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FOREWORD

No competency or competency components are presented in this Booklet. The concepts covered serve as prerequisites to understand the product modules. Therefore, they will not be evaluated.

The taxation principles specific to each insurance product are incorporated into each respective module of the Program and **evaluated in the corresponding examinations.**

In this text, the masculine form is used for both men and women.

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LIST OF ABBREVIATIONS

ACB	Adjusted cost base
CCB	Canada child benefit
CCPC	Canadian-controlled private corporation
CDA	Capital Dividend Account
CPP	Canada Pension Plan
CRA	Canada Revenue Agency
CSV	Cash surrender value
DPSP	Deferred profit sharing plan
EI	Employment Insurance
GAAR	General Anti-Avoidance Rule
GIC	Guaranteed investment certificates
GIS	Guaranteed Income Supplement
GST	Goods and services tax
HST	Harmonized sales tax
IVIC	Individual variable insurance contract
IRA	Individual retirement account
LBT	Lifetime benefit trust
LCGE	Lifetime capital gains exemption
NCPI	Net cost of pure insurance
OAS	Old Age Security
PA	Pension adjustment
PDOC	Payroll Deductions Online Calculator
PST	Provincial sales tax
QPP	Québec Pension Plan
REIT	Real Estate Investment Trust
RESP	Registered education savings plan
RPP	Registered pension plan
RDSP	Registered disability savings plan
RRIF	Registered retirement income fund
RRSP	Registered Retirement Savings Plan
SBD	Small business deduction
TFSA	Tax-free savings account

CHAPTER 1
TAXATION FRAMEWORK

The purpose of this Chapter of the Booklet is to provide a basic introduction to the tax system in Canada and how it can relate to the functions of a life insurance agent.

Insurance agents should have a basic knowledge of the Canadian tax system to better serve their clients. This includes:

- Canadian tax system;
- Personal income tax;
- Federal and provincial income taxes;
- Commodity taxes;
- Self-assessed system;
- General Anti-Avoidance Rule (GAAR);
- Types of income;
- Marginal and average tax rates;
- Deductions and credits;
- Tax reporting;
- Role of a tax expert.

However, it is essential that agents recognize that this Chapter will not make them an authority on all matters pertaining to tax. There will be times that they must bring in tax experts and even legal experts to best serve their clients' interests.

1
TAXATION FRAMEWORK

1.1 Taxation and the practice of life insurance agents

Taxes are obligations imposed on individuals, corporations and trusts by federal, provincial and municipal governments. Taxes are mandatory and, depending on the level of government, may be levied on earnings, investment income, property, imports, and sales and services.

Services funded by taxes vary in nature. For instance, federal taxes are used for purposes such as defence, programs including Old Age Security (OAS) and benefits such as the Canada child benefit (CCB). Provinces and territories use provincial taxes, and in some cases transfers from the federal government, to pay for services, such as education and health care. Municipalities use taxes levied on property to pay for police and fire departments, sanitation, water and sewage, park management and restaurant inspections.

1.2 Canadian tax system

Federal and provincial governments collect income taxes and also raise money through what are collectively known as commodity taxes. These will each be addressed below.

1.2.1 Personal income tax

Personal income tax is the tax levied on the total income of individuals, net of deductions and credits. The amount of income tax that an individual must pay is based on the amount of their taxable income (income earned less eligible expenses and deductions) for the tax year. Types of income, total, taxable and net, are discussed further on in this Chapter.

Taxable income includes:

- Salaries and wages;
- Commissions;
- Net income from unincorporated businesses;
- Certain benefits;
- Interest;
- Dividends and capital gains.

For the purpose of this Booklet, a capital gain can be described as an increase in the monetary value of a capital asset or property, such as a share or land, resulting in a profit made on the resale.

1.2.2 Federal income taxes

Canada has graduated federal tax rates for individuals. This means that the percentage of income that is paid as federal tax depends on the amount of taxable income reported. The more income a person earns the greater the percentage of that income they are required to pay in tax.

Most individuals must file a federal income tax return with the Canada Revenue Agency (CRA).[1] The main criteria for filing a return are set out below:

- Does the individual owe unpaid taxes?
- Is the individual required to contribute to the Canada Pension Plan (CPP) or the Québec Pension Plan (QPP)?
- Does the individual have taxable capital gains?

Up-to-date federal rates can be found on the CRA website. To serve as an example for this Booklet, the 2022 tax rates are shown below in Table 1.1.[2]

With the exception of Québec, which has a separate provincial tax return, the federal tax return for residents of the other provinces and territories includes provincial and territorial returns.

1. Canada Revenue Agency. *Do you have to file a return?* [online]. Revised January 18, 2022. [Consulted May 10, 2022]. https://www.canada.ca/en/revenue-agency/services/tax/individuals/topics/about-your-tax-return/you-have-file-a-return.html
2. Canada Revenue Agency. *Canadian income tax rates for individuals – current and previous years.* [online]. Revised January 18, 2022. [Consulted May 10, 2022]. https://www.canada.ca/en/revenue-agency/services/tax/individuals/frequently-asked-questions-individuals/canadian-income-tax-rates-individuals-current-previous-years.html

TABLE 1.1

Federal tax rates (2022)

RATE	AMOUNT OF TAXABLE INCOME
15% (12.53*)	On the first $50,197
+	
20.5% (17.12*)	On the next $50,195
+	
26% (21.71*)	On the next $55,233
+	
29% (24.22*)	On the next $66,083
+	
33% (27.55*)	Over $221,708

* Québec has a reduction of 16.5% (called the "Québec reduction or allowance").

EXAMPLE

Simon has a taxable income of $175,000.

According to the federal tax tables, Simon (a resident of a province other than Québec) will pay $32,180 on the first $155,625 ($7,530 + $10,290 + $14,360). To determine the amount of additional tax he needs to pay, he calculates:

$175,000 – $155,625 = $19,375

He multiplies $19,375 by 29% to determine the tax on his taxable income over $155,625 (that is, $5,619). He then adds the amounts of $5,619 and $32,180 to determine his total federal tax of $37,799.

In 2022, corporations pay either a 15% or a 9% federal tax rate. The lower rate applies to Canadian-controlled private corporations eligible to claim the small business deduction. Provincial corporate tax rates will be discussed below.[3]

3. Canada Revenue Agency. *Corporation tax rates.* [online]. Revised May 12, 2022. [Consulted May 24, 2022]. https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/corporations/corporation-tax-rates.html

1.2.3 Provincial income taxes

Individuals also have to pay provincial income taxes. The criteria may vary from province to province, but they are generally asked to provide information from their federal returns including:

- Taxable income;
- Net income;
- Dividend income;
- Canada Pension Plan (CPP) and Québec Pension Plan (QPP) contributions;
- Employment Insurance (EI) premiums;
- Medical expenses;
- Donations and gifts.

The provincial forms are included with the *Income tax package*, except for Québec,[4] which has its own.

The provinces also have graduated tax rates for individuals.

Certain provinces offer credits and programs that reduce provincial taxes for seniors or low-income individuals.

Table 1.2 lists the 2022 provincial graduated tax rates and surtaxes, if applicable. All are applied to the amounts noted as net income on the federal tax return.[5]

4. Government of Canada. *T1 Income tax packages for 2021*. [online]. Revised May 12, 2022. [Consulted May 24, 2022]. https://www.canada.ca/en/revenue-agency/services/forms-publications/tax-packages-years/general-income-tax-benefit-package.html
5. Canada Revenue Agency. *Canadian income tax rates for individuals – current and previous years.* [online]. Revised January 18, 2022. [Consulted May 10, 2022]. https://www.canada.ca/en/revenue-agency/services/tax/individuals/frequently-asked-questions-individuals/canadian-income-tax-rates-individuals-current-previous-years.html

TABLE 1.2

Provincial tax rates (applied to taxable income) for 2022

PROVINCE OR TERRITORY	RATE
British Columbia	5.06% on the first $43,070 of taxable income, + 7.7% on the next $43,071, + 10.5% on the next $12,760, + 12.29% on the next $21,193, + 14.7% on the next $42,738, + 16.8% on the next $64,259, + 20.5% on the amount over $227,091.
Alberta	10.0% on the first $131,220 of taxable income, + 12.0% on the next $26,244, + 13.0% on the next $52,488, + 14.0% on the next $104,976, + 15.0% on the amount over $314,928.
Saskatchewan	10.5% on the first $46,773 of taxable income, + 12.5% on the next $86,865, + 14.5% on the amount over $133,638.
Manitoba	10.8% on the first $34,431 of taxable income, + 12.75% on the next $40,285, + 17.4% on the amount over $74,716.
Ontario[6]	5.05% on the first $46,226 of taxable income, + 9.15% on the next $46,228, + 11.16% on the next $57,546, + 12.16% on the next $70,000, + 13.16 % on the amount over $220,000.
Québec[7]	15% on the first $46,295 of taxable income, + 20% on the next $46,285, + 24% on the next $20,075, + 25.75% on the amount over $112,655.

6. Ontario's surtax was eliminated in 2018.
7. Québec residents complete a separate return that is not based on federal taxable income. [Consulted May 10, 2022]. https://www.revenuquebec.ca/en/citizens/income-tax-return/completing-your-income-tax-return/income-tax-rates/

PROVINCE OR TERRITORY	RATE
New Brunswick	9.40% on the first $44,887 of taxable income, + 14.82% on the next $44,888, + 16.52% on the next $56,180, + 17.84% on the next $20,325, + 20.3% on the amount over $166,280.
Newfoundland and Labrador	8.7% on the first $39,147 of taxable income, + 14.5% on the next $39,147, + 15.8% on the next $61,486, + 17.3% on the next $55,913, + 19.8% on the next $54,307, + 20.8% on the next $250,000, + 21.3% on the next $500,000, + 21.8% on the amount over $1,000,000.
Nova Scotia	8.79% on the first $29,590 of taxable income, + 14.95% on the next $29,590, + 16.67% on the next $33,820, + 17.5% on the next $57,000, + 21% on the amount over $150,000.
Prince Edward Island[8]	9.8% on the first $31,984 of taxable income, + 13.8% on the next $31,985, + 16.7% on the amount over $63,969.
Northwest Territories	5.9% on the first $45,462 of taxable income, + 8.6% on the next $45,465, + 12.2% on the next $56,899, + 14.05% on the amount over $147,826.
Nunavut	4% on the first $47,862 of taxable income, + 7% on the next $47,862, + 9% on the next $59,901, + 11.5% on the amount over $155,625.
Yukon[9]	6.4% on the first $50,197 of taxable income, + 9% on the next $50,195, + 10.9% on the next $55,233, + 12.8% on the next $344,375, + 15.0% on the amount over $500,000.

8. PEI also charges a 10% surtax on provincial tax exceeding $12,500.
9. Yukon surtax was eliminated in 2015.

1.2.4 Commodity taxes

Commodity taxes include the goods and services tax (GST), the provincial sales tax (PST) and, in those provinces that combine the two, the harmonized sales tax (HST). In addition, commodity taxes include the excise tax. This is a tax applied to products such as fuel-inefficient vehicles, air conditioners designed for use in automobiles and gasoline. They also include excise duties on alcohol and tobacco products as well as customs duties charged by the federal government on certain imports.

1.2.4.1 Exemptions

HST is charged against most goods and services. Goods and services exempt from HST may be either zero-rated or exempt. These include:

- Basic foods;
- Prescription drugs;
- Medical devices, such as dentures and eyeglasses;
- Healthcare services, such as dentistry;
- Financial transactions, such as paying or receiving interest;
- Buying a financial instrument, such as a bond;
- Rent on residential properties;
- Wages and commissions paid to employees;
- Insurance premiums;
- Commission earned by insurance agents for selling policies.[10]

Insurance premiums are exempt from HST. However, provinces can apply tax to premiums of certain types of insurance, including group insurance. These will be covered in Chapter 3.

10. Canada Revenue Agency. *GST/HST Technical Information Bulletins*. [online]. Revised June 4, 2017. [Consulted May 12, 2022]. https://www.canada.ca/en/revenue-agency/services/tax/technical-information/technical-information-gst-hst/gst-hst-tech-info-bulletin.html

1.2.5 Withholding taxes

Withholding taxes are simply taxes withheld by the payer to be submitted to government as a credit against the payee's tax otherwise payable that typically represent the prepayment of income taxes. This helps reduce the impact of tax evasion if someone does not file a tax return as a credit against the payee's tax otherwise payable.

Withholding taxes include:

- Domestic;
- Foreign;
- Assets owned by non-residents.

1.2.5.1 Domestic withholding taxes

Withholding taxes are generally applied to withdrawals from a registered retirement savings plan (RRSP), payments from employment income, benefits from a registered pension plan (RPP) and deferred profit sharing plan (DPSP), and payments over the minimum amount required to be withdrawn from a registered retirement income fund (RRIF).

For example, a client may decide to cash in all or part of an RRSP. When this happens, the financial institution or insurance company withholds a specific amount of tax to submit to the Canada Revenue Agency (CRA) based on the amount the client withdraws (current rates subject to change):

- 10% (5% for Québec*) on amounts up to $5,000;
- 20% (10% for Québec*) on amounts over $5,000 up to $15,000;
- 30% (15% for Québec*) on amounts over $15,000.

* In Québec, there is an additional amount of 15% that will be withheld by financial institutions and insurance companies. This amount will be paid to Revenu Québec.

EXAMPLE

Dana, a resident of Manitoba, withdrew $25,000 from her registered retirement savings plan (RRSP). The financial institution that held her plan would be required to withhold and remit tax. Based on the amount she withdrew, the 30% rate would apply, so it would withhold 30% of $25,000 = $7,500.

Consequently, she will receive $25,000 – $7,500 = $17,500.

The amount withheld may be too little or too much depending on the tax rate applicable to Dana's overall income. Any amounts owing or overpaid would be determined when she files her tax return for that year.

1.2.5.2 Foreign withholding tax

People who own shares of foreign companies may face withholding tax on dividends paid to them. These vary among countries. Generally, these foreign taxes may be used to fully or partially reduce the amount of Canadian tax otherwise payable, as the individual may be eligible to claim a foreign tax credit on his tax return.

EXAMPLE

Jason owns shares in several U.S. dividend-paying companies. He understands that there will be a default withholding tax rate of 30%. If, however, he files the applicable form, he will get a preferential rate of 15%. He may reduce the Canadian taxes otherwise owing on this U.S. dividend income by claiming a foreign tax credit when he files his Canadian tax return.

As a result of tax treaties, signatory countries waive or significantly reduce withholding tax on income paid on assets held within registered retirement savings plans (RRSP), registered retirement income fund (RRIF) and similar retirement plans. However, there is no mechanism for refunding withholding taxes pertaining to dividends paid on foreign securities held in tax-free savings accounts (TFSA), registered education savings plans (RESP) or registered disability savings plans (RDSP).

1.2.5.3 Withholding taxes on assets owned by non-residents

The Canada Revenue Agency (CRA) requires withholding taxes on a large range of assets paid to or owned by non-residents, including pension and annuity payments and insurance policies. The payer is responsible for withholding and submitting the required amount(s). An insurer is required to withhold tax when a non-resident disposes of an insurance policy that was issued when the policy owner was a resident of Canada.[11]

1.3 Definition of a self-assessed tax system

Canada uses a self-assessed tax system. In other words, individuals voluntarily fill out their tax returns, report their income and claim their various deductions and credits. Note that a self-assessed system does not mean that income tax payment is optional; it only means that individuals are the ones filling their tax returns, not the government. In so doing, taxpayers themselves calculate how much they owe or the size of the refund they are entitled to receive. Assuming a return is filed electronically, a notice of assessment should be received within a couple of weeks, along with a refund cheque or request for any amount owing.

11. Canada Revenue Agency. *T2062B Notice of disposition of a life insurance policy in Canada by a non-resident of Canada*. [online]. Revised February 3, 2016. [Consulted May 12, 2022]. https://www.canada.ca/en/revenue-agency/services/forms-publications/forms/t2062b.html

A taxpayer may get a request for more information to support income claimed or deductions taken. For example, an individual may be asked to provide receipts for medical expenses claimed or charitable donations reported. These requests are relatively routine and would not be considered an audit. In most cases, where the additional documentation provided supports the income or deduction, the individuals will receive a notice that the information has been accepted. In other cases, more information will be requested or notice will be given that the amount claimed was not accepted.

1.3.1 Canada Revenue Agency (CRA) audits

Each year, the Canada Revenue Agency (CRA) audits or inspects a number of individual and corporate income tax returns, HST/GST returns, as well as excise tax, duties and payroll records. According to its website, audits "help the CRA maintain public confidence in the fairness and integrity of Canada's tax system."[12]

Most taxpayers earn salaries or wages or are pensioners. Their incomes are easily verified by comparing the information they file with CRA with the information employers and financial institutions provide. Consequently, they are unlikely to be audited unless they claim out-of-the-ordinary or new deductions such as very costly medical expenses or unusually large sums in charitable donations. However, the CRA will randomly select a small proportion of individual claims that may not appear to be excessive on the surface. Taxpayers who are in compliance should not be concerned about such reviews. These aim to encourage voluntary compliance with the Canadian tax system.

