

Submission on the Taxation of Insurance Commissions on Personally Owned Life Insurance Policies

Submitted by:

***Advocis and The Conference for Advanced Life
Underwriting to the Canada Revenue Agency***

July 2010

Table of Contents

- 1. Background on Advocis and CALU 3
- 2. Background on the Submission 3
- 3. Discussion 4
 - (a) Policy Rationale 4
 - (b) Impact of Bilodeau Decision 5
 - (c) Need to Modify CRA’s Position5
 - (d) Equity of Tax Treatment7
- 4. Summary7

1. Description of Advocis and CALU

The Financial Advisors Association of Canada, which operates under the name of Advocis™, is the largest voluntary professional membership association of financial advisors in Canada, representing more than 10,000 financial advisors across Canada. Advocis members provide comprehensive financial and retirement planning, wealth management, estate and tax planning, risk management and employee benefits planning products and advice to millions of Canadians.

CALU was formed to meet the needs of Advocis members who specialize in advanced applications of life insurance and related financial services, including such areas as estate planning, business succession, employee benefits, wealth accumulation and retirement planning.

2. Background for this Submission

Paragraph 27 of Interpretation Bulletin IT-470R¹ outlines the Canada Revenue Agency's ("CRA") administrative position on the tax treatment of certain employee discounts and commissions earned on the purchase of merchandise or life insurance intended for personal use:

“Where it is the practice of an employer to sell merchandise to employees at a discount, the benefits that an employee may derive from exercising such a privilege are not normally regarded as taxable benefits. However, this does not extend to an extraordinary arrangement with a particular employee or a select group of employees nor to an arrangement by which an employee is permitted to purchase merchandise (other than old or soiled merchandise) for less than the employer's cost. Furthermore, this treatment does not extend to a reciprocal arrangement between two or more employers whereby the employees of one can exercise such a privilege with another by whom the employees are not employed. A commission received by a sales employee on merchandise acquired for that employee's personal use is not taxable. Similarly, where a life insurance salesperson acquires a life insurance policy, a commission received by that salesperson on that policy is not taxable provided the salesperson owns that policy and is obligated to make the required premium payments thereon.” (Underlining added)

¹ Employees' Fringe Benefits, dated April 8, 1988, as revised by Special Release dated December 11, 1989; and subsequent amendments thereto.

Recently the Tax Court of Canada (“TCC”) in *Bilodeau v. The Queen*² addressed the issue of whether commission income received by a life insurance agent on a life insurance policy was taxable. The TCC found that the commission income was fully taxable as business income in the hands of the agent, and that the taxpayer could not rely on paragraph 27 of IT-470R to exempt this amount from taxation.

At the 2010 CALU CRA Roundtable, the CRA was asked to provide further guidance as to the situations or fact patterns where it may seek to apply the *Bilodeau* decision rather than follow its administrative position as described above.

As part of the CRA’s response, Mark Symes, Director of the Financial Sector and Exempt Entities Division of the Income Tax Rulings Directorate, indicated that given the comments of the TCC in *Bilodeau*, the CRA has commenced a review of the administrative position in paragraph 27 of IT-470R as it applies to life insurance commissions. It was further noted that any changes to its position will first be published in an Income Tax Technical News with a prospective effective date.

As most members of Advocis and CALU are licensed life insurance agents, we appreciate the opportunity to provide the CRA with this input as part of its review process.

3. Discussion

a) Policy Rationale for Non-Taxation of Employee Discounts and Commissions

From a review of technical interpretations relating to the scope of paragraph 27 of IT-470R, we have surmised that the CRA’s position on the non-taxation of employee discounts is primarily based on the view that while an employee may be paying less than “retail” for the product or service provided by the employer, the employee is not purchasing the item at less than “cost” to the employer. Subject to the discount not being too substantial³, the CRA is prepared to treat the discount as a non-taxable benefit. In our view this would appear to be an appropriate position to take, given that an employee discount typically reflects an employer’s costs savings arising from not having to pay its normal distribution costs, and it is therefore not impoverished through this transaction. Also, the CRA has acknowledged that since an employee may be able to purchase the product at a discounted price from an arm’s length vendor, it would be difficult to put a value on such benefit.⁴

² 2009 D.T.C. 1757 (Eng.), 2009 TCC 315 (herein referred to as the “*Bilodeau* decision”).

