

## Alternative minimum tax – Where are we now?

By: Florence Marino B.A., LL.B., TEP  
Vice President, Tax & Estate Planning

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### By way of background

The 2023 Federal budget proposed changes to the AMT that included broadening the base by increasing inclusions and decreasing deductions and credits, raising the AMT basic exemption amount to the 4th federal tax bracket and increasing the rate from 15% to 20.5%. Detailed draft legislation was released on August 4, 2023, but noticeably absent from Bill C-59 last fall ([Tax legislation – Some highlights](#)).

The 2024 Federal budget announced some tweaks, the main one being, to allow 80% (rather than 50% as originally proposed) of charitable donation credits for AMT purposes. Only 50% of numerous other deductions and credits will be allowed for AMT purposes. Draft legislative provisions implementing the tweaks were released with the budget and are to be applicable as of January 1, 2024.

As we previously observed ([Federal budget 2024 – Reflections on the increase to the capital gains inclusion rate through an insurance lens](#)), with the increase to the capital gains inclusion rate, the effective tax rate on capital gains now exceeds the AMT tax rate, in effect eliminating the broad application of AMT to capital gains that are not eligible for preferred tax treatment. Capital gains with preferred tax treatment - the proposed \$250,000 threshold for individuals, sheltered by the lifetime capital gains exemption, new Canadian Entrepreneur's Incentive, or the Employee Ownership Trust exemption – may still bring on AMT implications.

Individuals with substantial realized capital gains that make large donations to charity may still end up with AMT liabilities even with the tweak announced in the 2024 Federal budget. The bottom line is the AMT implications should be considered before large capital gains are realized. In general, AMT as an alternative tax calculation, will be more and more in play with these changes. At the very least, it will result in greater complexity, if not greater tax liabilities (that could become unrecoverable).

### Life insurance and AMT

AMT applies to individuals and most trusts. It does not apply in the year of death or to the graduated rate estate (GRE).

The growth in cash values within an “exempt” life insurance policy is not subject to taxation under Part I of the Act and on a disposition of the policy, any policy gain is taxed as ordinary income. AMT, therefore, would not be an issue.

A charitable gift of an existing life insurance policy may run into AMT implications. In general, under Part I, a donor may claim a donation tax credit equal to the fair market value (FMV) of a life insurance policy. FMV may be much greater than the cash surrender value of the policy depending upon, among many factors, the state of health of the life insured. Since only 80% of charitable gifts will be allowed for AMT purposes, depending on the individual’s other sources of income, AMT may be triggered.

Donations of policy proceeds on death by way of direct designation of a charity allow for flexible use of the donation tax credit in the terminal return and in the GRE under Part I. This use would not attract AMT since as noted above, AMT would not apply in the year of death or to the GRE.

Where a life insurance policy is owned personally and is used as collateral security for a loan to produce income from a business or property, interest expenses and a portion of the premium under the policy may be deductible under Part I. These expenses would be reduced to 50% in the AMT calculation. Also, where a policy is corporately-owned and used by a shareholder as collateral security for a personal loan to produce income from a business or property, interest expenses and guarantee fees payable by the shareholder to the corporation, may also give rise to AMT implications since these deductions would be reduced to 50% in the AMT calculation.

Life insurance death benefits are not taxable. Death benefits received by a private corporation are non-taxable and credit the corporation’s capital dividend account (CDA) less the adjusted cost basis of the policy. Capital dividends payable to a shareholder are tax-free under Part I and AMT. The use of corporate owned insurance to fund estate liabilities on death, buy-sell funding or to facilitate post-mortem planning should have no adverse impacts from AMT changes.

### **The bottom line**

Life insurance is a unique asset that has many favourable tax characteristics. In general, these characteristics are not in and of themselves a problem for AMT. It’s only where life insurance is used in certain planning situations – personal leverage and certain charitable gifts involving life insurance - where tax preferences arise that may result in AMT application.

### **FOOTNOTE:**

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**[florence@tompkinsinsurance.com](mailto:florence@tompkinsinsurance.com)**