The CRA will generally take more care to review individuals who have business or professional income, as well as corporations and trusts. All returns are recorded in a computer system that allows the CRA to compare financial information for one or more years for any number of taxpayers in similar businesses or occupations. This allows the CRA to develop sophisticated tools for determining questionable claims based on analysis among multiple taxpayers across multiple industries and multiple tax years. Those whose expenses or other information do not fit the norm may be picked for audit.

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12. Canada Revenue Agency. *Business audits*. [online]. Revised March 10, 2021. [Consulted May 12, 2022]. https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/changes-your-business/business-audits.html

1.3.1.1 Types of Canada Revenue Agency (CRA) audits

According to the Canada Revenue Agency (CRA), there are four ways of selecting files for audit:

- **Computer-generated lists:**

  Most returns are selected for audit review from computer-generated lists.

- **Audit projects:**

  In some cases, the CRA tests the compliance of a particular group of clients.

- **Leads:**

  These include information from other audits or investigations, as well as information from outside sources.

- **Secondary files:**

  Sometimes, the CRA selects files for audit because of their association with other previously selected files.

If the CRA selects a return for audit, an auditor will review the individual's, corporation's or trust's return at a CRA office or at the taxpayer's place of business. In addition to the information the CRA has on file, such as the taxpayer's returns and financial statements, it will request specific business records. Alternatively, it can start an audit at the place of business, obtaining additional information if required from employees.

When the CRA completes the audit, the auditor will either inform the taxpayer that there are no proposed adjustments to the return or he will propose adjustments. These will be discussed with the taxpayer or his accountant or lawyer, and additional information can be provided. After that, a notice of assessment or reassessment will be issued. If a taxpayer disagrees with the notice of reassessment, he can try to resolve the issues that led to reassessment at a CRA tax services office. If the taxpayer has no success at the tax services office level, a notice of objection can be prepared. This will lead to a review by the CRA's Appeals office. Beyond that, appeals may be made to the courts.

1.3.1.2 Statutory limits on audits

The normal reassessment period for most taxpayers is three years after the CRA sends its notice of assessment. The exceptions are mutual fund trusts and corporations other than Canadian-controlled private corporations. For these, the normal assessment period is four years. After this period, the CRA is barred from commencing an audit. Similarly, a taxpayer cannot ask to have a file reopened to claim a refund.

Exceptions that would allow an audit beyond the normal assessment periods include fraud and gross negligence (a conscious disregard of tax rules). In such cases, there is no time limit. Also, the reassessment period can be extended to six years in situations when a person wants to offset a loss.

EXAMPLE

Joan incurred a loss on a technology stock in 2017. She wants to offset this loss against a gain she reported in 2014. This would result in a tax refund. In this case, the reassessment period for the 2014 return is extended to 2020, a six-year period.

1.3.2 Retention of records

Because of the possibility that an adjustment can occur, the *Income Tax Act* requires that taxpayers keep all records, books of account and vouchers necessary for the audit to prove information reported in their income tax return for six years from the end of the tax year relating to those records.[13] So, an individual who filed a return for 2019 should keep his records and receipts for that year until the end of 2025.

1.4 General Anti-Avoidance Rule (GAAR)

The purpose of the General Anti-Avoidance Rule (GAAR) is to prevent transactions designed specifically to obtain an inappropriate tax benefit and for no other legitimate purpose.

1.4.1 Nature of the General Anti-Avoidance Rule (GAAR)

An “avoidance transaction” is defined as a single transaction or part of a series of transactions that result directly or indirectly in a tax benefit, unless the transaction is carried out primarily for purposes of good faith other than to obtain a tax benefit.

The CRA defines tax benefit under the *Income Tax Act* as “a reduction, avoidance or deferral of tax or other amount payable under this Act or an increase in a refund of tax or other amount under this Act.”[14]

A number of individuals use some form of tax planning strategy. For example, individuals who contribute to retirement plans with their employer are avoiding paying tax because the amount of taxes paid on the funds when they are withdrawn is usually less than the amount that the individual would owe today. In addition, retirement plans permit individuals to defer paying taxes until a later date, which allows their savings to grow at a faster rate.

13. Income Tax Act, RSC 1985, c. 1 (5th Supp).
14. *Ibid*.

The CRA has implemented the following processes to combat tax avoidance:[15]

- Regular reviews for potential tax avoidance issues;
- Monitoring of tax avoidance trends – for example, the CRA now reviews 100% of all tax shelters;
- Keeping up-to-date about tax avoidance strategies people are using;
- Communicating with the Department of Finance on legislative changes related to abusive tax avoidance strategies that are being used.

1.5 Filing tax returns

Individuals and corporations must file their returns by specific dates to avoid penalties. Agents should also be aware that clients or potential clients who have U.S. citizenship or who hold Green Cards must also file U.S. returns.

1.5.1 Fiscal year and tax reporting year-end

Individuals file T1 tax returns based on a calendar year. The December 31 year-end also applies to individuals who are self-employed. The CRA categorizes self-employment income as business, professional, commission, farming or fishing income.

The term "fiscal year" refers to the reporting period of a corporation. It is at most 12 months, but can be shorter in a corporation's first year of operation. Members of partnerships generally report their share of partnership income or losses on the T1 return using the December 31 reporting year. A corporation's fiscal year-end does not have to be December 31, although most corporations choose a calendar year. If not, the corporation must file the tax return exactly six months to the day from the corporation's tax year end.

EXAMPLE

- If the tax year ends March 31, the filing due date is September 30.
- If the tax year ends August 31, the filing due date is February 28.
- If the tax year ends September 23, the filing due date is March 23.[16]

15. Canada Revenue Agency. *Tax avoidance*. [online]. Revised December 23, 2013. [Consulted May 12, 2022]. https://www.canada.ca/en/revenue-agency/corporate/about-canada-revenue-agency-cra/tax-alert/tax-avoidance.html
16. Canada Revenue Agency. *When to file your corporation income tax return*. [online]. Revised May 5, 2022. [Consulted May 12, 2022]. https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/corporations/corporation-income-tax-return/when-file-your-corporation-income-tax-return.html

Diagram 1.1 illustrates the important dates throughout the year that agents should remember.

DIAGRAM 1.1

Tax filing in Canada[17]

January	April	June	October	December
No later than 6 months before January 31, i.e., the fiscal year-end for most retailers	April 30 for most individuals	June 15 for self-employed individuals; the fiscal year-end is December 31	No later than 6 months before October 31, i.e., the fiscal year-end for Canadian chartered banks	No later than 6 months before December 31, i.e., the fiscal year-end for Canadian life insurance companies and most corporations

1.5.2 Canada and the United States (U.S.)

One situation that agents will likely come across applies to two groups of clients or potential clients: Canadian citizens who are also citizens of the United States (U.S.) and Canadian citizens who hold Green Cards, which allow them to work in the U.S., and who must file U.S. tax returns.

Unlike Canada, where people are taxed based on residency, the U.S. taxes on citizenship. Consequently, a U.S. citizen living in Canada is required by American law to file U.S. tax returns, even if his income originates entirely from Canadian sources. This rule applies even to those who have not lived in the U.S. for decades.

17. For 2020 only, the April 30 deadline is extended to June 1 for filing and September 30 for payment without penalties or interest. The deadline of June 15 remains unchanged for filing, but is extended to September 30 for payment.

A U.S. citizen living and earning income in Canada would file a U.S. individual tax return Form 1040 each year to report his worldwide income. A personal tax return would also have to be filed in Canada. Generally, double taxation is avoided because, through tax credits, the income tax paid in Canada reduces the amount of U.S. income tax payable. This stems from international tax treaties. However, U.S. tax law differs from Canadian law, and what may be permitted in one country may not be in the other.

Many Canadians have also worked or lived in the U.S. and still hold assets in the form of retirement savings (mostly, individual retirement accounts (IRAs), Roth IRAs and 401(k) plans). Withdrawing funds from these plans is complex, with some options available for transfers to RRSPs.

Most insurance agents will recommend RRSPs to clients as a means of deferring taxes while saving for retirement. However, the tax deferral benefits from RRSPs and registered retirement income funds (RRIF) may not be available to U.S. citizens. The annual income earned in an RRSP or RRIF is taxable for U.S. tax purposes. But if the person completes U.S. tax Form 8891 it is possible to defer the tax on the investment income. Similarly, income earned in a tax-free savings account (TFSA) is taxable for U.S. income tax purposes, so it may not be the best option for a client who has dual U.S. and Canadian citizenship.

1.6 Types of income

The tax return has sections for total income, net income and taxable income. This Section discusses these in detail.

1.6.1 Total income

Taxpayers must report most of the income they receive during the calendar year. Total income includes:

- Employment income, wage loss replacement contributions, tips;
- Pension-related income;
- Disability benefits;
- Child care benefits;
- Employment Insurance (EI) and other benefits;
- Taxable amount of dividends from taxable Canadian corporations;
- Interest and other investment income;
- Registered Retirement Savings Plan (RRSP) or Registered Retirement Income Fund (RRIF) income.

This list is not exhaustive, and the *Federal Income Tax and Benefit Guide* provides detailed explanations and examples.[18]

There are exceptions that are not taxable, including the following:

- Death benefits paid from a life insurance policy;
- GST/HST credits, including credits pertaining to provincial programs;
- Child assistance payments (in Québec);
- Lottery winnings;
- Guaranteed Income Supplement (GIS) benefits;
- Certain awards;
- Most gifts and inheritances;
- Strike pay.

While such income is not taxable, any income earned on the invested capital arising from the income is.

EXAMPLE

Theo won $1 million in a lottery last year and earned $20,000 interest when he invested the money in an unregistered vehicle. He must report this interest on his tax return.

1.6.2 Net income

The next part of the tax return is the net income section and is calculated in the following way:

Net income = total income – specific deductions

It begins with total income, then lists the items, expenses and contributions that are deducted from it. A list of the key deductions follows:

- Registered pension plan or RRSP contributions;
- Child care expenses;
- Disability support;
- Business investment loss;

18. Canada Revenue Agency. *5000-G, Federal Income Tax and Benefit Guide (for all except non-residents)*. [online]. Revised January 18, 2022. [Consulted May 12, 2022]. https://www.canada.ca/en/revenue-agency/services/forms-publications/tax-packages-years/general-income-tax-benefit-package/5000-g.html

- Moving expenses;
- Support payments made, excluding most child support payments;
- Carrying charges and interest expenses;
- Canada Pension Plan (CPP) contributions on self-employed earnings;
- Social benefits repayments.

Net income is important because it is used for certain calculations, such as the child tax credit and GST/HST credit. It is also required on provincial and territorial tax returns.

1.6.3 Taxable income

Taxable income is net income after certain additional deductions, including:

- Canadian Forces personnel and police deduction;
- Employee home relocation load deduction;
- Security options deduction;
- Other payments deduction;
- Limited partnership losses of other years;
- Non-capital losses of other years;
- Capital gains deduction;
- Northern residents deduction;
- Additional deductions.

Taxable income is used to calculate federal tax and may also be required on a provincial or territorial tax form.

1.7 Marginal and average tax rates

As stated earlier, Canada has a graduated tax system with marginal tax rates applied to different income brackets. An individual with taxable income of $80,000 could have a combined federal-provincial marginal tax rate of between 32% and 39.4%, depending on the province or territory of residence. In other words, he would pay 32% and 39.4% of the last dollar earned as federal and provincial tax. This is calculated in the following way:

Marginal tax rate = federal income tax rate + provincial income tax rate

EXAMPLE

Margaret has taxable income of $80,000. The federal marginal tax rate for taxable income over $50,197, but not more than $100,392, is 20.5%. Margaret lives in Nova Scotia where the provincial marginal tax rate applicable on income between $59,180 and $93,000 is 16.67%. So her combined marginal tax rate is 20.5% + 16.67% or 37.17%.

Average tax rate is simply the percentage of each dollar of income paid as tax and is much lower than the marginal tax rate.

EXAMPLE (CONT.)

Margaret would pay $7,530 in federal tax on her first $50,197 of income and $6,110 (or 20.5% on the amount exceeding $50,197, i.e. $29,803) on the remainder, for a total of $13,640. In addition, she would pay provincial tax of $7,025 on her first $59,180 of income and $3,471 on the remaining $20,280 or taxable income, for a total provincial tax of $10,496.

Combined, her federal and provincial taxes will therefore total $24,136.

Dividing this amount by her $80,000 taxable income gives an average tax rate of 30.17%.

Federal and provincial tax credits will reduce federal and provincial taxes payable as well as the marginal and average tax rates.

1.8 Deductions and credits

Deductions reduce the income that is used to calculate gross tax payable, whereas credits reduce the calculated gross tax payable to arrive at the net tax payable.

Consequently, individuals may be able to reduce the amount of tax otherwise payable by claiming deductions and tax credits on their tax returns, as we saw above.

1.8.1 Difference between a deduction and a credit

The amount paid into an RRSP is an example of a deduction that reduces total income. For every dollar contributed to an RRSP, net income is reduced by a dollar.

Credits, however, reduce tax, and their availability and amount depend on income in some cases.

For example, each taxpayer claims $14,398 (2022) as a personal amount, while people 65 years of age or older with income below $39,826 claim an additional age amount of $7,898 (this amount is adjusted downward according to income). The federal non-refundable tax credit rate is 15%.

Provinces also have a system of credits, which reduce provincial tax. The tax credits noted above should not be confused with investment tax credits, which are based on specific types of investments or job creation.

1.8.2 Refundable and non-refundable credits

Some tax credits are refundable. An example is the GST/HST tax credit, which is a tax-free quarterly payment to individuals or families with what CRA terms low or modest incomes.

However, most credits are non-refundable, which means that that they cannot be used to reduce taxes below zero and cannot result in a refund to the taxpayer. Any non-refundable credits that cannot be used will be lost.

1.8.3 Widely used credits

Some of the most widely used credits include:

- the labour-sponsored funds tax credit;
- the pension income amount.

1.8.3.1 Labour-sponsored funds tax credit

Up to $750 per year is available if contributions are made to such funds. The tax credit is 15% of the contribution paid to the fund.

It is a non-refundable credit.

1.8.3.2 Pension income amount

Up to $2,000 is available for those reporting eligible pension, superannuation or annuity payments.[19]

It is a non-refundable credit.

19. Canada Revenue Agency. *Line 31400 - Pension income amount*. [online]. Revised January 18, 2022. [Consulted May 12, 2022]. 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-31400-pension-income-amount.html

1.9 Tax reporting in the year of death of a person

An agent should be familiar with tax reporting in the year of death of a person. The CRA has written a document entitled *What to do following a death*.[20]

1.9.1 Rules that a legal representative must comply with following the death of a person

A legal representative[21] is responsible for administering the estate of the deceased and distributing of the estate assets as specified in the deceased's will.

The legal representative has specific responsibilities pertaining to the CRA and Services Canada:

- Provide the CRA with the deceased's date of death;
- Stop or, in some cases, transfer certain benefits the deceased was receiving.

If a person dies between January 1 and October 31, the final tax return generally is due April 30 of the following year.

If the person dies between November 1 and December 31, the return is due six months after the date of death. If the deceased was self-employed or was married to a person who is self-employed, slightly different due dates apply.

A surviving spouse who lived with the deceased has the same filing dates as the deceased rather than the April 30 filing date.[22]

If a person dies after December 31, but on or before the due date for the return, generally April 30, the due date for filing the return of the deceased and the surviving spouse or common-law partner is six months after the date of death. In the case of the spouse or common-law partner, any tax owing must be paid by April 30 to avoid interest charges.

The legal representative is responsible for the following under the *Income Tax Act*:

> Filing all required returns for the deceased; making sure all taxes owing are paid; letting the beneficiaries know which, if any, of the amounts they receive from the estate are taxable; and obtaining a clearance certificate to certify that all amounts owing to the CRA have been paid.[23]

Any fees paid to the legal representative or the administrator are reported on a T4 slip, unless included in that person's business income.

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20. Canada Revenue Agency. *What to do following a death*. [online]. Revised March 15, 2022. [Consulted May 10, 2022]. https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/rc4111.html
21. Also referred to as "executor" and, in Québec, "liquidator."
22. Canada Revenue Agency. *Preparing returns for deceased persons 2021.* [online]. Revised February 7, 2022. [Consulted May 12, 2022]. https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/t4011/preparing-returns-deceased-persons.html
23. Canada Revenue Agency. *What to do following a death.* [online]. Revised January 18, 2022. [Consulted May 12, 2022]. https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/rc4111/canada-revenue-agency-what-following-a-death.html

1.9.2 Definition of probate

Probate is the process through which a will is certified to be the deceased's last valid will and through which an estate's executor, in turn, receives approval from a court to obtain and distribute assets. Generally, financial institutions will not release financial assets without a certified copy of the probated will. With the exception of Québec, probate fees in Canada fees are charged based on the fair market value of assets passing through a probated will and vary from province to province, but can be substantial.

Whether a will must go through probate depends on specifics and varies among provinces. For example, if the deceased's only assets were a life insurance policy with named beneficiaries and a joint bank account, there might be no need for probate. However, probate confirms the executor's legal authority.

