July 19, 2022

Bob Naufal, Senior Manager, Income Tax Rulings Directorate
Canada Revenue Agency
320 Queen Street
9th floor, Tower A, Place de Ville
Ottawa, ON K1A 0L5

SENT VIA EMAIL: Bob.Naufal@cra-arc.gc.ca

Dear Mr. Naufal:

Re: Request for interpretation on taxation of a jointly owned life insurance policy on death of a joint owner

I am writing on behalf of the Conference for Advanced Life Underwriting (CALU). CALU is seeking a technical interpretation relating to the application of subsection 148(7) of the Income Tax Act (Canada) (herein the "Act") to the joint owners of a life insurance policy on the death of one of the joint owners, as outlined in the fact pattern below. We have also included an Appendix which provides more information on the legal and tax nature of joint ownership with right of survivorship and tenancy in common, as well as a discussion of the property law underpinnings of life insurance as a "chose in action".

Background

Life insurance policies can be owned jointly by several individuals. A common situation is where children jointly own insurance coverage on a parent. Where there is joint ownership of a life insurance policy, it is possible that one of the joint owners could predecease the life insured. In this case, the deceased's interest in the policy will pass to the surviving joint owners.

Assuming the rollover provisions in subsections 148(8) - (8.2) are not applicable, subsection 148(7) would appear to apply in determining the tax consequences arising from the death of a joint owner. It provides that where there is a disposition of an interest in a life insurance policy by operation of law only to any person, or in any manner whatever to a person with whom the policyholder was not dealing at arm's length, the policyholder is deemed to become entitled to receive proceeds of the disposition equal to the greatest of:

- The value of the interest at the disposition time;[1]
- The fair market value at the disposition time of the consideration given for the interest; and
- The adjusted cost basis (ACB) to the policyholder of the interest immediately before the disposition.

[1] The term value is defined in subsection 148(9) to be the amount of the policy's cash surrender value (CSV) that the holder of the interest would be entitled to receive if the policy were surrendered at that time.

In determining the application of subsection 148(7) it is important to note that the various provisions reference the policyholder's *interest* in the life insurance policy in determining the policyholder's proceeds of the disposition. This raises questions as to the appropriate tax reporting for the joint owners where one of the joint owners predeceases the life insured and their interest in the policy passes by right of survivorship to the surviving joint owners.

Technical discussion

In several technical Interpretations addressing a situation where two persons (A and B) jointly own a capital property, the CRA took the position that upon A's death, there is a deemed disposition by A of a 50% interest in the capital property immediately before the death.[2] In the context of the deemed disposition of capital property on death, the CRA has taken the position that the deemed disposition rule applies "to the deceased person's interest in property held in joint tenancy even though each joint tenant in the property has an interest in the whole of the property such that, where one joint tenant dies, the surviving joint tenant does not acquire any more property but rather enjoys an increase in the value of the existing property."[3]

While life insurance is not capital property subject to a deemed disposition on death, as noted, subsection 148(7) provides a specific rule governing non-arm's length dispositions and dispositions by operation of law of life insurance policies. This subsection applies "if an interest of a policyholder in a life insurance policy is… disposed of… by operation of law." Clearly the sole ownership by B after A's death (applying the scenario above) is brought about by operation of law, namely, the right of survivorship embedded in the common law of joint tenancy.[4] However, as a characteristic of B's joint tenancy ownership interest, B always possessed entitlement to the whole interest. So, B came into sole possession of property that B always possessed wholly, leaving open a question of whether there has been a disposition of an interest in the life insurance policy by A on A's death, and if there has, what are the proceeds of the disposition. In general, a broad meaning has been applied to the term "disposition" and any transaction resulting in a transfer, alienation, or extinguishment of property has been seen as constituting a disposition. Presumably, when A dies, there is an extinguishment or termination of A's interest in the life insurance policy.

Insurers may differ on what tax treatment arises on the death of a joint tenant. Some insurers may administer the policy from the perspective that a change in ownership interest will occur upon a joint tenant's death, resulting in a disposition of that person's one-half (or relevant portion) interest in the policy (in our example, reported to A's estate or jointly to A and B - as joint tenants). This treatment is somewhat consistent with CRA's position as stated in the non-life insurance context, although, to whom it is reported may be inconsistent with CRA's comments. Alternatively, other insurers may treat the entire policy as being disposed of and a T5 issued to all joint tenants jointly on the death of a joint tenant for the entire policy gain and not a portion thereof. This

[2] See for example CRA technical interpretations AC58385 dated March 28, 1990; 2000-0054905 dated November 14, 2000; 2005-0152011E5; 2008-0278801C6 STEP Q5.
[3] CRA technical interpretations 9429915 dated March 3, 1995 and 2003-0013735 dated May 2, 2003.
[4] See Appendix A for a more general discussion of the legal entitlements arising from ownership of property in joint tenancy and tenancy in common.

position is easier to administer since the policy owners are viewed as having one interest and one policy ACB but this appears to be inconsistent with the CRA commentary.

