benefit than Term-to-100 or Universal Life policies (discussed below), as those other policies do not pay dividends and generally do not have guaranteed cash values.

- Par policies can be structured to have premiums required for a set period such as 10 or 20 years, or can require premiums until death.

#### Term-to-100 and Universal Life:

Term-to-100 policies have a fixed face amount and level monthly or annual premiums that are paid until death or until the life insured turns age 100. Simplest form of permanent coverage.

Universal Life separates the insurance costs from the investment or savings component of the policy. Policyholders can deposit additional amounts (referred to as overfunding), over and above the minimum premiums required to keep the policy in force, into an investment account within the policy that accumulates **tax-free**. The investment account balance can be used to offset future premiums, and at death any amount remaining in the investment account is added to the death benefit. There are ITA limitations as to how much overfunding is permitted, as that amount accumulates tax free.

There are two insurance cost structures typically found in Universal Life policies. The most common is called Level Cost of Insurance (LCOI), and is the cost structure that can produce FMVs that exceed CSV. As the name suggests, under LCOI, the insurance cost charged to the policy is an equal amount every year, so the required minimum premiums are more than actuarially required to pay for the death benefit early in the policy's life and are less than required later. The longer a policy has been in force, the greater the difference between the actuarial present value of the future death benefits and the actuarial present value of future required premiums, and thus the greater the FMV.

The less common cost of insurance structure found in Universal Life policies is called Yearly Renewable Term or YRT. Under this structure, the insurance costs increase each year to reflect the actual probability of death benefit payout in the given year. For policies with YRT cost of insurance, the FMV will be the cash surrender value.

## **2. Why Term Policies Generally Have No Fair Market Value**

The guaranteed renewal premiums (premiums after the first term of the policy) under a term policy are generally much higher than the premiums that would be required under a new, identical, policy on the same individual, which will only be issued if the insured can pass underwriting. This is a result of term policies being contractually required to permit renewal after each term with no new underwriting, and thus are susceptible to policyholders who have developed health issues or are uninsurable taking advantage of the guaranteed renewal and those who are healthy being more likely to seek new coverage at a lower premium.

The actuarial result of this selection risk, combined with the fact that term policies typically cease coverage at some age (typically 80), is that most term policies will have no FMV.

The situations where a term policy might have a FMV is if the life insured has developed a known and documented medical condition that has caused a measurable impairment to their future mortality, or if their death is imminent.

### **3. CSV vs. FMV for Permanent Policies**

CSV: This CSV of any policy is simply the amount that the insurance company is prepared to buy the policy back from the policyholder. Permanent policies that generally will not have a CSV include Term-to-100 policies and Universal Life policies that have no accumulated investment account (or where the accumulated investment account is less than the surrender charges that would apply if the policy were cancelled).

FMV: The FMV should reflect an assessment of the highest price obtainable in an open and unrestricted market between knowledgeable, informed, and prudent parties acting at arm's length, with neither being under any compulsion to transact.

The FMV is calculated using accepted actuarial principles and suitable discount and mortality rates selected by the actuary. While there can be inconsistencies between different actuaries as to the selection of assumptions, most generally select assumptions that are consistent with assumptions inherent in the pricing of new policies.

The main factors that can impact FMV include the length of time the policy has been in force, the age of the life insured, the insurance cost structure, the amount of accumulated investment account in Universal Life policies, and any measurable, significant health changes in the period since the policy was issued.

### **4. Valuation Methods for Permanent Policies**

The basic calculation of FMV is (the actuarial present value of the future expected death benefit) minus (the actuarial present value of the future minimum premiums required to keep the policy in force) PLUS any investment account balance in policies where such amounts are added to the death benefit.

A second approach to calculate FMV is (the actuarial present value of future minimum premiums for a hypothetical replacement policy with identical features as the existing policy) minus (the actuarial present value of the future minimum required premiums for the existing policy), again plus any investment account balance in policies where such amounts are added to the death benefit.

FMV would be set as the lower of the above two values.

For some situations, for example with participating policies, finding a hypothetical replacement policy for comparison might not be possible, making the second calculation not possible.

The Canadian Institute of Actuaries' Standards of Practice does not have a specific standard relating to the calculation of FMV of insurance policies, although all such calculations are subject to the relevant aspects of the general Standards of Practice (objectivity, avoidance of bias when selecting assumptions, operating within the law).

## 5. Valuation Under the ITA – For QSBC Purposes and on Death

There are special deeming rules in 110.6(15)(a)<sup>14</sup> which apply for the purposes of determining whether shares are QSBC shares in the event of the death of an insured. In summary:

- Sub-clause (i) provides that where an insured, whose life was insured under an insurance policy owned by a particular corporation, owned shares of the capital stock of the particular corporation, then the fair market value of the life insurance policy shall, at any time before the death of the insured, be deemed to be its CSV at that time.
- Sub-clause (ii) deems the FMV value of the insurance proceeds or the right to receive the proceeds not to exceed the CSV of the policy immediately prior to the shareholder's death to the extent that such proceeds are used to redeem, acquire or cancel shares of the particular corporation owned by the insured within 24-months of the insured's death.

For the LCGE to be available on a sale of QSBC shares, the 90%/50% active asset tests must be satisfied.<sup>15</sup> The above rules are therefore beneficial to the insured's estate, as they deem the FMV of the policy and the insurance proceeds to be CSV, rather than the now high (as a result of the death of the insured) FMV for purposes of the QSBC test. This may assist the insured's estate in accessing the LCGE.

### D. Analysis: Planning Options

- All Option discussed result in a disposition (deemed or otherwise) of the Policy by Opco and a resulting policy gain which is fully included in Opco's income, reducing share purchase price by the inherent taxes.

#### Adjusted Share Price:

	In-Kind	Redemption
Share Proceeds	\$6,000,000	\$6,000,000
Adjustments:		
Corporate Tax Liability	(\$253,350)	(\$772,718)
Dividend Refund	\$153,350	\$467,718
<b>Adjusted Share Proceeds</b>	<b>\$5,900,000</b>	<b>\$5,695,000</b>

#### Opco Tax Liability:

Deemed Proceeds [148(7)]	\$1,200,000	\$2,225,000	<--Note Difference
Less: ACB of Policy	(\$700,000)	(\$700,000)	
Policy Gain	\$500,000	\$1,525,000	
Taxable Capital Gain [111(4)(e)]	N/A	N/A	
Donation Deduction	N/A	N/A	
Taxable Investment Income	\$500,000	\$1,525,000	

#### Corporate Tax:

Permanent Tax	(\$100,000)	(\$305,000)
Refundable Tax	(\$153,350)	(\$467,718)
	(\$253,350)	(\$772,718)

<sup>14</sup> ITA, s. 110.6(15) (value of assets of corporations).

