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August 18, 2014

Income Tax Rulings Directorate
Canada Revenue Agency
320 Queen Street
Place de Ville, Tower A, 16th Floor
Ottawa, ON K1A 0L5

Attention: Victor Pietrow, Senior Rulings Officer, Deferred Income Plans

Dear Mr. Pietrow:

RE: Life Insurance held as an investment by a Retirement Compensation Arrangement

Thank you for the opportunity to make submissions to you on behalf of the Conference for Advanced Life Underwriting ("CALU") relating to the question posed by CALU as part of the CRA and Finance Roundtable held in May, 2014 concerning life insurance held by a retirement compensation arrangement ("RCA"). As you will recall, CALU's question to the Canada Revenue Agency ("CRA") set out a fact pattern involving a "top-up pension" RCA that held life insurance as an investment to fund the promised pension payments under the RCA. The question and fact pattern are attached as an appendix for your reference.

Following the CRA's indication that it was not prepared to answer this question at the Roundtable, we had a helpful telephone discussion concerning the CRA's position and during that call you raised several questions relating to life insurance held by an RCA. The submission below does not respond to all of the questions that you posed, but rather focuses on the fact pattern posed in CALU's question. However, we would be happy to have further discussions with you on these other issues if that would be of assistance.

As you are aware, CALU is concerned that the CRA has developed a view that in every instance where life insurance is held by an RCA, other than where the death benefit to be paid on the death of the life insured is "nominal" in amount, an "advantage" as defined for purposes of Part XI.3 of the Income Tax Act (the "Act") would be considered to arise. CALU is clearly not of that view.

In our experience the fact pattern that CALU posed is not uncommon and is one that we believe would not give rise to an "advantage" as defined in Part XI.3. This is not to say that it is not possible for an advantage to arise in respect of a life insurance policy held by an RCA. For example, if the insurance policy is an investment held by the RCA, it is possible an advantage could arise if the RCA named someone other than itself as the beneficiary of the death benefit under the policy. This is discussed below in the context of an RCA strip. If the policy was held pursuant to a split dollar arrangement so that the savings portion is held by the RCA and the death benefit portion is held by some other person, but the premium for both portions of the policy is disproportionately borne by the RCA, then this may also give rise to the owner of the death benefit portion of the policy or the beneficiary of such portion, as the case may be, that could constitute an advantage as defined.

In this submission our goal is to illustrate that the fact pattern posed in our question is one in respect of which it may be clearly concluded that an advantage under Part XI.3 does not arise. To this end, we have set out below submissions that address, first, the legislative history concerning the advantage concept and registered plans, second, the implications of the deemed RCA rule that applies to certain insurance policies, and third, a detailed review of the definitions of "advantage" and "RCA strip" in the context of our proposed fact pattern.

Legislative History – RRSPs and the Advantage Rule

In the course of our discussions, you indicated that one consideration in the proper interpretation of the RCA "advantage" provisions is that the concepts of advantages and prohibited investments apply not only to RCAs but also to registered retirement savings plans (RRSPs), registered retirement income funds (RRIFs) and tax-free savings accounts (TFSAs)[1], and that the CRA wished to take a consistent approach in interpreting these terms. In particular, you commented that insurance in a RRSP has been considered an "advantage" for many years in the context of registered plans, and made reference to paragraph 146(2)(c.4) of the Act (now repealed) which had been in place since 1982.

Our review of the legislation in respect of advantages for RRSPs indicates that such rules were first introduced in 1982 when the Act was amended to add paragraph 146(2)(c.4).[2] Subsection 146(2) set out the conditions for registration of an RRSP, and paragraph (c.4) added the following condition

> *(c.4) the plan requires that no advantage, other than*
>
> > *(i) a benefit or an amount that would, but for subparagraphs (1)(b)(i) and (iii) be a benefit,*
> >
> > *(ii) an advantage arising from the registration as a retirement savings plan of the savings portion of a life insurance policy,*
> >
> > *(iii) an advantage from life insurance in effect on December 31, 1981, or*
> >
> > *(iv) an advantage derived from the provision of administrative or investment services in respect of the plan,*
>
> *that is conditional in any way on the existence of the plan may be extended to the annuitant or to a person with whom he was not dealing at arm's length...*

[1] Although in slightly different form taking into account the different structure and purpose of those plans as opposed to an RCA.
[2] This provision was initially applicable after November 12, 1981 and required compliance by June 30, 1982 or the RRSP would be deemed to become an amended plan and to have its registration revoked (S.C.1980-81-82-83, c.140, subsection 98(4)). A subsequent amendment deemed the provision in force on March 30, 1983 applicable to plans issued after March 1983 (S.C.1983-84, c.1, s.113).

Paragraph 146(2)(c.4) denied registration of a RRSP where an annuitant or a person with whom the annuitant does not deal at arm's length could receive an advantage, with the exception of the advantages set out in subparagraphs (i) to (iv), that was conditional in any way on the existence of such a plan. The excepted advantages of interest here are "(ii) an advantage arising from the registration as a retirement savings plan of the savings portion of a life insurance policy" and "(iii) any advantage arising from life insurance in effect on December 31, 1981".

The excepted advantage in subparagraph (ii) refers to what we understand was the not uncommon practice of registering as an RRSP the savings portion of a life insurance policy, while the insurance risk portion was held "outside" the RRSP. The CRA, together with an insurance industry association that was a predecessor to the CLHIA, developed criteria for the registration of such plans and this included a detailed formula for the allocation of insurance premiums between the registered savings portion of the policy and the non-registered death benefit portion of the policy.[3] Insurance policies sold in this bifurcated form may have had some drawbacks for the policyholder, in that when the policyholder reached the age at which the RRSP had to be matured into an annuity or a RRIF, it may not have been possible to do so without effectively cancelling the life insurance policy, with the loss of the death benefit coverage.