As discussed above, in the context of capital property, the CRA commentary appears to treat each joint owner's interest as a proportional interest in the property in order to address this, which ignores the true legal characteristic of joint tenancy under the common law. In particular, on the death of a joint tenant pursuant to the right of survivorship, the surviving joint tenant retains the entire interest in the property (which they always possessed) and the deceased joint tenant's interest in the property is extinguished.

Given the potential for inconsistency in reporting across insurance carriers, and the difference in law between common law provinces and Quebec (and indeed within common law provinces as between joint tenancy and tenants in common ownership types[5]), we submit the following scenario and questions for the CRA's consideration. Please note that while we are primarily interested in your views on the following questions as they relate to the joint owners residing in common law provinces, we would appreciate being advised if your views are also applicable to joint ownership arrangements where one or more of the joint owners reside in Quebec.

Questions

Assume that a life insurance policy is owned by three siblings (A, B and C) as joint tenants on the life of their parent D. They share equally the premiums payable under the policy and are equal beneficiaries of the death benefit. A predeceases D, and at that time the policy has an ACB of $60,000 and a CSV of $120,000.

Question 1:

Can the CRA confirm that it would be acceptable for the insurer to only report a policy gain to A based on a pro-rata share of the policy gain to the policyowners and increase the ACB of the policy by a similar amount? Thus, in this example, a policy gain of $20,000 would be reported for inclusion in A's terminal return. No policy gain would be reported to B/C and the ACB of the policy would be increased to $80,000.

Question 2:

If the insurer reports the full policy gain of $60,000 to A/B and C as joint owners, can the CRA confirm that it would be acceptable for the policyholders to redetermine the policy gain based on the position that only A disposed of a pro-rata interest in the policy? Thus, a $20,000 policy gain would be reported to A for inclusion in the terminal return and B/C would not have to report any gain as they would not have disposed of their

[5] One CRA technical interpretation 9818445 dated November 5, 1998 addresses the difference on death between ownership as tenants in common vs. joint tenancy. It states "In a tenant in common arrangement, the deceased taxpayer's estate would be deemed to have acquired the interest in the property at its fair market value. In a joint tenancy arrangement, each of the joint tenants would be deemed to have acquired their portion of the interest in the property at its fair market value."

interests in the policy? Similar to Question 1, would it also be acceptable for B and C to proceed on the basis that the ACB of the policy has increased by the amount reported by A's estate as a policy gain?

Yours truly,

Kelly Adams
Chair, Board of Directors

Guy Legault
President & CEO

Appendix A – General discussion of joint ownership

The following discussion provides more information on the legal and tax nature of joint ownership with right of survivorship and tenancy in common, as well as a discussion of the property law underpinnings of life insurance as a "chose in action".

Joint tenancy

Joint tenancy is a common law concept. There is no equivalent concept in Quebec civil law. It is a form of property ownership where each owner has an undivided and identical interest in the property. As regards to third parties, the co-owners are treated collectively as a single owner. In effect, there is one title to the underlying property in which all of the joint tenants participate concurrently. Although originally developed in the context of real property, joint ownership of personal property in joint tenancy would have the same legal characteristics.

A joint tenant's undivided interest is in the whole property and is identical to that of the other joint tenants in terms of possession, interest, title and time. These are what are referred to as the "four unities". Unity of possession means that each joint tenant is equally entitled to possession of the whole property at the same time. Each joint tenant has an equal right to use or enjoy the property and would have equal control over the property. Unity of interest means that the nature of each joint tenant's interest in the whole property is identical in amount, duration and nature – i.e. quantitatively and qualitatively. Unity of title requires that at inception the interest of joint tenants be created by the same instrument or document. The unity of time requires that each joint tenant's interest vests at the same time. Vesting means that the interest is fixed and absolute.

One of the most important features of joint tenancy is the right of survivorship. On the death of a joint tenant, the right of survivorship automatically entitles the surviving joint tenant(s) to the interest of the deceased joint tenant. The deceased joint tenant has no post-mortem control of the interest (i.e. any attempted disposition of an interest of a deceased joint tenant by Will is not effective). The joint tenant's interest is extinguished on death and the interest in the property does not form part of their estate. Corporations can be joint tenants even though a corporation does not die.

The common law presumes co-ownership is a joint tenancy unless the document or instrument relating to establishing title to the property indicates otherwise.[6] The common law presumption can be displaced if one or more of the unities is absent or as noted above, if the document or instrument creating title shows a clear intention to create a tenancy in common.

