

Armstrong

— Financial Services —

Is My Life Insurance Plan a Tax Shelter? (And if So ... So What?)

David Kakon, Math Honours B.Sc., May 2026 / David@ArmstrongLife.com

Immediate Financing Arrangements (IFAs) have been widely promoted to high-net-worth individuals as a strategy to fund permanent life insurance. The structure typically involves paying an annual premium, immediately borrowing the funds back to replenish capital (for legitimate income-generating purposes), and deducting the annual loan interest and a portion of the premium from income each year. The loan is expected to be carried indefinitely and paid back at death from the insurance proceeds, generating what is often pitched as a so-called net "free insurance."

*While much of the industry is focused on whether these arrangements violate the newly expanded General Anti-Avoidance Rule (GAAR), there is a more immediate, mechanical compliance risk. Based on a strict reading of the Income Tax Act's mathematical definitions, certain leveraged life insurance structures may qualify as **tax shelters**.*

The Math: How Could a Life Policy Become a Tax Shelter?

The CRA does not rely on subjective labels to define a tax shelter. Instead, under Subsection 237.1(1) of the Income Tax Act, they apply a strict mathematical test: if the “**statements or representations**” made to an investor (such as financial illustrations or marketing brochures) indicate that the expected tax deductions within the first four years will equal or exceed the investment's “net cost,” the arrangement technically qualifies as a tax shelter.

Here is how that mathematical calculation applies to a typical IFA:

1. **The Deductions:** IFA illustrations generally highlight the ability to deduct the interest on a loan collateralized by the life insurance policy, and a portion of the premium (NCPI).
2. **The Net Cost & Limited-Recourse Debt:** When calculating the 'net cost' of an arrangement, Section 237.1 of the *Income Tax Act* requires the investment to be mathematically reduced by any 'prescribed benefits,' which explicitly includes limited-recourse debt. For the loan in question to avoid being classified as a limited-recourse amount under Subsection 143.2(7), it must meet strict statutory criteria:
 - **Requirement:** The rules require “... *bona fide arrangements in writing, at the time the indebtedness arose, for repayment of all principal and interest and the repayment will occur within a reasonable period not exceeding 10 years.*” Furthermore, the CRA states that “... *the maximum 10-year time period for repayment cannot be avoided through a series of loans and repayments.*”
 - **Commercial Reality:** Marketing materials and illustrations often explicitly present these loans as lifelong facilities intended to be “repaid out of the death benefit.”
 - **Tax Classification:** Even if a loan is structured as a renewable facility, the CRA's assessing position—supported by Subsection 143.2(12) regarding a series of loans—**creates a material risk** that the loan will be classified as a limited-recourse amount if the illustrated intent is to carry the debt indefinitely until death.

If the loan is deemed a limited-recourse amount, the resulting calculation is purely mathematical. Because, in most cases, the borrowed funds fully offset the premiums paid, the calculated “net cost” drops to exactly \$0. In this scenario, illustrating even \$1 in tax deductions within the first four years against a \$0 net cost exposes the client to the severe technical risk of being assessed as an unregistered tax shelter—regardless of any legitimate business or investment use of the loan.

The Consequences of an Unregistered Tax Shelter

By law, a promoter must register a tax shelter with the CRA and obtain a Tax Shelter Identification Number before selling it. Based on the files we have reviewed to date, we have not seen these arrangements registered with a Tax Shelter Identification Number.

If a client's arrangement is assessed as an unregistered tax shelter, the potential CRA assessing positions are severe and would be applied retroactively:

Retroactive Denial of Deductions: Under Subsection 237.1(6), the CRA can automatically disallow all interest and NCPI deductions claimed under the arrangement, going back to the date the policy was purchased. The Income Tax Act explicitly states that without a valid Tax Shelter Number, no person may claim any deduction for any year.

Reduction of Cost Basis: Under Section 143.2, the CRA is legally empowered to erase the out-of-pocket investment for tax purposes. Because limited-recourse debt forces the recognized cost basis to \$0, this reduction could apply not only to the insurance policy itself but also, critically, to any assets or investments acquired with the borrowed funds.

Third-Party Penalties: Promoters and advisors who sell unregistered tax shelters can face a penalty equal to 25% of the total "consideration" received (which could encompass the total insurance premiums deposited by the subscriber).

What Can You Do?