It is not clear what "advantage" arises as a result of the registration of the savings portion of a life insurance policy, and we have not found any contemporaneous discussion or guidance on what was the specific concern. Arguably one could take the view that because the non-registered death benefit or "face amount" payable in respect of the exempt life insurance policy, and the portion of the premiums paid to support that benefit, created the savings "room" in the registered portion of the policy, this inherently gave rise to a benefit for the annuitant/planholder, at least where the life insurance policy would otherwise not be an exempt policy. In any event, it is clear that while the legislation contemplates that an advantage could arise as a result of the registration of the savings portion of a life insurance policy, this particular advantage is permitted. The existence of this specific exception with respect to the savings portion of a policy does not, in our view, create the opposite inference in respect of the registration of the death benefit, or of the whole policy, as an RRSP.

Turning to subparagraph (iii), it is our understanding that notwithstanding the general reference to "an advantage from life insurance", this excepted advantage was intended to grandfather life insurance that had been issued to RRSP plan holders as an incentive for entering into the RRSP contract. After December 31, 1981 (and subsequently, as amended, after March 30, 1983) granting a life insurance policy for free as an incentive conditional upon the existence of an RRSP is treated as an advantage.

In a 1982 Canadian Tax Foundation article, it is observed, in discussing the proposed insertion of paragraph 146(2)(c.4):

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[3] See for example, "Registered Retirement Savings Plan Digest", dated January 1978 (4th ed), Canadian Life Insurance Association.

> "One of the purposes of this proposed amendment appeared to have been to eliminate any benefit that may arise to an annuitant or non-arm's length person in respect of "free products or services" offered by financial institutions marketing their products or services in this area. For instance, it would eliminate the registration of a retirement savings plan if the annuitant or a related person were to receive "free" life insurance coverage where the RRSP holder used the services of a financial institution as was the situation with at least two financial institutions in 1981."[4]

Indeed, it appears from a story in the Winnipeg Free Press dated January 8, 1982, that the measure had the desired effect, as shortly following the introduction of this measure Canada Trust announced that it was cancelling free life insurance for approximately 160,000 RRSP holders "even though Ottawa has decided against outlawing the coverage immediately".[5] The story goes on to quote a Canada Trust employee, who indicated that the promotion of free insurance had been withdrawn as "insurance can no longer be used to attract future clients" and citing "administrative and tax problems with the scheme". This is consistent with the advantage provisions as the applied to RRSPs and RRIFs up until the amendment of the rules to address TFSA abuses in 2009 – that is, the conferring of an advantage on or to the plan itself was not considered an advantage, but the conferring of a benefit on or to the plan holder, outside of the registered plan, was considered an advantage.[6] With the expansion of the rules to cover TFSAs, the rules broadened considerably so that any advantage conferred, inside or outside of the plan, that is conditional on the existence of the plan, would give rise to an advantage.

In summary, the first insurance related advantage described in paragraph 146(2)(c.4) refers to the registration of a savings portion of an insurance policy, and the second insurance related advantage refers to the granting of free insurance to the plan annuitant outside the registered plan. In neither case does the advantage arise from the *holding* of life insurance by the registered plan, which is the relevant comparison for purposes of our fact pattern and indeed for RCAs generally.

There is one other point that we believe is important to make at this time. Life insurance was a permitted investment for a trusteed RRSP for many years. While never a "qualified investment", as defined, for an RRSP, subsections 198(6) and (8) together with subsection 146(11), deemed the acquisition of an interest in or a payment of an amount under a life insurance policy not to be the acquisition of a non-qualified investment, and the disposition of an interest in a life insurance policy was deemed not to be the disposition of a non-qualified investment. Further, where an RRSP made a payment under or to acquire

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[4] L.C. Murray, "Statutory Deferred Income and Employee Benefit Plans, Termination Payments, and Retiring Allowances", Report of Proceedings of the Thirty-Fourth Tax Conference, 1982 Tax Conference (Toronto: Canadian Tax Foundation, 1982), 159-182.

[5] Winnipeg Free Press, January 8, 1982, page 39, "Ottawa may be C of C's new HQ".

[6] See for example CRA documents E57539, dated February 22, 1989; 1991-53, "Advantage provided to a registered retirement savings plan', October 1991; 2001-0089635, "Incentives for opening registered retirement savings plan", August 16, 2001; and 2004-0054671E5, "Prohibited advantages in an RRSP". Paragraph (c.4) prohibited the extension of an advantage to the annuitant or *to a person with whom the annuitant was not dealing at arm's length*, which it appears was interpreted not to include the RRSP itself. We note paragraph 251(1)(b) which deems certain trusts, but not an RRSP, to be non-arm's length to its beneficiary, and so it remains a question of fact under paragraph 251(1)(c)whether an annuitant deals at arm's length with his or her RRSP.

an interest in a life insurance policy, if the life insurance policy met certain conditions, then the making of the payment would not be deemed to be the acquisition of a non-qualified investment at a cost equal to the amount of the payment.

The conditions for purposes of this subsection were as follows:

> *(c) the trust is, or by virtue of the payment about to become, the only person entitled to any rights or benefits under the policy (other than the rights or benefits of the insurer),*
>
> *(d) the cash surrender value of the policy (exclusive of accumulated dividends) is or will be, at or before the end of the year in which the insured person attains 71 years of age, if all premiums under the policy are paid, not less than the maximum total amount (exclusive of accumulated dividends) payable by the insurer under the policy, and*
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> *(e) the total of the premiums payable in any year under the policy is not greater than the total of the amounts that, if the annual premiums had been payable in monthly instalments, would have been payable as such instalments in the 12 months commencing with the date the policy was issued.*

A discussion of these requirements is found in Interpretation Bulletin IT-408R.[7] Based on our reading of the paragraphs (c), (d) and (e), and a review of the CRA commentary found in the bulletin, there is nothing to suggest that a life insurance policy described there could not be a policy that included a death benefit and a savings portion held within the plan. For example, the bulletin discusses particular policy provisions that would not meet these conditions such as a double indemnity rider and an option to acquire additional term insurance coverage with policy dividends. [8] Clearly not all life insurance policies would have met the stipulated conditions, but presumably some did.[9] Further, it is clear that such policies were not exclusively annuities or other segregated fund contracts, as annuity contracts issued after 1997 were specifically provided in subsection 146(11.1) *not* to be covered under subsection 146(11). If subsection 146(11) was thought to include only annuity and segregated fund contracts, the more logical step would have been to repeal subsection 146(11) at that time. Rather, after 1997, annuity contracts that were permitted to be held by RRSPs were specifically defined as "qualified investments" in paragraphs (c), (c.1) and (c.2) of that definition.[10] While subsection 146 (11) was repealed in respect of investments

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[7] Dated February 15, 1980 but archived by the CRA in 2004, and subsequently cancelled on September 30, 2012

[8] Ibid, at paragraph 7.

