

Life Insurance and Shareholder Benefits – Part 2

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In an earlier article,¹ we discussed *Harding v. The Queen*.² In *Harding*, the Tax Court of Canada (TCC) included corporate-paid premiums in a shareholder's income where the beneficiaries were the shareholder's spouse and stepchildren, and the life insured was the shareholder. The TCC applied subsection 15(1) of the *Income Tax Act (Canada)*³ to include the premiums in the shareholder's income.

*Gestion M.-A. Roy Inc. v. The King*⁴ deals insurance planning considerations when different corporations within a corporate structure are the owner, beneficiary, or payor of an insurance policy(ies). In *Gestion Roy*, the TCC found that there was a taxable shareholder benefits to two holding companies (Holdcos) when an operating company (Opco) paid insurance premiums for various insurance policies owned by the Holdcos and where Opco was the beneficiary. The TCC concluded that a subsection 15(1) shareholder benefit applied to Gestion M.-A Roy Inc. (Holdco1) and a subsection 246(1) benefit applied to 4452712 Canada inc. (Holdco2). This article discusses *Gestion Roy* and what to keep in mind when considering a shareholder benefit under subsections 15(1) and 246(1).⁵

¹ See Sanjana Bhatia, "Life Insurance and Shareholder Benefits," September 2022. ([Click here for the French version.](#))

² 2022 TCC 3 (*Harding*).

³ R.S.C., 1985, c. 1 (5th Supp.) (ITA). Unless otherwise noted, all statutory references will be to the ITA.

⁴ 2022 CCI 144 (*Gestion Roy*). This article cites from an unofficial English translation of this decision.

⁵ It's best to involve the Client's tax advisor in order to help consider potential shareholder benefit issues. Please see the full disclaimer at the end of this document.

Facts

The corporate structure

In 1996, Marc-André Roy (Marc-André) founded Opco, a technology consulting company. Holdco1 held about two-thirds of Opco's shares. Marc-André was Holdco1's majority shareholder.

The company expanded internationally and created foreign subsidiaries to offer the same services as Opco. In 2011, the company consolidated the foreign subsidiaries into one entity, R3D International Inc. (R3DI). Holdco2 was R3DI's majority shareholder. Marc-André was also Holdco2's majority shareholder. This meant that Holdco1 and Holdco2 were sister companies.

The buy-sell agreement

In 2004, Marc-André and three other significant shareholders entered into a buy-sell agreement. The purpose of this agreement was to fund the redemption (buy back) of shares upon the shareholder's death from his/her estate. Insurance policies would fund the redemption. The agreement stated that the value of the insurance policies were to reflect the shares' fair market value and provided a mechanism to evaluate the company annually.

The life insurance policies

In 1998, Opco purchased a \$3 million, 10-year term policy. It insured Marc-André's life and Opco was the policyholder and the revocable beneficiary. In 2004, after the signing of the buy-sell agreement, Marc-André's advisors recommended converting the term policy to a whole life insurance policy with cash values. They also recommended that Marc-André transfer the policy from Opco to Holdco1 and Opco would remain as the revocable beneficiary.

The business grew by about 40% per year. To reflect this growth, the shareholders purchased more insurance to fund the buy-sell agreement. Holdco1 owned two life insurance policies for a total face amount of \$5 million. Holdco2 owned four policies for a total of \$15 million. Therefore, Marc-André was insured for a total of \$20 million.

The sale of Opco and R3DI

In 2019, a third party purchased Opco and R3DI. With the sale, the Holdcos no longer required the insurance policies, and the policies were cancelled.⁶ After the cancellation of the insurance policies, Marc-André instructed the insurance carrier to pay the insurance policies' cash values to Opco. Also in 2017, Marc-André withdrew \$360,000 from the Holdco-owned policies. He directed the insurance carrier to pay these proceeds to Opco. Opco showed the amount of the withdrawal on its financial statements and included a taxable policy gain of \$98,840 in its income.

The premiums and assessment

During the taxation years 2014 to 2017, Holdco1 paid total premiums of \$88,782 on its two policies. Holdco2 paid total premiums of \$279,763 on its four policies. While Holdco1 and Holdco2 were the policyholders, Opco paid the premiums on all of the policies. The Holdcos did not reimburse Opco for the premiums it paid.

The Minister of National Revenue (MNR) assessed the Holdcos for taxable benefits. The taxable benefits were the premiums that Opco paid. The assessed amounts are summarized in the chart below:

Amount of taxable benefit for the taxation years 2014-2017		
	Holdco1	Holdco2
Premiums paid	\$88,782	\$279,763
Applicable ITA section	15(1)	246(1)

The MNR assessed Holdco 1 under subsection 15(1) and Holdco2 under subsection 246(1).