³ See paragraph 2 of IT-470R.

⁴ Refer to TI-950365 dated September 12, 1995, where the CRA said, “As stated in the bulletin (IT-470R), any benefit the employee may derive from exercising such a privilege is not normally regarded as a taxable benefit. This reason for this is not that the discounted price is greater than the employer’s cost but that it is questionable on any particular purchase whether the employee has in fact received a benefit because of the variations which can be found in the market price charged for retail goods.”

Similar tax treatment has been extended to certain commissions paid to sales employees resulting from the sale of goods and services intended for personal use, as well as commissions earned by insurance agents from the sale of personal policies.⁵ The CRA has viewed the payment of the commission as being analogous to the offering of an employee discount.⁶

b) Impact of the Bilodeau Decision on Paragraph 27 of IT-470R

It is our view that the CRA could in many situations successfully assess a taxable benefit under paragraph 6(1)(a) of the Income Tax Act (the “Act”) for the receipt by an employee of an employee discount, as well as the amount of a commission earned by a sales employee on products purchased for personal use. Similarly, an independent agent who earns commissions on personal policies would normally have to include this amount in income under subsection 9(1) of the Act.

In fact, the CRA has on a number of occasions indicated that its administrative position on the tax treatment of employee discounts and commissions was a concession to taxpayers, and has placed limits on the scope of such concession through various technical interpretations.⁷

Thus, while the Bilodeau decision has generated much discussion and debate in the tax community, we would suggest it does not represent a change in the interpretation of tax law applicable to these types of employee “perks”. Therefore, this decision does not necessarily require the CRA to modify its current assessing practices set out in paragraph 27 of IT-470R.⁸

c) Is There a Need to Modify the CRA Administrative Position?

We are of the view that the original policy reasons for paragraph 27 of IT-470R remain sound and the concession should be maintained for all the enumerated types of benefits in that paragraph.

We would note that the administrative policy enumerated in paragraph 27 of IT-407R has also been subject to a number of interpretations that have resulted in a significant narrowing of the scope of the exemption. For example, with respect to insurance

⁵ With respect to insurance commissions, the CRA has extended this tax treatment to independent sales persons. See CRA TI 2001-0070655F dated October 31, 2001.

⁶ In TI-2007-0260051E5 the CRA reviewed a program where employees purchased the employer’s appliances at retail cost and were upon proof of purchase provided a rebate by the employer. The CRA found that the rebates were the same in substance as non-taxable discounts and such rebates did not have to be included in the income of the employee.

⁷ For example, the CRA declined to extend the benefits of paragraph 27 of IT-470R in TI 2001-0098297 dated November 21, 2001 and successfully challenged the taxpayer’s reliance on this Interpretation Bulletin in the case of *Delice v. R.*, 2003 TCC 751,

⁸ As clarified by subsequent Technical Interpretations.

commissions earned on personal policies, the CRA has indicated that the following conditions have to be satisfied:

1. The salesperson must own the policy and be obligated to pay the premium.⁹
2. The policy must have been acquired for personal purposes and not as an investment.¹⁰
3. The amount of the commission cannot be substantial.¹¹

When asked to comment further on these limits, the CRA responded as follows:

“We would first like to specify that the positions expressed in paragraph 27 of Interpretation Bulletin IT-407R ... are administrative relief that may not apply in all situations. In that respect, we refer you to paragraph 2 of Interpretation Bulletin IT-470 which indicates: "...there may well be a point beyond which the "privilege" concept is no longer valid, i.e., the advantage to the employee is, in fact, a form of extra remuneration."