[9] See for example CRA document 2003-002781, "Life insurance on mortgage held in RRSP", dated March 30, 2004; AC59193, "Whether a particular life insurance policy is a qualified investment for a registered retirement savings plan", February 6, 1990. In the first document the life insurance appeared not to qualify as it had no cash surrender value (it may have been term insurance but it cannot be determined from the disclosed facts), in the latter it appears that the requirements of (c), (d) and (e) were not met.

[10] The Department of Finance Technical Notes in respect of the repeal of subsections 14611) and (11.1) comment as follows: "When subsection 146(11) was enacted, the Act did not define the term "life insurance policy" and the term had its ordinary meaning, which did not include an annuity contract. However, the term "life insurance policy" was subsequently defined in subsections 138(12) and 248(1) to include an annuity contract. Accordingly, subsection 146(11) permitted an RRSP trust to acquire and hold an annuity contract in some cases. Subsection 146(11.1) was

acquired after March 22, 2011, insurance policies that met the conditions set out in subsection 198(6) and were acquired before that time can presumably continue to be held in trusteed RRSPs and to benefit from the deeming rule in subsection 198(6).

Subsection 198(6) addressed the issue of whether a life insurance policy was a qualified investment for an RRSP – in short it was not – but the legislation effectively treated policies that met the specified conditions as a qualified investment for an RRSP until 2011. Whether or not many life insurance policies so qualified, the issue is one of whether the holding of the insurance policy was permitted in the context of the qualified investment regime, and not whether the life insurance policy gave rise to an advantage. Notably, RCAs are not subject to any requirement to hold only qualified investments – in contrast to the rules that apply to RRSPs, RRIFs and TFSAs.

Accordingly, in light of these various legislative provisions we would suggest that it is too broad a statement to say that registered plan holders have not been able to hold the life insurance (as opposed to the savings) component in a registered plan since 1982. Rather it appears to be the case that this is only clearly problematic after March 22, 2011 with the repeal of subsection 146(11), since after that time the acquisition of a life insurance policy by an RRSP would be the acquisition of a non-qualified investment and subject to adverse tax consequences on that basis.[11] We submit that it is very difficult to conclude, in light of the legislative provisions and in particular the wording of paragraph 146(2)(c.4) as it read in 1982, that the death benefit component of a life insurance policy has constituted an "advantage" for a RRSP since that time. If anything, the wording suggests that it is the savings component of such a policy that could be considered the advantage (where the savings component is itself registered, as opposed to held by a trusteed registered plan). But in any event this was excepted from the advantage rule and thus not an advantage that would have led to deregistration of the plan.

In summary, while we appreciate that there may be some merit in adopting similar and consistent approaches to the analysis of an "advantage" across these plans, which are now subject to similar (although not identical) regimes, we submit that in the instant case there is no similar approach to be taken here, as it cannot be concluded that an insurance policy, or in particular the death benefit portion of a life insurance policy, is an advantage as defined for RRSPs, RRIFs or TFSAs, much less, in our submission, for RCAs.

The Deemed RCA Rule – Subsection 207.6(2)

In our view there is support for the proposition that a mere holding by an RCA trust of a life insurance policy with a material death benefit is not an advantage, if one considers the deeming rule found in subsection 207.6(2) and its interaction with the advantage rules.

Subsection 207.6(2) of the Act deems the RCA rules to apply to situations where

> 1) the employer has a legal obligation to provide benefits that are to be received or enjoyed by any person on, after, or in contemplation of any substantial change in services rendered by the retirement or loss of an office or employment of a taxpayer;

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introduced to limit the application of subsection 146(11) to annuity contracts issued before 1998. Paragraph (c) to (c.2) of the definition "qualified investment" in subsection 146(1) expressly sets out the types of annuity contracts that are qualified investments for trusteed RRSPs. Subsections 146(11) and (11.1) are being repealed as they are no longer necessary." This suggests that as a practical matter few if any insurance policies that were not also annuities were being acquired by RRSPs, though we have no particular knowledge of what was the practice at that time.

[11] This assumes that such a policy would not otherwise be a qualified investment under (c) through (c.2) of the definition of "qualified investment" in subsection 146(1).

2) the employer acquires an interest in a life insurance policy; and

3) such insurance policy "may reasonably be considered to be acquired to fund, in whole or in part," the benefits.

There is no case law which provides guidance on when an interest of an employer in an insurance policy "may reasonably be considered to be acquired to fund, in whole or in part," in the context of subsection 207.6(2).[12] The provision does not define any particular benefit or provide any detail with respect to the type of life insurance policy – indeed the policy need only fund part of the benefit. Accordingly the provision could be applied to a life insurance policy that has a material death benefit amount.

If the RCA rules apply, the person or partnership (i.e. the employer) that acquired the insurance policy will be deemed to be the custodian of an RCA and its interest in the policy will be considered the subject property of an RCA. The employer will have to pay Part XI.3 refundable tax in an amount equal to the amount of any premium paid in respect of the insurance contract and any payment received in respect of the interest in the life insurance policy is considered a payment out of an RCA and so is required to be included in income.

If in the context of this deemed RCA and its subject property, it is determined that an advantage arises, then the 100% tax would apply to the amount of the advantage extended to or received or receivable by the deemed RCA trust, the specified beneficiary or any non-arm's length person, whatever this amount is determined to be. Unlike the situation where a policy is actually held by an RCA, however, there is no ability to avoid the tax by simply transferring the insurance policy from the RCA trust to the employer. It would appear that the employer must surrender or cancel the policy to avoid the tax. Alternatively the advantage tax may be able to be avoided by transferring the ownership of the policy to, for example, the relevant employee.[13] In both cases, the action may avoid the advantage tax but it also would result in the deemed RCA ceasing to exist.