<sup>15</sup> ITA, s. 248(1), definition of "small business corporation"; see also s. 110.6(1), definition of "qualified small business corporation share";

ITA, s. 110.6(1), definition of "small business corporation" in s. 248(1): "all or substantially all" is generally administered by the CRA as 90% or more on a fair market value basis;

ITA, s. 110.6(1), definition of "qualified small business corporation share", para. (c): throughout the 24-month period immediately before the disposition, more than 50% of the fair market value of the corporation's assets must have been attributable to assets used principally in an active business carried on primarily in Canada, shares of connected small business corporations, or eligible combinations thereof.

### Option 1(a): High FMV - Dividend in-Kind to Michael Personally

Opco declares a dividend in-kind of the life insurance policy to Michael (the insured shareholder). The dividend is equal to the FMV of the policy. Opco realizes a policy gain (deemed proceeds<sup>16</sup> less ACB) fully included in income. Michael receives the policy at a cost equal to the dividend amount.

- Dividend to Michael: taxable dividend equal to FMV; taxed at Michael's personal rate (eligible or non-eligible)
- Helena's position: she receives no value from the distribution - purchase price allocation and equalization between co-shareholders may need to be addressed

#### Cash Flow - OPTION 1a:

	Michael/Helena
Share proceeds	\$5,900,000
Tax Liability:	
Capital gain (sale of shares)*	(\$856,800)
Taxable dividend (insurance policy)	(\$1,038,408)
<b>Net after-tax cash on hand</b>	<b>\$4,004,793</b>
Life Insurance Policy (@ FMV)	\$2,225,000
<b>Total Value</b>	<b>\$6,229,793</b>

Note: \*Assume capital gain eligible for CGE

### Option 1(b): High FMV - Dividend In-Kind to a Parent Corporation

Rather than paying the dividend to Michael personally, Opco pays the dividend in kind to a holding company owned by Michael and/or Helena (after some planning to insert the HoldCo into the structure). This may be more efficient depending on available safe income. This scenario makes the following assumptions with respect to the structured planning:

- Michael and Helena will retain enough shares directly in Opco to fully utilize their personal capital gains exemptions on a future sale while all remaining shares will be transferred to HoldCo on a tax deferred basis.
- HoldCo is connected<sup>17</sup> to Opco and as such intercorporate dividends should be received tax-free by HoldCo under the intercorporate dividend deduction.<sup>18</sup>
- If there is insufficient safe income available that contributes to the gain on the shares held by Holdco, the intercorporate dividend would give rise to a deemed capital gain to Holdco<sup>19</sup>.

#### Cash Flow - OPTION 1b:

	Option 1b - Sufficient Safe Income			Option 1b - Insufficient Safe Income		
	Holdco	Michael/Helena	Total	Holdco	Michael/Helena	Total
Share Proceeds	\$3,400,000	\$2,500,000	\$5,900,000	\$3,400,000	\$2,500,000	\$5,900,000
Tax Liability:						
Capital Gain (sale of shares)	(\$861,390)	\$0	(\$861,390)	(\$861,390)	\$0	(\$861,390)
Deemed Gain (dividend in-kind)	N/A		\$0	(\$563,704)		(\$563,704)
Part IV tax (Opco dividend refund)	(\$153,350)		(\$153,350)	(\$153,350)		(\$153,350)
Capital Dividend	(\$1,700,000)	\$1,700,000	\$0	(\$1,821,556)	\$1,821,556	\$0
	<b>\$685,260</b>	<b>\$4,200,000</b>	<b>\$4,885,260</b>	<b>\$0</b>	<b>\$4,321,556</b>	<b>\$4,321,556</b>
Deferred Distributions:						
Non-eligible dividend	(\$1,111,232)	\$1,111,232	\$0	\$0	\$0	\$0
Tax Liability on taxable dividends	\$425,972	(\$518,612)	(\$92,640)	\$0	\$0	\$0
	<b>\$0</b>	<b>\$4,792,620</b>	<b>\$4,792,620</b>	<b>\$0</b>	<b>\$4,321,556</b>	<b>\$4,321,556</b>
Suspended CDA	\$0			\$990,944		
Suspended NERDTH	\$248,768			\$1,015,944		

<sup>16</sup> ITA, s. 148(7)(a) deems the transferor's proceeds to be the greatest of: the "value" of the interest at the disposition time, the FMV of the consideration, if any, given for the interest, and the ACB of the interest immediately before the disposition.

<sup>17</sup> ITA, s. 186 (Part IV tax on taxable dividends received by private corporations).

<sup>18</sup> ITA, s. 112(1) (deduction of taxable dividends received by corporation from another corporation).

<sup>19</sup> ITA, s 55(2) recharacterized certain intercorporate dividends to be a capital gain for certain purposes of the act.

### Option 1(c): Roll and Redeem - Preference Shares Redeemed by Transfer of Policy

A more structured alternative is one where Opco issues preference shares to Michael (on a share exchange or by way of stock dividend), who then rolls them to Holdco on a section 85 rollover,<sup>20</sup> with the redemption amount of the preference shares equal to the FMV of the policy. The preference shares are then redeemed by Opco, with the redemption proceeds satisfied by transfer in-kind of the policy to Holdco.

- The redemption gives rise to a deemed dividend<sup>21</sup> to Holdco equal to the excess of the redemption amount over the paid-up capital<sup>22</sup> of the preference shares, which is a tax-free intercorporate dividend
- The policy is received at a cost equal to the FMV of the policy
- Paragraph 55(3)(a) is not available as the transfer of the life insurance policy would be part of the same series of transactions as the sale of shares to an unrelated party.