If you suspect your life insurance arrangement may be an unregistered tax shelter, it is critical to act proactively before the CRA initiates an audit on your file.

- **Run the Math:** Work with an independent technical resource to calculate the "net cost" of your policy against the illustrated tax deductions in the first four years. If the deductions equal or exceed the net cost, the arrangement technically meets the tax shelter definition.
- **Ask for the TS Number:** Contact the promoter or broker who sold you the plan and request the Tax Shelter Identification Number. If they cannot provide one, your tax claims may be at risk of denial under the statute.
- **Seek Independent Tax Advice:** Do not rely solely on the promoter who sold you the plan to assess its compliance. Consult a qualified, reputable tax professional who has no financial connection to the policy or its outcome.
- **Consider the Voluntary Disclosures Program (VDP):** If you and your independent tax advisor determine you have participated in an unregistered tax shelter, discuss whether applying for relief through the CRA's Voluntary Disclosures Program is appropriate. Coming forward before the CRA initiates an audit or contacts you may offer relief from the potentially severe penalties and interest you could otherwise face.

Navigating the landscape of leveraged life insurance products requires specialized technical expertise. Our firm has the modelling tools and experience to independently stress-test the mechanics of these complex arrangements. Because we do not sell or promote these strategies, we can offer an objective, conflict-free analysis. If you are a professional or advisor seeking a third-party review of an existing or proposed plan, feel free to reach out.

David Kakon

Math Honours, B.Sc.

Direct: (514) 574-0233

David@ArmstrongLife.com

Appendix: The Statutory Chain

For professionals reviewing the structural integrity of these arrangements, the mathematical transition to a tax shelter could be triggered by the following legal chain:

- **ITA Section 143.2(7):** Classifies the financing as a “limited-recourse amount” if the arrangement lacks a bona fide written agreement requiring the principal to be fully repaid within 10 years. Additionally, 143.2(12) was added to stop promoters from using short-term renewable loans to bypass the 10-year repayment requirement (Sherman).
- **ITR Regulation 3100(3):** Specifically classifies any limited-recourse amount under Section 143.2 as a “prescribed benefit.” Critically, this includes debt relating to “the arrangement under which the property is acquired,” thereby integrating all parts of the plan as presented.
- **ITA Section 237.1(1):** Mandates that the legally recognized “net cost” of the investment must be reduced by all “prescribed benefits.” Under this subsection, an arrangement meets the statutory definition of a tax shelter if the expected deductions within the first four years equal or exceed this adjusted net cost.
- **ITA Section 237.1(6):** Explicitly states that without a mandatory Tax Shelter Identification Number, no person may claim any deduction related to the arrangement. This statutory mechanism allows the CRA to automatically disallow all interest or Net Cost of Pure Insurance (NCPI) deductions claimed through the structure.
- **ITA Section 143.2(6):** Mandates that the recognized expenditure (the cost basis) must be proportionally reduced by the limited-recourse amount. This reduces the taxpayer's out-of-pocket investment for tax purposes, thereby exposing future policy distributions or the sale of assets acquired with the borrowed funds to increased or full taxation.
- **ITA Section 163.2:** Outlines substantial third-party civil penalties for promoters and advisors who facilitate or sign off on non-compliant arrangements. Professionals can face a gross negligence penalty equal to 25% of the total “consideration” received for the arrangement (which, in an IFA, the CRA may interpret to include the total insurance premiums deposited and commissions paid), creating severe personal liabilities.

Disclaimer: This article, including any mathematical examples, case studies, and interpretations of the Income Tax Act, is provided for educational and informational purposes only and represents the personal opinion of the author. It does not constitute legal, tax, accounting, or financial advice. The application of tax shelter definitions, the General Anti-Avoidance Rule (GAAR), and Canada Revenue Agency (CRA) enforcement policies to Immediate Financing Arrangements (IFAs) is highly complex and depends heavily on the specific facts, documentation, and structure of each individual case. Tax laws, regulations, and CRA administrative positions are dynamic and subject to change, potentially retroactively. Readers, including professional advisors, should not act or rely upon any information contained herein without first seeking independent, qualified tax and legal counsel tailored to their specific circumstances. The author assumes no liability for any errors or omissions, nor for any assessments, penalties, or financial damages arising from actions taken or not taken in reliance on the contents of this article. Reviewing this article does not establish an advisor-client relationship, nor is any offer to review policies intended to solicit or infringe upon any existing relationships.