Québec does not require a notarial will (a will made before a notary) to be probated. Wills prepared by an attorney and witnessed must be probated.

1.9.2.1 Exemption from probate of life insurance policies

Life insurance policies that have named beneficiaries are exempt from probate and, generally, the insurer pays the benefit shortly after the agent submits the paperwork. In contrast, a policy must go through probate if it has no named beneficiary or the beneficiary is the deceased's estate.

1.9.3 Estate taxation

The CRA considers that the disposition of a taxpayer's assets takes place at death. In other words, all of the individual's assets were presumed to be disposed of, which means sold, transferred or gifted at death at fair market value. This is called "deemed disposition." Consequently, certain assets, such as RRSP and capital assets (for example, stock portfolios or individual variable insurance contracts (IVIC) holding segregated funds), are deemed sold for proceeds equal to their fair market value for tax purposes.

1.9.3.1 Spousal deferrals

An exception to the deemed disposition rule is the spousal rollover, which allows transfers of assets, such as stock portfolios, to the surviving spouse. Assets left to a spouse or common-law partner are deemed to have been disposed of for proceeds equal to the deceased's adjusted cost base and acquired by the spouse/partner at an identical tax cost.

"Spouse" means a married spouse, a common-law partner or a partner, including a same-sex partner.

EXAMPLE

Louis died with an RRSP valued at $300,000. Under CRA rules, his RRSP can be transferred directly to an RRSP registered in the name of his wife Nancy with no tax consequences. Similarly, his stock portfolio can be transferred to her with no reporting of capital gains for Louis. In the case of the stock portfolio, Nancy's adjusted cost base (ACB) is the deceased's ACB, so any taxes on gains may be deferred until her death or until she actually disposes of the portfolio.

The adjusted cost base (ACB) can be described as the cost of an asset, for tax purposes. It is generally equal to the sum of the purchase price, plus expenses incurred to make the purchase, plus expenses incurred to sell the asset, less any capital realized.

1.9.3.2 Rollover to dependent children or grandchildren

The fair market value of an RRSP is generally included in the deceased's income for the year of death. However, if an amount is paid from the RRSP to a financially dependent child or grandchild, the amount reported on the deceased's final return is reduced by that amount and a T4RSP slip is issued to the child or grandchild, who then reports it as income. For this purpose, financial dependence would require the child or grandchild to have income less than the personal amount. If the beneficiary is a dependant of the deceased due to mental or physical infirmity, the RRSP proceeds may be rolled over, tax-free, into an RRSP or a registered disability savings plan (RDSP) in the beneficiary's name, up to his available RDSP contribution room.

Finally, a dependent child, or grandchild, under the age of 18 is entitled to a rollover of the RRSP refund of premiums to an annuity for which the child is the sole beneficiary. The annuity must be for a number of years not exceeding 18, minus the age of the child at the time of its acquisition.

It should be noted that if the child or spouse was financially dependent on the deceased due to a mental disability, it will also be possible to use a lifetime benefit trust (LBT).[24]

1.10 Understand how individuals are taxed

Individuals must pay federal and provincial income tax. Employers deduct federal and provincial tax from their employees' gross income and submit them to the Canada Revenue Agency (CRA). The amount deducted is a credit against the employee's taxes otherwise payable. If, due to the impact of deductions and tax credits, the tax otherwise payable turns out to be less than the amount deducted the taxpayer will receive a refund when he or she files a tax return.

24. Canada Revenue Agency. *Trust types and codes.* [online]. Revised March 16, 2022. [Consulted May 16, 2022]. https://www.canada.ca/en/revenue-agency/services/tax/trust-administrators/types-trusts.html

Employers also deduct Canada Pension Plan (CPP) or, in Québec, Québec Pension Plan (QPP), contributions and Employment Insurance (EI) premiums and, in Québec, Québec Parental Insurance Plan premiums. Deductions can also be made for employee contributions to an RRSP, registered pension plans (RPP), items such as retirement savings plan contributions, and taxable benefits, including parking, cell phone and Internet use. Employers determine the amounts they deduct by using tables, formulae or an online calculator, all available from the CRA.[25]

Telework deductions in connection with COVID-19

Since the COVID-19 pandemic began, many businesses have required their employees to work from home. Such employees have most likely created work spaces in their homes for this purpose. As well, they have made investments in home office supplies and equipment. Some of the expenses relating to an employee's home office may be deducted from their income for the 2020 tax year, provided that certain criteria are met. Most of the deductions have been extended for 2021.

An employee can deduct from employment income home office rent and the cost of supplies that were consumed directly in the performance of the duties ("Home Office Expenses"), if these outlays by the employee were required by a contract of employment.[26] The CRA has already stated that a "tacit" understanding between the employee and employer is sufficient to meet this "contract of employment" condition.[27]

The principal condition for the deduction of expenses in respect of a work space at home, such as rent, utilities and maintenance costs, is that the employee must principally perform (i.e. more than 50% of) his work from that work space for more than six months out of the year. This condition is also met where an employee works from home more than 50% of the time in the period during which the employee is required to work from home (e.g., during the COVID-19 lockdown).

To claim a deduction for Home Office Expenses, the employee must file a Form T2200 with the employee's personal tax return. This form is signed by the employer and certifies that the employee's contract required the employee to incur such expenses while carrying out his duties.

The CRA has also stated that, in the context of COVID-19, an employer may reimburse an employee for the purchase of personal computer equipment up to $500, and such reimbursement will not be a taxable benefit for the employee.[28]

25. For more information on the *Payroll Deductions Online Calculator (PDOC), payroll tables, TD1s, and more.* [online]. Revised January 31, 2020. [Consulted May 16, 2022]. https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/payroll/payroll-deductions-online-calculator-pdoc-payroll-tables-td1s.html
26. *Income Tax Act*, RSC 1985, c. 1 (5th Supp.), sub-paragraphs 8(1)(i)(ii) and (iii).
27. Canada Revenue Agency, Views Doc 9230748 (November 9, 1992).
28. Canada Revenue Agency. *Taxable benefit.* [online]. Revised April 22, 2020. [Consulted May 16, 2022]. https://cdn.ymaws.com/www.cerc.ca/resource/resmgr/covid_info_page/cra_views_2020-0845431c6_ava.pdf

1.10.1 Working on commission (employment Commissions)

Salaried employees are limited as to the deductions they can take. In contrast, employees who are paid commission can make certain deductions for expenses related to their employment. Examples include allowable motor vehicle expenses, entertainment expenses related to earning income and work-space-in-the-home expenses.

1.10.2 Self-employed

Self-employed individuals who have business or professional income can deduct their business expenses and report their net income or loss, as the case may be, on their personal tax return. Self-employment income can be earnings from a sole proprietorship or from a partnership. Generally, reasonable expenses related to the income earning activity can be deducted subject to certain specific limitations or exclusions.

The business expenses allowed include, among others, the following:

- Insurance premiums;
- Interest;
- Business tax, fees, licenses, dues, memberships and subscriptions;
- Legal, accounting and other professional fees;
- Management and administration fees;
- Maintenance and repairs;
- Rent;
- Salaries, wages and benefits, including employer contributions;
- Property taxes;
- Travel;
- Fuel costs (except for motor vehicles).

Many small businesses do not operate out of the proprietor’s home. However, for those that do, business-use-of-home expenses can be deducted from income only up to an amount that would reduce net income to zero. Any additional home office expense can be carried forward to future years.

EXAMPLE

Roz runs a moving service out of her home and uses one room specifically as a home office. In it, she keeps her computers and business records. She calculates that her office is 16% of the living space of the home.

She is therefore able to deduct from her gross business income 16% of:

- Heat;
- Electricity;
- Insurance premiums;
- Maintenance;
- Mortgage interest;
- Property taxes;
- Other expenses.

If Roz buys new furniture or more equipment for her office, she can write these down or claim a deduction based on the type of asset. Special rules exist to determine the appropriate amounts that can be deducted each year based on the type of asset. These categories are used for capital cost allowance purposes. For example, if she uses her car for business, she can deduct a portion of her expenses equal to the business mileage as a percentage of her total mileage. It is important that she maintain a log tracking both business and personal mileage in order to determine the appropriate proportion of expenses eligible to be deducted for tax purposes.

1.10.3 Business owners

Owners of incorporated businesses (corporations) generally draw a salary as employees of their corporation, but may also receive dividends, which are paid from after-tax profits. A potential key advantage of a corporation from a tax perspective is the lower tax rate at which the corporation pays taxes in comparison to the marginal tax rate of the owner(s). Depending on which province the corporation operates in and assuming it is eligible for the small business deduction, it will have a tax rate between 11% and 23%; the rate in several provinces is 15%. This means that funds left in the company can grow at a higher after-tax rate than funds held personally.

EXAMPLE

Linda’s corporation had $50,000 of after-tax profit last year. This money is now available to buy new equipment to expand the business. Had she been a sole proprietor, she would have had less funds after tax for expansion.

The lower tax rate for corporations also means that it may be more cost-effective for a corporation to purchase life insurance for its executives rather than for the executives to purchase it themselves. This will be discussed in more detail in a subsequent chapter.

1.10.4 Trusts

Another entity or structure is the trust, which in some cases is taxable and in others is not. All personal trusts are either testamentary or *inter vivos* (living, non-testamentary trusts) and are often used for estate planning purposes. Other trusts are used to hold assets for specific purposes, such as registered retirement savings plans (RRSP) or pension plans.

1.10.4.1 Testamentary trust

The CRA defines this type of trust as follows:

> A testamentary trust is a trust or estate that is generally created on the day a person dies. All testamentary trusts are personal trusts. The terms of the trust are established by the will or by court order in relation to the deceased individual's estate under provincial or territorial law.[29]

From an insurance agent's perspective, the proceeds of a life insurance policy can be used to provide the funds to establish a testamentary trust for the benefit of specific beneficiaries on the death of the life insured.

EXAMPLE

Herman, age 70, is concerned about how his daughter Patricia will handle her inheritance when he dies. He meets with his legal advisor and insurance agent and makes the appropriate arrangements. Consequently, when he dies, a trust will be created with conditions established in his will to provide for his daughter. The trust will be funded by Herman's life insurance.

Trusts may also be used when the beneficiaries of life insurance policies are minors.

EXAMPLE

Amos is a widower with two children ages 4 and 8. He changed his will to establish a testamentary trust with his children as beneficiaries and two of his brothers as trustees.

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29. Canada Revenue Agency. *Trust types and codes*. [online]. Revised March 16, 2022. [Consulted May 16, 2022]. https://www.canada.ca/en/revenue-agency/services/tax/trust-administrators/types-trusts.html

Prior to 2016, testamentary trusts were taxed federally using the same graduated tax rates as individuals. However, following a change, for 2016 and subsequent years, this taxation is limited to 36 months for estates, after which the top marginal rate would apply. Graduated tax rates continue for trusts whose beneficiaries are eligible for the disability tax credit.[30]

1.10.4.2 Inter vivos trusts

Inter vivos trusts generally pay federal tax at a rate of 33%,[31] which is the highest marginal tax rate for individuals. Inter vivos trusts are created by a person during his lifetime. An agent may come across certain inter vivos trusts established before June 18, 1971. These grandfathered inter vivos trusts pay federal tax calculated using individual graduated tax rates rather than 33%. There are many types of trusts.[32] However, the ones that an agent will almost certainly become familiar with are those that he will discuss with clients. These are discussed below.

1.10.4.3 Registered retirement savings plan (RRSP)

A registered retirement savings plan (RRSP), for example, is a trust held by a trustee for the benefit of a beneficiary. The trustee is the institution that holds the assets. The beneficiary is generally the contributor or, in the case of a spousal plan, the contributor's spouse.

1.10.4.4 Segregated funds

A segregated fund is considered a trust with the fund's investments, property and income of the trust. The life insurance company is the trustee.

1.10.4.5 Real estate investment trusts (REIT) and mutual fund trusts

Real estate investment trusts (REIT) hold real estate properties for the benefit of unit holders. Similarly, most mutual funds are trusts. In the case of these trusts, income flows through the trust to the unit holders for tax purposes.

1.10.5 Understand how income taxes can be deferred or avoided

It is illegal to evade taxes. This can mean failing to report all income or making fictitious deductions. For instance, taxpayers must report all income including income earned outside of Canada. Any failure would be considered evasion.

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30. Canada Revenue Agency. *Annex 2 - Tax measures: Supplementary information*. [online]. Archived. [Consulted May 16, 2022]. https://www.budget.gc.ca/2014/docs/plan/anx2-1-eng.html
31. 27.55% in Québec.
32 Canada Revenue Agency. *Trust types and codes*. [online]. Revised March 16, 2022. [Consulted May 16, 2022]. https://www.canada.ca/en/revenue-agency/services/tax/trust-administrators/types-trusts.html

The T1 General – Income Tax and Benefit Return form asks the following question (for example, for tax year 2021): “Did you own or hold specified foreign property where the total cost amount of all such property, at any time in 2021 was more than CAN$100,000? If yes, complete Form T1135 and attach it to your return.”[33]

For the purposes of this form, real estate for personal use is excluded, as is any investment for which the taxpayer received a T3 or T5 slip from a Canadian issuer. The form also excludes mutual fund trusts and registered investments, even if they invest primarily in foreign securities. However, any foreign shares, debt securities, bank accounts, real estate, interests in non-resident trusts and other property must be reported. Failure to do so can result in penalties, even if the income is reported.

EXAMPLE

Rachel has $300,000 in U.S. company shares in her registered retirement savings plan (RRSP) and $50,000 in U.S. company shares in a non-registered brokerage account. She does not have to complete the form because the RRSP is exempt and she therefore has less than $100,000 in foreign assets for reporting purposes.

1.10.5.1 Tax planning

As noted it is illegal to evade taxes. However, it is quite legal to avoid some taxes entirely and defer others through financial planning, government programs or different types of investments.

Tax planning therefore means taking advantage of government programs or using strategies to minimize the tax burden.

Tax planning is an important part of financial planning to maximize tax reductions. Many individuals put money into tax-free savings accounts (TFSA) before putting funds into regular savings accounts such as an RRSP, particularly if they have low income. The tax-free savings account, as its name suggests, allows income to grow tax-free, and no tax is payable when that income is withdrawn.

1.10.5.2 Government programs

A number of government programs encourage saving for specific purposes, such as retirement or children’s education, through deferral of taxes. Cases in point are RRSP and registered education savings plans (RESP).

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33. Canada Revenue Agency. Get a *T1 income tax package.* [online]. Revised May 12, 2022. [Consulted May 16, 2022]. https://www.canada.ca/en/revenue-agency/services/forms-publications/tax-packages-years/general-income-tax-benefit-package.html

In the case of an RRSP, contributions, within limits, are based on earned income. Earned income includes employment earnings, self-employment earnings, as well as other income, such as royalties from an invention and net rental income. An individual can then subtract certain expenses, such as annual union and professional dues.[34]

Earned income does not include interest income, dividends or capital gains. RRSP contributions are deductible from income in the year contributed. Any income earned in the plan is not taxable. Funds are only taxable when they are withdrawn directly or from annuity payments or from a registered retirement income fund (RRIF) which stem from an RRSP.

EXAMPLE

Juan wants to start saving for retirement. By using an RRSP, he lowers the amount of income tax he pays in the current year. His income within the plan grows tax deferred and he only has to pay tax when he withdraws funds or receives payments from an RRIF or a registered annuity. Individuals can contribute up to 18% of the previous year's earned income to a maximum of $29,210 (for 2022), less the pension adjustment (PA).35 Last year, Juan had a salary income of $75,000. This amount is Juan's total earned income. He did not receive any other income that could be deemed earned income. His contribution room for this year is 18% of $75,000, or $13,500. He also has unused contribution room from previous years that he can use if he chooses. He decides to open a plan and contribute $13,500. He will be able to deduct that amount from his income when he completes his tax return for the current year. This will reduce his taxable income by $13,500.[36]

1.10.5.3 Investments

Taxes can be deferred through certain investments. The tax an individual pays on interest, capital gains and dividends from Canadian public companies is different and varies by marginal tax rate and by province. For example, interest income is taxed in the year earned or accrued. Capital gains, however, are taxable on disposition of the investment.

34. To calculate earned income, consult: https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/t4040/rrsps-other-registered-plans-retirement.html. Revised May 18, 2022. [Consulted May 21, 2022].
35. The pension adjustment (PA) basically represents a tax estimate of the retirement savings generated with a pension plan in a given year of accrual.
36. For more information on registered retirement savings plan (RRSP) limits, consult: https://www.canada.ca/en/revenue-agency/services/tax/registered-plans-administrators/pspa/mp-rrsp-dpsp-tfsa-limits-ympe.html. Revised April 22, 2022. [Consulted May 21, 2022].

EXAMPLE

Ten years ago, Laryssa purchased shares in a technology company for $10,000. The company has not paid dividends, and the investment is currently valued at $50,000. If Laryssa sells the shares now, she will pay tax on the taxable portion of her $40,000 capital gain, less transaction costs.