#### Cash Flow - OPTION 1c:

	Option 1c - Insufficient Safe Income (Redemption)		
	Holdco	Michael/Helena	Total
Share Proceeds	\$0	\$5,695,000	\$5,695,000
Tax Liability:			
Capital Gain (sale of shares)	\$0	(\$805,140)	(\$805,140)
Deemed Gain (redemption)	(\$563,704)		(\$563,704)
Part IV tax (Opco dividend refund)	(\$467,718)		(\$467,718)
Shareholder Loan (to fund taxes)	\$1,031,421	(\$1,031,421)	\$0
	<b>\$0</b>	<b>\$3,858,439</b>	<b>\$3,858,439</b>
Deferred Distributions:			
Non-eligible dividend	\$0	\$0	\$0
Tax Liability on taxable dividends	\$0	\$0	\$0
	<b>\$0</b>	<b>\$3,858,439</b>	<b>\$3,858,439</b>
Suspended CDA	\$1,112,500		
Suspended NERDTH	\$808,921		
Suspended Shareholder Loan	\$1,031,421		

Note that as a result of the deemed dividend, Holdco is in a cash shortfall position and will require a contribution in order to fund its tax liabilities. In addition to the cash flow shortfall, there are significant tax attributes that are trapped in the corporate environment.

Planning opportunities may exist to:

- Access the Holdco tax attributes through possibly another corporate entity; or
- Distribute the Life Insurance Policy to personal shareholder utilizing the tax attributes created by way of 55(2) deemed gain.

These concepts are outside the scope of this paper but should be considered when implementing any planning.

<sup>20</sup>ITA, s. 85(1) (election on disposition of property to taxable Canadian corporation).

<sup>21</sup>ITA, s. 84(3) (deemed dividend on redemption, acquisition or cancellation of shares).

<sup>22</sup>ITA, s. 89(1), definition of "paid-up capital".

## Option 2: Low FMV Scenarios

The analysis above under Option 1 assumes a scenario in which the FMV of the policy materially exceeds its CSV, giving rise to a meaningful economic extraction problem. However, in many real-world files—particularly where policies are relatively new, structured on a yearly renewable term (“YRT”) cost basis, or have not accumulated significant internal investment value—the FMV of the policy may approximate, or be effectively equal to, its CSV.

In these “low FMV” scenarios, the planning analysis shifts in an important but sometimes understated way. While the same legal framework applies—most notably subsection 148(7) governing non-arm’s length transfers and subsection 110.6(15) deeming policy value for QSBC purposes—the economic distortion between transfer value and tax attributes is significantly reduced. Put differently, the policy behaves more like a conventional corporate asset with limited embedded economic value, rather than a highly leveraged planning constraint.

As a result, the core planning question is no longer how to extract a high-value policy without creating disproportionate tax cost or shareholder inequity. Instead, the focus becomes whether the policy can be removed from Opco in a manner that (i) ensures the QSBC tests are satisfied at the time of disposition, (ii) maintains alignment between the shareholders’ economic positions, and (iii) avoids introducing unnecessary complexity relative to the value at stake.

Accordingly, the same planning alternatives described in Options 1(a), 1(b), and 1(c) remain technically available. However, when FMV approximates CSV, the relative tax and economic consequences of each option are materially less pronounced, and the analysis becomes more driven by simplicity, timing, and commercial considerations than by tax arbitrage.

Cash Flow - OPTION 1a:			
	High FMV Michael/Helena	Low FMV Michael/Helena	
Share proceeds	\$5,900,000	\$5,900,000	
Tax Liability:			
Capital gain (sale of shares)*	(\$856,800)	(\$856,800)	
Taxable dividend (insurance policy)	(\$1,038,408)	(\$560,040)	
<b>Net after-tax cash on hand</b>	<b>\$4,004,793</b>	<b>\$4,483,160</b>	
Life Insurance Policy (@ FMV)	\$2,225,000	\$2,225,000	
<b>Total Value</b>	<b>\$6,229,793</b>	<b>\$6,708,160</b>	
			<b>Change:</b> <b>\$478,368</b> ←

  

Summary of Change:	
High FMV	\$2,225,000
Low FMV	\$1,200,000
Decrease in Dividend	(\$1,025,000)
Tax Rate	46.67%
Reduced Tax Liability	<b>(\$478,368)</b>

Note: \*Assume capital gain eligible for CGE

The practical effect of a lower FMV policy (where FMV approximates CSV) is that the overall tax burden associated with extracting the policy is reduced. In particular, the amount of any dividend in-kind is correspondingly lower, resulting in a proportionate reduction in the personal tax liability. This outcome is reflected in the model, where the dividend tax decreases in line with the reduced policy value.

Notwithstanding this, the application of subsection 148(7) remains unchanged. The deemed proceeds of disposition to Opco continue to be determined by reference to the greater of CSV, FMV consideration, and ACB, with CSV generally governing in a low FMV scenario. Accordingly, while the economic cost of extraction is reduced, the underlying corporate income inclusion mechanics are unaffected.

A similar scaling effect is observed in the corporate-level alternatives described in Options 1(b) and 1(c). Where FMV approximates CSV, the amount of any inter-corporate (deemed) dividend arising on a dividend in-kind or share redemption is likewise reduced. This proportionately limits the potential exposure under subsection 55(2), as the magnitude of any amount that could be recharacterized as a capital gain is correspondingly lower.

### **Option 3: Insurance Tracking Shares**

An alternative structure in rare cases involves using a separate class of shares in Opco which track the value of a particular insurance policy - sometimes called "insurance shares" or "insurance tracking shares." At a high level, the share rights are structured so that the redemption value equals the CSV of the policy during the insured's lifetime and escalates to the face amount of the policy on the insured's death. The shares are held by the insured, separating the economic interest in the insurance from the business equity.

The structure requires careful drafting of share rights and a shareholders' agreement to ensure the tracking mechanism functions correctly, including what happens on the insured's death. The use of the capital dividend account to pay the insurance proceeds must be clearly specified. There are also a host of other practical issues on a sale of the business to an arm's length buyer, where the insurance shares would be retained by the vendor-insured.

There are a number of tax landmines to navigate when contemplating the use of insurance shares. See Diane E. Everett and Cy M. Fien, "Tax Issues in Respect of Shareholder Agreements", Prairie Provinces Tax Conference (2022).

### **Option 4: Donation of the Insurance Policy**

In certain circumstances, the donation of a corporate-owned life insurance policy to a registered charity or other qualified donee may represent a viable planning alternative in advance of a contemplated share sale. While this approach is less conventional than the extraction strategies described above, it can be attractive in situations where the policy is no longer required for business or estate-planning purposes, and where the shareholder is amenable to converting the economic value of the policy into philanthropic outcomes.