⁶ Except for one insurance policy which served as collateral in the sale.

Subsections 15(1) and 246(1)

Subsection 15(1) provides generally that, where a corporation has *conferred* a benefit on a shareholder, the value of that benefit will be included as income to that shareholder. The amount, or value, of the benefit is taxed as regular income to the shareholder in the year the benefit is conferred. Subsection 15(1) also applies to a person contemplating becoming a shareholder. Its purpose is to prevent shareholders from using corporate property for personal use without paying tax.

Subsection 246(1) generally requires a taxpayer to include in income the value of a benefit conferred on the taxpayer, directly or indirectly, in any manner whatever by a person, to the extent that it is not otherwise included in computing the taxpayer's income and to the extent that it would be included in the taxpayer's income if it were a payment made directly to the taxpayer.

Commercial reasons for the holdco-owned policies

Marc-André and the Holdcos asserted that it was better to have the Holdcos as policyholders for commercial reasons:

- to have the flexibility of changing the beneficiary if the corporate structure changed
- to shelter the cash values from Opco's creditors
- to ensure that Opco had the necessary cash to redeem the shares on death as per the buy-sell agreement, and
- to reassure Opco's other shareholders that they could avoid a third party obtaining control of the company upon Marc-André's death.

They also explained that it was "logical for [Opco] to pay the premiums" because it would receive the death benefit.

Issues and arguments

The court accepted that it was practical for Opco to pay the premiums, but the court asserted that that was not the issue. The issue was whether Opco conferred a shareholder benefit on the Holdcos under

subsections 15(1) and/or 246(1). The court then proceeded to address the Holdcos' arguments, a few of which were as follows:

- The advisors recommended that Opco be the premium payor and beneficiary.
- Opco behaved as the "real owner" of the insurance policies.
- The Holdcos did not receive any economic benefit from the insurance policies.
- There was an "implicit" assignment of the Holdcos' policy rights to Opco.

We discuss each of these arguments below.

TCC Decision

The advisors recommended that Opco be premium payor and beneficiary

The taxpayers argued that they accepted their advisors' recommendation to change the insurance policies' ownership from Opco to the Holdcos. They appeared to assert that they were prejudiced in doing so. The court rejected this argument stating that an accounting error cannot be accepted as exonerating the taxpayers' liability and making it possible to conclude that they did not want what happened.⁷ The court reiterated that: "The same is true whether it is an insurance broker or another professional."

Opco behaved as the "real owner" of the insurance policies

The Holdcos also argued that Opco always behaved as the "real owner" of the policies. To support this argument, they asserted that Opco controlled the policies because it decided on:

- the amount of insurance to purchase
- when to take out a new insurance policy
- the policyholder
- the policies' cancellation, and
- instructions to the insurer.

In rejecting this argument, the court agreed with the MNR that the Holdcos cannot claim that Opco, as revocable beneficiary, had the same rights and obligations as a policyholder or that it could exercise the

⁷ For this proposition, the court relied on *Dyck v. La Reine*, 2007 TCC 458 and *Helwani c. Quebec Revenue Agency*, 2015 QCCQ 6676.

policyholders' rights while the insured is alive. For example, the court stated that the right to receive the cash surrender value is a right of the insured or the policyholder, and not of the beneficiary.⁸ The court noted that Marc-André (as the administrator of the Holdcos):

- signed the insurance contracts
- designated Opco as the revocable beneficiary
- reserved the right to change the beneficiary designation, and
- instructed the insurer for the transfer of the cash values to Opco in 2017 and in 2019.

The court further explained that the Holdcos were the real policyholders with the following policyholder rights:

- to dispose of the insurance contract
- to redeem, transfer, mortgage the insurance contract
- to give pledge the insurance policy as security
- to sell the insurance contract to a third party, and
- to name and change revocable beneficiaries.

The policy beneficiary only acquires the right to the death benefit proceeds and cash values on the insured's death.

The Holdcos did not receive any economic benefit from the insurance policies

The Holdcos argued that as policyholders, they did not see their wealth increase from the value of the insurance policies or from the Opco-paid premiums. The only economic benefit was the receipt of the cash values, but these were paid to Opco.

The Court rejected this argument because the premiums are an easily measurable economic benefit. The court stated that the Holdcos "got rich" by the Opco-paid premiums and Opco "got poorer." The court also stated that the cash values that Opco received is irrelevant to the taxable benefit issue.

There was an "implicit" assignment of the Holdcos' policy rights to Opco

⁸ *Scotti v. Agence du Revenu du Québec*, 2019 QCCQ 7579 and *White v. The Queen*, 2008 TCC 414.