When looking at various types of investments, an individual should normally consider the after-tax income generated, depending on the nature of the income that the investment generates. Of course, all types of income are taxed at the taxpayer's marginal tax rate when withdrawn from a registered plan like an RRSP. This is because that income loses its tax identity. As such, it may be beneficial to place certain assets within an RRSP and hold other assets in some other form of investment vehicle.

As mentioned above, a TFSA allows Canadian residents 18 and over with a valid social Insurance number to contribute funds annually. Any income earned in the account grows tax-free, and no tax is payable when funds are withdrawn. The contribution limit for 2022 is $6,000.

In addition to the current year's allowable contribution, the account holder can add any unused TFSA contribution room from a previous year. Contribution room also includes any withdrawals made in previous years.

1.11 When to refer to a tax expert

Life insurance agents should have basic taxation knowledge. They should understand how income is taxed and be familiar with the most common deductions and credits available. They should also understand the tax implications of various tax-assisted programs, such as RRSP, that they will recommend to clients. They are not, nor should they be considered, experts in all aspects of tax.

Agents should refer clients to tax experts when the circumstances or knowledge required are beyond the general rules. Examples of tax experts include accountants specializing in tax and tax lawyers.

1.11.1 Tax accountant

A tax accountant would be able to advise clients on complex tax matters and on managing tax liabilities.

1.11.2 Tax lawyer

A tax lawyer would be involved in complex estate planning strategies. He would also be involved in complex situations involving income or business interests in two or more countries.

It is common for both types of experts to be involved in structuring buy-sell agreements where insurance will provide the funds if one of the principals, shareholders or partners dies or becomes disabled. Both experts and possibly an independent business evaluator would be involved in valuations, while the lawyer would be involved in developing the most tax effective structure.

EXAMPLE

Alfred, Anthea, Roberto and Fatima are shareholders in a small advertising agency. Alfred is age 60, Anthea is age 40, while Roberto and Fatima are in their 30s. Their insurance agent recommends life insurance and disability insurance such that, if one of the four should die or become disabled, there will be funds available to buy out his or her interests. The agent has therefore brought accountants and a tax lawyer to advise on whether, in the case of this agency, the insurance should be owned by the corporation or by the individuals.

It may also be advisable to turn to experts when valuing assets outside of Canada to determine insurance coverage to cover taxes for estate planning purposes.

CHAPTER 2

INVESTMENT INCOME

For most individuals, the main source of income is employment income. However, anyone who sets aside funds in a savings account, holds securities for dividend income, buys and sells shares, or buys and sells property may have earnings from these. This is called investment income.

2
INVESTMENT INCOME

2.1 Taxation of investment income

Not all investment income is taxed the same way. For example, interest is taxed in its entirety. Capital gains have a 50% inclusion rate, which means that only half of capital gains are taxable. Dividends from Canadian corporations are taxed on a preferential basis.

When investment income comes from registered investments, it loses its tax nature. There is no more tax distinction between interest income, capital gains or dividends; the full withdrawal will eventually be taxable.

If the investment income comes from a tax-free savings account (TFSA), the income does not have to be declared unless it is business income.[37]

If investment income is earned within the context of a registered retirement savings plan (RRSP), a registered pension plan (RPP) or a deferred profit sharing plan (DPSP), all income is taxable and so is the capital invested because it reduces the taxpayer's taxable income at the time of investment. For a registered education savings plan (RESP), a registered disability savings plan (RDSP) or any other tax-deferred registered plan, income does not have to be declared before it is withdrawn. It is then fully taxable.

The tax rate paid on income also reflects the business structure. For instance, what corporations pay is substantially lower than the top rates paid by individuals.

It is important that agents understand how income from investments is taxed because it will assist them in developing insurance and investment strategies.

These are discussed in detail in the following order:

- Accrued interest;
- Dividend income;
- Foreign income;
- Capital gains income;
- Capital losses;
- Tax-deferred income;
- Tax-free income;
- Small business income;
- Rental income.

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37. This could be the case, for example, if a TFSA account holder generates business income in the TFSA through day trading.

2.1.1 Accrued interest

It has been stated that interest is taxed in its entirety. However, some investments do not pay out this interest annually, but accrue it until maturity. Even though the interest is not paid out, it is taxable annually and must be reported.

EXAMPLE

Madeleine bought a $5,000 three-year Canada Savings Bond that compounds interest rather than paying it annually. She received a tax slip for the $50.15 in interest the bond accrued last year. She must report this amount even though she did not receive it. She will not pay tax on that amount when it is paid to her at the bond's maturity. This way, there will not be any double taxation.

2.1.2 Dividend income from Canadian corporations

Dividends from Canadian corporations get preferential tax treatment. In other words, the tax rate paid on these dividends is lower than individuals' marginal tax rate at which interest is taxed. The historical reason has been to encourage investment in Canada. Dividends are paid out to shareholders from after-tax profits. The amount the investor receives has already been taxed at the corporate level. However, investors must report what is called the "gross-up amount" of the dividends received on their tax returns. These result in an estimate of the pre-tax amount of the dividends. This is then offset by the dividend tax credit.[38]

To avoid having the same corporate income taxed twice, the Canadian Revenue Agency (CRA) initiated the "dividend tax credit" system.[39] The CRA requires that tax received be "grossed-up" to an estimate of the pre-tax amount. That becomes the taxable amount. Exactly how much this amount is "grossed-up" depends on the type of corporation. Eligible dividends, such as those paid by public companies, are "grossed-up" by a higher amount (38%) than non-eligible dividends, sometimes called "ordinary dividends" (15%). The taxable amount, however, is reduced by a federal tax credit for eligible dividends (15.0198%) or ordinary dividends (9.0301%). The provinces each have varying dividend tax credits.[40] Finally, the treatment of an eligible dividend, mainly those dividends paid by listed companies, is illustrated above. A dividend paid by a Canadian-controlled

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38. For more information on the two types of dividends that Canadian corporations can pay, consult: https://www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/federal-government-budgets/budget-2013/budget-2013-dividend-tax-credit.html. Archived. [Consulted May 21, 2022].
39. Canada Revenue Agency. *Line 40425 - Federal dividend tax credit.* [online]. Revised January 18, 2022. [Consulted May 21, 2022]. 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-40425-federal-dividend-tax-credit.html
40. These percentages are taken from the most recent data on the Canada Revenue Agency website. For more information, consult: https://www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/federal-government-budgets/budget-2013/budget-2013-dividend-tax-credit.html. Archived. [Consulted May 21, 2022].

private corporation (CCPC) from its small business deduction (SBD) income or investment income will be an ordinary dividend and its treatment will be slightly different.

Generally, the corporation paying the dividends reports all three figures (actual dividend, taxable dividend and dividend tax credit) on the T5 statement it issues. If the dividend is paid through a trust, such as a mutual fund, it will be on a T3 slip. These slips typically separate eligible dividends from ordinary dividends.

EXAMPLE

Douglas received a T5 tax statement from the company whose shares he owns, indicating the following:

- The actual dividends received were $7,870.00;
- The taxable dividends were $10,860.60;
- The federal dividend tax credit was $1,631.24.

Douglas wanted to confirm that the dividends are in fact eligible dividends. To do so, he multiplied $7,870 by 138% and got $10,860.60. He multiplied that by 15.0198% and got $1,631.24.

Douglas's federal marginal tax rate is 22%. He calculates that he will pay $2,389.33 in tax on the "grossed-up" taxable dividend, which, when reduced by the $1,631.24 dividend tax credit, will amount to $758.09. As a result, he will have $7,111.91 after tax.

2.1.2.1 Other types of dividends

In addition to the dividends described above, an agent is likely to come across the terms Capital Dividend and Capital Dividend Account (CDA). The CDA is a theoretical tax account that a private corporation uses to keep track of the portion of tax-free amounts it receives that it is allowed to credit to the CDA. These include some or all of the death benefits depending on the type of life insurance policy that names the corporation as the beneficiary, less the policy's adjusted cost base (ACB). The corporation can distribute (flow through) the proceeds of the CDA to shareholders as tax-free capital dividends.

EXAMPLE

Martina is the president of a small corporation whose shares are owned by her children. The corporation is the beneficiary of a term insurance policy on her life. Martina dies and the proceeds of the policy are paid out to the corporation and applied to the CDA. They are distributed tax-free to the shareholders.

2.1.3 Dividend income from foreign sources

Dividend income from foreign sources, such as shares from the United States (U.S.) or other foreign countries, is taxed in the same way as interest, that is, in its entirety and at the individual's marginal tax rate. It is not eligible for the dividend tax credit, which applies only to dividends from Canadian corporations.

2.1.4 Withholding taxes on foreign income

Individuals who own shares of foreign companies may face a withholding tax on the dividends paid to them. These vary among countries, but in general are fully or partially offset when the individual claims a foreign tax credit on his Canadian tax return. As a result of tax treaties, most countries waive withholding on income paid from registered retirement savings plans (RRSP), registered retirement income funds (RRIF) and similar retirement plans. However, there is no mechanism for refunding withholding taxes pertaining to dividends paid on foreign securities held in TFSA, RESP or RDSP. Consequently, investors should consider the potential impact of withholding taxes before placing foreign dividend-paying securities in a TFSA, an RESP or an RDSP.

2.1.5 Capital gains – Disposition of capital assets

A capital gain occurs when an individual or corporation sells what the CRA calls "capital property" at a higher price than the adjusted cost base (ACB), resulting in a profit, or for tax purposes, a capital gain (a loss if the amount is less than the ACB). Currently, only 50% of capital gains are taxable. This is called the "inclusion rate."

Taxable capital gain = 50% × (proceeds of disposition – ACB)

Capital property includes cottages, rental properties, buildings and equipment used in a business. It also includes stocks and bonds, mutual fund units, and segregated funds held outside tax deferral plans, such as RRSPs.[41]

EXAMPLE

Jonah sold shares with an adjusted cost base (ACB) of $3,000 for proceeds of $15,000.

Jonah had a capital gain of $12,000, calculated as

($15,000 – $3,000), and a taxable capital gain of $6,000, calculated as ($12,000 × 50%).

41. Canada Revenue Agency. *When do you have a capital gain or loss?* [online]. Revised January 18, 2022. [Consulted May 21, 2022]. https://www.canada.ca/en/revenue-agency/services/tax/individuals/topics/about-your-tax-return/tax-return/completing-a-tax-return/personal-income/line-127-capital-gains/you-have-a-gain-loss.html

A property need not be sold to trigger a capital gain or loss. A deemed sale occurs if:

- An individual exchanges one property for another;
- Property is given as a gift;
- Property is stolen or destroyed;
- An individual emigrates from Canada;
- Death occurs;
- There is a "deemed disposition" triggering taxation.

The disposition of personal property will not usually trigger a capital gain or loss.

Examples of personal property are:

- A boat or an automobile (other than an antique);
- Household furniture;
- Clothing.

The CRA assumes each item has an ACB of $1,000 and holds the view that most personal property depreciates over time.[42]

EXAMPLE

Andreas holds a garage sale to sell CDs, videos, clothing, toys, and a table and chair set. She need not report her income from the garage sale.

The exceptions to this rule are listed as personal property and include:

- Prints, etchings, drawings, paintings, sculptures or other works of art;
- Jewellery;
- Rare folios, manuscripts or books;
- Stamps;
- Coins.

Net gains (and losses) on these must be reported on tax returns, although losses on listed personal property may only be deducted against gains from listed personal property.[43]

42. Canada Revenue Agency. *Capital gains – 2021*. [online]. Revised January 18, 2022. [Consulted May 21, 2022]. https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/t4037/capital-gains.html
43. For definitions of capital gains, consult: https://www.canada.ca/en/revenue-agency/services/tax/individuals/topics/about-your-tax-return/tax-return/completing-a-tax-return/personal-income/line-127-capital-gains.html. Revised January 18, 2022. [Consulted May 21, 2022].

2.1.6 Rules pertaining to capital losses

A capital loss stems from the sale or disposition of a capital asset for less than the ACB. The loss is increased by the expenses, if any, of selling the property.[44]

EXAMPLE

Jerome bought $1,000 in shares in a technology company four years ago. He paid a $30 commission, so his ACB is $1,030.

Last week, he sold his shares and received $450 after commission. His capital loss is $580. Using the current inclusion rate of 50%, Jerome's allowable capital loss is $290.

2.1.6.1 Offsets, carry forwards and carry backs

Allowable capital losses must be applied against taxable capital gains for the current tax year to offset part or all of that gain. If a loss remains, it becomes part of the taxpayer's net capital loss, which is simply the difference between the allowable capital loss and taxable capital gains for that year.

A taxpayer can carry back the net capital loss to reduce or eliminate capital gains in any of the three preceding years or into any future year. If the net capital loss is carried back three years, currently no adjustment has to be made because the inclusion rate is 50% in each of those years.

Using net capital losses from past years against the current year's capital gains can get complicated. This is because the capital gains inclusion rate may have changed. The CRA, however, provides this information on a taxpayer's notice of assessment. The notice includes losses from prior years and the current year after adjustment. Adding these up provides the total net capital loss available for the tax year.[45]

At death, notwithstanding what is stated above, capital losses may be applied against all sources of income of the deceased.

44. Canada Revenue Agency. *When do you have a capital gain or loss?* [online]. Revised January 18, 2022. [Consulted May 21, 2022]. https://www.canada.ca/en/revenue-agency/services/tax/individuals/topics/about-your-tax-return/tax-return/completing-a-tax-return/personal-income/line-127-capital-gains/you-have-a-gain-loss.html
45. Canada Revenue Agency. *Line 25300 – Net capital losses of other years.* [online]. Revised January 18, 2022. [Consulted May 21, 2022]. 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-25300-net-capital-losses-other-years.html

2.1.6.2 Superficial losses

Active investors in the stock markets regularly review their trades for the year and current holdings in early December. The objective is to see whether they can reduce their tax liability by selling those securities that are trading well below cost value and using those losses to offset capital gains.[46]

In some cases, they may anticipate buying these securities back. However, if they buy them back immediately, the loss from the disposition will be deemed a superficial loss and they will not be able to use the loss to offset gains for that year.

The CRA defines a superficial loss as the taxpayer disposing of capital property for a loss if the taxpayer (or person affiliated with the taxpayer) buys, or has a right to buy, the same or identical property (called "substituted property") during the period starting 30 calendar days before the sale and ending 30 calendar days after the sale, and the taxpayer (or person affiliated with the taxpayer) still owns, or has a right to buy, the substituted property 30 calendar days after the sale.[47] Both conditions must be fulfilled. This rule also applies where the taxpayer sells the property (e.g., a security) in a cash account, even if the property is repurchased in the taxpayer's RRSP.

However, if the individual acquiring the substituted property is the taxpayer, the amount of the superficial loss can usually be added to the ACB of the substituted property. This will either decrease capital gains or increase the capital loss when the substituted property is sold.

2.1.7 Tax deferral

Because of the time-value of money, it is quite often efficient to defer taxation as much as possible. A good example of this is the use of RRSP. An appreciation in value (or a decline in value) is not recognized on an annual basis the same way as accrued interest. Such changes are known as "paper" or "unrealized" gains or losses. Instead, the reporting of the gain or loss is deferred until the year in which the asset is actually sold or "deemed" sold; this is known as a "realized" or actual gain or loss sold or otherwise disposed of.

EXAMPLE

Iqbal bought shares in a communications company 10 years ago at a cost of $3,000, including commission. This is his ACB. The shares increased in value, and Iqbal can now sell them for $10,000, net of commission on the sale. He will have a capital gain of $7,000. When taking the 50% inclusion rate into consideration, Iqbal's taxable capital gain is $3,500.

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46. Canada Revenue Agency. *What is a superficial loss?* [online]. Revised January 18, 2022. [Consulted May 21, 2022]. https://www.canada.ca/en/revenue-agency/services/tax/individuals/topics/about-your-tax-return/tax-return/completing-a-tax-return/personal-income/line-12700-capital-gains/capital-losses-deductions/what-a-superficial-loss.html
47. *Ibid*.

2.1.8 Tax-free capital gains

Some capital gains are tax-free, meaning no tax is payable, but in terms of magnitude, the potentially largest tax-free gain is on an individual's or family unit's principal residence.

2.1.8.1 Tax-free gains on principal residence

In Canada, any gains on a principal residence are tax-free. The rule, however, is that only one principal residence can be owned at a time per family unit, which includes the taxpayer, his spouse and his children 18 or over. A principal residence can be:

- A house;
- A condominium;
- A cottage;
- A houseboat;
- A trailer;
- A mobile home;
- An apartment unit in an apartment building or duplex.

2.1.9 Valuation Day rules, 1982 changes and 1994 capital gains elections and implications

Prior to December 31, 1971, capital gains were not taxed in Canada. This changed after 1971. An ACB for publicly traded shares was established using fair market value on December 22, 1971. For other assets, the ACB was the fair market value at December 31, 1971.[48]

An exception was that gains on a principal residence remained tax-free. At that time, each person could have a principal residence; a couple could therefore have both a house and a cottage as principal residences, provided they were not jointly owned.

This ended in 1982 when the rules changed. A couple who owned two residences then had to designate only one as the principal residence. Tax advisors told couples to determine the fair market values of the homes as of December 31, 1981, to have a base against which to measure future gains, if any.