From a tax perspective, the planning hinges on two key outcomes. First, the donation removes the policy from Opco's balance sheet, which may assist in satisfying the QSBC asset tests at the time of disposition. Second, the corporation is generally entitled to a charitable donation receipt based on the fair market value of the policy, which can be used to offset taxable income, subject to the usual limitations applicable to corporate donations.

Unlike the extraction options, which often seek to preserve or reallocate economic value within the shareholder group, the donation strategy deliberately relinquishes that value in exchange for a corporate-level tax benefit. As such, the analysis is not driven solely by minimizing aggregate tax cost, but rather by comparing the after-tax cost of donation against the value derived from other planning alternatives, including the preservation of the LCGE and the potential tax efficiency of extracting the policy through dividends or reorganizations.

Accordingly, this option is most relevant where (i) the policy has meaningful value that may otherwise impair QSBC status, (ii) there is sufficient taxable income in Opco to utilize the resulting donation receipt, and (iii) the charitable intent is aligned with the shareholders' broader objectives. Where these conditions are met, donation-based planning can provide a tax-efficient mechanism to address both balance sheet cleanup and philanthropic goals, albeit with a permanent disposition of the underlying asset.

## Tax Planning:

The general planning behind this option is to have Opco make the donation of the life insurance policy to a registered charity and receive a donation receipt equal to the FMV of the insurance policy donated (i.e. \$2,225,000)<sup>23</sup>.

As part of the pre-closing steps, Opco would designate certain property under 111(4)(e) and generate a capital gain of ~\$4,933,333 (i.e. \$2,466,667 taxable capital gain) to ensure there is sufficient taxable income in Opco to utilize the full donation credit and secondly, to increase Opco's capital dividend account.

Opco would undertake two separate increases to legal stated capital:

- Equal to the CDA balance and designate the deemed dividend to be paid from Opco's CDA; and
- Sufficient to recover the balance of the NERDTOH account and ensure the dividend is a non-eligible dividend

The purpose of the two increases to legal stated capital (i.e. PUC bump) is to utilize the tax attributes of Opco in an efficient way and to also increase the ACB of Michael and Helena's share of Opco.

### Adjusted Share Price:

	<b>Donation</b>
Share Proceeds	\$6,000,000
Adjustments:	
Corporate Tax Liability	(\$375,803)
Dividend Refund	\$227,469
<b>Adjusted Share Proceeds</b>	<b>\$5,851,667</b>

### Opco Tax Liability:

Deemed Proceeds [148(7)]	\$1,200,000
Less: ACB of Policy	(\$700,000)
Policy Gain	\$500,000
Taxable Capital Gain [111(4)(e)]	\$2,466,667
Donation Deduction	(\$2,225,000)
<b>Taxable Investment Income</b>	<b>\$741,667</b>

### Corporate Tax:

Permanent Tax	(\$148,333)
Refundable Tax	(\$227,469)
	(\$375,803)

<sup>23</sup> Where a corporation donates a life insurance policy, subsection 248(35) can limit the eligible amount of the gift to the policy's adjusted cost basis rather than its fair market value if the policy was acquired within the prior three years, or within ten years where one of the main reasons for the acquisition was to make the gift. Because a policy gift is not excluded by subsection 248(37), this rule can apply directly to policy donations. The result can be particularly harsh where the corporation acquired the policy on a recent non-arm's length transfer, since subsections 148(7) and 248(36) may further reduce the relevant cost base.

As a result of the above steps, the future sale of Opco should result in a much more efficient result for Michael and Helana aligning to both their tax and philanthropic objectives:

**Cash Flow - OPTION 4:**

	<b>Michael/Helena</b>	
Adjusted Share Proceeds	\$5,851,667	
Less Tax Liability:		
Capital gain (sale of shares)*	(\$73,484)	
Taxable dividend (PUC bump)	(\$276,939)	
	<b>\$5,501,244</b>	
<b>*Calculation of Capital Gain:</b>		
Adjusted Share Proceeds	\$5,851,667	
Less:		
PUC Increase #1	(\$2,466,667)	Deemed dividend (paid from CDA)
PUC Increase #2	(\$593,398)	Deemed dividend (non-eligible)
Capital gains exemption	(\$2,500,000)	
<b>Capital Gain</b>	<b>\$291,602</b>	

Planning Opportunity

Many Community and other Charitable Foundations will accept donation of an in-force insurance policy, providing the policy meets their specific criteria for acceptance. Some charities do not appreciate that the charitable receipt should reflect FMV if it is greater than CSV.

Future policy premium requirements and who will be responsible for those premiums might influence a charity's decision whether to accept a policy. Donor commitment to continue paying the premiums may incentivize the charity to accept a policy, but that commitment is not guaranteed. Ideally, the charity should be prepared to take on the premium requirements, or have reasonable confidence that the donor will meet their premium commitment. The calculation of FMV is not affected by who will be responsible for paying the future premiums.

The charity must be named beneficiary and must become the owner of the policy through an unconditional transfer of ownership.

Tax Treatment to the Opco<sup>24</sup>

Transfer of ownership is treated like a policy surrender for tax purposes. The excess of CSV (not FMV) over ACB, if positive, will be taxable income to the corporation in the year of donation/transfer.

The charitable donation tax receipt is issued to the Opco in the year of donation/transfer in an amount equal to the FMV of the policy.

Any future premiums paid by the Opco are considered to be a donation in the year of giving. Note that the insured could also commit to covering the premiums in future years, and the premium payments would be donation(s) when paid.

Commercial Realities

If the donation of the insurance policy results in a large charitable tax credit to Opco, and the donation occurs in the lead-up to an impending share sale, the parties should consider whether or how this would impact the purchase price or other commercial realities.

<sup>24</sup> For more information see IT-244R3 (Archived) - Gifts by Individuals of Life Insurance Policies as Charitable Donation, September 6, 1991. While this document focuses on individuals, the general principals are the same.

## IV. Scenario 3: Longer Horizon Exit - Marketable Securities and the 50% Test

### A. Facts

Carol and Connie James are married co-shareholders of James Logistics Inc. ("**Opco**"), a Manitoba-incorporated company that operates a regional freight brokerage business. They each own 50% of the shares. They are planning to sell the business in approximately three years. Their accountant has flagged that Opco holds a portfolio of publicly traded marketable securities (the "**Portfolio**") accumulated over the years from retained earnings. The Portfolio is causing Opco to fail the 50% active business asset test on a look-back basis.

