

Personal borrowing and corporate owned life insurance – The gory details

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

Recently, we were asked to assist an individual who had a corporate-owned life insurance policy in his corporation. He was told that setting up a line of credit using this policy as collateral security for a personal loan was easy. And that he could draw down on this line of credit to pay down his home mortgage. The policy his corporation owned was well funded and had significant cash values.

While it might be easy to set this type of line of credit up, what's not easy is what problems this could give rise to.

Corporate owned insurance is a corporate asset

Like any other asset of value, life insurance cash values can be used as collateral security for a loan. However, where the policy is corporately-held and a shareholder wishes to use the corporation's asset as collateral security for a personal loan, this could bring about a shareholder benefit. Subsection 15(1) includes in the taxable income of a shareholder, the amount or value of a benefit that is conferred on a shareholder by a corporation.

As an aside but highly relevant to this discussion is the recent spate of shareholder benefit cases ending up in Tax Court. (See for example: Poce et al. v. The King, 2026 TCC 34; De Pellegrin v. The King, 2025 TCC 7; Kumar v. The King 2024 TCC 105; 1048547 Ontario Inc. et al. v. The King 2024 FCA 113 confirming 2023 TCC 24; to name a few.) These cases are not in respect of corporate-owned insurance used as security, but rather, are cited to highlight the audit efforts of the CRA, 15(1) shareholder benefit reassessments and 163(2) penalties arising from this activity as a trend.

Value or amount of the benefit

How much would be included in the shareholder's income as a shareholder benefit in the context of a shareholder borrowing against their corporation's life insurance policy?

It has been the CRA's general stated position that it would assess a benefit where the shareholder does not deal at arm's length with the corporation and, the taxable benefit may be measured as the difference in interest rates charged with and without the pledge of the corporate security or as the amount that the borrower would have to pay a third party to provide similar security for the loan (i.e. a guarantee fee). (See for example #2006-0174011C6.)

Where a "reasonable" guarantee fee is paid, the CRA confirmed (#2022-0936301C6) the shareholder may be able to deduct the guarantee fee paid to the corporation pursuant to paragraphs 20(1)(e) or (e.1) but also subject to subsection 18(9). The corporation would have to include the guarantee fee in its income (the characterization and nature of this income is a question of fact).

What is a reasonable guarantee fee? This is a factual valuation question and there is no universal answer. Formal documentation of the guarantee arrangement and engaging a professional valuator to establish the basis upon which the fee was determined would provide evidence that the taxpayer had turned their mind to this question.

Also, CRA's 2022 response assumes that the borrowed money was used to invest for an income earning purpose. This would clearly not be the case where the borrowed funds are used to pay down a home mortgage. And similarly, any interest on the borrowing would not be deductible by the shareholder. (See [The nuts and bolts of interest deductibility and leveraged life insurance – A primer – Tompkins Insurance](#) for more on interest deductibility.)

A sleeping giant

If this is not problematic enough, think about what happens on death or if there is a default under the loan causing the lender to request the surrender of the policy to satisfy the debt. Normally, a collateral assignment is filed with the life insurer to notify it of a restriction on title to the policy. The life insurer would request information about the extent of the lender's interest in respect of the policy and could pay death benefit or surrender proceeds directly to the lender in satisfaction of the loan.

At this point a shareholder benefit could arise since the corporation's asset would be directly repaying a shareholder's personal liability. At death, to prevent that result, the executor must be fully aware of the structure of the borrowing and take action to satisfy the debt using assets other than the policy so that the policy proceeds do not directly repay the borrowing. In a situation of default, this type of accommodation may not be possible. Worse still, on surrender there would be a disposition of the policy, and a taxable policy gain may be reported to the corporation for the amount by which the policy's cash surrender value exceeds the policy's adjusted cost basis.

Other tax problems?

Let's assume all of the above have been addressed. A guarantee fee is paid to the corporation and personal investments are made with the borrowed funds, all the accounting and records of the corporation document all of this properly, is it OK? Maybe not. If those personal investments are in shares or debt of the corporation there could be a heightened risk of GAAR. It's certainly circular.

While personal borrowing instead of the corporation borrowing against its asset may avoid the need to consider interest deductibility limitations which may arise from the excessive interest and financing expense limitation (EIFEL) regime, the shareholder would still have to consider the AMT implications of interest deductions (see: [Alternative minimum tax – Where are we now? – Tompkins Insurance](#)).

It's not easy

Careful planning and consideration of these types of issues is a must.

TOMPKINSights

FOOTNOTE:

This publication is protected by copyright. Tompkins Insurance is not engaged in rendering tax or legal advice. TOMPKINSights contains a general discussion of certain tax and legal developments and should not be construed as tax or legal advice.

Should you wish to discuss this or any other TOMPKINSights article, please contact florence@tompkinsinsurance.com