The rules changed again in 1994 when the federal government eliminated a lifetime capital gains exemption (LCGE) of $100,000.

48. Canada Revenue Agency. IC73-13 *Investment clubs*. [online]. Revised January 18, 2006. [Consulted May 21, 2022]. https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/ic73-13.html

Many individuals with second residences applied any unused exemption to their second residences to raise the ACB.

From an insurance perspective, many families that have second residences, such as a cottage, and who want to pass it on to their children or grandchildren use life insurance to provide the funds to pay the tax on the taxable capital gains at death.

2.1.10 Small business exemption and farm exemption

There is an LCGE applicable to qualified small business corporation shares, working farms and qualified fishing property. The purpose of the exemption is to make it easier for people to pass their businesses, farm or fishing properties on to the next generation.

As indicated on the CRA website:

> For qualified farm or fishing properties (QFFP) disposed of after April 20, 2015, Budget 2015 introduces an additional deduction, effectively increasing the lifetime capital gains exemption (LCGE) to $1 million for QFFP.[49]

Indexed to inflation since 2014, the LCGE for small businesses (non-farm or fishing) is $913,630 (in 2022), which means a capital gains deduction of up to $456,816.

2.1.11 Taxation of rental income

Many people earn income by investing in property and renting space that provides services, including heat, light, parking and laundry facilities.[50] They can deduct related expenses, such as:

- Legal, accounting and other professional fees;
- Maintenance and repairs;
- Office expenses;
- Insurance costs and property taxes.

If the rented space is within the taxpayer's home, certain expenses, such as property taxes, would be limited to a reasonable percentage based on the number of rooms or square footage rented out as a percentage of the overall residence.

49. Canada Revenue Agency. *Lifetime capital gains exemption for qualified farm or fishing property.* [online]. Revised July 15, 2015. [Consulted May 21, 2022]. https://www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/federal-government-budgets/budget-2015-strong-leadership/lifetime-capital-gains-exemption-qualified-farm-fishing-property.html
50. Canada Revenue Agency. *T4036 Rental income*. [online]. Revised March 8, 2022. [Consulted May 23, 2022]. https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/t4036.html

Net rental income is viewed the same way as income from employment and, consequently, represents earned income for the purposes of RRSP contributions.

2.1.12 Exceptions (an adventure or concern in the nature of trade)

The CRA's position is that if an individual does something that produces a profit on a regular basis, it is not a capital gain but income. The phrase the CRA uses is "carrying on a trade or business notwithstanding that these activities may be quite separate and apart from his ordinary occupation. An example is that of a dentist who habitually buys and sells real estate."[51] In some circumstances, this rule can also apply to buying and selling securities.

EXAMPLE

Karen quit her job to become a day trader.[52] Last year, she had more than 500 trades. She had profits on some and losses on others. Overall, she had a net profit of $125,000 after transaction costs. Because this is her full-time occupation, the CRA is likely to take the view that Karen is in "an adventure or concern in the nature of trade" and the $125,000 is business income (against which she can deduct office and similar expenses) and not capital gains.

2.2 Corporate structure and taxation

Many small businesses use a corporate structure. In other words, the business owner incorporates the business, and it becomes a separate entity legally and for tax purposes. The corporate structure offers a number of advantages for the business owner, such as:

- Limited liability (although directors can be liable for the actions of the corporation);
- A share structure that provides opportunities for income splitting;
- The option to hold surplus income within the corporate structure for investment purposes;
- Lower taxes resulting in substantial savings relative to the tax rates individuals pay.

51. Canada Revenue Agency. *Adventure or concern in the nature of trade*. [online]. Archived. [Consulted May 23, 2022]. https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/it459-archived-adventure-concern-nature-trade/archived-adventure-concern-nature-trade.html
52. Day trading is defined as a brokerage activity that allows investors to ''carry out transactions on a sale or purchase (without having to advise or give a recommendation)'' in order to quickly generate profits within their portfolio due to daily fluctuating prices of securities.

Disadvantages include:

- Greater regulation;
- Record keeping;
- Higher legal costs;
- Accounting costs.

2.2.1 Flat tax rate

Unlike individuals, who have marginal tax rates, corporations have flat tax rates. The federal tax rate for Canadian-controlled private corporations as a small business is 9.0% (2022). Provincial tax rates for companies eligible for the federal small business deduction range from nil to 4.5%. Québec's rate for small business is 3.2%.[53]

2.2.2 Using a corporation to meet income splitting demands

Corporations can pay dividends from after-tax profits to shareholders. A company can also tailor its share structure to meet specific needs to provide income splitting among shareholders.

For example, a spouse with limited or no other income, but access to capital, could buy shares in a company run by the other spouse. Because the spouse with the limited income pays the lower marginal tax rate, he would pay minimal tax on dividends received on the shares. Of course, if the "grossed-up" dividend put that spouse in a higher tax bracket, the benefit would be reduced. However, the private corporations tax reform announced in 2018, commonly called the Morneau reform, significantly reduced the benefit of such strategies.

2.2.3 Holding companies

An agent may meet clients who have investments in holding companies. Holding companies are often used in conjunction with operating companies, with the holding company holding the shares of the operating company. As with other corporations, there is the cost of preparing and filing financial statements and corporate tax returns, which can be significant relative to the income earned. At one time, holding companies were very popular as a means of holding investments because of tax deferrals and a lower tax rate than individuals would normally pay. However, changes in tax rates over the years have in effect reduced this benefit.

53. Canada Revenue Agency. *Corporation tax rates*. [online]. Revised May 12, 2022. [Consulted May 23, 2022]. https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/corporations/corporation-tax-rates.html

2.3 Taxation of trusts

Mutual funds and segregated funds are trusts with which most insurance agents quickly become familiar. Such trusts avoid paying taxes. They do this by flowing any net interest income, eligible dividends and foreign dividends through to investors. In the case of mutual fund trusts, the fund flows through net capital gains and, in the case of segregated funds, through capital gains and capital losses. The funds issue the relevant tax slips to the share or unit holders.

2.4 Arm's length and non-arm's length transactions

Arm's length transactions take place between non-related parties, while non-arm's length transactions are between related parties.

The *Income Tax Act* stipulates that "related persons shall be deemed not to deal with each other at arm's length," regardless of how they actually conduct business with each other.[54] It lists family relationships, such as by marriage or blood.

The Act also states that a corporation will be related to another person, including a corporation, where that person controls the corporation. It shows various other corporate relationships where business dealings would be considered non-arm's length.

A corporation will be related to a person if:

- That person controls the corporation;
- That person is a member of a related group that controls the corporation;
- That person is a person who is related to a person described above.

From a tax perspective, these definitions are important, and special tax rules apply to transactions between related persons, such as between husband and wife or a corporation and its president.

The corporation can grant an interest-free loan to the president. However, the CRA would consider the zero interest as a taxable benefit. If the corporation were to charge the president what the CRA deems the prescribed interest rate for shareholder loans, or include the interest as a taxable benefit, no taxable benefit would arise.

EXAMPLE

Georgina is the president of a small business corporation with surplus cash it does not need for its current operations. She therefore borrows funds from the company, which charges her the prescribed interest rate in force.

54. Income Tax Act, RSC 1985, c 1 (5th Supp).

At time of writing, the “interest rate used to calculate taxable benefits for employees and shareholders from interest-free and low-interest loans will be 1%.”[55] The rate may change quarterly.

2.5 Spousal and common-law relations

Married couples and common-law couples have property rights; these may vary from province to province. For example, a province may consider that a husband and wife have equal interests in the family residence even though it was paid for by one spouse. That same province may hold that, in a common-law situation, the owner of the house has property rights.

2.5.1 Rights on relationship breakdown

Generally, the value of property that a couple accumulates during marriage or their relationship will be divided equally between them, subject to any prenuptial or postnuptial agreement.[56] However, property acquired by each prior to the relationship generally remains with that person, as do any inheritances and insurance benefits.

Outside experts are often brought in to help make the division of assets as tax-effective as possible.

2.5.2 Tax implications on relationship breakdown

This can be a complicated area if it involves support payments to the spouse and child support. When asked by clients, insurance agents should always direct clients to speak with tax and legal specialists to address these matters. Generally, support payments to a spouse are deductible, but payments made for child support are not. Depending on the equalization payment required, certain RRSP, RRIF or pension plan assets can be directly transferred from one party to another using form T2220.

2.5.3 Tax implications on death

Generally, if one spouse dies, assets can be transferred to the survivor without tax implications. Such assets would include marketable securities, RRSPs and RRIFs. The surviving spouse would assume the deceased’s ACB for the securities. The surviving spouse would be able to transfer the deceased’s RRSP or RRIF as a tax-free refund of premiums to his own RRSP or RRIF or buy an eligible annuity. Proceeds of a life insurance policy that had the surviving spouse as beneficiary would be paid tax-free (as would proceeds to any beneficiary).

55. Canada Revenue Agency. *Prescribed interest rates.* [online]. Revised March 15, 2022. [Consulted May 23, 2022]. https://www.canada.ca/en/revenue-agency/services/tax/prescribed-interest-rates.html
56. In Québec, common-law partners do not automatically divide the estate.

2.6 Income attribution rules

The CRA has put some attribution rules in place that are designed to prevent income splitting between spouses and other family members.[57] Income splitting is a means of reducing overall taxes paid by a family unit by moving income from a higher marginal tax rate member to one who has a lower marginal tax rate.

2.6.1 Between spouses

The attribution rules cover zero interest loans, transfers of property and gifts that could be used for investment purposes.

EXAMPLE

Ethel (whose federal marginal tax rate is 29%) lends $100,000 to her spouse Fred (whose federal marginal tax rate is 15%) to invest in the stock market. The loan is not documented, and no interest is charged. Under attribution rules, any income earned must be taxed as Ethel's since she has the higher federal marginal tax rate. The attribution rules would not apply, however, if Ethel were to lend funds to Fred to start up a business. In that case, any gains or losses would be Fred's.

However, if one spouse charges the other market interest rates or the prescribed interest rate, the attribution rules do not apply. The interest must be collected no later than January 30 of the following year and reported as income on the lender's tax return.

EXAMPLE

George lends his wife Loretta $100,000 for investment purposes. He charges her 1% interest, the CRA prescribed rate at the time. He collects that interest and reports it on his tax return. Loretta must declare any interest, dividends or capital gains received from the investments on her tax return.

57. Canada Revenue Agency. *Interspousal and certain other transfers and loans of property.* [online]. Archived. [Consulted May 23, 2022]. https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/it511r/archived-interspousal-certain-other-transfers-loans-property.html

2.6.2 Between parents and minor children or grandchildren

It is quite common for parents or grandparents to give children or grandchildren monetary gifts (CRA rules also apply to nieces and nephews). If these funds are invested, the attribution rules apply, but somewhat differently than between spouses.[58] Any interest or dividends earned on the investments by the children are attributed back to the parents or grandparents. However, any capital gains or losses are not attributed back, but taxed in the hands of the child.

EXAMPLE

Irving buys $10,000 worth of bank shares and gifts them to his minor granddaughter Ellen. The shares pay about $400 in dividends each year. Irving is responsible for reporting the dividend as his income. Any capital gains triggered when the shares are sold are Ellen's and therefore reported on her tax return.

2.6.3 Between parents and adult children or grandchildren

There are no restrictions on giving gifts to adult children or grandchildren. Once they receive the gift, it is theirs to do with as they please. However, attribution rules may apply to income splitting between parents and adult children and grandchildren if zero-interest loans are involved, for example. Again, by charging the prescribed rate of interest and collecting it, any income earned is taxed in the hands of the child or grandchild.

2.6.4 Tax treatment of income stemming from below-market loans to spouses

The exemption to the attribution rules is dependent on the loan to the spouse having interest charged at the market rate or the prescribed rate. While the prescribed rate is only 1% at time of writing (second quarter 2022), it is tied to Treasury bill rates and has been substantially higher in the past.

58. Canada Revenue Agency. *Transfers and loans of property made after May 22, 1985 to a related minor.* [online]. Archived. [Consulted May 23, 2022]. https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/it510/archived-transfers-loans-property-made-after-may-22-1985-a-related-minor.html

CHAPTER 3

TAXATION AND INSURANCE

The taxation aspects of life insurance are often described as complex. The purpose of this Chapter is to address the general principles of life insurance and how they relate to taxation across Canada. Unless stated otherwise, the principles and concepts covered in this Chapter apply to all types of life and disability insurance products (including annuities and segregated funds).

The following topics will be discussed:

- Death benefits;
- Named beneficiary;
- Premiums;
- Adjusted cost base;
- Life insurance policy dispositions;
- Exempt and non-exempt policies;
- Policy loans;
- Corporate ownership of life and disability insurance;
- Policy dividends;
- Specifics of annuities and segregated funds.

3
TAXATION AND INSURANCE

3.1 Death benefits

When the insured dies, the benefit is paid to the beneficiary or beneficiaries on a tax-free basis.

EXAMPLE

Richard bought a $300,000 life insurance policy and named his wife, Suzanne, as the beneficiary. Richard has only had this policy for a few years. Even if he dies tomorrow and has only paid a fraction of the policy's premiums, Suzanne will still receive $300,000 tax free.

However, if there is a delay in payment, any interest that accrues is taxable in the hands of the beneficiary or beneficiaries.

EXAMPLE (CONT.)

Richard purchased a $300,000 life insurance policy on his life. His wife, Suzanne, was designated as the beneficiary. When Richard died overseas, there was a delay in obtaining the documentation required by the insurer. After it was obtained, the insurer paid the death benefit, plus $945 in interest. Suzanne was required to report the $945 as interest income.

Death benefits end the life insurance contract, but they can be used to purchase a new contract called an "annuity," in which case the interest portion of payments will be taxable on an annual basis. However, if there is a delay in the payment of the death benefit, any interest that accrues is taxable in the hands of the beneficiary or beneficiaries just like in the previous example.

EXAMPLE

As the beneficiary of her husband's life insurance policy, Martha chose to take the death benefit as a life annuity rather than as a lump sum. She will be taxed on the interest portion of the annuity payments.

3.2 Named beneficiary

Individuals buying life insurance can name family members, a designated person or their estate as beneficiaries. If the beneficiary is the estate, then the proceeds of the policy will be considered estate assets, subject to probate and available to the estate's creditors. Probate is the process of proving that a document offered as the last will and testament of a deceased person is genuine. When successfully completed, an estate's executor receives approval to obtain and distribute assets. Generally, financial institutions will not release financial assets without a probated will.[59] Probate fees vary from province to province and can be substantial.[60]

Insurance policies are excluded from probate if there is a named beneficiary (a family member or designated person) and are generally protected from creditors.

EXAMPLE

Michael had substantial debts when he died and few assets. The named beneficiary on his life insurance policy was his wife, Renata. The insurer paid her the benefit. Michael's creditors, which included the Canada Revenue Agency, therefore had no claim on the amount paid. If Michael had named his estate as beneficiary, the insured amount would have been available to his creditors and subject to probate.

3.3 Premiums

The tax treatment of premiums depends on the type of life insurance policy. Some premiums must be paid from after-tax income, while others can be deducted from income for tax purposes. In this section, the taxation of premiums is discussed for the policies listed below:

- Individual life insurance policies;
- Group life insurance;
- Group health insurance;
- Individual health insurance;
- Individual disability insurance;
- Group disability insurance.

59. Unless this applies to a notarized will.
60. Please refer to Appendix A for official provincial probate rules. These rules do not apply in Québec.

3.3.1 Individual life insurance

The premiums paid to cover the cost of individual life insurance and any deposits made to a policy are generally not deductible from income for tax purposes.

EXAMPLE

Jenn bought a 10-year life insurance policy and pays her premiums monthly. She cannot deduct these premiums from income for tax purposes.

An exception that an agent might come across is when insurance is required to secure a business loan. In this case, the insurance acts as collateral or "collateral life insurance." The loan must be with a chartered bank, trust company or credit union and be documented. The deduction of premiums is available in such case, even if additional collateral is provided. Only the portion of the lesser amount of the actual premium that is attributable to the loan or what is called the "net cost of pure insurance" (NCPI) attributable to the loan can be deducted. The NCPI is a measure of the cost of the insurance for tax purposes and will be provided to the agent by the insurance company.

EXAMPLE

Saul personally guarantees his business line of credit at the bank where he does business. His bank requires that he have life insurance equal to the line of credit, with the benefit assigned to the bank. The term policy issued to Saul has $1,000,000 coverage. The loan amount Saul's business owed the bank last year was about $400,000. Given that the loan is for business purposes and from a financial institution, he can deduct 40% ($400,000 ÷ $1,000,000) of the lesser amount of the premium and net cost of pure insurance (NCPI) as a business expense.

3.3.2 Group life insurance

Many employers offer group life insurance equal to some multiple of an employee's salary. If group members pay premiums directly or through the employer and the employer reports the premiums paid as a taxable benefit, the death benefit will be paid on a tax-free basis.