Opco's key attributes:

- FMV of Opco shares: \$9,500,000
- Active business assets (equipment, receivables, goodwill): \$4,500,000
- Marketable securities portfolio FMV: \$5,000,000 (cost base: \$2,000,000)
- No other passive assets of significance
- Expected annual after-tax net income over the next 3 years: \$1,750,000 /year
- Opco has (or will have) sufficient GRIP with respect to all future taxable dividends.

### B. Legal Framework: The 50% Test (Reiterated)

As noted in Scenario 1, the 50% test requires that throughout the 24-month period immediately preceding the disposition, more than 50% of the FMV of the corporation's assets be attributable to active business assets or shares of connected small business corporations.<sup>25</sup> The Portfolio is a passive asset for these purposes. Because the 50% test is applied on a 24-month rolling basis, the timing and amount of purification steps are critical: they effectively need to be taken 24-months prior to a sale.

	Current State	
	FMV	% of Assets
<b>Active Business Assets:</b>		
Working capital (inventory, receivables)	\$700,000	7.4%
Tangible assets (equipment)	\$400,000	4.2%
Goodwill & other intangibles	\$3,400,000	35.8%
	<b>\$4,500,000</b>	<b>47.4%</b>
<b>Passive Assets:</b>		
Marketable Securities	\$5,000,000	52.6%
<b>Total Assets</b>	<b>\$9,500,000</b>	<b>100.0%</b>

<sup>25</sup>ITA, s. 110.6(1), definition of "qualified small business corporation share", para. (c): throughout the 24-month period immediately before the disposition, more than 50% of the fair market value of the corporation's assets must have been attributable to assets used principally in an active business carried on primarily in Canada, shares of connected small business corporations, or eligible combinations thereof.

## C. Analysis: Planning Options

### Option 1: Deploy the Securities in the Business

The simplest solution is to deploy the Portfolio to fund capital expenditures or working capital in Opco, converting passive assets into active business assets. Capital gains or losses arise on the sale of the securities but the passive asset balance is reduced.

- Tax on disposition of securities: capital gains triggered on sale; taxed at the corporate rate. May be offset with corresponding capital losses.
- Does this make business sense? Not always - it forces Carol and Connie to deploy capital in the business when they are planning to exit.

#### Redeployment of Marketable Securities:

FMV	\$5,000,000
Less: ACB	(\$2,000,000)
Capital Gain	\$3,000,000

#### Available for Redeployment:

Proceeds	\$5,000,000
Less:	
Tax Liability***	(\$760,000)
Capital Dividend*	(\$1,500,000)
	\$2,740,000

#### Active Business Assets\*\*:

Working capital (inventory, receivables)	\$700,000	10%
Tangible assets (equipment)	\$400,000	6%
Goodwill & other intangibles	\$3,400,000	47%
	<b>\$4,500,000</b>	<b>62%</b>
	\$2,740,000	38%
	<b>\$7,240,000</b>	<b>100%</b>

-----> Additional capital for active business\*\*\*

#### Notes:

\*Carol and Connie each have \$750,000 of tax paid cash on hand personally

\*\*All assets of Opco are utilized in the active business

\*\*\*Prior to a sale, Opco would pay a dividend sufficient to recover the NERDTH resulting in the following adjustments to working capital:

Non-eligible Dividend	(\$1,200,000)
Dividend Refund	\$460,000
<b>Net Adjustment to working capital</b>	<b>(\$740,000)</b>

### Option 2: Pay Out as a Dividend to Carol and Connie Personally

Opco pays a dividend directly to Carol and Connie as individuals - more immediately tax-inefficient than what is set out in Option 3, but structurally simpler.

- Taxable dividend at personal rates (eligible or non-eligible).
- Whether securities are first converted to cash, or are paid in-kind, capital gains triggered on sale; taxed at the corporate rate. May be offset with corresponding capital losses.
- Accomplishes clean-up of Opco's balance sheet for 50% test purposes.

#### Payout as Dividend:

	Opco	Carol/Connie	TOTAL
Proceeds on Marketable Securities	\$5,000,000		\$5,000,000
Tax Liability on (deemed) Disposition	(\$760,000)		(\$760,000)
	\$4,240,000	\$0	\$4,240,000
Corporate Distributions:			
Capital Dividend	(\$1,500,000)	\$1,500,000	\$0
Non-eligible Dividend	(\$1,200,000)	\$1,200,000	\$0
Eligible Dividend	(\$2,000,000)	\$2,000,000	\$0
Tax Refund/Liability on Taxable Dividend	\$460,000	(\$1,315,640)	(\$855,640)
<b>Net Cash/Marketable Securities</b>	<b>\$0</b>	<b>\$3,384,360</b>	<b>\$3,384,360</b>

Tax Cost: \$1,615,640

### Option 3: Freeze in Favour of a Trust with a Corporate Beneficiary

The most comprehensive planning option for a two-to-three year horizon is to implement an estate freeze now, with new common shares issued to a family trust. The trust includes a corporate beneficiary ("**BenCo**"). This structure accomplishes two objectives:

- i. it allows Opco to be purified by removing passive income and assets to BenCo over time; and
- ii. it creates the conditions for multiplication of the LCGE on the eventual sale (for example, if children are included as beneficiaries of the trust).

The steps may may look something like these:

- Incorporate and organize BenCo. Issue Carol and Connie separate classes of dividend "sprinkling" common shares.
- Settle a new family trust. The family trust has as beneficiaries Carol, Connie, their children (potential LCGE claimants), and BenCo.
- Carol and Connie each freeze their Opco shares under s. 86<sup>26</sup> or s. 85<sup>27</sup> of the ITA. Frozen preference shares are retained; new common shares are issued to the trust.
  - Practical consideration: The trust's common shares will only be eligible for the LCGE if issued and outstanding for 2-years prior to sale.<sup>28</sup>
  - Practical consideration: Carol and Connie will want to freeze enough value in their hands to maximize their access to the LCGE.<sup>29</sup>
  - Practical consideration: Typically non-voting common shares would be issued to the trust so that the trust is never in a position to control Opco (with control being retained by Carol and Connie through their preference shares). A number of technical issues may arise of the trust controls Opco.
- Over the planning horizon, Opco pays dividends on the common shares to the trust; the trust allocates income to BenCo, progressively reducing Opco's passive asset balance.
  - Potential trap: ensure there is enough safe income attributed to the trust's common shares as to not trigger 55(2) on the dividends.
  - Potential trap: Corporate solvency tests must be met when paying dividends to the trust, which may be difficult with high-value preferred shares outstanding, particularly where their value was driven in large part by the investment portfolio.<sup>30</sup>

---

<sup>26</sup>ITA, s. 86(1) (exchange of shares by a shareholder in course of reorganization of capital).

