Date: 20101027

Docket: A-496-09

Citation: 2010 FCA 285

CORAM: **EVANS J.A.**
SHARLOW J.A.
STRATAS J.A.

BETWEEN:

HER MAJESTY THE QUEEN

Appellant

and

INNOVATIVE INSTALLATION INC.

Respondent

Heard at Toronto, Ontario, on October 27, 2010.

Judgment delivered from the Bench at Toronto, Ontario, on October 27, 2010.

REASONS FOR JUDGMENT OF THE COURT BY: EVANS J.A.

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REASONS FOR JUDGMENT OF THE COURT
(Delivered from the Bench at Toronto, Ontario, on October 27, 2010)

EVANS J.A.

[1] This is an appeal by the Crown from a decision of the Tax Court of Canada (2009 TCC 580), in which Justice MacArthur (Judge) allowed an appeal by Innovative Installations Inc. (Innovative) from an assessment by the Minister of National Revenue of $120,000 under Part III of the *Income Tax Act*. R.S.C. 1985 (5th Supp.) c. 1 (Act) in respect of a capital dividend of $160,000 declared by Innovative on June 14, 2004.

[2] The Judge held that, contrary to the position of the Crown, Innovative was entitled to include in its capital dividend account (CDA) the sum of $160,000 without being assessed for tax. This sum had been paid by Sun Life Insurance Company on the death of the principal of Innovative, Rod Peacock, pursuant to a group creditor life insurance policy that Sun Life had issued to the Royal Bank of Canada (RBC). Innovative had a business loan from RBC, which offered to enrol Innovative (and other clients to which it had made loans) in a group creditor life insurance policy to provide for the discharge of a loan on the death of a person essential to the ability of the debtor to discharge its loan from the bank.

[3] Under the terms of the group policy, Innovative paid the premiums to RBC as part of its loan repayments, and RBC remitted them to Sun Life. The sum insured was the amount outstanding on the loan from time to time. On the death of a named person who was “key” to the debtor, Sun Life paid the proceeds of the policy to RBC as the policyholder. RBC was contractually obliged to use those proceeds to discharge the borrower’s debt.

[4] At the time of the death of Mr Peacock, Innovative owed $196,922 to RBC. Between the time of his death and the payment of the proceeds of the policy by Sun Life to RBC, Innovative had paid another $21,422 on the loan. RBC used the proceeds of the policy to discharge the outstanding balance of the loan ($175,500), and credited Innovative’s RBC bank account with the rest ($21,422).

[5] A dividend payable by a private corporation is deemed, on the election of the corporation, to be a capital dividend to the extent of the corporation's CDA, and is not included in computing shareholders' income: subsection 83(2) of the Act. Section 89 specifies what is included in a corporation's "capital dividend account". For the purposes of this appeal, the relevant provision is subparagraph 89(1)(*d*)(ii), which reads in part:

…all amounts each of which is the proceeds of a life insurance policy of which the corporation was not a beneficiary on or before June 28, 1982 received by the corporation in the period and after May 23, 1985 in consequence of the death of any person	…les montants dont chacun représente le produit d'une police d'assurance-vie dont la société n'était pas bénéficiaire au plus tard le 28 juin 1982 que la société a reçu au cours de la période et après le 23 mai 1985 par suite du décès d'une personne, …
…	[…]

[6] The Judge held that, although Sun Life had paid the proceeds of the policy to RBC, as was required by the group insurance policy, Innovative "received" "proceeds of a life insurance policy" when RBC applied them, as the contract required, to discharge Innovative's debt. He reasoned that the policy was principally for the benefit of Innovative, which had paid the premiums. Consequently, when the proceeds were used by RBC to benefit Innovative by discharging its debt, Innovative "received" them for the purpose of subparagraph 89(1)(*d*)(ii). *Vis-à-vis* Innovative, RBC was merely the conduit through which the proceeds flowed.

[7] We are not persuaded that the Judge erred in so concluding. The Crown advanced two principal arguments in support of its appeal.

[8] First, it says, the Judge erred in finding that Innovative's CDA included the proceeds of the group life insurance policy, because he thereby improperly ignored the form of the transactions in favour of the economic realities of the situation.

[9] We disagree. The Judge's conclusion is consistent with the terms of the contract between RBC and Sun Life, and between RBC and Innovative. Once Sun Life had paid the proceeds of the policy to RBC pursuant to the policy, RBC was bound to pay them to Innovative's benefit by discharging the loan. He correctly pointed out that it would have been anomalous to conclude that Innovative had not "received" the proceeds because it had effected insurance through RBC, but would have "received" them if it had contracted *directly* with Sun Life. Paragraph 89(1)(*d*) does not require that a corporation receive the proceeds directly from the insurer or that it be named as the beneficiary of the policy. It only had to have "received" them in consequence of Mr Peacock's death.

[10] Second, the Crown says that the Judge erred in treating this as a case of constructive receipt in that Innovative merely received the benefit of the proceeds of the policy. The concept of constructive receipt was inappropriate here, because Innovative had no prior claim to be paid the proceeds.

[11] We do not agree. While Sun Life was contractually bound to pay the proceeds to RBC, RBC was contractually bound by the terms of the group insurance policy to credit Innovative with them by discharging the balance of the loan. Innovative could have sued RBC in the event that it failed to

apply the proceeds of the policy to pay off the loan and, if necessary, probably could have joined RBC to an action against Sun Life if it failed to pay the proceeds of the policy to RBC on Mr Peacock's death.

[12] In argument, the Crown submitted that, on the basis of the Judge's decision, both RBC and Innovative could be regarded as recipients of the proceeds of the policy. This concern is unfounded. For the purpose of subparagraph 89(1)(*d*)(ii), there was only one recipient of the proceeds of the policy: Innovative.

[13] For these reasons, the Crown's appeal will be dismissed with costs.

"John M. Evans"

J.A.

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-496-09

(AN APPEAL FROM THE JUDGMENT OF THE HONOURABLE MR. JUSTICE C.H. MCARTHUR FROM THE TAX COURT OF CANADA, DATED NOVEMBER 12, 2009, IN TAX COURT FILE NO. 2008-724(IT)(G)).

STYLE OF CAUSE:	HER MAJESTY THE QUEEN v. INNOVATIVE INSTALLATION INC.
PLACE OF HEARING:	TORONTO, ONTARIO
DATE OF HEARING:	OCTOBER 27, 2010
REASONS FOR JUDGMENT OF THE COURT BY:	(EVANS, SHARLOW, STRATAS JJ.A.)
DELIVERED FROM THE BENCH BY:	EVANS J.A.

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