EXAMPLE

Lana's employer pays the premiums on the company's group life insurance policy and reports the amount of the premium attributed to Lana as a taxable benefit on her T4 slip. Since Lana pays the premiums from after-tax income so the death benefit would be received tax-free.

3.3.3 Group health insurance

If an employer provides group health coverage, such as a supplementary medical and dental plan, the premiums paid are deductible from the employer's income for tax purposes.

Furthermore, and unlike for a group life insurance policy, the premiums paid by the employer for a group health insurance plan are not a taxable benefit to the employees. The exception is Québec, where premiums paid by the employer are considered a taxable benefit to be reported on the employee's provincial tax return but not on the federal tax return.[61] This is why the employment income reported on a T4 often differs from the one reported on the Relevé 1 for a Québec resident.

In all provinces, any portion of medical expenses that are prescribed (or eligible) under tax law and not covered by the policy can be claimed as medical expenses on that employee's tax return. The logic behind this is governments' objective to encourage employers to offer their employees a group health insurance plan. In Québec, the taxable value of the premiums paid by the employer are added to the specified medical expenses and to the portion of premiums paid by employees for health insurance medical care.

3.3.4 Individual health insurance

Premiums paid to private health plans can be claimed by individuals as eligible medical expenses.

EXAMPLE

Karen's employer does not offer group health insurance coverage. Consequently, she arranged her own coverage online. She can claim the premiums she pays as eligible medical expenses.

3.3.5 Individual disability insurance

As with individual life insurance, the premiums paid on individual disability insurance are not tax-deductible. Any benefits paid are tax-free and are not reported on income tax returns.

EXAMPLE

Jonathan is self-employed. He takes out an individual disability insurance policy. He cannot deduct the premiums from income for tax purposes, but any benefits he receives will be tax-free.

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61. Sun Life Assurance Company of Canada. *Are insurance premiums deductible?* [online]. Revised August 2014. [Consulted May 23, 2022]. https://www.sunnet.sunlife.com/files/advisor/english/PDF/Are_Insurance_Premiums_Deductible.pdf

3.3.6 Group disability insurance

Most group insurance contracts offer protection in the event of disability. This can include long-term or short-term disability coverage. Some policies even offer both.

It is important to know that when the employer pays the premium for the disability insurance, those premiums are deductible for tax purposes by the employer. There is no taxable benefit for the employee at the time the premiums are paid, and the disability benefit that he may receive is taxable to the employee. However, where the disability insurance premiums are paid from the employee's after-tax income, the benefit, in the event of disability, will not be taxable and will not need to be reported on the tax return.

The vast majority of premiums from long-term disability insurance contracts are paid from employees' after-tax income. This is so employees can receive tax-free benefits in the event of disability.

It is common for the employer to pay the premiums for short-term disability insurance. This makes the disability benefit taxable in the same way as the salary.

If the employer contributes, even in part to the short or long-term group disability premium, the benefit is taxable for the employee.

3.4 Life insurance policy dispositions

If a life insurance policyholder takes a policy loan, makes a partial withdrawal, surrenders a life insurance policy or transfers it to another party, the CRA generally considers it a disposition for tax purposes and the policy gain, if any, will be taxable. There are exceptions, however, such as transferring a policy between spouses.[62]

The calculation to determine the taxable policy gain is the following:

Taxable policy gain =
proceeds of disposition or cash surrender value (CSV) – adjusted cost base (ACB)

EXAMPLE

Sandra decides to surrender her policy. The policy has a cash surrender value of $13,500 and an adjusted cost base of $8,000. Sandra will therefore report taxable income of $5,500 = ($13,500 – $8,000).

62. Sun Life Assurance Company of Canada. *Tax implications of a life insurance policy transfer*. [online]. [Consulted May 23, 2022]. https://www.sunnet.sunlife.com/files/advisor/english/PDF/TaxImpWhenTransOwnershipofLifeInsPolicy.pdf

3.4.1 Adjusted cost base

The adjusted cost base (ACB) is the cost of a life insurance policy for tax purposes. The ACB amount of an insurance policy can vary from year to year. Insurance companies will usually provide the policyholder with the amount if the policy is surrendered, used as collateral for a loan or had an amount withdrawn. It is important for agents to understand how the ACB is calculated and what factors can affect the ACB over the life of a policy.

For policies last acquired after December 1, 1982, the ACB is calculated using the amount of the premium for investment purposes. For grandfathered policies issued prior to December 2, 1982, the entire premium is considered to be the ACB. Essentially, the ACB for policies last acquired after December 1, 1982 (whether for insurance or investment purposes), is based on the principle that every penny out of the policyholder's pocket is for "investment purposes." To identify this, the CRA separates the investment portion of the premium (premiums paid) from the cost of protection (insurance). It should be noted that the calculation of the NCPI was modified in 2017 and that this new calculation tends to decrease the NCPI. A simplified formula for ACB is as follows (as of December 1, 1982):

Adjusted cost base (ACB) = premiums paid – net cost of pure insurance (NCPI)

3.5 Exempt or non-exempt life insurance policies

Permanent life insurance policies can be described as exempt or non-exempt.

3.5.1 Exempt

If a life insurance policy is exempt (exempt from paying tax), earnings on the cash value in the policy can grow untaxed (although the policy is subject to an investment income tax levied on the insurer).[63]

Permanent life insurance policies acquired prior to December 2, 1982, are always exempt, regardless of whether or not they were designed to shelter investment income beyond what was required to fund death benefits. Any grandfathering would be lost, however, if that policy were sold.

Policies acquired after December 1, 1982, are exempt if they are purchased for the sole purpose of providing insurance and not as a means of investment.

63. Sun life Assurance Company of Canada. *Overview of Canadian taxation of life insurance policies.* [online]. Revised January 2005. [Consulted May 23, 2022]. https://www.sunnet.sunlife.com/files/advisor/english/PDF/Overview_of_canadian_taxation.pdf

3.5.2 Non-exempt

A non-exempt policy is last acquired after December 1, 1982, but fails to meet the exemption requirements stipulated by the *Income Tax Act.* In the case of a non-exempt policy, earnings will be taxable annually as income in the hands of the policyholder.

To ascertain the exempt or non-exempt status of a policy, an exemption test must be carried out by the insurance company on the policy's anniversary.[64] As stated above, a policy is considered exempt if the death benefit is the main reason for having insurance. Non-exempt policies provide a lifetime investment option, such as annuity contracts. Agents will be able to give clients information about the tax status of their policy from the insurance company.

The tax rules pertaining to exempt and non-exempt policies are in flux; some changes in effect after 2015 will have an impact on many insurance policies, in particular universal life insurance policies.

3.5.3 Universal life insurance policies

An agent may encounter situations involving universal life policies where cash accumulation limits permitted under tax law are exceeded because of investment growth. In this event, the insurance company transfers the funds to what is known as a "side account" in order for the policy to remain exempt. Income earned on this side account is taxable.

3.6 Policy loans

A policyholder can borrow from a life insurance policy. The policy must, however, have cash values and allow for policy loans. The policyholder can borrow up to the cash surrender value (CSV).

Amounts up to the value of the ACB can be borrowed on a tax-free basis. Any amount above the ACB will be taxable. However, when the loan is repaid, the policyholder can deduct up to the amount previously reported from his taxable income.[65] In other words, as a result of this transaction, the ACB is further increased by the policy gain figure to avoid double taxation in the future should there be a policy surrender.

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64. Manulife Financial. *The exempt test*. [online]. Revised December 2016. [Consulted May 23, 2022]. https://advisor.manulife.ca/advisors/insurance/tax-retirement-and-estate-planning/technical-planning-support/the-exempt-test.html
65. *Ibid*.

EXAMPLE

Mario needs money for a home renovation. His insurance agent tells him he can borrow up to $9,000 from his life insurance policy (the CSV), but he will have to declare $4,000 as income because his ACB is $5,000. Mario borrows the money and, when he repays it the following year, he deducts the $4,000 from his taxable income.

3.7 Corporate ownership of life and disability insurance

Corporations may buy insurance on the lives of key executives. Generally, the corporation does not deduct the premiums from income. Consequently, benefits that corporations receive, as beneficiaries of these policies, are tax-free.

There are more situations that can arise within the corporate ownership of life and disability insurance, and these are addressed in the following order:

- Tax implications of a person buying back a corporate policy;
- Tax strategy based on the differential between corporate and personal tax rates;
- Capital Dividend Account (CDA);
- Tax treatments of benefits when the insured is an employee, a shareholder or both.

3.7.1 Tax implications of a person buying back a corporate policy

There are situations where a corporation will have a policy on the life of a key employee who leaves or reaches retirement age. The company can continue to pay the premiums until the policy expires or, more commonly, gift or sell the policy to the employee. In such cases the policy gain will be taxable to the corporation.[66]

If, however, the policy is a term insurance policy and consequently has no cash surrender value (CSV), there would be no policy gain on the transfer of the policy.

There can, however, be a taxable benefit to the employee or former employee, depending on the circumstances. Consequently, in such cases, professional advice should be sought.

66. Manulife Financial. *Corporate-owned life insurance – Tax attributes*. [online]. Revised March 2013. [Consulted May 23, 2022]. https://www.manulife.ca/advisors/insurance/tax-retirement-and-estate-planning/news-and-views/2013/corporate-owned-life-insurance-tax-attributes.html

EXAMPLE

When Yvette was hired by her employer five years ago, the company purchased a 10-year term policy on her life. The company merged with another, and Yvette's position was now redundant. As part of her severance package, the company assigned her the term policy. There is no policy gain for the company on the transfer of this term policy to Yvette.

3.7.2 Tax strategy based on the differential between corporate and personal tax rates

The advantage in having a closely held corporation buy life insurance on the key shareholder rather than have the shareholder buy the policy himself is the corporation's lower tax rate. The corporation is the beneficiary. If the insured dies, the corporation receives the benefit.

EXAMPLE

Bert has a combined federal and provincial marginal tax rate of 49.5%. The corporation he and his wife own has a combined federal and provincial marginal tax rate of 15.5%. Bert is not an employee of the firm. The premiums paid on a life insurance policy on Bert would not be deductible, either by the corporation or by Bert. Consequently, there are savings by having the corporation with its lower tax rate pay the premium. When Bert dies, the proceeds of the policy will flow through the company's Capital Dividend Account (CDA) to the shareholders on a tax-free basis. For example, to pay a $10,000 annual premium, the company would only have to access $11,834 of corporate profits, while Bert would have to be paid $19,802 out of company profits to have the necessary $10,000 after-tax to pay the premium.

3.7.3 Capital Dividend Account (CDA)

As mentioned in the previous chapter, the capital dividend account (CDA) is a tax account. It is used by a private corporation to keep track of tax-free amounts it receives. These include some or all of the death benefits, less the policy's adjusted cost base (ACB), depending on the type of life insurance policy that has the corporation as the beneficiary. The corporation can distribute (flow through) the proceeds of the CDA to shareholders as tax-free capital dividends.

3.7.4 Tax treatments of the benefit when the insured is an employee, a shareholder, or both

It is common for corporations to pay the premiums on life and disability insurance policies for shareholders and employees, and for shareholders who are also employees. The shareholder or employee can be the policyholder, the beneficiary or both.

If the premiums are paid on behalf of an employee, they can be deductible by the employer and constitute a taxable benefit for the employee.

If, however, premiums are paid on behalf of a shareholder, they are not deductible because shareholder, benefits paid by a corporation are not deductible and would be taxable to the shareholder under shareholder benefit rules.

However, the premiums are sometimes paid on behalf of an employee who is also a shareholder, and it must be determined which tax rules apply: those for employees or those for shareholders.

If the shareholder is a person who, at some point during the year, holds at least 10% of the shares issued from the share capital of the corporation or any other corporation related to it, or if the person has a family member who is a shareholder, such as a sister, brother or spouse, among others, then the rule for premiums paid on behalf of a shareholder applies. In that case, the premiums are not deductible by the corporation because shareholder benefits paid by a corporation are not tax-deductible.

EXAMPLE

Louise is employed as a financial controller for a corporation. She also owns 15% of the company's shares. Because of her ownership position, any premiums paid on her behalf are not deductible and are added to her income as a taxable benefit. Consequently, she pays the premiums on her life insurance policy directly.

3.8 Policy dividends

Participating life insurance policies may pay a policy dividend to policyholders. While they are called "dividends," they are not like corporate dividends. They are tax-free if paid out as a death benefit and non-taxable if used to offset premiums. However, if they are removed prior to death and paid out, they are considered proceeds of disposition and taxable if there was a positive policy gain. Moreover, in any year where the payout of a dividend exceeds the adjusted cost base (ACB) of the policy, the excess would be treated as a disposition of the policy gain and taxable in the hands of the policyholder.

3.9 Annuities and segregated funds

Insurance companies offer a variety of annuities, including individual variable insurance contracts (IVICs), or annuity contracts, which hold segregated funds. These are introduced below under the following Sections and the taxation of each explained:

- Non-registered annuities contracts;
- Non-registered individual variable insurance contracts (IVICs);
- Registered annuities contracts.

3.9.1 Non-registered annuities contracts

Income from non-registered annuity contracts is taxable, but how each is taxed depends on the structure, and in the case of segregated funds, the type of income flowed through. These are discussed below.

Premiums paid to buy non-registered annuities contracts are not tax-deductible. Conversely, the portion of annuity payments received, which is deemed a return of capital, is not taxable. The interest portion is taxable.

3.9.1.1 Accumulation annuities or guaranteed interest annuities

Accumulation annuities or guaranteed interest annuities are also products offered by insurance companies. They are savings instruments that are similar to guaranteed investment certificates (GICs) and term deposits offered by banks. Similar to other insurance products, they offer creditor protection, and, with named beneficiaries, they avoid probate.

Interest earned on these annuities is taxable in the year received or accrued.

3.9.1.2 Prescribed annuities

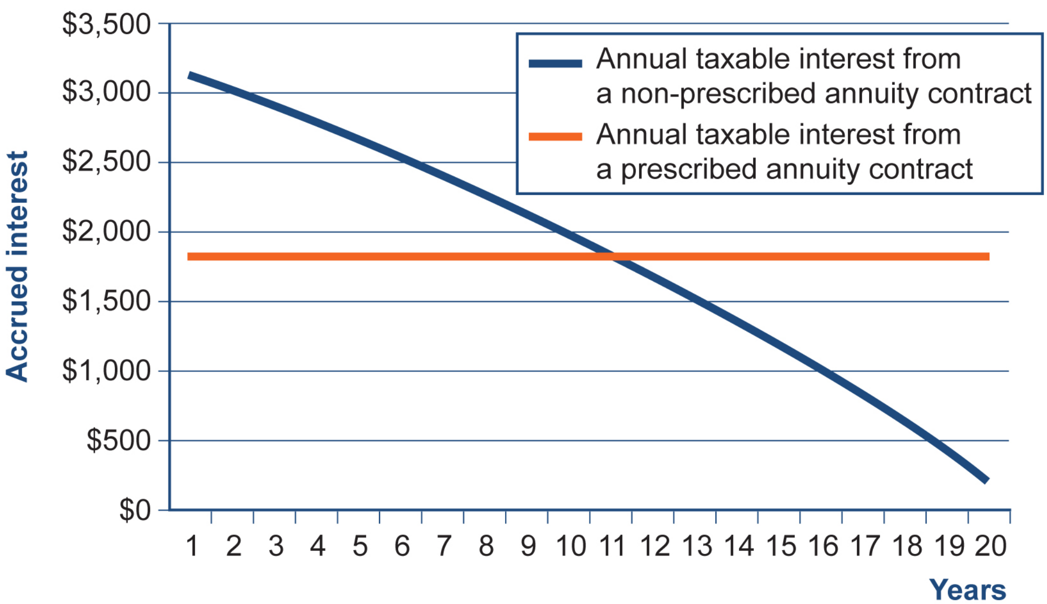
Prescribed annuities have a tax advantage in that the interest and the original capital are spread equally over all payments. The alternative would be a non-prescribed annuity, whose payments would be similar to a mortgage amortization, with a larger portion of the payment as interest in the early years of the term to maturity and a much smaller portion as interest near the end of the term. For two otherwise identical annuities, one qualifying as prescribed and the other one not, the total amounts of interest reported over the life of the annuity would be identical. What differs is that the holder of the prescribed annuity would report less taxable income in the early years and consequently pay less tax.

EXAMPLE

Lola has an inheritance of $100,000 and wants annual annuity payments for 20 years. Annuity interest rates for that term are currently 3.15%. Her agent tells her that the annual payment on a 20-year prescribed annuity with a $100,000 deposit will be about $6,800, of which $1,800 is taxable. The interest that would accrue for the first year on a non-prescribed annuity would be $3,150 (3.15% × $100,000). It would drop to approximately $1,800 by the eleventh year.

Lola chooses the prescribed annuity and understands that the taxable portion each year will be a level $1,800, as shown in the following graph. Had she chosen the alternative non-prescribed annuity, the taxable portion in the first year would be $3,150, declining each year after that. Lola decides that it is to her advantage to pay less tax now.

