"Safe income" and life insurance

Draft legislation containing the proposed changes to the taxation of inter-corporate dividends in subsection 55(2) of the Income Tax Act was released on July 31, 2015. Although still the subject of submissions by professional bodies, including an extensive submission made by STEP on September 30, 2015, the measures are expected to apply as of the date of the Federal Budget (to dividends received after April 20, 2015). I first discussed this topic in the June 2015 *As a Matter of Tax* article entitled Budget 2015 Changes - Potential impact on Inter-corporate dividends. If I could summarize 55(2): it's BAD if it applies! It has the effect of re-characterizing a tax-free inter-corporate dividend as a capital gain. One of the only remaining, though narrowed, exemptions from the application of subsection 55(2) is if the dividend represents a "safe income" dividend.

In layman's terms safe income is a corporation's retained earnings calculated under tax rules, rather than under accounting rules that are used in preparing the corporation's financial statements. So you can't just go to the financial statements of the company to find the number.

A safe income calculation is complicated and, in the past, would only be done when it needed to be (for example, prior to a sale of the corporation to a third party). To pay a safe income dividend, safe income needs to be "on hand" at the "determination time". Also the safe income calculated may not necessarily be attributable to the shares receiving the dividend in question. Now, because normal inter-corporate dividends may be impacted, it may become more common for safe income calculations to be done more regularly for standard inter-corporate dividend planning.

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In 2015-0573821C6, the CRA discussed the impact on the safe income of the transferor company. In this situation, the safe income determination time is the time immediately before the dividend is paid. The calculation would therefore not take into account any gain reported in respect of the transfer that would be included in the transferor corporation's income. That income would not be on hand at the determination time.

The CRA also confirmed the general view that had been previously expressed in technical interpretation 2005-0113931I7 regarding the treatment of life insurance premiums for purposes of safe income calculations. Generally any non-deductible expenses will reduce safe income on hand. Life insurance premiums are generally non-deductible expenses. However the commentary confirms that to the extent that non-deductible premiums have been reflected in the cash surrender value of the policy, they do not reduce safe income on hand.

In doing safe income calculations this information about how life insurance is treated is good to have - pardon the pun - on hand.

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