

ATTN: INTERNAL MEMORANDUM

FROM: David Kakon (David@ArmstrongLife.com)

IMMEDIATE FINANCING ARRANGEMENTS (IFAS) AS UNREGISTERED TAX SHELTERS

The CRA is actively auditing Immediate Financing Arrangements (IFAs). Due to a strict mathematical test in the Income Tax Act, many IFAs technically qualify as "tax shelters." If the plan qualifies as such and is "unregistered", this triggers severe, retroactive denial of all associated tax deductions. Note: This is not new legislation to combat aggressive tax planning. The Canadian tax shelter rules were formally introduced into the Income Tax Act in 1989.

1. The Issue: The "Zero Cost" Trap: IFAs are frequently pitched to busy executives as a highly efficient, no-cost way to fund permanent life insurance. The strategy involves paying an insurance premium, immediately borrowing the funds back to invest in your business, and deducting the loan interest and insurance costs from your taxable income. However, the financial illustrations used to sell these plans typically show the loan compounding indefinitely until death, with no out-of-pocket principal repayment required. This design feature triggers a compliance trap.

2. The CRA's Test: The CRA evaluates compliance based on the marketing illustrations and pitch presented to you, not just the bank's loan paperwork. Here is how the trap closes:

- **The 10-Year Rule:** Under tax law, if the arrangement lacks a bona fide written intent to repay the loan principal within 10 years, the debt is classified as limited-recourse.
- **The \$0 Net Cost:** Because the loan is limited-recourse, the CRA mathematically reduces your recognized out-of-pocket "net cost" for the investment to exactly \$0.
- **The Tax Shelter Trigger:** If the initial pitch illustrates that your expected tax deductions will exceed your net cost (which is forced to \$0) in the first four years, the arrangement legally becomes a tax shelter.

3. The Consequences: Because these aggressive arrangements are almost never registered with a mandatory Tax Shelter Identification Number, the penalties are automatic and severe:

- **Retroactive Denial:** The CRA can retroactively disallow 100% of the interest and insurance deductions you have claimed since inception.
- **Basis Reduction:** The recognized cost basis for both your policy and the investments acquired with the borrowed funds may be reduced to zero, increasing tax liabilities.
- **No Retroactive Fixes:** Paying the loan off early does not fix the issue. If the illustration modelled an unregistered tax shelter, the compliance failure occurred on Day 1.

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4. Action Required: If you currently hold an IFA or are considering one, you must not rely solely on the assurances of the promoter or broker who sold it to you.

- **Do Not Wait for an Audit:** The CRA has already begun issuing proposed assessments denying these deductions.
- **Get an Independent Review:** Have an independent, conflict-free tax specialist stress-test your specific IFA illustration against Section 237.1 of the Income Tax Act.
- **Demand Proof:** Ask your broker if the arrangement has a valid Tax Shelter Identification Number. If they claim it doesn't need one, ask for a formal, independent legal opinion proving why the illustration escapes the mathematical definition.

5. The CRA's Explicit Enforcement Warning: If statutory warnings and industry guidance are not enough, consider the CRA's explicit response to Question 1 at the 2026 CRA Roundtable (Reference: 2026-1089291C6) regarding their current audit activities:

We continue to seek out, audit and re-assess all arrangements which attempt to utilize insurance products or insurance-like products to gain a tax advantage not envisioned by tax policy and legislation.

Within CRA, the High Net Worth Compliance Directorate (HNWCD) develops, implements, and coordinates business intelligence and compliance initiatives to address non-compliance in the High Net Worth population through the Audit Program Division, which includes the Aggressive Tax Planning audit program (ATP), and the Tax Promoter and Advisor Compliance program (TPAC).

While the ATP Audit Program addresses aggressive tax planning by taxpayers who participated in such abusive insurance-related tax schemes, the TPAC program addresses non-compliance associated with promoters and advisors who promote or sell aggressive tax schemes. TPAC is accountable for identifying and combating aggressive tax schemes and holding promoters accountable through audit activities.

Please see a more complete analysis here: <https://tax-shelter.ca>

Sincerely,

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