

The 60-Second IFA Tax Shelter Math Test

Statutory Tax Shelter Analysis of Immediate Financing Arrangement Representations

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This memorandum offers a plain-English version of the comprehensive analysis available at tax-shelter.ca. It provides a statutory breakdown of Immediate Financing Arrangements (IFAs) under the rules of the Income Tax Act (ITA), demonstrating why standard IFA sales illustrations are susceptible to meeting the statutory definition of a tax shelter. For technical analysis, including statutory references, please visit tax-shelter.ca

Beyond the Pitch Deck

If you are reading this, you are probably familiar with the Immediate Financing Arrangement (IFA) life insurance structure and sales pitch. You may have also heard some experts ask the question: Can an IFA be a tax shelter? Usually, this question gets derailed by complex tax theories, "limited-recourse" debts, "prescribed" benefits, and "composite property" arguments. But the truth is, you need only look at a standard IFA illustration and ask a few basic, common-sense questions to find out for yourself.

What is a Tax Shelter?

Under subsection 237.1(1) of the Income Tax Act, an arrangement is defined as a tax shelter if, based on representations made or proposed to be made, it is reasonable to conclude that within the plan's first four years, the represented tax benefits will equal or exceed the plan's Net Cost.

The tax shelter test is not based on what ultimately happens after the plan is in place. It is based entirely on what is reasonable to conclude from the broker's verbal or written representations, including sales pitches, meeting decks, and especially the financial illustrations. If the representation itself triggers the test, the plan legally requires a Tax Shelter Identification Number from the CRA before it can be sold, issued, or funded.

How an IFA Works (and Why Deductions Matter)

First, a quick refresher on how an IFA is illustrated: A client buys a permanent life insurance policy, and a bank lends them back an amount matching some or all of the premium they just paid. The sequence here is crucial: the premium must be paid first to put the policy in force, and only then is the loan issued. This loan is explicitly deployed to acquire an income-producing asset, rather than paying the premium directly. Because those borrowed funds are used strictly for investment purposes, the bank loan interest becomes deductible under paragraph 20(1)(c) of the Income Tax Act—along with a pro-rated portion of the policy's cost of pure insurance under paragraph 20(1)(e.2). These tax deductions are the financial engine of the strategy. The client's accountant and tax planner usually validate that the borrowing is properly sequenced so that the interest is deductible as illustrated.

The IFA Tax Shelter Walkthrough

Let's walk through Year 1 of a generic IFA representation via an illustration (attached) and answer questions to see whether the pitch crosses the statutory threshold:

1. Does the illustration include a loan?

Yes. The client borrows \$100,000 at 5% in Year 1 (Col. #4) against their policy and additional collateral (Col. #6).

2. How does the illustration represent the \$100,000 loan being used?

To acquire an investment. The presentation models the full \$5,000 interest charge (5% of \$100,000) and \$175 of insurance cost as tax-deductible (Col. #8-#11). Under the tax rules, this deduction is only legally possible if the borrowed funds are used to acquire an income-producing asset. By illustrating the tax savings on the entire loan interest amount, the presentation explicitly represents that 100% of the funds were used to acquire the property. [1]

3. Does the plan show the loan being fully repaid within 10 years?

No. The entire strategy is engineered so the debt remains outstanding for life (Col. #5) to eventually be settled by the tax-free death benefit (Col. #12). Though it is important to evaluate the actual terms of the IFA loan, if the client were obligated to repay the loan within a short period (without a reasonable expectation to immediately re-borrow that same amount), the plan would simply not function as represented. [2]

The Math Test: $C \geq A - B$

The Year 1 representation is clear: a \$100,000 income-earning investment (A), financed by a \$100,000 limited-recourse loan (B), generating \$5,175 in tax deductions (C).

Applying these figures to the Canada Revenue Agency's statutory tax shelter formula (section 237.1)[4], the rule asks: Is it reasonable to conclude, based on the representations made, that during any of the first four years, the represented tax deductions (C) equal or exceed the plan's Net Statutory Cost (A - B)? Or, simply put:

Is \$5,175 (C) $\geq$ \$100,000 (A) - \$100,000 (B)?

Because $A - B = \$0$, the plan has a **Zero Net Cost**, and the math is simple:

\$5,175 $\geq$ \$0?

Yes.

Result: Tax Shelter. Registration is required.