One would assume, and as a matter of statutory interpretation is required to assume, that the drafters of the provision were well aware of subsection 207.6(2). On that basis, if Finance intended that the advantage rules would apply to life insurance policies with material death benefits in every case, then one might have also expected the drafters to have included transitional provisions to allow the orderly unwinding of deemed arrangements under subsection 207.6(2) (which could certainly include the renegotiation of employment contracts in respect of the benefits to be provided) along the same lines as the transitional provisions in respect of the prohibited investment rules as they apply to RRSPs and RRIFS, as well as RCAs.

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[12] We note that the CRA has provided some guidance, and in particular has commented that the RCA deeming rule may not necessarily apply to: (i) "key man" insurance acquired as coverage for losses or damages the employer might suffer on the death of an employee; and (ii) life insurance policies acquired solely to pay benefits in the event of the death of an employee. See in particular CRA document no. 9713175, "Retirement compensation arrangement death benefits", dated July 28, 1997. See also CRA document no. 9322475, dated September 16, 1993, and CRA document no. 2012-0435771C6, "CALU CRA Roundtable – May 2012 - question 10".

[13] This assumes that surrender or cancellation, or a disposition of the policy, would result in the employer no longer being viewed as having acquired an interest in a life insurance policy – this would be clearer if subsection 207.6(2) required that the employer owns or holds an interest in a life insurance policy, as it would no longer do so once the policy is cancelled or surrendered or transferred. We note also that in the event of a transfer of the policy, it is arguable whether this would be considered a "payment received in respect of the interest" and thus required to be included in income under paragraph 207.6(2)(d).

This is further supported if one has regard to the Budget documents in which the advantage rules for RCAs were introduced. First, the Budget document, in Annex 6, stated with respect to RCAs:

> The Canada Revenue Agency has identified a number of arrangements that seek to take advantage of various features of the RCA rules in order to obtain unintended tax benefits. For example, some arrangements involve the deduction of large contributions that are indirectly returned to the contributors through a series of steps ending with the purported RCA having little or no assets but still being able to claim the refundable tax using the impaired asset exception. Other arrangements use insurance products to allocate costs to the arrangement for benefits that arise outside the arrangement.

Accordingly it is clear that Finance was aware and intending to address the fact that insurance was being used in connection with RCAs in certain ways that it viewed as abusive. However, the budget document also stated the following in terms of the implementation of the proposals:

> *Transitional Rules*
>
> If RCA property acquired, or transactions occurring, before Budget Day cause an advantage to be obtained by a specified beneficiary of the RCA (or a person who does not deal at arm's length with the specified beneficiary) on or after Budget Day, then the amount of the advantage will not be subject to the special tax provided that the amount is included in computing the income of the specified beneficiary. For example, if on or after Budget Day a specified beneficiary of an RCA proceeds with steps, such as the removal of assets from a debtor corporation, that cause a pre-Budget Day promissory note to lose its value, the amount of the decline in value will be treated as an "RCA strip" and therefore as an advantage subject to the special tax, unless the specified beneficiary includes the amount of the advantage in their income.
>
> If RCA property acquired, or transactions occurring, before Budget Day cause an advantage to be obtained (such as income earned, and capital gains accrued and realized, on a prohibited investment) by the RCA on or after Budget Day, the amount of the advantage will not be subject to the special tax provided that the amount is distributed from the RCA and included in the income of a beneficiary or an employer in respect of the RCA. Such distributions will be treated as regular taxable distributions for the purpose of determining RCA tax.

If it was intended that all insurance arrangements where there was a non-nominal death benefit would give rise to advantage, and the 100% penalty tax, then one would reasonably expect Finance to specifically address the issue of deemed RCAs where the insurance cannot be "distributed" from the RCA to the employer. A reading of the provisions that is also consistent with the words of the provision, and what appears to be the intended application (taking guidance from the extrinsic evidence of the budget document), would be that the holding of an insurance policy with a material death benefit is not in and of itself an advantage, but rather further circumstances – such as an inappropriate allocation of costs of the insurance resulting in a benefit arising outside the arrangement – would give rise to an advantage.

Our position is not that Finance could not have intended such harsh rules to apply to existing arrangements - the advantage rules were clearly intended to effect a harsh result and to apply, across both

the RRSP, RRIF, TFSA and RCA regimes, to situations and investments that prior to their introduction would have been "permitted" arrangements. Nor is it our argument that because the particular description of a life insurance policy with a non-nominal death benefit does not appear in the Finance technical notes, or budget commentary, that it could not have been contemplated by Finance. Rather, the point we wish to make here is that it appears that Finance specifically turned its mind, over the period in which these provisions were introduced and subsequently amended both prior to and following enactment, to allowing taxpayers to take steps to avoid the tax if they wished, and yet did not address the situation of a deemed RCA which necessarily involves a life insurance policy.

Accordingly, we would submit that a more reasonable interpretation of the advantage rules, in the context of an RCA arrangement in which the trust holds a life insurance policy with a non-nominal death benefit, or a deemed RCA as a result of an employer's acquisition of such a life insurance policy, is that an advantage can arise but that the arrangement in and of itself is not an advantage without further facts giving rise to the advantage. Under this approach, the specific facts giving rise to the advantage could presumably be addressed to ensure that the advantage is removed and the penalty tax can be avoided.

Definition of "Advantage" in Part XI.3

Turning now to the RCA "advantage" definition in particular, you have asked us to review the definition and also the definition of a "RCA strip", and we propose to do so with particular reference to the fact pattern posed in our roundtable question.