The Holdcos argued that there was an “implicit” assignment of the policyholders’ rights. The insurance carrier recognized this assignment when it agreed to pay the cash values to Opco.

The court rejected this argument because there cannot be an assignment of the cash value balance which was paid out under Marc-André’s instructions.

The court concluded that Opco conferred a subsection 15(1) benefit on Holdco1. The court also concluded that the analytical framework on subsections 15(1) and 246(1) is essentially the same in this case.⁹ Therefore, Opco also conferred a benefit on Holdco2 within the meaning of subsection 246(1).

Canada Revenue Agency (CRA) Views

The Canada Revenue Agency (CRA) has affirmed that there is no subsection 15(1) shareholder benefit where a Holdco is the policyholder and premium payor and where Opco is the beneficiary.¹⁰ However, the CRA stated subsection 246(1) could apply.¹¹ The CRA has also stated that the general anti-avoidance rule (GAAR) could apply.¹²

The CRA also asserts that if Opco reimbursed the Holdco policyholder for the premiums, the reimbursement could be included in the income of the Holdco under section 9 or paragraph 12(1)(x).¹³ However, Opco can pay its parent company tax-free intercorporate dividends to provide liquidity within its corporate group. Therefore, it would difficult for the CRA to sustain its position that subsection section 9 or paragraph 12(1)(x) applies to this structure.

Section 9 generally states that a taxpayer's income for a taxation year from a business or property is the taxpayer's profit from that business or property for the year. Paragraph 12(1)(x) generally requires a taxpayer to include in computing income for a taxation year an amount received in the year from another person who pays the amount for the purpose of gaining or producing income from a business or property if

⁹ The court relied on *Laliberte v. The Queen*, 2020 FCA 97.

¹⁰ 2022 Association de planification fiscal et financier CRA Roundtable Q2#2022-0936281C6 (October 7, 2022) (APFF Conference 2022); CRA Document No. 2021-0882441E5, November 16, 2022; CRA Document No. 2010-0359421C6, May 4, 2010.

¹¹ *Ibid.*

¹² See CRA Document No. 2007-0257251E5, November 19, 2009.

¹³ CRA Document No. 2010-0359421C6, May 4, 2010. At the APFF Conference 2022, the CRA stated that it would be necessary to review all the facts and relevant documentation to determine whether the reimbursement should be included in the holding company's income under section 9 or paragraph 12(1)(x).

the amount can reasonably be considered to have been received as an inducement, reimbursement, contribution or allowance to the extent that the amount was not already included in computing the taxpayer's income.

Key takeaways

Key takeaways from *Gestion Roy* include:

- When a Holdco is the policyholder and Opco is the beneficiary and payor on an insurance policy, the CRA may apply subsection 15(1) and/or 246(1) to state there is a shareholder benefit to the Holdco. The CRA may include the shareholder benefit in the Holdco's income. This will be taxed as regular income. Therefore, it's best that Opco not pay the premiums on a holdco-owned policy, or reimburse the Holdco for the premium.
- The CRA could apply subsection 246(1) and the GAAR if the Holdco is the policyholder and payor and Opco is the beneficiary of an insurance policy.
- It is important to identify the Clients' insurance needs at the outset. Some of the Client's corporate insurance needs may be funding for buy-sell purposes.¹⁴ This would involve considering issues such as:
 - Equitable premium allocation
 - Avoiding a policy transfer in the future
 - Creditor protection of Opco

Documenting the business purpose for the insurance is always a good practice.

- Clients' personal insurance needs may include:
 - Estate equalization
 - Providing spousal support and children
 - Donating to a charity
- When considering shareholder benefit issues, it may be better for Clients to purchase more than one policy to fund different purposes: one (or more) for business and one (or more) for personal. This is because, depending on the circumstances, it may not be advisable to name the insured

¹⁴ For more information, see Sun Life's Guides by Stuart Dollar: 1) [Buy-Sell Agreements: Funding and Basic Structures](#); 2) [Buy-Sell Agreements: Planning for Incorporated Businesses](#); 3) [Buy-Sell Agreements: Planning for Businesses Owned Through Holding Companies](#).

shareholder's spouse, children, estate, or other related parties as beneficiaries on a corporate-owned life insurance policy.

- *Gestion Roy* is the second case released in 2022 on the issue of life insurance and shareholder taxable benefits. This may indicate an increasing audit trend of these type of cases and that there may be more cases in the pipeline.
- The Holdco taxpayers appealed the TCC decision on December 20, 2022 to the Federal Court of Appeal (FCA). It will be interesting to see how the FCA decides the shareholder taxable benefit issues in this case.

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