



CAPITAL DIVIDEND ACCOUNT

The Mechanism Behind *Every Tax-Free* Estate Transfer

A plain-language guide to the Capital Dividend Account — how it works, how life insurance creates CDA credits, and why it makes corporate life insurance the most tax-efficient wealth transfer tool in Canada.

\$0

PERSONAL TAX ON A CAPITAL
DIVIDEND TO SHAREHOLDERS

100%

OF LIFE INSURANCE DEATH
BENEFIT ABOVE ACB FLOWS TO
CDA

Tax-Free

WEALTH TRANSFERRED FROM
CORP TO HEIRS VIA CDA
ELECTION

The Capital Dividend Account — *Why It Exists*

The Capital Dividend Account (CDA) is a notional tax account maintained by Canadian-controlled private corporations (CCPCs). It is not a bank account, and it holds no actual cash — it is a running balance tracked by the CRA that represents certain tax-free amounts your corporation has received that can be distributed to shareholders without triggering personal income tax.

The CDA exists because of a fundamental principle in Canadian tax law: **amounts that were never taxed at the corporate level should not be taxed again at the personal level when distributed to shareholders.** Life insurance death benefits are the primary example. When a corporation receives a life insurance death benefit, the proceeds were never subjected to corporate income tax — and the CDA ensures they are not taxed at the shareholder level either.

*The CDA is the reason corporate life insurance is described as the most tax-efficient wealth transfer tool in Canada. It is the **legal mechanism** that allows a dollar to travel from your corporation to your heirs — completely untaxed at every stage.*

What Creates a *CDA Credit*?

Several types of corporate receipts contribute to the CDA balance. Life insurance is by far the most significant and most commonly used — but understanding all the sources helps paint the full picture:

01 **Life Insurance Death Benefits (Primary Source)**

When a corporation is the named beneficiary of a life insurance policy and the insured dies, the death benefit is paid to the corporation tax-free. The amount of the death benefit that exceeds the policy's adjusted cost basis (ACB) is credited directly to the CDA. For well-structured policies with low ACBs, this means the vast majority of the death benefit flows into the CDA and can be distributed to shareholders with zero personal tax.

02 **Capital Gains — The Non-Taxable Portion**

When a corporation realizes a capital gain — from the sale of shares, real estate, or other capital property — only 50% of the gain is included in taxable income (the capital gains inclusion rate). The other 50% (the non-taxable portion) is credited to the CDA. This allows shareholders to receive that untaxed half as a capital dividend, tax-free.

03 **Capital Dividends Received from Other Corporations**

If your corporation receives a capital dividend from another CCPC, that amount is added to your corporation's CDA balance in full. This allows tax-free amounts to flow up through a corporate structure — for example, from an operating company to a holding company — and ultimately to shareholders, without triggering tax at any level.

04 **Capital Losses (Negative CDA Impact)**

Capital losses realized by the corporation reduce the CDA balance. The non-deductible portion of a capital loss (50%) reduces the CDA. This is why tracking the CDA balance carefully — with your accountant — is essential before making a capital dividend election. A negative CDA balance means no capital dividend can be paid until new credits are created.

How Life Insurance Creates *CDA Credits — The Math*

The formula is straightforward: **CDA Credit = Death Benefit – Adjusted Cost Basis (ACB)**. The ACB is essentially the cumulative net premiums paid into the policy, reduced by the pure insurance cost over time. For participating whole life policies with large death benefits, the ACB is typically a small fraction of the total death benefit — meaning the CDA credit is close to the full death benefit amount.

Here is how the numbers work across three different policy sizes:

POLICY SIZE	DEATH BENEFIT – ACB	CDA CREDIT CREATED
Small Policy \$500K death benefit	\$500,000 – \$85,000 ACB	\$415,000 to CDA 83% of death benefit
Mid-Size Policy \$1.8M death benefit	\$1,800,000 – \$210,000 ACB	\$1,590,000 to CDA 88% of death benefit
Large Policy \$5M death benefit	\$5,000,000 – \$480,000 ACB	\$4,520,000 to CDA 90% of death benefit

ACB figures are illustrative estimates. Actual ACB depends on the policy type, carrier, premium history, and policy age. Your advisor tracks ACB projections as part of every strategy design.

How to Distribute CDA Proceeds

Tax-Free to Shareholders

Having a CDA balance is not enough on its own — you must elect to pay a capital dividend before the funds can be distributed tax-free. This is a formal CRA process with specific filing requirements. Here is how it works, step by step:

1

NO TAX EVENT

Confirm the CDA Balance with Your Accountant

Before any election, your accountant must calculate and verify the current CDA balance. This involves reviewing the corporation's history of capital gains, capital losses, life insurance receipts, and any prior capital dividends paid. The CDA balance must be positive before an election can be made. Your advisor and accountant work together on this step.

2

ADMINISTRATIVE

Board Resolution to Declare a Capital Dividend

The corporation's directors pass a board resolution declaring a capital dividend in the amount of the elected CDA credit. This resolution specifies the amount of the dividend, the class of shares it will be paid on, and the payment date. Your corporate lawyer typically prepares this document as part of the broader estate or succession planning process.

3

CRA FILING

File Form T2054 — Election in Respect of a Capital Dividend

The corporation files CRA Form T2054 no later than the earlier of: the day the dividend is paid, or the day a dividend becomes payable. The form includes a Schedule 89 (the CDA calculation) and must be accompanied by a copy of the board resolution. Filing late results in Part III tax — a penalty equal to 60% of the excess over the CDA balance. Accuracy and timing are non-negotiable.

