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Rogers Enterprises (2015) Inc. - Tax Court Finds that an Increase in a Capital Dividend Account Balance is Not a Tax Benefit Under the GAAR

Sanjana Bhatia, B.B.A., LL.B., LL.M., TEP - Director, Tax and Insurance Planning, Insurance Tax Solutions Group, Sun Life

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Introduction

Rogers Enterprises (2015) Inc., 2020 TCC 92 (*Rogers*) is one of the most important tax cases of 2020. One of the reasons for this is because it is rare for the Tax Court of Canada (TCC) to decide a case involving policyholder taxation and the General Anti-Avoidance Rule (GAAR) under subsection 245 of the *Income Tax Act (Canada)* (ITA).

Rogers involves the pre-March 22, 2016 regime regarding the addition to the capital dividend account (CDA) of a corporate beneficiary of life insurance proceeds received under a life insurance policy owned by a parent corporation. This case is a great example of how corporate owned life insurance (COLI) has been used by one of Canada's wealthiest families in its corporate group. This article discusses *Rogers,* which was decided in favour of the taxpayer.

Facts in *Rogers*

The late Mr. Edward Samuel (Ted) Rogers was the President and Chief Executive Officer of Rogers Communications Inc., a Canadian public company in the Rogers corporate group (the RPC Group). From 1982 to 1991, private corporations in the RPC group and a family trust purchased twelve life insurance policies on the life of Mr. Rogers. More specifically, E.S.R. Limited (ESRL) was the owner (that is, the policyholder) and beneficiary of ten of the policies, and the 1984 Rogers Ownership Trust (1984 Trust) was the policyholder of the other two policies.

In 2005, in the course of a significant corporate reorganization of the RPC Group, CGESR Limited (CGESR) became the beneficiary of the policies. ESRL and the 1984 Trust remained the policyholders and continued to pay the premiums on their respective policies.

Mr. Rogers passed away in December 2008. CGESR credited the full amount of the insurance death benefit proceeds to its CDA (~ $102 million) and did not deduct the ACB of the policy (~ $42 million). CGESR relied on its understanding of the law as per the pre-2016 rules.

In 2009, CGESR paid capital dividends to two companies (ESRIL 98 and CGESR 2009) who were CGESR's shareholders. Each of these companies added the capital dividends they received from CGESR to their CDAs. CGESR 2009 paid a capital dividend to another family trust in the RPC group (the 1995 Trust). The total capital dividends paid up to this point were ~ $10 million.

Later in 2009, CGESR redeemed ESRIL 98's shares for ~ $92 million and elected the dividend on the redemption to be a capital dividend under subsection 83(2) of the Act. ESRIL 98 added the capital dividend it received to its CDA. ESRIL 98 paid ~ $50 million in capital dividends to its shareholder, ESRIL (the policyholder of ten of the twelve policies). ESRIL 98 did not pay out any further capital dividends and thus its CDA balance remained at ~ $42 million. The taxpayer, Rogers Enterprises (2015) Inc., became the successor by amalgamation of CGESR and ESRIL 98.

In 2015, the CRA issued the taxpayer a "notice of determination" on the basis that the GAAR applied to the series of transactions, and reduced the taxpayer's CDA by the ACB of the policy. The taxpayer appealed the CRA's decision to the Tax Court of Canada (TCC).

The TCC's Decision

One of required elements for the GAAR to apply is that the transactions must result in a "tax benefit" to the taxpayer. The CRA reassessed the taxpayer on the basis that it received a "tax benefit" since the CDA credit was not reduced by the ACB of the policies.

The TCC found that the taxpayer's series of transactions did not result in a tax benefit for a number of reasons. First, an increase in a corporation's CDA does not in and of itself fall within the definition of a "tax benefit". Also, the taxpayer treating the dividends as capital dividends did not result in any change in tax. This is because the taxpayer paid the dividends to corporate

shareholders who could have deducted them in any event under subsection 112(1). (Subsection 112(1) allows inter-corporate dividends to be received tax-free. The dividend is not taxed until it reaches the individual shareholder). As such, the capital dividend treatment did not result in any reduction of tax, and therefore could not be a tax benefit.

The TCC dealt with the issue of whether a tax benefit existed by comparison with an alternative arrangement. The comparison in this case would be whether ESRIL 98 avoided Part III tax that would have applied to an excess capital dividend election in relation to its capital dividend of ~ $50 million. The Court concluded that there was no tax benefit because ESRIL 98 had a sufficient balance in its CDA to cover the amount of the dividend (even if the CRA's position that the CDA was only ~ $50 million, not ~ $92 million, was correct).

