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DOCNUM 2010-0363091C6
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DESCKEY 20
RATEKEY 2
REFDATE 100608
SUBJECT Gift of an interest in a life insurance policy
SECTION 248(35), 248(36), 148(9) and 148(7)
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PRINCIPAL ISSUES: An interest in a life insurance policy is transferred from a non-arm's length person to a donor and subsequently gifted to a qualified donee. Where the gift is subject to proposed subparagraph 248(35)(b)(i) or (ii) and proposed subsection 248(36), what is the deemed FMV of the gift?
POSITION: The deemed FMV of the gift will be determined based on the lesser of the cost of the interest in the life insurance policy to the donor and the cost of the interest in the policy to the non-arm's length person immediately before the interest in the policy was disposed of by that person. It is the CRA's view that the ACB of an interest in a life insurance policy is generally a reasonable proxy for the "cost" of an interest in a policy. Where subsection 148(7) has applied to deem the cost of an interest in a policy to be the value of the interest in the policy, this adjustment will be relevant in the determination of the ACB of the interest in the policy and the fair market value of a gift pursuant to proposed subparagraph 248(35)(b)(i) or (ii).
REASONS: Legislation

STEP CRA Roundtable - 2010
Question 4:
Determining the "Cost" of Life Insurance Policies as a Charitable Gift

Proposed subsections 248(35) to (37) set out special rules for determining the FMV of a property that is subject to a charitable gift for purposes of determining the eligible amount of a gift under subsection 248(31). Proposed paragraph 248(35)(b) provides that the FMV of the gifted property is deemed to be the lesser of its FMV otherwise determined and its cost, or in the case of capital property, its adjusted cost base ("ACB") immediately before the gift is made, if one of two conditions are met:

(i) The taxpayer acquired the property that is the subject of the gift less than three years before the day that the gift is made (except if the gift is made as a consequence of death), or

(ii) The taxpayer acquired the property that is the subject of the gift less than ten years before the day that the gift is made (except if the gift is made as a consequence of death) and it is reasonable to conclude that, at the time the taxpayer acquired the gifted property, one of the main reasons for its acquisition was to make the gift.

Proposed subsection 248(37) excludes several types of gifts from the application of subsection 248(35). However, a gift of an interest in a life insurance policy is not excluded from the proposed application of subsection 248(35).

During the CLHIA Roundtable in May 2009, the CRA confirmed that proposed subsection 248(35) could apply to the gift of an interest in a life insurance policy such that the amount that may be receipted would be the lesser of policy's "cost" and its FMV.

Could the CRA provide further guidance as to what factors it would consider in determining the cost of an interest in a life insurance policy for purposes of proposed subsection 248(35)? For example, could the CRA comment on the transfer of an interest in a life insurance policy that is personally owned to a wholly-owned corporation, where the policy has a FMV of $300,000, and no cash surrender value ("CSV"). The deeming rule in subsection 148(7) provides that such a transfer between non-arm's length parties is deemed to occur at CSV or zero in this case. Therefore, where the deemed cost of the interest in the policy to the corporation is zero, but its FMV is $300,000 and subsection 248(35) applies, would the CRA allow the gift which occurs immediately after the transfer to take place at $300,000?

The FMV of an interest in a life insurance policy otherwise determined and the cost of that interest must be considered in applying proposed subsection 248(35) to a gift of an interest in a life insurance policy to a qualified donee. As stated by the CRA at the CLHIA Roundtable in May 2009, we recognize that the Income Tax Act (the "Act") does not specifically define the cost of an interest in a life insurance policy and we have brought this to the attention of the Department of Finance for their consideration.

The "adjusted cost basis" to a policyholder of an interest in a life insurance policy is determined by a formula under subsection 148(9). In general terms, the adjusted cost basis to the original policyholder will be the amount by which the cash premiums paid by the policyholder (excluding premiums for accidental death benefits), and any income in respect of the interest in the policy that has previously been reported for tax purposes, exceeds the "net cost of pure insurance" under the policy.

It is our view that the adjusted cost basis of an interest in a life insurance policy, as defined in subsection 148(9), would generally be a reasonable proxy for the "cost" of an interest in a life insurance policy for purposes of the deemed FMV of a policy under proposed subsections 248(35) and 248(36).

Where subparagraph 248(35)(b)(i) or (ii) applies to the gift of an interest in a life insurance policy, the FMV of the interest in the policy to the donor is deemed to be the lesser of its FMV otherwise determined and its cost, and where a person dealing non-arm's length with the donor had acquired the same property within the relevant time, subsection 248(36) will apply to deem the cost of the interest in the life insurance policy for purposes of subsection 248(35) to be the lesser of the cost to the donor at the time of the gift or the cost to the non-arm's length person immediately before the interest in the policy was disposed of by that person.

Where subsection 148(7) applies to deem the cost of the interest in the policy held by the donor to be the CSV and the CSV of that policy is NIL, the deemed FMV of the interest gifted will be deemed to be the lowest of its cost to the donor at the time of the gift, which is NIL, or the cost to the non-arm's length person immediately before the interest in the policy was disposed of by that person. In the example provided, since the cost of the interest in the policy to the donor is deemed to be NIL, the deemed FMV of the gift of the interest in the life insurance policy will also be NIL.

[Note: On July 16, 2010, the Department of Finance released draft legislative proposals to implement outstanding income tax technical measures. Included in the proposals is an amendment to proposed subsection 248(35) to refer to the adjusted cost basis of a life insurance policy.]

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2010-036309
June 8, 2010