4

ZERO PERSONAL TAX

Capital Dividend Paid to Shareholders

The corporation pays the capital dividend to eligible shareholders — typically the business owner, surviving spouse, children, or estate beneficiaries. The shareholder receives the full dividend amount with **zero personal income tax**. No T5 slip is issued for the taxable portion (there is none). No withholding. The shareholder simply receives the cash, completely tax-free.

5

POST-ELECTION

CDA Balance Reduced by the Dividend Paid

Once the capital dividend is paid, the CDA balance is reduced by the amount distributed. If the full balance was paid out, the CDA returns to zero. Future life insurance proceeds, capital gains, or capital dividends received will rebuild the CDA balance again over time — making it a recurring planning opportunity for corporations with ongoing insurance strategies.

Sandra — Edmonton

Incorporated Entrepreneur, Age 58

Corporate-owned life insurance · Policy in force 18 years · Insured passes at age 76

DEATH BENEFIT	POLICY ACB	CDA CREDIT	PERSONAL TAX
\$2,400,000	\$310,000	\$2,090,000	\$0

STEP-BY-STEP CDA FLOW

Death benefit paid to corporation (tax-free)	\$2,400,000
Less: Policy adjusted cost basis (ACB)	(\$310,000)
CDA credit created	\$2,090,000
Board resolution passed — capital dividend declared	Day 3 after death
CRA Form T2054 filed by accountant	Day 7 after death
Capital dividend paid to Sandra's estate / heirs	\$2,090,000
Personal income tax on \$2,090,000 received	\$0
Remaining \$310,000 (ACB portion) — taxable dividend	~\$140,000 after-tax
Total net to Sandra's estate	~\$2,230,000

WHAT WOULD HAVE HAPPENED WITHOUT LIFE INSURANCE?

Same \$2,400,000 in corporate GICs / investments	\$2,400,000
Passive income tax drag over 18 years (~50%/yr)	~(\$620,000)
Estimated net corporate value	~\$1,780,000
Personal dividend tax to extract (45% avg)	~(\$800,000)
Total net to estate without strategy	~\$980,000

** Sample illustration only. Actual results depend on policy ACB, tax rates, dividend scale, and individual circumstances. Not a guarantee of future performance.*

WHY LIFE INSURANCE

Why Corporate Life Insurance Is *the Most Effective CDA Tool*

While several events can create CDA credits, life insurance is uniquely powerful because it creates a **guaranteed, pre-planned, tax-free transfer** at a known future date. Here is how it compares to the other sources of CDA credits:

CDA CREDIT SOURCE	CERTAINTY	CONTROL	SIZE	BEST USE
Life insurance death benefit	Guaranteed at death	Fully controlled — policy design determines ACB and benefit	Large — often \$500K to \$5M+	Primary estate transfer tool
Capital gains (50% non-taxable)	Uncertain — depends on when assets are sold	Partial — timing can be managed but not guaranteed	Variable — depends on gain realized	Opportunistic CDA building alongside asset sales
Capital dividends received	Dependent on other corps paying	Moderate — requires inter-company planning	Variable	HoldCo / OpCo flow-through structures

*No other CDA credit source offers **certainty, scale, and control** simultaneously. A capital gain requires selling an asset. A capital dividend requires another corporation paying one. Life insurance delivers a guaranteed, pre-designed CDA credit at exactly the moment your estate needs it most — at death.*

Four CDA Mistakes That *Cost Business Owners Dearly*

01

Not Tracking the ACB

Every participating whole life policy has an adjusted cost basis that changes each year. Advisors who do not track ACB projections may leave clients believing the full death benefit flows into the CDA — when a meaningful taxable portion actually remains. ACB tracking must be built into the plan from day one and reviewed annually.

02

Filing the T2054 Late

The CDA election must be filed by the dividend payment date. Filing after the dividend is paid, or failing to file at all, triggers Part III tax — a penalty of 60% of the excess dividend over the CDA balance. In a large estate situation, this error can cost hundreds of thousands of dollars. Your accountant must be looped in well before any CDA distribution.

03

Paying a Capital Dividend in Excess of the CDA Balance

If the capital dividend paid exceeds the CDA balance at the time of election, the excess is subject to Part III tax at 60%. This error typically occurs when the CDA balance has not been properly calculated, or when prior capital losses have reduced the balance below what the advisor or accountant assumed. Always calculate before electing.

04

Personally-Owned Policy — No CDA Benefit

If the life insurance policy is owned personally rather than corporately, the death benefit is paid directly to the personal beneficiary — bypassing the corporation entirely. There is no CDA credit created, no capital dividend, and no tax-free corporate distribution. The CDA benefit only exists when the corporation is the policy owner and the named beneficiary. This is one of the most costly structural errors in life insurance planning.

Find Out What Your Corporation's *CDA Could Look Like*

The CDA is only as powerful as the strategy behind it. A 15-minute call with our team will show you exactly how to structure a corporate life insurance policy to maximize your CDA credit — and what that means in real dollars for your estate.

- ✓ Review of your current corporate structure and policy ownership
- ✓ Death benefit and ACB projection for your situation
- ✓ Estimated CDA credit and net estate value modelled out
- ✓ Coordination with your accountant on T2054 and CDA tracking
- ✓ Carrier recommendation to maximize the CDA credit for your age and health

[BOOK A STRATEGY CALL →](#)

Cody Vass · Goald & Co Financial Inc. · Licensed in BC, AB & ON

Goald & Co Financial Inc. is a licensed life insurance brokerage operating in British Columbia, Alberta, and Ontario. Cody Vass is a licensed life insurance advisor. This guide is intended for general informational purposes only and does not constitute tax, legal, or financial advice. CDA elections require the filing of CRA Form T2054 and should be completed with the assistance of a qualified accountant. Filing errors may result in Part III tax penalties. All figures shown are illustrative estimates only. · goald.ca