<sup>27</sup>ITA, s. 85(1) (election on disposition of property to taxable Canadian corporation).

<sup>28</sup> ITA, s. 110.6(7) definition of "qualified small business corporation shares", para b: throughout the 24 months immediately preceding the determination time, [the shares] was not owned by anyone other than the individual or a person or partnership related to the individual.

<sup>29</sup> As per CRA: "Under proposed changes, for 2025, the lifetime capital gains exemption (LCGE) is \$1,250,000 for dispositions of qualifying property. This means that the maximum capital gains deduction for qualifying properties is \$625,000 (50% of \$1,250,000)." <https://www.canada.ca/en/revenue-agency/services/tax/individuals/topics/about-your-tax-return/tax-return/completing-a-tax-return/deductions-credits-expenses/line-25400-capital-gains-deduction.html>

<sup>30</sup> Section 40 of *The Corporations Act* (Manitoba) states: "A corporation shall not declare or pay a dividend if there are reasonable grounds for believing that (a) the corporation is, or would after the payment be, unable to pay its liabilities as they become due; or (b) the realizable value of the corporation's assets would thereby be less than the aggregate of its liabilities and stated capital of all classes."

- On the sale of Opco shares, Carol and Connie claim capital gains exemption on their preferred shares. Capital gains are allocated from the trust on its common shares to individual beneficiaries who each claim the LCGE<sup>31</sup> - potentially multiplying the exemption across several family members

Planning opportunity: This plan can be combined with a “roll and redeem” strategy where some or all of the preferred shares held by Carol and Connie are rolled to BenCo under s. 85<sup>32</sup> of the ITA and then redeemed. This addresses some of the practical issues, such as the corporate solvency issue (by eliminating the high-value preferred shares) and the 55(2) issue (likely by virtue of 55(3)(a)), and allows excess passive assets to move from Opco to BenCo at a faster rate.

Trust matters: A trust cannot claim the LCGE directly. Rather, under subsection 104(21) of the ITA, a trust may designate a capital gain realized on the disposition of QSBC shares as a 'taxable capital gain' of a particular beneficiary for the year. The beneficiary then claims the LCGE on that designated gain in their personal return, subject to their available exemption room. To be eligible:

- i. the trust must be a personal trust;
- ii. the shares must have been QSBC shares when disposed of by the trust;
- iii. the gain must be properly designated to the beneficiary in the trust's T3 return for the year; and (iv) the beneficiary must have held (or be deemed to have held) the shares for the required 24-month period - the trust's holding period generally counts for this purpose. A full analysis of trust planning is beyond the scope of this paper, as those rules are the subject of a separate presentation at this conference.

### **Option #3 - Potential Benefits:**

Deferred Tax Liability	\$855,640	
Multiple CGE (via Trust)	\$630,000	(assume 2 kids)
	<u>\$1,485,640</u>	
Less: Professional Fees	[TBD]	
	<u><b>\$1,485,640</b></u>	

---

<sup>31</sup>ITA, s. 110.6.

<sup>32</sup>ITA, s. 85(1) (election on disposition of property to taxable Canadian corporation).

In summary, the estimated overall implications of the various planning options are summarized below:

	Do Nothing	OPTION #1 Deploy in Business	OPTION #2 Distributed	OPTION #3 BenCo
<b>Consideration:</b>				
Share Consideration:				
Base Purchase Price	\$4,500,000	\$4,500,000	\$4,500,000	\$4,500,000
After-tax Net Income (3 years)	\$5,250,000	\$5,250,000	\$5,250,000	\$5,250,000
	\$9,750,000	\$9,750,000	\$9,750,000	\$9,750,000
Adjustments:				
Working capital adjustments	\$0	\$2,000,000	(\$0)	\$0
Marketable Securities	\$5,000,000	Redeployed	Distributed	Distributed
	\$14,750,000	\$11,750,000	\$9,750,000	\$9,750,000
Shareholder Transactions (cash):				
Capital Dividend		\$1,500,000	\$1,500,000	\$1,500,000
Taxable Dividend (non-eligible)		\$1,200,000	\$1,200,000	
Taxable Dividend (eligible)			\$2,000,000	
	\$0	\$2,700,000	\$4,700,000	\$1,500,000
Marketable Securities	Sold with Shares	Redeployed	Distributed	\$2,740,000
<b>Total Consideration Received</b>	<b>\$14,750,000</b>	<b>\$14,450,000</b>	<b>\$14,450,000</b>	<b>\$13,990,000</b>
<b>Personal Tax<sup>(See below)</sup>:</b>				
Share Proceeds (cash)	(\$3,717,000)	(\$2,331,000)	(\$1,827,000)	(\$1,197,000)
Taxable dividends (cash/Marketable Securities)	\$0	(\$560,040)	(\$1,315,640)	\$0
	<b>(\$3,717,000)</b>	<b>(\$2,891,040)</b>	<b>(\$3,142,640)</b>	<b>(\$1,197,000)</b>
<b>After-tax Net Consideration:</b>				
Cash (after-tax)	\$11,033,000	\$11,558,960	\$11,307,360	\$10,053,000
Marketable Securities (after-tax)	Sold with Shares	Redeployed	Distributed	\$2,740,000
	\$11,033,000	\$11,558,960	\$11,307,360	\$12,793,000
Deferred tax on Marketable Securities	N/A	\$0	\$0	(\$855,640)
	<b>\$11,033,000</b>	<b>\$11,558,960</b>	<b>\$11,307,360</b>	<b>\$11,937,360</b>
<b>Personal tax on Capital Gain:</b>				
Estimated Capital Gain:	\$14,750,000	\$11,750,000	\$9,750,000	\$9,750,000
Less: capital gains exemption	Not Eligible	(\$2,500,000)	(\$2,500,000)	(\$5,000,000)
Net Capital Gain	\$14,750,000	\$9,250,000	\$7,250,000	\$4,750,000
Tax rate	25.20%	25.20%	25.20%	25.20%
	<b>\$3,717,000</b>	<b>\$2,331,000</b>	<b>\$1,827,000</b>	<b>\$1,197,000</b>

## V. Scenario 4: Succession to Children

### A. Facts

Carol Bradley is the sole shareholder of Bradley Building Products Ltd. ("**Opco**"), a Manitoba-incorporated company that manufactures and distributes building supply products. Opco has been in the family for 30 years. Carol is 65 and has no immediate plans to sell. She would like to transition the business to her three children: Thomas (40, active in the business and its general manager), Claire (37, not involved in the business, lives in Calgary), and James (34, not involved in the business, works in finance in Toronto).

