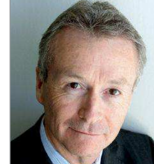
BY KEVIN WARK



True Insurance Value

CRA challenges capital dividend amount arising from insurance proceeds

Most insurance advisors are familiar with the benefits of corporate-owned life insurance. To start, it may be "cheaper" to fund the premiums with after-tax corporate dollars rather than using personal funds. The tax-free receipt of the insurance proceeds can be used to pay down business debt and/or create needed liquidity. And most (if not all) of the death benefit can be paid as a tax-free capital dividend to the deceased's estate to fund estate liabilities.

The recent Tax Court of Canada (TCC) decision in *Rogers Enterprises (2015) Inc. v. The Queen* implicitly demonstrates the value of corporate-owned life insurance for even the wealthiest of families, with an additional tax twist that was decided in favour of the taxpayer.

Ted Rogers built Rogers Communications into one of Canada's largest public companies, a leader in wireless communications, cable television, telephone, and internet connectivity. Although he passed away in 2008, his family continues to have a significant shareholder interest in Rogers Communications.

In recognition of the importance of Ted Rogers to the business enterprises and family wealth, 12 life insurance policies were taken out on his life. Family-owned private corporations primarily held these policies. Over the course of time, a number of transactions involved the policies, and upon Rogers's death the taxpayer corporation received approximately $100 million in life insurance proceeds. The taxpayer credited the full amount of the insurance proceeds to its capital dividend account (CDA) — more on this later — and subsequently distributed dividends to other family corporations, electing the full amount of these dividends be treated as capital dividends.

The CDA credit from life insurance proceeds will normally be reduced by the adjusted cost basis (ACB) of the related life insurance policies. In this case the policies had a cumulative ACB of approximately $42 million, and thus it might have been expected that the taxpayer's CDA credit would be reduced by this amount. But the Canada Revenue Agency (CRA) had previously confirmed in several technical interpretations that where the corporate beneficiary was not the owner of the insurance policies, the ACB of the policies would not reduce the CDA credit.

However, the CRA also indicated that it did not feel this was the appropriate tax result, and might apply the general anti-avoidance rule (GAAR) to challenge situations where it appeared that the main purpose for arranging the ownership and beneficiary designation in this manner was to increase the CDA credit. The taxpayer therefore relied on its understanding of the law, as well as the CRA's interpretations, to credit the full amount of the insurance death benefit to its CDA. The CRA responded by applying the GAAR to these arrangements and issuing a "notice of determination" to reduce the taxpayer's CDA credit by $42 million. Not surprisingly, the taxpayer appealed this decision to the TCC.

One more very relevant fact is that in 2016, the federal government amended the CDA definition (effective for deaths occurring after March 21, 2016) to ensure that the ACB of the insurance policy would reduce the CDA credit of a corporate beneficiary, even where that beneficiary was not the owner of the policy. Thus, if Ted Rogers had died after the 2016 changes, the taxpayer's CDA would have been $42 million lower.

THE TCC DECISION

One of the required elements for the GAAR to apply is that the impugned transactions must result in a "tax benefit" to the taxpayer. In this case the CRA alleged that the taxpayer received a "tax benefit" since the CDA credit was not reduced by the ACB of the policies. The Court disagreed, finding that an increase in a corporation's CDA does not in and of itself fall within the definition of a "tax benefit." The Court further held that the distribution of the CDA arising from the insurance proceeds to other corporate shareholders also did not create any tax benefit, as those dividends would otherwise have been received as tax-free intercorporate dividends. In effect, there could be no tax benefit until capital dividends arising from the ACB portion of the insurance proceeds were paid to individual shareholders.

Despite finding that the transactions did not result in a tax benefit to the taxpayer, the Court went on to consider whether the transactions were "abusive" such that the GAAR would apply if a tax benefit existed. The Court explored the "intent" of the legislation by reviewing the evolution of the CDA definition since the early 1970s. The Court concluded that it could not discern a clear legislative policy that required the CDA be reduced by the ACB of an insurance policy, where such a policy is owned by someone other than the corporate beneficiary. The Court also noted that the CDA definition was amended in 2013 to deal with certain abusive transactions involving life insurance, but the government took no action at that time to deal with this planning strategy. As a consequence, even had this court found there was a tax benefit to the taxpayer, the CRA would have failed in its GAAR challenge. We understand that the CRA has decided to not appeal this decision.

Although the 2016 tax changes eliminated the advantages arising from the CDA planning undertaken in *Rogers Enterprises*, this case exemplifies the main benefits of life insurance in managing the financial needs of the Rogers family. The ability to pay out a significant portion of the insurance proceeds on a tax-free basis to the estate and/or surviving shareholders may be considered icing on the cake. F

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