Characteristics of an Immediate Financed Arrangement (IFA) Life Insurance Plan

Income Tax Rate: 50.17%

Loan Interest Rate: 5.00%

Deposits as Scheduled

Dividend Scale Rate 5.35% (For Information Purposes Only)

Policy Information			Loan Details			Annual Deductions				Benefits	
#1	#2	#3	#4	#5	#6	#8	#9	#10	#11	#12	
Deposit	Cash Value	Death Benefit	Annual Loan Amount	Cumulative Loan Amount	Loan Security Collateral (#5 - #2)	Tax Deductible Interest	Tax Deductible Premium	Total Annual Tax Deductions (#8 + #9)	Total Annual Tax Savings (#10xTx%)	Net Death Benefit (#3 - #5)	
1 60	\$100,000	\$61,091	\$1,446,039	\$100,000	\$100,000	\$38,909	\$5,000	\$175	\$5,175	\$2,596	1,346,039
2 61	100,000	127,089	1,586,368	100,000	200,000	72,911	10,000	486	10,486	5,261	1,386,368
3 62	100,000	197,740	1,728,112	100,000	300,000	102,260	15,000	896	15,896	7,975	1,428,112
4 63	100,000	272,084	1,868,904	100,000	400,000	127,916	20,000	1,417	21,417	10,745	1,468,904
5 64	100,000	349,913	2,008,261	100,000	500,000	150,087	25,000	2,060	27,060	13,576	1,508,261
6 65	100,000	447,235	2,146,651	100,000	600,000	152,765	30,000	2,845	32,845	16,478	1,546,651
7 66	100,000	554,921	2,284,685	100,000	700,000	145,079	35,000	3,790	38,790	19,461	1,584,685
8 67	100,000	673,270	2,422,740	100,000	800,000	126,730	40,000	4,915	44,915	22,534	1,622,740
9 68	100,000	802,556	2,561,174	100,000	900,000	97,444	45,000	6,243	51,243	25,709	1,661,174
10 69	100,000	943,038	2,700,334	100,000	1,000,000	56,962	50,000	7,789	57,789	28,993	1,700,334
11 70	0	995,100	2,666,002	0	1,000,000	4,900	50,000	8,874	58,874	29,537	1,666,002
12 71	0	1,054,681	2,634,855	0	1,000,000	0	50,000	10,053	60,053	30,128	1,634,855
13 72	0	1,121,971	2,606,979	0	1,000,000	0	50,000	11,348	61,348	30,778	1,606,979
14 73	0	1,197,165	2,582,453	0	1,000,000	0	50,000	12,739	62,739	31,476	1,582,453
15 74	0	1,280,453	2,561,357	0	1,000,000	0	50,000	14,229	64,229	32,224	1,561,357
16 75	0	1,323,698	2,543,051	0	1,000,000	0	50,000	15,829	65,829	33,027	1,543,051
17 76	0	1,368,098	2,526,713	0	1,000,000	0	50,000	16,133	66,133	33,179	1,526,713
18 77	0	1,414,037	2,512,257	0	1,000,000	0	50,000	16,226	66,226	33,225	1,512,257
19 78	0	1,461,654	2,499,626	0	1,000,000	0	50,000	16,308	66,308	33,266	1,499,626
20 79	0	1,511,107	2,488,774	0	1,000,000	0	50,000	16,379	66,379	33,302	1,488,774
21 80	0	1,562,582	2,479,661	0	1,000,000	0	50,000	16,439	66,439	33,332	1,479,661
22 81	0	1,616,301	2,472,255	0	1,000,000	0	50,000	16,488	66,488	33,357	1,472,255
23 82	0	1,672,174	2,466,528	0	1,000,000	0	50,000	16,526	66,526	33,376	1,466,528
24 83	0	1,729,676	2,462,467	0	1,000,000	0	50,000	16,554	66,554	33,390	1,462,467
25 84	0	1,788,435	2,460,038	0	1,000,000	0	50,000	16,570	66,570	33,398	1,460,038
26 85	0	1,848,331	2,459,189	0	1,000,000	0	50,000	16,576	66,576	33,401	1,459,189
27 86	0	1,909,255	2,459,866	0	1,000,000	0	50,000	16,571	66,571	33,399	1,459,866
28 87	0	1,971,085	2,462,024	0	1,000,000	0	50,000	16,557	66,557	33,391	1,462,024
29 88	0	2,033,645	2,465,619	0	1,000,000	0	50,000	16,532	66,532	33,379	1,465,619
30 89	0	2,096,731	2,470,612	0	1,000,000	0	50,000	16,499	66,499	33,363	1,470,612
31 90	0	2,159,535	2,476,217	0	1,000,000	0	50,000	16,462	66,462	33,344	1,476,217
32 91	0	2,229,555	2,530,229	0	1,000,000	0	50,000	0	50,000	25,085	1,530,229
33 92	0	2,298,778	2,584,179	0	1,000,000	0	50,000	0	50,000	25,085	1,584,179
34 93	0	2,368,072	2,638,095	0	1,000,000	0	50,000	0	50,000	25,085	1,638,095
35 94	0	2,438,237	2,691,999	0	1,000,000	0	50,000	0	50,000	25,085	1,691,999
36 95	0	2,509,972	2,745,912	0	1,000,000	0	50,000	0	50,000	25,085	1,745,912
37 96	0	2,584,750	2,799,844	0	1,000,000	0	50,000	0	50,000	25,085	1,799,844
38 97	0	2,665,320	2,853,789	0	1,000,000	0	50,000	0	50,000	25,085	1,853,789
39 98	0	2,756,593	2,907,715	0	1,000,000	0	50,000	0	50,000	25,085	1,907,715
40 99	0	2,867,532	2,961,547	0	1,000,000	0	50,000	0	50,000	25,085	1,961,547
41 100	0	3,015,145	3,015,145	0	1,000,000	0	50,000	0	50,000	25,085	2,015,145