The TCC concluded that an increase in a tax attribute (the CDA in this case) does not result in a reduction, avoidance or deferral of tax. He concluded that, "…the future reduction of tax under Part I of the *ITA* by the ultimate shareholders at ESRIL 98, as suggested by the Crown, is not a tax benefit at this time." In other words, there is no tax benefit until the taxpayer pays capital dividends out of the increased CDA to its ultimate shareholders.

The TCC's conclusion that there was no tax benefit was sufficient to allow the taxpayer's appeal and dispose of the case. However, the TCC proceeded to analyze whether the series of transactions was abusive such that the GAAR would apply if a tax benefit existed. For this purpose, he analyzed the underlying rationale (the object, spirit and purpose) of the key provisions in the CDA regime. He also conducted a textual, contextual, and purposive analysis of those provisions that would reduce the proceeds of a life insurance policy by the ACB of the policy.

The TCC concluded that the transactions were not abusive. Therefore, even if a tax benefit existed, the GAAR would not apply to the taxpayer's transactions to disallow the ***42 million CDA credit.

First, the TCC rejected the Crown's argument that the rationale of the ITA's provisions required a CDA reduction where the recipient of the life insurance proceeds is not the policyholder. The TCC then examined the text of the CDA provision and concluded that concluded that the relevant words in subparagraph 89(1)(d)(iii) must mean the ACB of the policy to the corporation, which

supported the taxpayer's position. In affirming the textual approach, Justice Sommerfeldt stated that "…Parliament said what it meant to say."

With respect to the context, Justice Sommerfeldt concluded that Parliament was deliberate and intentional in describing the ACB of a life insurance policy by reference to a particular person. For example, he refers to other provisions of the Act dealing with life insurance, and ascertains that they sometimes refer to the ACB to the corporation, sometimes to the ACB to the taxpayer, and sometimes to the ACB to the policyholder. Therefore, the contextual analysis indicates that in 2008, we were to use the ACB to the corporation that received the policy proceeds. In other words, the context of the Act supports the textual meaning.

The TCC also found that the Crown was inconsistent as to the purpose of subparagraph (d)(iii) in the definition of "capital dividend account" under subsection 89(1), as it read in 2008 and 2009. The Crown's reasons as to why the ACB needed to be deducted from the policy proceeds in order for a corporate beneficiary to credit its CDA was also unclear. For example, the Crown agreed earlier in the litigation process that the purpose behind excluding the ACB from the capital dividend account was "to limit the amount of retained earnings that a corporation can distribute to a shareholder on a tax-free basis through the purchase of a life insurance contact and the use of CDA account." However, in a written statement during the trial, the Crown stated that, "if amounts had been distributed by the corporation to the shareholder personally to personally pay for the life insurance policy, such amounts would have been taxable to the shareholders".

Because of the Crown's lack of clarity, Justice Sommerfeldt was not satisfied that the Crown had adequately explained the provision, and concluded that the Crown had not met its onus under subsection 245(4) to establish clearly the object, spirit and purpose of the relevant provisions. Accordingly, the series of transactions that resulted in the addition of the full amount of the death benefit proceeds of the policy (not reduced by the premiums paid under the policy) was not abusive.

The CRA's Interpretation of ACB and No Pro-Rating of the ACB

Beyond *Rogers*, it is also important to note that the CRA's views regarding the ACB of the policy under subparagraph 89(1)(d)(iii) leads to an unfair result. For example, the CRA's interpretation is that where there are multiple beneficiaries, the CDA will be reduced by the *full* ACB of the policyholder's interest in the policy for each beneficiary and cannot be prorated. (See, for example, CRA Document No. 2018-0745811C6, "CALU 2018 Q2 – CDA credit-joint ownership," May 8, 2018 and CRA Document No. 2017-0690311C6, "CLHIA 2017 – Q1 CDA," May 18, 2017). The insurance industry has brought this issue of double counting the ACB to the attention of Finance.

Conclusion

The Minister has decided not to appeal *Rogers*. The Minister could challenge this transaction in the future, however, if the taxpayer pays out the ~ $42 million of capital dividends to its individual shareholders on the basis that there is now a tax benefit resulting from a series of transactions. However, the abuse test will remain a difficult obstacle for the Minister because another Tax Court judge could agree with Justice Sommerfeldt's findings.

In any event, *Rogers* is an important decision because it adds to the GAAR jurisprudence that an increase in a tax attribute (the CDA in this case) is not a tax benefit. *Rogers* is also a unique case because it is rare that the TCC rules on issues involving policyholder insurance taxation and the GAAR.

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