Opco's estimated current fair market value is \$4,000,000. Carol has used none of her LCGE. She does not need the proceeds of any sale or redemption in the near term but would like to draw down corporate value progressively over the next 15 years to fund her retirement. There is no active family law dispute at present, but Carol is aware that Thomas is recently divorced and Claire is in a common-law relationship.

Opco's key tax and balance sheet attributes are as follows:

- FMV of Opco shares: \$4,000,000
- Adjusted cost base of Carol's shares: approximately nil (founder shares)
- Active business assets (equipment, receivables, inventory): \$1,500,000
- Goodwill and other intangibles: \$2,500,000 (nil cost base)
- Retained earnings / distributable surplus: \$800,000 (with a \$600,000 general rate income pool [GRIP] supporting an eligible dividend designation)
- No significant passive assets; Opco qualifies as a QSBC for LCGE purposes.
- Eligible RDTOH balance: \$NIL; non-eligible RDTOH balance: \$NIL
- Capital dividend account balance: zero at present.
- No corporate-owned life insurance in place at present (insurance addressed separately as a planning tool below)

### B. Analysis

#### 1. Freeze in Favour of the Next Generation

The major planning tool in this scenario is an estate freeze. Carol's existing common shares are exchanged for freeze preference shares under section 86<sup>33</sup> or section 85<sup>34</sup> of the ITA, with the redemption amount of the preference shares fixed at the current FMV of Opco's shares (\$4,000,000). New common shares are then subscribed for by Thomas, Claire, and James (or by a family trust for their benefit) at a nominal amount. From the date of the freeze, any future appreciation in Opco's value accrues to the new common shareholders.

- Carol holds freeze preference shares redeemable at \$4,000,000 - her equity position is crystallized and no further gain accrues to her (or to her estate)
- Any appreciation above \$4,000,000 accrues to the next generation at no additional tax cost to Carol

---

<sup>33</sup>ITA, s. 86(1) (exchange of shares by a shareholder in course of reorganization of capital).

<sup>34</sup>ITA, s. 85(1) (election on disposition of property to taxable Canadian corporation).

- If Thomas is to have a greater operating role, consider issuing him a separate class of common shares with voting rights that reflect his management position; Claire and James hold non-voting or limited-voting common shares (note – this may raise a valuation issue as to how to value the voting versus non-voting shares)
- Practical consideration: Is it fair for Thomas to be “in business” with his siblings, if he is the only active sibling?
- Practical consideration: Carol should put a comprehensive USA in place as a condition to her children receiving equity.

## 2. The Wasting Freeze

A wasting freeze is a variation in which the freeze preference shares are redeemed progressively over time using corporate surplus, reducing Carol's estate value - and the corresponding deemed disposition on death - in a managed way. Each redemption generates a deemed dividend to Carol (to the extent the redemption proceeds exceed paid-up capital<sup>35</sup>), but also reduces the terminal tax exposure. This further provides Carol with funds for retirement.

- Carol redeems, say, \$200,000 of preference shares per year from distributable corporate surplus, providing retirement income.
- The deemed dividend on each redemption is taxable to Carol at dividend rates.
- On Carol's death, the unredeemed balance of the freeze preference shares is included in her estate and is subject to a deemed disposition at FMV; the smaller the unredeemed balance at death, the lower the terminal tax.
- The redemption schedule should be coordinated with Carol's retirement income needs and her other sources of income to optimize the tax result in each year.
- The corporation should consider the use of corporate owned life-insurance to provide liquidity to redeem Carol's remaining preference shares on her death, as well as assist her estate with funding its tax liability.
- Post-mortem tax planning for Carol planning would need to be considered as part of this scenario.

		Wasting Freeze Redemption Implications							
		Annual Impact			12 Years Aggregate			Reduced Estate Liability	
		Carol	Estate	Net	Carol	Estate	Net		
Redemption Value (i.e. FMV)	Estate Liability	\$200,000	(\$200,000)	\$0	\$2,400,000	(\$2,400,000)	\$0	\$1,600,000	
Less:		37.78%	25.20%	0.00%	37.78%	25.20%	0.00%		
Adjusted Cost Base	nominal	<b>\$75,560</b>	<b>(\$50,400)</b>	<b>\$25,160</b>	<b>\$906,720</b>	<b>(\$604,800)</b>	<b>\$301,920</b>	nominal	
Capital Gains Exemption	(\$1,250,000)	Tax Cost	Reduced Estate Tax		Tax Cost	Reduced Estate Tax		(\$1,250,000)	
Capital Gain	\$2,750,000							\$350,000	
Tax Rate	25.20%							25.20%	
<b>Estimated Terminal Tax Liability</b>	<b>\$693,000</b>							<b>\$88,200</b>	

\*Assuming top marginal rates in Manitoba

Consideration: If Carol needs access to cash flow on an annual basis from Opco and would otherwise be taking a dividend on her shares, she would be paying dividend tax rates on the dividend distributions anyways. As such, why the Wasting Freeze works is Carol is in the same net cashflow position annually, but reducing her future estate tax liability with every redemption. This allows growth to accrue to the Kids (or Trust – See below) on a tax efficient basis.

<sup>35</sup>ITA, s. 89(1), definition of "paid-up capital".

### 3. Freeze in Favour of a Trust

Rather than issuing common shares directly to Thomas, Claire, and James, Carol may prefer to have the new common shares issued to a discretionary family trust. The trustees hold the shares for the benefit of the family members as a class, with income and capital allocated at their discretion each year.