It should be noted that in our fact pattern we posited a privately owned corporation that provides a "top-up" supplementary pension through an RCA for several key owner-managers of the employer. We did not state whether these key employees were "specified beneficiaries", as defined in subsection 207.5(1), although clearly they could be. We will review the definition of "advantage" and "RCA strip" assuming that the employees may be specified beneficiaries. However, we note that even if the employees were not specified beneficiaries, then the definition of "advantage" would still be relevant to the extent of the potential application of paragraph (a) and subparagraph (b)(i).[14] This highlights the potential breadth of the concern if a life insurance death benefit creates an RCA advantage. Many employers, including widely-held corporations, that provide defined benefit registered pension plans to their employees will have top-up plans for executives to address the monetary limits on pension benefits that can be funded through a registered pension plan. Of these, many would wish to consider funding their top-up pension obligation through the acquisition of life insurance policies by the RCA.

Paragraph (a)

Paragraph (a) of the definition of an "advantage" provides that it means "any benefit...that is conditional in any way on the existence of the arrangement" other than, *inter alia*, "a payment out of or under the arrangement that is included in computing a taxpayer's income under Part I". For this purpose we have

[14] We note that where an "advantage" is considered to exist, tax is exigible under subsection 207.62(1) only where the advantage in relation to the arrangement is extended to, or is received or receivable by, an RCA trust under the arrangement, a specified beneficiary of the arrangement or any person who does not deal at arm's length with the specified beneficiary. Accordingly where the advantage is extended to or received or receivable by an RCA beneficiary who is not a specified beneficiary or a person who deals at arm's length with the specified beneficiary, or by the employer or person dealing not at arm's length with the employer or to any other person other than the RCA trust itself, then no tax arises notwithstanding that an advantage exists.

assumed that there is no loan or indebtedness, nor any provision of administrative or investment services, in respect of the RCA in any way relevant to its holding of the life insurance policies.

It seems that a necessary first step in determining whether paragraph (a) could apply is determining whether there is any benefit arising from the life insurance, and if so whether that benefit is conditional on the existence of the RCA. Looking at the life insurance policies in question, one might take the view that an obvious benefit of a life insurance policy held by the RCA is the death benefit the policy will pay to the RCA, as the beneficiary of the policy, on the death of the insured life/RCA member. However, this benefit arises as a result of the provisions of the life insurance policy itself and is not attributable to the existence of the RCA. We do not think that it is a reasonable reading of the provision that any benefit arising for the RCA from an investment is considered to be conditional on the existence of the RCA merely by the fact that the RCA paid for and owns the investment. It is trite to say that the benefit would not have arisen but for the RCA's existence – but this argument simply goes too far in that it could be applied to every investment made by an RCA so that every investment gives rise to an "advantage". It is submitted that this cannot have been the intention and is an unreasonable interpretation of the provision.

An alternate approach is to focus on the tax benefits arising from an exempt life insurance policy. These would include the tax deferred and potentially tax free buildup of value in the policy, in the event that this value is paid out as a death benefit. Again these benefits arise by virtue of the provisions of the Act that specifically relate to the taxation of insurance policies and not in any way by virtue of the fact that the policy is held by an RCA. The RCA will bear refundable tax in the exact same manner as, say, an individual will bear Part I tax in respect of the life insurance policy – that is to say, neither the RCA nor the individual will bear tax on the life insurance policy other than in respect of a surrender of the policy or withdrawal or policy loan in or for an amount in excess of the adjusted cost basis of the policy. None of this is conditional on the existence of the RCA. If anything, as the rate of refundable tax would generally exceed the rate of tax borne by the individual, there is no benefit that is conditional on the existence of the RCA for these purposes as the tax payable on any income arising in respect of the policy is higher if held in the RCA than if the individual holds the policy directly.

If we consider the tax free death benefit in particular, this is received tax free regardless of the holder – that is, whether the beneficiary of the policy is the RCA, an individual or a corporation or other recipient the benefit should be received tax free. This arises by operation of the provisions of section 148 and related regulations under the Act that apply to the taxation of life insurance, and not in any way as a result of the ownership of the policy by an RCA. Indeed, if the RCA seeks to distribute the death benefit to a RCA beneficiary or to the employer, the death benefit will be considered a distribution from the RCA and will be fully taxable to the recipient. This is in contrast to a corporation, for example, which can distribute the death benefit from a life insurance policy through use of the capital dividend account. In the absence of a benefit, paragraph (a) of the definition of "advantage" cannot apply.

One final benefit for an RCA beneficiary could be the value, monetary or otherwise, to the beneficiary of having the payment of promised pension benefits secured through the acquisition of the insurance policy by the RCA. The role of RCAs as vehicles for securing retirement benefits for employees is obvious and it is the funded nature of these vehicles that causes them to be considered RCAs, as opposed to unfunded promises to pay an amount or to provide a particular benefit. However, this is not a benefit that is in any way unique to insurance and indeed could arise in respect of any investment held by the RCA such as a letter of credit, or simply from the fact that the RCA is funded at all. Taken to its logical conclusion, every amount or property held by the RCA could be considered to give rise to an advantage. However, we submit that this is an overly broad and circular way to read the definition as it in effect causes the very existence of the RCA to be an advantage.

For all of these reasons we do not think that the life insurance policies held by the RCA in our fact pattern gives rise to a benefit that is conditional in any way on the existence of the RCA for the purposes of paragraph (a) of the definition of "advantage".

We have considered whether paragraph (a) could ever apply to an RCA holding life insurance, that is, when could a benefit relating to the insurance be considered to be conditional on the existence of the RCA? One situation where this might be the case is a split dollar arrangement, where the death benefit portion of the policy is held by the RCA and the savings portion is held outside the RCA. In this instance, one could argue that the tax-sheltered savings portion of the life insurance policy gives rise to a benefit that is conditional on the existence of the RCA, in that if the RCA did not exist and did not hold the death benefit portion of the policy then the ability to access the tax-sheltered savings room in the policy would not exist. This scenario could be argued is analogous to situations that the CRA has considered in the context of RRSP advantages involving bonus interest payable on registered and non-registered deposits of a planholder with a financial institution. In these situations an advantage is considered to arise if the planholder benefits from a higher interest rate payable on, for example, non-registered deposits because the planholder's total deposits, including the registered deposits, has exceeded a certain level.[15] In this case, the bonus rate is only available because the registered assets have been taken into account and the CRA has determined that this is an instance where the advantage rules would apply. Presumably if the facts were reversed, with only the savings portion held by the RCA and the death benefit portion held outside, it cannot be said that the benefit of the savings "room" created by the face amount of the policy is conditional on the existence of the RCA.[16]