Annual taxable interest from a prescribed annuity contract and a non-prescribed annuity contract



3.9.1.3 Structured settlement annuities

A structured settlement annuity is an annuity generally purchased by a casualty insurer as settlement of a personal injury lawsuit. A lump sum is paid to a life insurance company, which then issues a single premium annuity to the injured party and makes the payments.

Since they are treated as personal injury damages, structured settlement payments are tax-free.

EXAMPLE

Rudolph became a paraplegic after a vehicle ran a red light and hit him. The driver's insurer and Rudolph's lawyer have agreed on a settlement. The casualty insurer will purchase the annuity, which will be paid to Rudolph tax-free.

3.9.2 Non-registered individual variable insurance contracts (IVIC) holding segregated funds

Switches from one segregated fund to another, even under the same insurance contract, are dispositions for tax purposes and consequently trigger capital gains or losses.

Segregated funds do not distribute income to the contract holders. Rather, the income is reinvested and the value of the holding adjusted to reflect this reinvestment.

However, holders of non-registered IVICs will pay tax on interest and dividend income and the taxable portion of capital gains, even though they are not received. Income is deemed to flow from the funds to contract holders, in whose hands the income will be taxed. It will be reported by the insurer on a T3 slip.

3.9.2.1 Dividend, interest, and capital gains distributions

Segregated funds allocate, or prorate, dividend, interest and capital gain income based on the terms and conditions of the contract, as outlined in the information folder for the fund in question. Some allocations are based on the length of time an investor holds his units during a year.

EXAMPLE

Massimo bought 1,000 units of XYZ Segregated Equity Fund on June 1. The fund declared a dividend distribution of $1 a unit at year-end. Massimo's T3 will show an allocation of $583.33, reflecting that he owned the units for seven of the 12 months:

$$\$583.33 = (7 \div 12) \times \$1 \times 1{,}000 \text{ units}$$

In contrast, mutual funds do not prorate income by time held.

EXAMPLE (CONT.)

Had Massimo bought a comparable mutual fund, his T3 from the fund would show a $1,000 distribution, whether he bought it on January 1, June 1 or the day before the distribution was declared.

3.9.2.2 Treatment of capital losses

Unlike mutual funds, which use capital losses to offset capital gains within the fund and carry unused losses forward, any capital losses in a segregated fund are reported on the contract holder's T3. Any capital losses that the contract holder cannot use in the current year in relation to capital gains from other transactions can be applied to losses in the previous three years or carried forward.

3.9.2.3 Tax treatment of death benefit or maturity guarantee

Insurers provide maturity and death benefit guarantees on segregated funds. The insurer, depending on the specific contract, guarantees that, at maturity (generally 10 years or at death), the contract holder is guaranteed a minimum of 75% or 100% of the amount invested in the contract.

The taxation rules applicable to these guarantees are ambiguous and uncertain. Each insurer's position on this will be included in its current segregated fund information folder, with some taking the view that the top-up is a taxable capital gain. However, if the contract holder disposes of the holding at the time of the top-up, there will be an offsetting capital loss.

3.9.3 Taxation of registered contracts

Interest, dividends and capital gains grow tax-deferred within registered contracts, such as registered retirement savings plans (RRSPs) and registered retirement income funds (RRIFs). When money is withdrawn from these, or taken as annuities, all funds are treated as income; no tax advantages are available for capital gains or dividends from Canadian corporations.

Registered education savings plans (RESP) are treated somewhat differently, as subscriber contributions, which were made with after-tax income, can be withdrawn without tax consequences. However, the income withdrawn is fully taxable regardless of whether it is dividend, interest or capital gains.

CHAPTER 4

TAX STRATEGIES USING LIFE INSURANCE

The purpose of this Chapter is to discuss strategies that use life insurance contracts to offset or potentially reduce taxes that are payable at death.

This Chapter also looks at taxable investment strategies that use life insurance products for specific tax advantages, as well as leveraging strategies for which the cost of borrowing is deductible from income for tax purposes.

It also looks at donation program tax shelters, which may not use life insurance but whose promoters may approach life insurance agents to be involved in their distribution.

The following topics will be discussed:

- Estate planning;
- Leveraging or using borrowed funds as investment funds;
- Using insurance products for long-term income;
- Charitable donations;
- Donation program tax shelters.

4
TAX STRATEGIES USING LIFE INSURANCE

4.1 Estate planning

When a person dies, he is deemed to have disposed of all assets for proceeds equal to their fair market value for tax purposes. In the case of people who are married or in common-law relationships, certain assets, such as registered retirement savings plans (RRSP), can be rolled over to the surviving spouse tax-free, deferring taxation until funds are withdrawn on the death of the second spouse.

4.1.1 Capital gains

It is usual for individuals and corporations to use life insurance to provide funds to pay taxes on the taxable portion of capital gains due at the time of death where the objective is to maintain ownership of an asset within a family or among surviving shareholders.

EXAMPLE 1

Ralph and Melinda own a cottage that will be left to their daughter Martha, as stated in their wills. They purchased the cottage several decades ago and estimate that the tax on the taxable capital gain on the property will be around $100,000. They purchased a second-to-die $100,000 permanent life insurance policy to provide this amount so the estate will have the funds to pay the tax.

EXAMPLE 2

Three brothers own equal shares in a successful landscaping company. They have an agreement in place whereby, if one of the brothers should die, the surviving brothers will purchase the shares from the deceased's estate. Their insurance agent arranges for each to buy insurance on the others' lives in amounts adequate to buy the shares.

4.1.2 Income tax payable on the death of a registered plan owner

A RRSP and a registered retirement income fund (RRIF) are often the largest financial assets an individual may have. Assuming the owner does not have a spouse, the value of the plan at the time of death must be taken into account as income and is taxable in that year. Depending on the size of the RRIF at the time of death, the amount could be taxable at the highest marginal tax rate in the deceased's province of residence.

Some individuals use life insurance so that their estates have sufficient funds to pay the tax, allowing the beneficiaries to receive the full value of their RRIF should they die in their early years.

EXAMPLE

Ethel, who is a widow, turned 71 last year and rolled her $500,000 RRSP into an RRIF at year-end. Ethel wants to leave an estate for her children. Her major asset is her RRIF. She recognizes that when she dies, the market value of her RRIF will be income for tax purposes and a major portion of its value will be payable as income tax. She also realizes that if she lives a long time there will be very little value left in her RRIF to provide an estate. If the value of her RRIF was $500,000 at the time of death, all of it would be considered as income and, depending on her other income at the time of death, most if not all would be taxable income. Depending on the province in which she resides at the time of death, the tax owing could be as much as $249,000.

Her insurance agent determines that she can obtain $250,000 of term-100 insurance at an annual premium of $9,540; this will provide the funds required to pay the substantial taxes that will be owed after her death if she dies in the next few years, and if there is little residual value in her RRIF when she dies, the insurance proceeds will provide funds for her children. Ethel therefore decides to apply for $250,000 to cover the potential tax bill, and funeral and other final expenses. Ethel decides that a life insurance policy will meet her specific need to ensure an estate for her beneficiaries.

4.1.3 Estate taxes and probate fees

Canada does not impose estate taxes on the death of a taxpayer. While certain assets are deemed to be sold on a taxpayer's death and taxable as income or taxable capital gains, these are not estate taxes. However, a deceased's estate may face estate taxes on property the deceased owned in the U.S. Agents with little expertise in this area would be wise to work with the client's legal and taxation experts to determine what tax exposure, if any, the client has to U.S. estate taxes in order to make an appropriate insurance recommendation.

As noted in Chapter 3, probate fees do not apply to life insurance death benefits where the policies have named beneficiaries. Probate fees also do not apply to insurance company investment products, such as annuities, including segregated funds where there are named beneficiaries. In contrast, mutual funds and savings instruments issued by banks would be subject to probate at death (outside of Québec).

4.2 Leveraging to make an investment

Borrowing money to make an investment is a common strategy. The concept is to enhance the investor's equity by borrowing to invest and increase the investor's profit over what it would normally be without the additional borrowed funds.

Agents and investors considering leverage should, however, recognize that if the value of the investment goes down, the investor is still responsible for repayment of the loan, as well of as the interest. Agents should also be familiar with any guidelines pertaining to leverage provided by the insurers whose products they sell. Similarly, agents who are registered to sell mutual funds should be aware of industry guidelines and their mutual fund dealer's internal rules pertaining to leverage. These may include restrictions on using leverage programs for people who are approaching retirement age. In some cases, the interest on the loan will be deductible from income for tax purposes. In others, such as borrowing funds to contribute to a registered retirement savings plan (RRSP), the interest is not deductible.

4.2.1 Borrowing to contribute to a registered retirement savings plan (RRSP)

In the weeks before the RRSP contribution deadline of the 60th day of the year, insurance agents usually contact those clients who have not made RRSP contributions. One strategy for clients who do not have the cash is to borrow a portion, or all the funds necessary to make that contribution and partially repay the loan using the tax refund stemming from the contribution and the remainder from income over the rest of the year.

Interest on money borrowed to contribute to an RRSP is not deductible for income tax purposes.

4.2.2 Borrowing to buy a non-registered investment

Interest on money borrowed to earn income is deductible from income for tax purposes. In Québec, this deduction is generally limited to income received during the year. This can be done with non-registered investments.

Relatively common strategies used by individuals include opening what are called "margin accounts" with investment dealers. These allow investors to borrow against the equity in their accounts within defined limits. Interest on the money borrowed is deductible, provided the money borrowed is used to buy additional investments.

The ratio of debt to equity must stay within defined limits, which may change over time. If the value of the equity in the account declines, the borrowers will be required to put up additional capital. If they cannot, the dealer will sell enough assets to maintain the required ratio.

Borrowing money to buy segregated funds is a strategy that some insurance agents suggest to their clients, especially in periods of rising markets. Interest on money borrowed to invest is deductible from income for tax purposes. Therefore, if the borrowing costs paid by the investor are 5% and the investor has a marginal tax rate of 46%, the after-tax cost to the investor is 2.7%.

EXAMPLE

Madeline paid $500 interest on her investment loan. Her marginal tax rate is 46%. Consequently, she deducts this amount as a business expense, reducing the tax payable by 46% × $500 = $230. The after-tax cost is $270 ($500 – $230).

Some advisors recommend a strategy that involves clients borrowing against the equity in their homes to provide funds for a leverage strategy. The suitability of this for a client should be determined on a case-by-case basis.

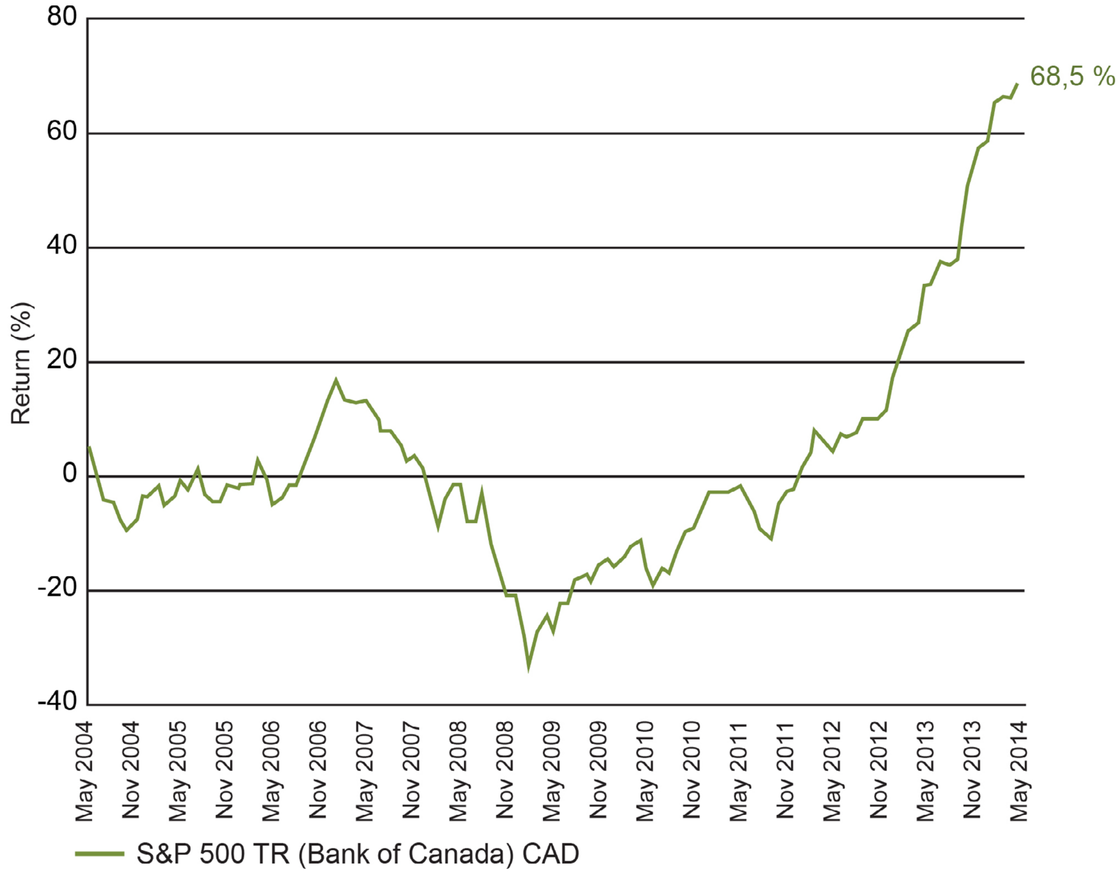
While money can be made using leverage in periods of a rising market, there are risks that should not be overlooked. Leverage programs should generally be considered long-term. Markets move in cycles, and declines can be significant. For example, although the stock markets have been very generous to investors in recent years, the Autorité des marchés financiers has identified 11 episodes since 1969 of Canadian stock markets declining more than 20%.[67]

Diagram 4.1 shows the cumulative return of the S&P 500 index from May 2004 to May 2014 and demonstrates the index's volatility.[68] The period covered includes the substantial market declines of 2007 and 2008 and the subsequent recovery.

67. Autorité des marchés financiers. *Turbulence on the Canadian stock markets.* [online]. Revised 2022. [Consulted May 24, 2022]. https://lautorite.qc.ca/en/general-public/investments/tips-for-better-investments/turbulence-on-the-canadian-stock-markets
68. Permission granted by Morningstar. PALTrak. June 2014 data download.

DIAGRAM 4.1

Cumulative return of the index over a 10-year period



While recent performance has been excellent, the 10-year average annual compound rate of return for the period ending May 31, 2014, was 5.4%. The cost of borrowing funds on a secured basis over that term would have ranged between 4% to just under 5% using the average 5-year residential mortgage rate as the rate an investor would likely pay. The benefit of leverage over this period would therefore be marginal.

Agents should also be aware that interest rates have historically been much higher than recent levels and that significantly higher rates can reduce, and in some cases eliminate, the attractiveness of a leverage strategy by raising the cost of borrowing and the cash flow required to pay interest. In mid-2014, the cost of borrowing on a secured basis was 3% to 4%. However, between 1974 and 1992, borrowing rates were in the double digits; 5-year rates exceeded 18% for more than 12 months in 1981 and 1982.

Those investors who do use leverage strategies should have income available to pay the interest or a possible margin call. While some people redeem units from their investments to pay interest, this strategy will reduce equity in periods of market decline and should be considered speculative and unsuitable for investors for reasons of age, income and ability to withstand risk.

The reasons many investors buy segregated funds rather than mutual funds include maturity guarantees and death benefit guarantees. These provide that the investor is entitled to receive, at maturity or death, the higher of market value or, depending on the specific contract, 75% or 100% of the initial investment made. Agents should also recognize that redemptions of segregated fund units to pay interest will also reduce the maturity guarantee.

Agents should determine whether a leverage program is suitable for a client prior to making a recommendation. They should establish whether the client has the cash flow required to service the debt over a prolonged time period should the market decline. They should also determine whether the client is in a high enough tax bracket to fully benefit from the interest deductibility. Most importantly, they should understand and respect the client's risk tolerance.

4.3 Using insurance products for long-term income

As noted in the previous chapter, prescribed annuities have a tax advantage in that interest and the original capital is spread equally over all payments for tax purposes. This can be very beneficial when combined with life insurance for someone who wants both to have income for the long-term and to leave an estate.

4.3.1 Insured annuity

Many people, especially seniors, have a need for income but are sometimes unwilling to risk their capital. Their first choices are guaranteed investment certificates (GIC) issued by chartered banks and trust companies.

An alternative to a GIC is a life annuity and a life insurance policy. Taken together, they are called the insured annuity. The prescribed annuity offers tax-advantaged income, while the life insurance will pay a benefit on the annuitant's death. With this combination, the individual receives higher after-tax income than from a GIC and his beneficiary receives insurance benefits upon the insured's death.

EXAMPLE

Fred, who is 70, recently sold his home and business and has $500,000 available for investment. He is unwilling to risk his capital and wants to leave that amount to his children. He is aware that he can earn 2.5% by purchasing a five-year GIC, which will provide him with a $12,500 annual income, all of which will be taxable.