- **Benefits:** flexibility to allocate income (and future capital gains) among beneficiaries in the most tax-efficient manner from year to year; ability to adjust allocations as family circumstances evolve; ability to multiply the LCGE on a future sale of Opco shares by allocating capital gains to multiple individual beneficiaries (if otherwise eligible)
- **Negatives:** the 21-year deemed disposition rule<sup>36</sup> must be factored into the planning timeline. If the business is not sold before the 21<sup>st</sup> anniversary of the trust, a deemed disposition of the trust's assets (i.e. the shares) occurs at FMV, potentially triggering significant gains at the trust level. Typically "21-year" planning is done to avoid the negative tax outcomes.
- **Risk:** none. If Carol does not "like" the trust, or if circumstances change, the trustees can generally transfer the shares from the trust to Carol on a tax-free basis.<sup>37</sup>
- **Practical consideration:** Carol should prepare a letter of wishes to guide the trustees regarding the distribution of the trust's income and assets after her death, reflecting her intentions for Thomas's management role and the equalization (or non-equalization, as the case may be) of interests among her children. A letter of wishes is not legally binding but provides important context to the trustees.

### 4. Equalization Among Children on Carol's Death

A central challenge in any family business succession is fairness to all the children. Carol has three children, only one of whom (Thomas) works in Opco. Let's assume that Carol did not implement any of the planning above. What might some options be for the distribution of her estate in her Last Will & Testament.

- **Option A:** Thomas receives shares in Opco; Claire and James receive cash or other estate assets of equivalent value on Carol's death. This requires Carol to have sufficient non-business assets to equalize. Carol's estate also needs to have sufficient assets to cover its tax burden. Carol's estate may be increased by virtue of life insurance proceeds if she owns a policy – insurance is a key consideration here.
- **Option B:** All three children receive shares in Opco. The considerations are similar to those discussed in the scenarios above. Carol's Will may set out that her children are required to enter into a USA on specified terms in order to receive the shares, although query as to whether this is an enforceable term.
- **Option C:** Thomas receives shares in Opco; Claire and James receive shares in a HoldCo holding non-business assets or receive life insurance proceeds equal in value to Thomas's Opco shares. That is, look for a creative solution that meets Carol's estate planning goals.

---

<sup>36</sup>ITA, s. 104(4) (deemed disposition at fair market value on 21st anniversary of a trust and every 21 years thereafter).

<sup>37</sup> ITA, s. 107(2) (distribution [rollout] by personal trust).

## **5. Intergenerational Business Transfer**

The 2021 amendments to section 84.1 of the ITA<sup>38</sup> created a regime for intergenerational business transfers amongst non-arm's length parties. A full analysis of the intergenerational transfer rules is beyond the scope of this paper, as those rules are the subject of a separate presentation at this conference.

## **6. Family Law Considerations**

Where children receive equity interests in Opco - either directly or as beneficiaries of a family trust - the family law implications must be considered. For example, should the children get marriage agreements? This is beyond the scope of this paper.

---

<sup>38</sup>ITA, s. 84.1 (non-arm's length sale of shares). The 2021 amendments introduced ss. 84.1(2.3)-(2.31) providing an exception for genuine intergenerational business transfers. For a full analysis of those rules see the materials for the intergenerational business transfer panel at this conference.

## VI. Scenario 5: Succession to Key Employees

Business owners sometimes wish to transition their businesses to key employees rather than family members. This situation often arises where there is no natural family successor, or where key employees have been instrumental in building the business and are best positioned to continue its operations. Unlike family succession, however, employee-based transitions must balance tax efficiency with financing constraints, governance considerations, and alignment of incentives over time.

A full analysis of management buy-out structures and governance issues in the succession-to-employees context is beyond the scope of this paper.

However, from a Canadian tax perspective, several high-level concepts are commonly relevant when considering a transition to employees:

- **Vendor financing and deferred consideration:**  
In most cases, key employees do not have the capital required to acquire shares at fair market value. As a result, transactions are frequently structured with vendor take-back financing, earnouts, or other forms of deferred consideration. While these structures may facilitate the transition commercially, they raise timing considerations for the vendor, including the potential application of the capital gains reserve under paragraph 40(1)(a)(iii), and introduce credit risk that must be considered alongside the tax outcome.
- **Use of holding companies and leverage:**  
Employees may acquire shares through a newly incorporated holding company, often funded with a combination of debt and vendor financing. The deductibility of interest at the HoldCo level and the ability to service that debt through dividends from the operating company become key structuring considerations. Proper planning is required to avoid adverse results under section 55 where funds are moved through the corporate group as part of a leveraged acquisition.
- **Equity participation and staged ownership:**  
Rather than an immediate sale of 100% of the shares, owners frequently introduce employees into the ownership structure over time. This may be accomplished through the issuance of growth shares, stock options, or restricted share arrangements. Such structures allow the vendor to retain control and manage transition risk while aligning employees with future growth. From a tax perspective, these arrangements must be carefully structured to address potential employment benefit inclusions and to preserve the characterization of gains as capital rather than income.
- **Preservation of the LCGE:**  
Where the transaction is structured as a share sale, the vendor will typically seek to preserve eligibility for the lifetime capital gains exemption. As with the earlier scenarios, this requires careful management of the QSBC asset tests, particularly where corporate surplus accumulates during the transition period or financing structures introduce additional balance sheet complexity.

- **Employee Ownership Trusts (“EOTs”):**

The introduction of the EOT regime provides an additional pathway for employee-based succession. In this structure, shares are sold to a trust for the benefit of employees collectively, rather than to individuals directly. While a detailed discussion of the EOT rules is beyond the scope of this paper, it is important to note that the tax treatment may differ in key respects from a direct share sale, including the application of specific “qualifying business transfer” rules.

On the topic of insurance, however, note that similar – but different – considerations respecting insurance may arise in the context of an Employee Ownership Trust. See for example the September 2025 CLHIA Roundtable,<sup>39</sup> where the CRA concluded that the deeming rule in paragraph 110.6(15)(a)(i) of the ITA - which deems corporate-owned life insurance as having a value equal to CSV in certain circumstances for LCGE purposes (as described above) - does not apply for “qualifying business transfer” purposes in the context of a sale to an Employee Ownership Trust.

In summary, succession to employees introduces a different set of constraints than the scenarios considered above. While many of the same tax principles apply, the analysis is more heavily influenced by financing limitations, incentive alignment, and phased ownership considerations. As a result, the optimal structure is often one that balances tax efficiency with commercial practicality over the transition period, rather than seeking to achieve a fully optimized result on closing.

---

<sup>39</sup> 18 September 2025 CLHIA Roundtable Q. 2, 2025-1067931C6 - Deemed Value of Life Insurance and QSBC