Paragraph (b)

Turning to paragraph (b) of the definition, this provision deems an advantage to mean a benefit that is an increase in the total fair market value of the subject property of the arrangement (i.e. the exempt life insurance policy) if it is reasonable to consider, having regard to all the circumstances, that the increase is attributable, directly or indirectly, to a transaction or event or a series of transactions or events one of the main purposes of which was to enable a person or a partnership to benefit from a provision of Part XI.3 or from the exemption from tax under paragraph 149(1)(q.1) if the transaction, event or series meets certain criteria set out in subparagraphs (i) and (ii).[17]

Considering the preamble in paragraph (b), and assuming the fair market value of the policy would be its cash surrender value, any such increase would be attributable to the payment of premiums by the RCA to the insurer in respect of the policy and the return effectively earned within the policy. Alternatively there could be circumstances where it is the amount of the death benefit payable under the policy that

[15] See for example CRA document 2004-0054671E5, noted *supra* at note 6.
[16] We note that a new exception to paragraph (a) of the definition of advantage found in subsection 207.01(1) in respect of "reasonable incentive programs" may in certain instances provide relief with respect to these programs from being considered to give rise to an advantage for RRSPs, RRIFs and TFSAs.
[17] Part XI.3 provides for the beneficial election that can be made under subsection 207.6(2) to trigger a payment of refundable tax to the RCA. This appears to be the only benefit arising from which a person or a partnership could benefit under Part XI.3 and it is assumed that the reference to such benefit in the preamble of paragraph (b) is intended to catch transactions or events one of the main purposes of which is to enable a person or partnership to make this election. The exemption from tax under paragraph 149(1)(q.1) means that an RCA trust is not subject to Part I tax, and clearly this is a benefit. However, the RCA is nevertheless subject to refundable tax under subsection 207.7(1) in respect of any contributions to the RCA and on its income from business or property (determined under the Act, other than paragraph 82(1)(b) [the dividend gross-up amount]) and its capital gains.

determines its fair market value, in which case this may be more attributable to the timely payment of the necessary amounts of insurance premiums.

We are not certain how one could conclude that "one of the main purposes" of the payment of premiums or the making of an investment choice could enable a person to benefit from the provision of Part XI.3. In particular, the payment of the premiums and the making of investment choices in respect of the insurance policy could not "enable" an election under subsection 207.5(2), as such election would not be permitted while the RCA held the insurance policies. Equally, we are struggling to understand how the premium payments or making of investment choices could allow a person or partnership to benefit from the exemption from tax under paragraph 149(1)(q.1). If the policy had been held outside the RCA, by either the employer or the employee, the same increase in the fair market value of the policy would have occurred and the same tax-deferred or tax-free growth in the value would have resulted notwithstanding that the employer or employee is not also tax-exempt under section 149. In effect, it is the exempt test rules applicable to the life insurance policy that provide any tax benefits associated with holding the life insurance and not the fact that the policy is held by the RCA.

Even where tax can arise in respect of transactions involving the life insurance policy (e.g. in the event of a taxable withdrawal, surrender or policy loan), the refundable tax payable by the RCA under Part XI.3, notwithstanding that the RCA is tax exempt under Part I, would generally be at a higher rate than the rate of Part I tax payable by the employer or the individual in the same circumstances. The after-tax increase in the fair market value of the policy would be equal to or lower if held inside the RCA rather than outside the RCA. Accordingly it is difficult to see how the investment in the policy is enabling a person to "benefit" from the provision of Part XI.3 or from the RCA's exemption from tax under paragraph 149(1)(q.1).

On this basis we would submit that paragraph (b) of the definition would not apply to our fact pattern, regardless of whether or not the members of the RCA are specified beneficiaries. However, we have also considered the specific criteria set out in subparagraphs (i) and (ii), one of which must also apply in addition to the preamble before an advantage will arise.

Subparagraph (i) provides that a transaction or event, or series of transactions or events, described in the preamble of paragraph (b) will give rise to an advantage if the transaction, event or series "would not have occurred in a normal commercial or investment context in which parties deal with each other at arm's length and act prudently, knowledgeably and willingly."

We have assumed on our facts that the terms and features of the insurance policy are "market driven" and in fact they would be negotiated between arm's length parties, namely the RCA trustee or employer and the insurer. In particular, we have assumed that the investment choices offered within the policy are generally offered to policyholders by the insurer and have not been "customized" or tailored for the RCA or the beneficiaries of the RCA in particular. In this event, we would submit that it cannot be said that this increase in value would not have occurred in a normal commercial or investment context, as this is exactly the context in which the increase in value has occurred. Moreover, this same increase in value would have occurred for any policyholder paying the premiums as required and making similar investment decisions, if any, to those made by the RCA. The RCA would have acquired the insurance policy knowledgeably and prudently, typically with the advice of a financial advisor or pension and benefits consultant as to how to best fund the promised pensions and minimize the risks of shortfalls.

Accordingly we do not believe subparagraph (b)(i) could have application in the instant case.

Turning to subparagraph (b)(ii), this provision looks to whether the transaction, event or series noted in the preamble includes a payment received as, on account or in lieu of, or in satisfaction of, a payment for services provided by a person who is or who deals not at arm's length with a specified beneficiary or a payment of interest, dividend, rent, royalty or of any other return on investment, or of proceeds of disposition in respect of property, other than the insurance policy or other property held by the RCA, held by a person who is or who does not deal at arm's length with a specified beneficiary.

In our fact pattern posed, any increase in the fair market value of the insurance policy held by the RCA is the result of the payment of the premiums and investment choices made pursuant to the terms of the policy. It is assumed that none of the increase is disguised consideration for services provided by the specified beneficiary[18], nor is any of the increase a disguised payment of interest, dividends or other investment returns on other property held by a specified beneficiary or person who deals not at arm's length with the specified beneficiary. As noted above, it should be assumed that the investment choices within the policy do not include any opportunities to invest in property held by a specified beneficiary or non-arm's length person.

