

Funding the Buy-Sell: Why the Insurance Structure Is Half the Agreement

A buy-sell agreement with no funding plan is a promise on paper. Here's what to flag before the ink dries.

THE GAP

- A shareholders' agreement says the shares get bought out on death. It rarely says where the cash comes from.
- Without a funded plan: a forced asset sale, a drawn-out promissory note to the estate, or the survivor at the bank on the worst possible day.

THREE WAYS TO FUND IT

Method	How it works	Trade-off
Cross-purchase	Owners personally insure each other; proceeds buy the shares directly from the estate.	Simple, but the deceased's estate absorbs the full capital gain.
Corporate redemption	Corp owns the policy, posts the tax-free proceeds to the CDA, redeems the deceased's shares.	Preserves corporate cash, but the survivor gets no ACB bump — the gain just moves downstream.
Hybrid / promissory note	Estate sells part of the shares directly to the survivor (using remaining LCGE); corp redeems the rest via CDA.	Usually the lowest combined tax bill — but more moving parts, and it needs LCGE room to work.

THE MECHANICS THAT MATTER

- **ACB:** only increases when the survivor actually pays for shares. A straight redemption leaves it at zero — that defers the tax, it doesn't eliminate it.
- **CDA:** tax-free insurance proceeds received by a corporation post to the capital dividend account. A “50% solution” is often used to preserve CDA room while still allowing a capital-loss carryback at the estate level.
- **Stop-loss rules:** can limit that carryback if the full CDA balance is used at once — this is where the redemption structure needs care.

WHERE YOU COME IN

- The funding method needs to be chosen before the agreement is drafted — it determines who owns the policy, how the purchase price is worded, and what the T2054 capital dividend election looks like.
- If a client's shareholders' agreement predates their policies (or vice versa), it's worth a joint look.

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For discussion with your professional advisors — not tax, legal, or accounting advice. Happy to work alongside whoever's already in the file.