

## Life Insurance and Shareholder Benefits

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Business owners may not be aware that there may be a taxable shareholder benefit when their corporations pay life insurance premiums on policies where their spouses, children, estate or other related parties are the named beneficiaries. In such cases, subsection 15(1) of the *Income Tax Act (Canada)*<sup>1</sup> could apply to include the premiums in shareholders' income. *Harding v. The Queen*<sup>2</sup> is a recent decision of the Tax Court of Canada (TCC) which dealt with this issue. In this case, the TCC included corporate-paid premiums in the shareholder's income where the beneficiaries were the shareholder's spouse and stepchildren, and the life insured was the shareholder. This article discusses *Harding* and what to keep in mind when considering a shareholder benefit under subsection 15(1).<sup>3</sup>

### **Significance of a subsection 15(1) shareholder benefit**

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

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

<sup>2</sup> 2022 TCC 3 (*Harding*).

<sup>3</sup> 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.

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.

Because the shareholder benefit is taxed as regular income (not dividends), the dividend tax credit is not available to the shareholder. Also, the corporation does not receive a corresponding deduction. Therefore, the shareholder benefit results in double taxation. For example, if the corporation is taxed at 12%, it has to earn almost \$114 to pay a \$100 premium. If the shareholder's tax rate is 50% on the \$100 premium, \$64 ( $\$14 + \$50$ ) is lost to taxes on the initial \$114 the corporation earned, or 56% ( $\$64/\$114$ ).

## Facts

Boyd Harding (Boyd) was the sole shareholder and sole director of 654818 N.B. Ltd., a holding company (Holdco). Holdco was the majority shareholder of Boyd B. Harding Ltd. (Opco). Boyd was a shareholder and the sole director of Opco. Opco was in the logging business with substantial annual income of \$18 million and annual profits of \$1 million. Opco paid the premiums on four life insurance policies that insured the lives of Boyd and/or his spouse, Deborah. Boyd did not reimburse Opco for the premiums. The beneficiaries of the policies were Boyd's spouse and/or his four stepchildren.

The Minister of National Revenue (MNR) reassessed Boyd to include in his income \$106,703.26, \$228,925.09 and \$140,973.01 for the 2013, 2014 and 2015 taxation years respectively. Opco paid these amounts as premiums on the policies.

The details of the four policies are in the chart below.

The Harding Life Insurance Policies					
Policy	Policyholder	Payor	Face Amount	Life Insured	Beneficiaries
1	Deborah	Opco	\$400,000	Deborah	Stepchildren <sup>4</sup>
2	Holdco	Opco	\$4,000,000	Deborah	Stepchildren – 75% <sup>5</sup> Holdco – 25%
3	Holdco	Opco	\$2,000,000	Boyd	Stepchildren – 75% <sup>6</sup> Holdco – 25%
4	Holdco	Opco	\$2,000,000	Boyd	Deborah

### Issues

The sole issue was whether Opco had *conferred* a benefit upon Boyd by paying premiums on insurance policies where Boyd's spouse and stepchildren were the policy beneficiaries.

This issue involved answering the following questions:

1. Did Opco purchase the policies for legitimate business purposes?
2. Did Opco confer a benefit upon Boyd?

<sup>4</sup> Policy 1 was cancelled in December 2014. Policy 2 was cancelled in November 2015.

<sup>5</sup> For policies 2 and 3, the MNR prorated the premium inclusions based on: 1) the percentages the stepchildren were beneficiaries of the policies and, 2) for the portion of the year where Boyd's stepchildren were the beneficiaries.

<sup>6</sup> For policy 2, for the first of 2013 and after November 26, 2014, Holdco was the sole beneficiary. For policies 3 and 4, for the first part of 2013 and latter part of 2015, Holdco was the sole beneficiary.

## TCC Decision

*Did Opco purchase the policies for a legitimate business purpose?*

In examining whether a benefit is “conferred,” the court stated that it is a question of fact whether a corporation enters into transactions for business purposes rather than for personal purposes.<sup>7</sup> In this case, Boyd’s lawyer acknowledged that there was no legitimate business purpose for the insurance policies. Boyd’s accountant further testified that it was inappropriate to have a policy with a non-corporate beneficiary such as a spouse or children. The court appeared to accept the accountant’s testimony.

*Did Opco confer a benefit upon Boyd?*

The court also stated that a benefit may be conferred without any intent or actual knowledge on the part of the shareholder if the shareholder or corporation *ought to have known* that a benefit was conferred upon him.<sup>8</sup> Boyd argued that there was no intention on Opco’s part to *confer* a benefit on him for the following reasons:

- the lives insured under the policies remained alive and death benefits were never paid,
- the premiums were insignificant,
- he did not know there was a policy insuring his wife, Deborah,
- he did not know that his spouse or his stepchildren were beneficiaries of any of the policies,
- Boyd’s stepdaughter, Nicole (also the insurance broker on the policies)
  - made various changes to the beneficiary designations without his knowledge,
  - duped him into purchasing the life insurance, and
  - changed the beneficiaries to benefit herself and her siblings.<sup>9</sup>

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<sup>7</sup> The leading cases are *Pillsbury Holdings Ltd. v. MNR*, (1964), [1965] 1 Ex CR 676 and *Laliberté v. Canada*, 2020 FCA 97.

<sup>8</sup> *Canada v. Chopp* [1998] 1 CTC 407 (FCA).

<sup>9</sup> The court noted, however, that Nicole was not called to give evidence at trial.