Fred's insurance agent suggests an alternative. He recommends that Fred apply for $500,000 of term-100 life insurance at an annual premium of $20,652. Once that is approved, Fred can buy a prescribed life annuity for $500,000, which will provide him with annual income of $38,440, with the taxable portion at $1,562. The annuity payment less the cost of the insurance will leave him an income of $17,788 ($38,440 – $20,652), which far exceeds the $12,500 income from the GIC. Moreover, only $1,526 of the annuity income is taxable compared with all of the $12,500 GIC income. Fred's major risk is that interest rates will rise in the coming years and he will not benefit from any rate increase.

4.4 Charitable donations

Many registered charities, including hospitals and universities, solicit donations from life insurance policies from their supporters. The donors receive federal and provincial charitable donation tax credits, while the organization, which becomes the policyholder or beneficiary, receives the insured amount, assuming premiums continue to be paid, where applicable.

The federal charitable tax credit is 15% on the first $200 and 33% on any remaining amount. The 33% credit applies only if the individual's income falls within the highest range of the marginal tax rate. Provincial charitable tax credit rates vary from province to province. These are non-refundable tax credits that reduce tax owed. For donations made after March 20, 2013, qualifying first-time donors may receive an additional federal tax credit of 25% on the first $1,000 of monetary donations.

Federal tax savings for Québec residents may be reduced for people entitled to refundable federal tax abatement. For individuals who pay provincial surtaxes, the actual savings from the credit will be boosted because it reduces the surtax. The total eligible amount of gifts is generally up to 75% of net income. The limit in the year of death is the lower of the eligible amount of gifts or 100% of income. Any unused portion can be applied against the previous year's income, up to 100%, by adjusting the deceased's previous year's tax return.

4.4.1 Assigning a new insurance policy to a charity

An individual can purchase a life insurance policy for the benefit of a registered charity. In order to obtain a charitable tax credit for the premiums, he must assign the policy to the charity, making it the holder and beneficiary.

EXAMPLE

Rifka has been donating $500 annually to the alumni fund of the university she attended and receives a tax credit receipt for that amount each year.

A representative of the university suggested that she consider buying a life insurance policy and assigning it to the university. She agreed and purchased a term-100 life policy with an annual premium of $500 and a face amount of $50,000 (Rifka is 40 years old and a non-smoker). She assigns the policy to the university and continues to pay the premium, for which the university issues a charitable donation tax credit receipt equal to the premium. Assuming Rifka does not let the policy lapse, the insurance company will pay $50,000 to the university when she dies.

4.4.2 Assigning an existing policy to a charity

Individuals can donate an existing policy to a registered charity. In such cases, the charity can issue a charitable donation tax credit receipt for the cash surrender value (CSV) and additional tax receipts for additional premiums paid. If, however, the CSV exceeds the policy's adjusted cost base (ACB), the policy gain will be taxable as income in the year the policy was donated. In some cases, the fair market value will be used, and the insurer could issue a receipt equivalent to this amount.

EXAMPLE

Lars has a permanent life insurance policy he no longer needs. The market value of the policy is $12,000. He calls the fund raising office at his local hospital and speaks with the director, who informs him that if he assigns the policy to the hospital, he will receive a tax credit receipt for the market value. Furthermore, if he continues to pay the premiums, he will receive tax credit receipts for these.

4.4.3 Naming a charity as beneficiary

A policyholder can name a charity as beneficiary of a policy. However, this may not be the most tax efficient option for the policyholder. First, the charity will not own the policy when this is done (or potentially even know it is the beneficiary), so it cannot issue receipts for the cash surrender value (CSV), if any, or for the premiums paid. It will however issue a receipt to the estate when the policyholder dies and the benefit is paid.

EXAMPLE

Rosalind reviewed her finances and decided that she no longer needed the benefit from an insurance policy she had purchased decades earlier. She called the issuer, who sent her a change of beneficiary form. She named a local animal shelter, which is a registered charity, as the beneficiary. If she continues to pay the premiums to keep the policy in effect and does not change the beneficiary, when she dies, the animal shelter will issue a charitable donation tax receipt to Rosalind's estate for the amount of the benefit it receives. Because the charity did not own the policy, it could not issue charitable donation tax credit receipts for any of the premiums she paid.

4.4.4 Donating a segregated fund contract

Special rules apply for the donation of publicly traded securities and insurance contracts holding segregated funds. In simple terms, the capital gains inclusion rate (which is otherwise 50% of the gain) is reduced to zero for the donated securities or segregated funds. The donor receives a charitable donation tax credit receipt for the full value of the donation.[69]

EXAMPLE

Jack redeems $100,000 of segregated funds, which have an ACB of $50,000. He donates the money to a registered charity and receives a charitable tax credit receipt for $100,000. He pays tax on half his capital gains, or $25,000.

Jill, on the other hand, donates her $100,000 of segregated funds contract to a registered charity. While her ACB is also $50,000, her capital gains inclusion rate for the donation is zero, so she pays no tax on the capital gain and receives a charitable tax credit receipt for $100,000.

4.4.5 Donation program tax shelters

In some cases, agents and financial advisors have been recruited to sell tax shelters and donation programs to their clients. These plans typically offer unusually high returns or tax reductions or refunds in excess of the amount actually invested.

Since the 1990s, the Canada Revenue Agency (CRA) has continuously issued warnings about donation program tax shelters. The common issue is that these involve the issuance of a charitable donation tax credit receipt in excess of the amount actually donated.

69. Manulife Financial. *Charitable giving: The facts*. [online]. Revised April 2021. [Consulted May 24, 2022]. https://www.manulifeim.com/retail/ca/en/resources/all/marketing-materials/charitable-giving-the-facts

An agent who is approached to become involved in such programs should recognize that it is unlikely that the payment is a valid donation. Moreover, it is almost certain that the donation will be disallowed, sometimes even retroactively. An agent should also be aware of employer policies (if any) prohibiting involvement in unauthorized activities.

The CRA provides an example of what it calls a deliberate overvaluation of a tax-shelter arrangement involving charitable donation receipts.[70]

> A promoter sells a tax shelter-like arrangement to individual taxpayers involving 10,000 pieces of art. Each taxpayer acquires one piece of art for its fair market value of $100. The valuator is aware of this information, but agrees to appraise each art piece at $1,000.
>
> Concurrently, the promoter solicits a registered charity that agrees to accept the art as a charitable donation and issue a charitable donation receipt in the amount of the appraised value ($1,000 per art piece). This charity immediately auctions off the art to the highest bidder, and the price paid reflects the $100 value per piece. A tax return specialist without any direct knowledge of the false statement prepares the income tax return of a client who purchased a piece of art and donated it under this arrangement. The CRA reviews the client's return and determines that it contains a false statement (the over-valuation of the property donated).

Agents should review CRA documents on donation tax shelter schemes. One particular document states that "[the CRA] audits every mass-marketed tax shelter arrangement and no arrangement has been found to comply with the *Income Tax Act*."[71]

Since June 2000, the CRA has imposed $137 million in third-party penalties against promoters and the professional tax preparers involved. It should be noted, however, that life insurance policies are acceptable for charitable gift giving.

70. Canada Revenue Agency. *Third-party civil penalties*. [online]. Archived. [Consulted May 20, 2021]. https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/ic01-1/third-party-civil-penalties.html
71. Canada Revenue Agency. *Tax shelters – Know the risk.* [online]. Revised July 10, 2021. [Consulted May 24, 2022]. https://www.canada.ca/en/revenue-agency/corporate/about-canada-revenue-agency-cra/tax-alert/tax-shelters.html

CONCLUSION

As noted in the foreword, the concepts covered in this Booklet serve as a prerequisite for understanding the product modules. Now that the four Chapters have been read, the following concepts and principles should be fully understood for insurance of persons agents to better serve their clients:

- Basic knowledge of the Canadian tax system;
- Taxation of personal income by federal and provincial governments;
- Taxation of corporate income;
- Taxation of investment income in its various forms;
- Strategies for investments and savings using life insurance.

The concepts and principles above are important because agents will make recommendations to clients and will need to consider some aspects of taxation, such as the tax-free nature of life insurance benefits, the tax advantages of saving within an insurance policy and the use of insurance to offset or reduce taxes payable at death.

It is, however, essential that agents recognize that this course will not make them an authority on all matters pertaining to tax. There will be times when agents must bring in tax experts and even legal experts to best serve their clients' interests.

APPENDIX A

PROVINCIAL PROBATE RULES[72] [73]

<table>
<tr><th>JURISDICTION AND SOURCE</th><th>PROBATE FEE SCHEDULE</th><th>APPLICABLE FEES</th></tr>
<tr><td>Alberta
Surrogate Rules, Schedule 2</td><td>Fees are charged based on the net value of the estate as follows:<table><tr><th>Estate value</th><th>Fee</th></tr><tr><td>≤$10,000</td><td>$35</td></tr><tr><td>>$10,000 but ≤ $25,000</td><td>$135</td></tr><tr><td>>$25,000 but ≤ $125,000</td><td>$275</td></tr><tr><td>>$125,000 but ≤ $250,000</td><td>$400</td></tr><tr><td>>$250,000</td><td>$525</td></tr></table></td><td>Fees are payable on the value of property located in Alberta that passes through the estate, less debts and encumbrances.</td></tr>
<tr><td>British Columbia
Probate Fee Act, Estate Administration Act</td><td>No fee is payable if the value of the estate does not exceed $25,000.
If the value of the estate exceeds $25,000, the fee is:
a) $6 for every $1,000 or part of $1,000 by which the value of the estate exceeds $25,000 but is not more than $50,000, plus
b) $14 for every $1,000 or part of $1 000 by which the value of the estate exceeds $50,000.
There is also a general filing fee of $208 for estates over $25,000.</td><td>Probate fees are payable on the value of assets that pass through the estate, which includes the gross value of:
a) the real and tangible personal property situated in British Columbia, and
b) if the deceased was ordinarily resident in British Columbia immediately before the date of death, the intangible personal property of the deceased, wherever situated.</td></tr>
<tr><td>Manitoba
The Law Fees and Probate Charge Act</td><td>Probate fees were eliminated in Manitoba as of November 6, 2020.</td><td></td></tr>
</table>

72. Learning Partner (www.learningpartner.ca). *Managing assets upon death*. September 2015.
73. Manulife Financial. *Provincial probate/verification fees and tax chart*. [online]. Revised February 2022. [Consulted May 24, 2022]. https://www.manulife.ca/advisors/insurance/tax-retirement-and-estate-planning/advisor-toolkit/2019/provincial-probate-verification-fees-and-tax-chart.html

<table>
<tr><th>JURISDICTION AND SOURCE</th><th>PROBATE FEE SCHEDULE</th><th>APPLICABLE FEES</th></tr>
<tr><td>New Brunswick
Probate Court Act</td><td>Fees are charged based on the value of the estate as follows:
<table><tr><th>Estate value</th><th>Fee</th></tr><tr><td>≤$5,000</td><td>$25</td></tr><tr><td>>$5,000 but ≤ $10,000</td><td>$50</td></tr><tr><td>>$10,000 but ≤ $15,000</td><td>$75</td></tr><tr><td>>$15,000 but ≤ $20,000</td><td>$100</td></tr><tr><td>>$20,000</td><td>$5 per $1,000 or part thereof</td></tr></table></td><td>The tax is payable on the value of all assets that pass through the estate, including real property (less encumbrances) as well as personal assets.</td></tr>
<tr><td>Newfoundland and Labrador
Rules of the Supreme Court, Rule 56</td><td>The fee is calculated as follows:
a) For estates of $1,000 or less, the fee is $60.
b) For estates over $1,000, the fee is $0.60 per $1,000 (including $60 on the first $1,000).</td><td>The fee applies to “the estate in Newfoundland and Labrador.” Property located outside of Newfoundland and Labrador is not included.</td></tr>
<tr><td>Northwest Territories
Judicature Act (Probate, Administration and Guardianship Fees Regulations)</td><td>Probate tax is determined as follows:
<table><tr><th>Estate value</th><th>Fee</th></tr><tr><td>≤$10,000</td><td>$30</td></tr><tr><td>$10,001 to $25,000</td><td>$110</td></tr><tr><td>$25,001 to $125,000</td><td>$215</td></tr><tr><td>$125,001 to $250,000</td><td>$325</td></tr><tr><td>>$250,000</td><td>$435</td></tr></table></td><td>The probate tax is based on the value of all property, real and personal, within the Northwest Territories that passes through the estate.</td></tr>
<tr><td>Nova Scotia
Probate Act (Probate Court Practice, Procedure and Forms Regulations)</td><td>Fees are charged based on the value of the estate as follows:
<table><tr><th>Estate value</th><th>Fee</th></tr><tr><td>≤$10,000</td><td>$85.60</td></tr><tr><td>>$10,000 but ≤ $25,000</td><td>$215.20</td></tr><tr><td>>$25,000 but ≤ $50,000</td><td>$358.15</td></tr><tr><td>>$50,000 but ≤ $100,000</td><td>$1,002.65</td></tr><tr><td>>$100,000</td><td>Flat fee of $1,002.65, plus $16.95 for every $1,000 or fraction thereof over $100,000</td></tr></table></td><td>The “value of the estate” means the value of the assets that pass by a will, or a trust under a will, or upon intestacy.
It is calculated as:
a) the gross value of the personal property of the deceased; and
b) the fair market value of the real property of the deceased less the amount of any mortgages and encumbrances on that property.</td></tr>
</table>

<table>
<tr><th>JURISDICTION AND SOURCE</th><th>PROBATE FEE SCHEDULE</th><th>APPLICABLE FEES</th></tr>
<tr><td>Nunavut
Judicature Act (Court Fees Regulations)</td><td>Probate fees are charged as follows:<table><tr><th>Estate value</th><th>Fee</th></tr><tr><td>≤$10,000</td><td>$25</td></tr><tr><td>$10,001 to $25,000</td><td>$100</td></tr><tr><td>$25,001 to $125,000</td><td>$200</td></tr><tr><td>$125,001 to $250,000</td><td>$300</td></tr><tr><td>>$250,000</td><td>$400</td></tr></table></td><td>Probate fees apply to the value of all property, real and personal, located within Nunavut, less any debts and liabilities against that property.</td></tr>
<tr><td>Ontario
Estate Administration Tax Act</td><td>The tax is calculated as follows:
0% on the first $50,000 of the estate value;
$15 for each $1,000, or part thereof, of the value of the estate exceeding $50,000.
If the estate does not exceed $1,000, the estate is exempt from tax.</td><td>The estate administration tax (EAT) is calculated on the total value of the assets that pass through the estate. Any encumbrance on real property is deducted from the estate value.</td></tr>
<tr><td>Prince Edward Island
Probate Act</td><td>Fees are charged based on the value of the estate as follows:<table><tr><th>Estate value</th><th>Fee</th></tr><tr><td>≤$10,000</td><td>$50</td></tr><tr><td>$10,001 to $25,000</td><td>$100</td></tr><tr><td>$25,001 to $50,000</td><td>$200</td></tr><tr><td>$50,001 to $100,000</td><td>$400</td></tr><tr><td>>$100,000</td><td>$400, plus $4 per $1,000 or part thereof over $100,000</td></tr></table></td><td>Probate tax is payable on the gross assets that pass through the estate.</td></tr>
<tr><td>Québec
Courts of Justice Act (Tariff of Court Costs in Civil Matters and Court Office Fees)</td><td>Probate is not required for notarial wills. The cost of filing an application for the probate of a non-notarial will is $217.[74]</td><td>The fee is fixed and is not contingent on the estate value.</td></tr>
</table>

74. Justice Québec. *Tarif judiciaire en matière civile.* [online]. Revised January 1, 2022. [Consulted May 24, 2022] https://www.justice.gouv.qc.ca/fileadmin/user_upload/contenu/documents/Fr__francais_/centredoc/publications/systeme-judiciaire/tarifs/TA_Frais_jud_Civil_2022_MJQ.pdf [French only].

JURISDICTION AND SOURCE	PROBATE FEE SCHEDULE	APPLICABLE FEES
Saskatchewan *Administration of Estates Act*	The fee is $7 on every $1,000 of value passing through the estate.	Fees are payable on the value of all the real and personal property that passes through the estate. The value of real estate is reduced by the amount of any mortgage (to the extent that the mortgage exceeds any mortgage insurance payable to discharge the mortgage). The value of the estate also excludes: ▪ personal property outside Saskatchewan, if the deceased person was domiciled outside Saskatchewan on the date of death; and ▪ real property outside Saskatchewan.
Yukon *Judicature Act* (Tariff of Costs and Fees Payable to the Crown)	For estates of $25,000 or less, no fee is payable. For estates that exceed $25,000, the fee is $140.	The fee applies to real and personal property that passes through the estate. It excludes the first $25,000 of real property that is transferred to the surviving spouse or minor children.

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https://www.canada.ca/content/dam/cra-arc/formspubs/pub/rc4022/rc4022-18e.pdf

Get a 2021 T1 income tax package.
https://www.canada.ca/en/revenue-agency/services/forms-publications/tax-packages-years/general-income-tax-benefit-package.html

Gifts by Individuals of Life Insurance Policies as Charitable Donation.
https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/it244r3/archived-gifts-individuals-life-insurance-policies-charitable-donation.html

Giving to charity: Information for donors.
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