This determination is a question of fact that must be resolved in light of all the facts and circumstances of a given situation. The amount of insurance coverage and the frequency of transactions given the particular context of the given situation, as compared to what a family would normally do, are other factors to be taken into account in this determination.¹²

We concur with the CRA's view that it would be difficult to put in place a policy that cannot react to the "facts and circumstances of a given situation." Life insurance is a very unique product where the retail cost or premium is dependent on a number of different factors including the age and health of the life insured. As a result, a person who is younger and in good health will pay a much lower premium than an older person who is in similar good health for the same amount of coverage. As the premium on a given life insured varies, so does the commission that is payable on that policy. An older insurance agent will receive a higher commission from the sale of a given face amount in relation to similar coverage on a younger insurance agent. For the most part this merely reflects the higher mortality cost and therefore premium that is being paid by the older individual.

As well, there can be significant variations between premiums and compensation paid on the same face amount of coverage, depending on the type of insurance (term, universal life, guaranteed whole life etc.), the insurance company offering the product and the type of distribution channel. To put in place additional rules and guidelines may create unintended and unfair results between various taxpayers.

⁹ Paragraph 27 of IT-470R. As a result, commissions earned on policies purchased through an incorporated insurance agency cannot qualify for this tax treatment (see TI-2005-012187).

¹⁰ See CRA TI 9923135 and 2000-0041355. The CRA's position on this qualification was commented upon favourably in the case of *Delisle v. R.*, 2003 TCC 751.

¹¹ TI-2006-0197161C6

¹² *Ibid.*

We recognize that the current administrative position creates some uncertainty as there is little guidance on when an insurance policy may be considered to have been purchased for “investment purposes”¹³ and when the commission will be considered “substantial”. While it would certainly be desirable to have more certainty as to when the CRA will challenge the tax treatment of an insurance commission on a personal policy, Advocis and CALU are prepared to accept that the CRA needs discretion and flexibility given the variety of factors that have to be considered. However, we would welcome the opportunity to work with the CRA to discuss options that might create more certainty for both taxpayers and the CRA in assessing particular taxpayer situations.

d) Equity of Tax Treatment

We understand that the current review of paragraph 27 of IT-470R is limited to the tax treatment of insurance commissions on personally owned policies. As already noted, the Bilodeau decision does not alter the interpretation of the law in this area, and we are of the view that employee discounts and other related sales commissions would also be taxable income under the Act if challenged by the CRA. We therefore don’t feel it is appropriate to review the administrative position under paragraph 27 of IT-470R applicable to insurance commissions, without the CRA also reconsidering this policy as it applies to other types of benefits described in paragraph 27.

4. Summary

The following summarizes our view on the tax treatment of insurance commissions earned on personally owned life insurance policies:

1. We continue to feel that the administrative concessions provided in paragraph 27 of IT-470R (as modified by Technical Interpretations) are appropriate, subject to the other restrictions that the CRA has previously communicated in Technical Interpretations.
2. The Bilodeau decision merely confirms that the CRA’s administrative position is a tax concession, and that the CRA is free to challenge situations even if they squarely fall within its current assessing practices.
3. We believe the current limits placed on the administrative concessions are appropriate as they apply to insurance commissions. While there is some uncertainty created by some of the criteria, we believe the CRA needs to have administrative flexibility given the variety of situations it has to consider. We would be pleased to have further dialogue on how to reduce some of this uncertainty in the application of these guidelines.

¹³ In the Bilodeau decision the CRA asserted the position that the policy was not for “personal use” as the premium paid resulted in a cash value in the first year (which was reduced to nil if the policy was terminated due to surrender charges). We would note that the presence of cash values in a policy is not necessarily indicative that the policy has been purchased for investment purposes. It may be that the owner needs to build cash values to subsidize the cost of insurance in later years and ensure the policy remains in force. This is another example of why it is necessary to look at the facts of each situation before making a determination of whether the commissions should be taxable or not.

4. Any changes to the CRA's administrative practice as set out in paragraph 27 of IT-470R should apply equally to employee discounts and other commissions paid to sales employees.

We would be pleased to discuss this submission further with you at your convenience.