It is possible to change a joint tenancy into a tenancy in common (discussed below). This is known as severing a joint tenancy. This can be accomplished by one person acting unilaterally upon their own share so as to destroy the four unities (for example, by selling their interest in the property); by the parties mutually agreeing to sever the tenancy; or any other "course of dealing" which indicates that all the parties wish to terminate the joint

[6]This presumption can be replaced by statute, for example in Ontario, the Conveyancing and Law of Property Act, R.S.O. 1990, c C.34. s. 14 has an opposite presumption in respect of land so that it is necessary to add language to a conveyancing document to evidence an intention to create a joint tenancy.

tenancy.[7] A joint tenancy will also be terminated on bankruptcy or can be terminated by a court order (for example, pursuant to a family law claim). It is possible to make an enforceable agreement preventing joint tenants from severing a joint tenancy.[8]

Tenancy in common

Where a property is co-owned by tenants in common, each tenant is equally entitled to possession (so, like joint tenancy, there is unity of possession) but in other respects, the interests of the tenants may differ. A tenant in common has a distinct but undivided ownership interest in the property. Their interest is not an interest in the whole property. The interests of the tenants may be different in extent, duration, may vest at different times and, importantly, there is no right of survivorship. The interest of each tenant in common is not extinguished on their death and would pass by Will or on intestacy to the tenant's heirs.

While the concept of joint tenancy is not recognized by the Civil Code of Quebec, co-ownership in Quebec may be achieved by way of tenancy in common whereby each co-owner maintains an exclusive right to their interest in a property.

Legal ownership and life insurance

Life insurance is personal property that can be co-owned. In simple terms, a life insurance policy has been described as follows:

Regarded as a contract, the essence of the life insurance policy may be said to be the insurer's promise to pay the contractual benefit when the insured event occurs. But the policy also contains a variety of other rights and options, including policy loan and cash surrender value privileges. From this perspective, it is a chose in action consisting of a bundle of rights and thus, a form of 'personal property.'[9]

Title is established upon acquisition of the policy by indicating the intended form of joint ownership on the life insurance application. If no indication is made, the common law presumes a joint tenancy.

The legal nature of the property that is a life insurance policy is relevant to this discussion. A life insurance policy is considered a "legal chose in action" – intangible property that is enforced by action, not by taking physical possession of it. The nature of legal rights in respect of a life insurance policy as a legal chose in action has been developed by the courts and specific legislation over a long time.[10] Unilateral enforcement actions in respect of purported separate and exclusive ownership over different parts of a life insurance policy is not effective. Norwood provides the following example:

> "…if X was given the sole and exclusive right to policy loans, Y the sole and exclusive right to surrender the policy, and Z the sole and exclusive right to designate beneficiaries, it can be seen that their rights

---

[7] Note that if there are more than one joint tenant, the joint tenancy will continue in relation to the other joint tenants unless they also take action to sever their joint tenancy. For example, if A, B and C hold property as joint tenants, and A takes action to sever his or her joint interest in the property, A will continue to own the property as a tenant in common and B and C will continue to own their interests in the property as joint tenants.

[8] Haan v. Hann, 2015 ABCA 395.

[9] David Norwood and John P. Weir, Norwood on Life Insurance Law in Canada, 3rd edition, 2002 at pg. 359.

[10] Ibid. "

> would conflict, and that the exercise of such a separate right by one of them would destroy the others' rights. This is not to say that the insured (owner) may not assign the policy under an arrangement whereby separate assignees agree, as a matter of *contract* between them, to hold separate interests – but *as a matter of legal title* to property the whole policy must be regarded as being owned "jointly" by all the assignees, so that all must join in consenting to the exercise of a right by any one of them."[11]

Norwood concludes,

> "a partial assignment encompassing only one of the bundle of rights constituting the life insurance policy would not seem to be effective as against the insurer. The assignee would have rights against the assignor, but in a suit by the assignee to enforce their rights against the insurer, it would seem that, technically, the assignor would have to be joined."[12]

As a result, when dealing with co-owners who are attempting to enforce their respective rights, insurers may require all parties to sign a discharge of the insurer's policy liability and leave them to sue each other for their respective rights. This approach is consistent with how many insurers perform administration, including tax administration, of life insurance policies that are co-owned. In general, administration is performed at the policy level and not at each co-owner's level. All parties must sign in respect of all policy transactions.

[11] Ibid. at pg. 363.

[12] Ibid at pg. 371. Norwood cites Di Giulo v. Boland, [1958] O.R. 384 (Ont. C.A.) which referred to Best v. Beatty (1921), 61 S.C.R. 576 (SCC). "The statute enabling an assignee of a chose in action to sue was never intended to enable the possessor of a valuable chose in action to issue a kind of currency, as it were, by dividing up his right into little bits and distributing them among his friends, and giving each of them a chance to worry and annoy the debtor."