Court Refuses CRA Demand for 10/8 Client Lists

On November 1, 2011, RBC Insurance, BMO Insurance, and Industrial Alliance Insurance **(the "Insurers")** won a Federal Court decision denying the CRA's request to force the Insurers to turn over their 10/8[1] client lists. The decision concludes two years of litigation over CRA's demands for the client lists. The decision was strongly influenced by internal CRA documents causing the Court to conclude that CRA's primary purpose in seeking the client lists was to "chill" the Insurers' 10-8 business, and not to verify compliance with the Income Tax Act.

CRA sought to obtain the client lists from the insurers under section 231.2 of the Income Tax Act, which allows CRA to obtain a court order to gather information about a person from a third party *"to verify compliance by the person … with any duty or obligation under this Act".*[2] The Court expects CRA to make "full and frank" disclosure when the request for the order is made.

The Court concluded, *"In my opinion, the Minister fell short of her obligation to make full and frank disclosure in two respects. First, she did not disclose the significant volume of information that the Insurers had already provided to her before the applications were commenced… The second, and more troubling, omission is the Minister's failure to disclose internal documents and information suggesting that the 10-8 plans comply with the letter of the Act…"*[3]

"More specifically,…the following material facts were not disclosed to the court:

a) The fact that the Department of Finance had refused to amend the Act to address the outdated policyholder provisions;
b) The ATR [advance tax ruling], which provided a great deal of information regarding a specific 10-8 plan for the express purpose of determining whether the plan complied with the Act;
c) The fact that the GAAR Committee had determined that the 10-8 plan likely complied with the letter of the Act, if not with its spirit; and
d) The decision to "send a message to the industry" by refusing to answer the ATR and to take measures to "chill" 10-8 plan business, in part by undertaking an "audit blitz".[4]

The Court agreed with the insurers that the CRA's primary purpose in obtaining the client lists was to "chill" the insurers' 10-8 plan business.[5]

"The ATR, although made by another insurer, provided sufficient concrete information to allow the Minister to make a determination – and, in fact, she determined that the 10-8 plan likely complies with the Act."[6]

"It was not open to the Minister to seek [the client lists] when her true purpose was to achieve through audits what the Department of Finance refused to do through legislative amendment."[7]

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[1] "10/8" refers to a leveraged life insurance program where policy cash value earns 2.0% less than the interest rate charged on a collateral or policy loan from the same insurer. Originally sold at rates of 10% loan interest and 8% cash value interest, the program is currently offered at rates of 9% loan interest and 7% cash value interest.
[2] See paragraph 231.2(3)(b) of the Income Tax Act..
[3] Paragraphs 39 and 40 of the decision.
[4] Paragraph 41 of the decision.
[5] Paragraph 58 of the decision.
[6] Paragraph 60 of the decision.

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The evidence submitted to the Court includes a CRA memo to the Manager of the GAAR & Technical Support Section stating, *"…the largest insurers are starting to lose a bit of their market share and they are concerned that the designs of the new products being offered by their competitors are no longer within the spirit of the legislation,"* and concluding that *"a limited number of targeted audits will be extremely effective in putting the industry on notice that CRA is concerned about the direction they are headed."* [8]

The evidence also includes a comprehensive memo from Lee Workman, manager of the CRA Charitable and Financial Institution Sectors to the GAAR Committee which includes the following points:

a) 10-8 collateral loans cannot be recharacterized as policy loans;
b) The only way to challenge the 10-8 tax benefits is on the basis of the reasonableness of the interest rate;
c) It is reasonable that the 10-8 policy is acquired primarily for insurance purposes;
d) It is reasonable that the 10-8 borrowing is primarily undertaken to obtain financing;
e) The reasonableness of the loan interest rate is not a GAAR issue;
f) The collateral assignment of the policy for the loan is an ordinary commercial transaction;
g) It may be difficult to convince a court that the 10-8 series of transactions is an avoidance transaction;
h) The 8% policy interest rate is consistent with the object, spirit and purpose of the exempt policy provisions in the Act;
i) The 10-8 transactions are not an abuse of the policy loan provisions in the Act; and
j) We [CRA] do not believe the GAAR can be successfully applied to these transactions. [9]

Our Take

CRA's repeated 10-8 scare announcements and its 10-8 audit blitz that started in November 2008 were designed to put a chill on 10-8 business **after** CRA had *itself* concluded that 10-8 plans comply with the Income Tax Act (including GAAR), subject to the reasonableness of the loan interest rate.

Since November 2008, Westward Advisors has consistently disputed CRA's public suggestions that negative tax results could apply to 10-8 under the Income Tax Act. We continue to dispute the final proposition that the 10-8 loan interest rate is unreasonable. Representatives from the life insurance industry have submitted plenty of evidence on this final point to CRA and we remain confident that the 10-8 loan interest rate is reasonable given the terms of the 10-8 loan facility.

We trust that this decision will provide taxpayers with comfort around the Taxpayer Bill of Rights[10] that includes:

#1 - You have the right to pay no more and no less than what is required by law.
#5 - You have the right to be treated professionally, courteously, and fairly.
#6 - You have the right to complete, accurate, clear, and timely information.
#8 - You have the right to have the law applied consistently.
#11 - You have the right to expect us to be accountable.

[7] Paragraph 62 of the decision.
[8] Paragraph 19 of the decision.
[9] Paragraph 19 of the decision.
[10] CRA Form RC4417

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