1,000,000

Why This Matters

This mathematical calculation triggers legal consequences under the Income Tax Act:

- **Mandatory Registration (Subsection 237.1(4)):** Promoters are legally required to obtain a Tax Shelter Identification Number from the CRA before selling, issuing, or funding the arrangement.
- **Complete Disallowance of Deductions (Subsection 237.1(6)):** If an arrangement meets the definition of a tax shelter but is unregistered, none of the claimed tax deductions may be applied by the client. The CRA can disallow these deductions retroactively to Day 1, exposing the taxpayer to back taxes and compound interest on arrears.
- **Promoter Penalties (Subsection 237.1(7.4)):** The promoter faces separate statutory penalties equal to the greater of \$500 and 25% of the consideration received.

Anticipating the Common Objections

When this mathematical reality is pointed out, promoters and lenders often rely on a predictable set of defences. Here are the short answers to why those arguments fail under the Income Tax Act. We develop these more thoroughly at tax-shelter.ca.

“The bank treats my loan as full recourse because it is callable on demand, cross-collateralized, and personally guaranteed.” The tax law governing limited-recourse debt is a statutory deeming rule that overrides standard commercial banking terms. Under section 143.2, a loan is legally deemed limited-recourse unless there is a written agreement at inception to fully repay the principal within 10 years.

“If this logic holds, every standard investment loan or HELOC would be a tax shelter.” Ordinary borrowing is a general-purpose financing tool; it is not pitched as a wealth “strategy” using pre-programmed illustrations designed to artificially manufacture a \$0 net cost. An IFA, however, is actively pitched and sold as an “arrangement.” Bank term sheets explicitly require the promoter’s integrated tax illustration to approve the credit facility, the loan is sized to exactly match the premium, and the policy is immediately pledged as collateral. This mandatory paper trail confirms it is a pre-packaged statutory “arrangement,” not a standard loan.

“I bought two distinct properties—a policy and an investment—so my property cost (A) should be \$200,000, not \$100,000.” The tax code tests properties individually. You cannot aggregate an unleveraged policy to inflate the cost base of a separate leveraged investment.

“The illustration does not specify the exact asset or property I will acquire.” By modelling the interest as fully deductible under paragraph 20(1)(c), the pitch explicitly represents that 100% of the loan is deployed into a qualifying asset. That representation legally sets the property cost (A) at \$100,000.

“The lender requires an annual review or obligates us to requalify prior to Year 10.” An annual credit review is an administrative checkpoint, not a principal repayment mandate. Under the Act, unless there is a bona fide (good faith) written contractual agreement at inception to fully repay all principal and interest within 10 years, rolling renewals—whether annual or extended every decade—are statutorily deemed under subsection 143.2(12) to be a single continuous debt. Commercial reality proves the point: many IFAs across Canada have been in place for well over 10 years without a single dollar of principal repaid, and banks have never called them. Lifelong rollover is not an accident—it is the engineered intent of the strategy.

Footnotes for References

[1]: Interest Deductibility: Paragraph 20(1)(c) of the ITA only allows interest deductions if the borrowed money is traced directly to earning income from a business or property. It strictly forbids deducting interest on money borrowed to acquire a life insurance policy.

[2]: The 10-Year Rule: Under subsection 143.2(7) of the Income Tax Act (ITA), a loan is automatically deemed to be a "limited-recourse amount" unless there are written arrangements to repay all principal within 10 years. Furthermore, subsection 143.2(12) states that if the loan is expected to roll over or be part of a series of loans lasting longer than 10 years (such as until death), it fails the 10-year test. (A loan that rolls over periodically is legally considered a single series of loans, meaning standard annual renewal terms do not bypass this rule).

[3]: Prescribed Amounts: Under Regulation 3100(3) of the Income Tax Regulations, any limited-recourse amount determined under section 143.2 that is expected to be received "in respect of" the property automatically becomes a prescribed amount. Because the loan was used directly to fund the property's acquisition, this legal connection is achieved.

[4]: The Tax Shelter Definition: Subsection 237.1(1) of the ITA defines a tax shelter as any property where it is represented that the deductions within the first four years will equal or exceed the cost of the property minus the prescribed benefits.

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