In considering the parallel interpretation of subsection 207.01(1) in respect of "advantage" for TFSAs, the 2009 Department of Finance technical notes in respect of this provision (then paragraph (b) of the definition) notes that this provision is "intended to guard against transactions designed to artificially shift taxable income away from the holder and into the shelter of a TFSA or to circumvent the TFSA contribution limits." In our case, bringing this same context to bear, we note that there is no artificial shifting of this type - indeed there is a conversion of otherwise non-taxable death benefit into taxable income when distributed to the RCA trust beneficiary, and no "sheltering" benefit provided by the RCA in a similar fashion to that provided by a TFSA.

Subparagraph (c)(i)

Subparagraph (c)(i) defines "advantage" to mean a benefit that is income or a capital gain that is reasonably attributable, directly or indirectly, to a prohibited investment in respect of the arrangement. In the instant case, the insurance policy held by the RCA does not constitute a "prohibited investment" as it is not a debt, a share or an interest in or a debt of, or a right to acquire a share, interest or debt of, a corporation, partnership or trust, and certainly not one in which any specified beneficiary has a significant interest. Further, as noted above, it should be assumed that investment choices within the insurance policy would be similarly limited and would not, if the rules applied at the policy level, constitute a prohibited investment vis-à-vis the specified beneficiaries of the RCA. Accordingly the insurance policies held by the RCA trust do not give rise to an advantage in (c)(i).

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[18] The reference to services in this provision we interpret to mean services separate and apart from the beneficiary's employment for which he or she is paid salary. By definition an RCA is an arrangement to provide benefits in contemplation of a change or termination of employment or retirement, and so one would expect the beneficiary to be or to have been an employee of the contributor to the RCA. We note that by definition an RCA does not include any plan that would be a salary deferral arrangement, and we would suggest that if benefits under the RCA were considered deferred salary or remuneration for services performed by the employee, then the plan would not qualify as an RCA but instead would be an SDA. As a result, we do not think in the instant case that a benefit arising in respect of the RCA that is income or a capital gain could be considered to be paid in respect of services provided by a specified beneficiary. We note that this reference to services also appears in the definition of "advantage" in section 207.01 in respect of registered plans that have no necessary relationship to employment of the plan annuitant, and so it would be consistent to interpret the services in question as service for which the beneficiary is not otherwise being compensated.

Subparagraph (c)(ii)

The advantage described in (c)(ii) means a benefit that is income or a capital gain attributable, directly or indirectly, to an amount received by a specified beneficiary or by a person who does not deal at arm's length with the specified beneficiary, if it is reasonable to consider having regard to all the circumstances that the amount was paid in relation to, or would not have been paid but for, the property held by the RCA and the amount was paid as, on account or in lieu of, or in satisfaction of, a payment for services provided by a specified beneficiary or as a payment of interest, dividend, rent or royalty, or other investment return.

While this provision is complex and difficult to understand, we would suggest that it is novel to consider income or a capital gain a "benefit" – typically benefits would be amounts not otherwise be required to be included in income in the ordinary course, and so these are typically the subject of provisions so requiring their inclusion, such as section 15. Here one is left speculating what type of benefit is being referenced, and whether this is simply the benefit that a beneficiary might receive in respect of the arrangement, which is income or a capital gain for tax purposes.

In our fact pattern, the only payment that could be received by a specified beneficiary are the very top- up pension benefits paid to the beneficiary pursuant to the terms of the top-up pension arrangement (or a survivor pension paid to his or her spouse after the specified beneficiary's death). These amounts would clearly be required to be included in the beneficiary's income under paragraph 56(1)(x) of the Act as payments out of or under an RCA that can reasonably be considered to have been received in respect of an office or employment of the beneficiary (or his or her spouse, if a survivor benefit is being paid). Accordingly, we submit that this payment would not be a payment as, in account or in lieu of, or in satisfaction of, interest, dividend, rent, royalty or other return on investment, or of proceeds of disposition as there is no basis upon which to conclude that the beneficiary is entitled to payments of this type in respect of any property as opposed to the pension benefits under the top up pension plan.

Paragraph (d)

Finally it is necessary to consider whether the RCA in question could be considered to have been a party to an "RCA strip", as defined. If so, the amount of the strip is considered an advantage.

An RCA strip is defined to mean the amount of a reduction in the fair market value of the RCA's property where the reduction meets certain criteria. In our fact pattern the fair market value of the policy would be reduced in only a limited number of circumstances. This could occur when and if amounts are withdrawn from the policy. Another instance where the value of the policy could be said to be reduced is in the event of the death of the life insured when the death benefit is paid, in our fact scenario to the RCA trust. In either case the amounts withdrawn or received by the RCA from the policy remain the property of the RCA until they are paid out to the employees or the employer (and so arguably there is no reduction in the value of the property of the RCA in total, at the time of the withdrawal from the policy or upon the death of a life insured, although the value of the policy itself is reduced or eliminated). If the RCA uses the amounts withdrawn or death benefit to pay pension benefits to a specified beneficiary or his or her spouse, or to the company, then the property of the RCA, in total, does suffer a reduction, but in these cases the amount of such payments would be included in computing the income of the member or spouse, or the company under paragraph 12(1)(n.3), and so these are each a reduction that is specifically excluded from the RCA strip definition.

One other possible scenario is where the RCA trust holds a life insurance policy but at a certain point the policy lapses and is cancelled, so that it has no further value. In this case there will be no payments from

the policy to the RCA trust as there is no cash surrender value or death benefit to be paid. Accordingly this would also not be an advantage as notwithstanding that there is a reduction in the value, no specified beneficiary nor any person that deals not at arm's length with a specified beneficiary benefits from the lapse of the policy, and so it could not be said that such a benefit could be one of the main purposes for lapsing the policy. In the normal course, it might be possible to still recover refundable tax remitted in respect of amounts contributed to the RCA trust to fund the insurance premiums in respect of the policy, under subsection 207.6(2), subject to the exercise of the Minister's discretion under subsection 207.5(3), but this refund is only available where the reduction in value is attributable to an advantage in relation to the RCA trust. Accordingly we would submit that access to such a refund cannot be itself an advantage as then the refund would not be available under any circumstances.