In addressing Boyd's first argument, the court referred to the decision in *Larue v. The Queen*.<sup>10</sup> In *Larue*, the taxpayer was the life insured under an insurance policy and his spouse was the named beneficiary. The premiums were paid by the taxpayer's corporation, J.A. Larue Inc. The MNR added \$4,438 to the taxpayer's income for both the 1997 and 1998 taxation years as benefits conferred on a shareholder under subsection 15(1).

The taxpayer argued that the life insurance proceeds were to be used for share redemption (buy-sell) purposes. He also argued that there was an error in naming the wife as the beneficiary and that J.A. Larue Inc. was the intended beneficiary.

The court concluded that even though there may have been an error, the spouse, in case of death, *would have become* the beneficiary of that insurance policy without any obligation toward the corporations or their shareholders. Also, a shareholders' agreement was not produced that could confirm the taxpayer's tax planning for purchasing life insurance for share redemption purposes. Since J.A. Larue Inc. paid premiums for a life insurance policy under which payment *would have been made* to his spouse in case of his death, the taxpayer received a subsection 15(1) shareholder benefit.<sup>11</sup>

The court in *Harding* relied on *Larue* as authority for the proposition that there is a taxable shareholder benefit on corporate-paid premiums where a spouse and/or children are beneficiaries because the death benefit *would have been paid* to them. Actual payment is not necessary for a taxable shareholder benefit.<sup>12</sup> Another reason not stated in the judgment is that life insurance protects the policy owner or beneficiary from the financial harm that could arise from a catastrophic event like the life insured's death. The price for that protection, the policy premiums, is the value of that benefit while the life insured is alive. When the corporation pays for life insurance protection that the shareholder (or someone close to the shareholder) enjoys, the corporation confers a benefit on the shareholder.

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<sup>10</sup> 2003 TCC 288 (*Larue*).

<sup>11</sup> The court also held that the circumstances justified a reassessment beyond the normal reassessment period and the imposition of penalties.

<sup>12</sup> See also *Reakes Enterprises Ltd. v. The Queen*, 2006 TCC 95.

In deciding that Boyd ought to have known that Opco was that payor of the premiums, the court referred to the following facts:

- Boyd's accountant reviewed Opco's financial statements with him at the time Boyd signed them, and Boyd admitted to signing them.
- Boyd knew that Opco paid the premiums on the insurance policies.
- The insurance premiums were expenses that were transferred to Holdco and appeared on Holdco's financial statements and tax returns. Boyd signed these as well.
- The insurance expenses were Opco's top expenses for each year and were, therefore, significant.
- The insurance company sent the insurance documents to Holdco which identified the life insured and beneficiaries.
- Boyd signed the beneficiary forms which were changed several times over the years.

The court also noted that this was not a situation where there could not be a shareholder benefit due to a simple bookkeeping error.

It's important to keep in mind that shareholder benefit cases each turn on their facts. The court may have reached a different result in *Harding* and found that there may not have been a shareholder benefit if:

- At the time of signing, this was the only beneficiary designation (and not several changes to the designations as in *Harding*), and
- Boyd produced a shareholders' agreement showing that his intention in purchasing the policies was for buy-sell purposes.

The above factors may have strengthened Boyd's case in showing that there was no shareholder benefit conferred on him under subsection 15(1).

## Canada Revenue Agency (CRA) Views

The CRA has published rulings on whether insurance premiums are shareholder benefits. For example, the CRA has stated that there is no shareholder benefit where Opco is the policyholder, payor and beneficiary on an insurance policy, the life insured is the shareholder,<sup>13</sup> and the lives insured are the shareholder and the shareholder's spouse on a joint first to die policy.<sup>14</sup> In another ruling, the CRA affirmed that there is no shareholder benefit where Holdco is the policyholder and payor and Opco is the beneficiary.<sup>15</sup> In another ruling, however, the CRA stated that Holdco must include in income the premiums Opco pays on a policy where Opco is the policyholder and payor, and Holdco is the beneficiary.<sup>16</sup> The CRA reasons that Opco is impoverished, and Holdco receives an economic benefit.

## Key takeaways

Some of the key takeaways from *Harding* include:

- When considering shareholder benefit issues, it may be better for Clients to purchase more than one policy to fund different purposes.
- Corporate purposes: If Clients purchase policies for corporate purposes like funding a buy-sell agreement, naming the corporation as the policyholder and beneficiary may help with tax planning. On the death of the shareholder, the corporation receives the death benefit. The death benefit can then flow out through the corporation's capital dividend account (less the policy's adjusted cost basis) to the spouse, children or estate as surviving shareholders.
  - Depending on the circumstances, it may not be advisable to name the insured shareholder's spouse, children, estate, or other related parties as beneficiaries on a corporate-owned life insurance policy.
  - It's a good idea to document the business purpose for the insurance.

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<sup>13</sup> CRA Document No. 2004-007297117, dated June 3, 2004.

<sup>14</sup> CRA Document No. 2012-0446491E5, dated July 25, 2012.

<sup>15</sup> CRA Document No. 2007-0257251E5, dated November 19, 2009. The CRA stated, however, the general anti-avoidance rule (GAAR) under section 245 and subsection 246(1) could apply.

<sup>16</sup> CRA Document No. 2007-0257251E5, November 19, 2009. The CRA stated, however, the GAAR and subsection 246(1) could apply.

- Personal purposes: If Clients purchase policies for personal purposes such as spousal support (spouse as beneficiary), support for children (children as beneficiaries), and charitable gifts (charity as beneficiary), it may be a good idea for the shareholder to personally own and fund the policies.

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