In considering the examples of RCA strips found in the Department of Finance technical notes, it appears that the RCA strip concept is intended to address situations where the nature of the property held by the RCA is such that its value can be reduced, to the benefit of a specified beneficiary or non-arm's length person to the beneficiary, without triggering an income inclusion in respect of the amount, presumably by avoiding making a payment from the RCA to the beneficiary. In the instant case, the life insurance policy is issued by an insurer who deals at arm's length with the company and the owners/executives. The value of the policy is not susceptible to manipulation in the same way as the shares or a debt of the employer may be, where the value of the property held by the RCA could be reduced but ultimately to the benefit of the shareholders of the employer, typically the specified beneficiaries or persons with whom they deal not at arm's length. One example that arguably would give rise to a RCA strip would be where the insurance policy names a beneficiary other than the RCA, for the benefit of a specified RCA beneficiary or other non-arm's length person. In the event of the death of the life insured the fair market value of the RCA property would clearly be reduced and the beneficiary receiving the death benefit would not have an income inclusion but rather a tax free receipt.

Accordingly, in our view no RCA strip arises in our fact pattern and so no advantage arises under paragraph (d) of the definition.

Paragraph (e)

Finally we are very relieved to note that there are not yet any prescribed benefits under paragraph (e) of the definition of advantage.

Summary of application of subsection 207.5(1) "advantage"

Based on our review of the various paragraphs of the definition of "advantage" in subsection 207.5(1), it is our submission that none of these paragraphs would apply to the fact pattern that CALU posed in its Roundtable question. If it is helpful to set out more assumptions or details concerning the fact pattern to address any points of uncertainty that you may have we would be very pleased to do so and would look forward to discussing this with you.

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As noted at the beginning of our submission, our goal is to take you through one fact pattern – one that may arise in many situations including those where the beneficiaries of the RCA are not specified beneficiaries – with a view to showing you that in this case an advantage does not arise. Clearly, an

advantage as defined can arise in the context of an RCA holding a life insurance policy, as it can in respect of many investments that an RCA might hold, and we have noted above instances where we can speculate that an advantage may arise. In our view, while insurance may be held by an RCA in a manner that inappropriate tax benefits do not arise, care would always need to be taken to review all of the aspects of the arrangement to ensure that this is the case, and it would be helpful to have guidance on particular factors that might invite greater scrutiny to determine whether an advantage arises. In this regard we would welcome a discussion with you concerning one factor you have articulated, namely a death benefit that is not nominal, as to whether this is an indicia of an advantage or not and to explore other criteria that may be useful indicia.

We would welcome the opportunity to discuss this submission with you at your convenience.

Best regards,

Jillian Welch

cc. Kevin Wark, President, Conference for Advanced Life Underwriting
Mary Pat Baldwin, Manager, Deferred Income Plans, Income Tax Rulings Directorate

Appendix A

Retirement Compensation Arrangements (RCAs) and Insurance

Background

In a recent technical interpretation[19] the CRA has expressed the following view with respect to life insurance owned by an RCA:

> .... it is also important to note the new advantage rules in connection with RCAs. Those rules were introduced in the 2012 federal budget, and added to the Act by Bill C-45, to address tax planning arrangements that had developed using RCAs. The new definition "advantage" in subsection 207.5(1) of the Act describes amounts derived from several types of transactions or events in respect of which unintended tax benefits could be obtained. Under that definition, an advantage includes a benefit that is conditional in any way on the existence of the RCA. Although there are certain exceptions in the "advantage" definition, a benefit arising from the RCA holding a life insurance policy is not among them.
>
> It is not clear under what circumstances an RCA would be holding a life insurance policy that provides for more than a nominal death benefit. The holding of such a life insurance policy would appear to have little to do with providing for benefits under the RCA in relation to retirement, a loss of an office or employment, or a substantial change in services rendered. The holding of such a life insurance policy by the RCA could give rise to an advantage and, therefore, advantage tax under section 207.62 of the Act.

Question

Could the CRA please comment on circumstances in which it may consider applying the advantage tax, where life insurance is owned by an RCA, and how the amount of the advantage would be determined in those circumstances?

In particular, could the CRA please confirm whether it would consider an advantage to arise from the following fact situation, and what the amount of the advantage would be for purposes of subsection 207.62 of the Act?

> An employer (a private corporation) has established a defined benefit registered pension plan for all of its employees. It has also established a trusteed defined benefit supplementary pension plan for several key owner-managers, which is considered an RCA for purposes of the Income Tax Act. Under the terms of the RCA, a reduced pension may be paid to the surviving spouse of a plan member, and new members may be added to the plan. Any surplus that exists upon the termination of the RCA (i.e. where there are no longer any members or the accumulated values in the RCA are determined to be more than sufficient to fund all future benefits) can be returned to the employer.
>
> The RCA is given broad discretionary investment powers, including the ability to purchase exempt life insurance policies on the life of plan members and make excess contributions to such policies that will result in the accumulation of cash values. Such policies are in fact acquired on certain plan beneficiaries' lives, and in these cases the employer contributions (after refundable tax) are used to fund both the mortality charges and accumulate cash within the policy. Benefits for those plan beneficiaries whose lives are insured will be primarily funded by the RCA by making withdrawals from the cash values of the policy on their life and using these funds to make payments to the beneficiaries.

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[19] CRA TI 2013-0481421C6. See also CRA TI 2013-0493741E5

On the death of an insured plan beneficiary, the death benefit will be retained in the RCA to fund benefits to the surviving spouse (if any) and/or provide benefits to those plan beneficiaries (or surviving spouses) who continue to participate in the plan. Upon a future wind-up of the RCA, any remaining funds including insurance death benefits will be returned to the employer on a taxable basis.