Docket: 2017-2613(IT)I

BETWEEN:

EMJO HOLDINGS LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on May 10, 2018, at Regina, Saskatchewan

Before: The Honourable Justice Guy R. Smith

Appearances:

Agent for the Appellant:	Darcy Spilchen
Counsel for the Respondent:	Taylor Andreas

JUDGMENT

The appeal from a Notice of Reassessment dated January 12, 2016 made under the *Income Tax Act* for the 2013, 2014 and 2015 taxation years is dismissed, without costs, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 22nd day of May 2018.

"Guy Smith"

Smith J.

Citation: 2018 TCC 97
Date: 20180522
Docket: 2017-2613(IT)I

BETWEEN:

EMJO HOLDINGS LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Smith J.

[1] This is an appeal from a Notice of Reassessment dated January 12, 2016 wherein the Minister of National Revenue (the "Minister") disallowed life insurance expenses of $8,612, $8,556 and $8,556 for each of the 2013, 2014 and 2015 taxation years, respectively.

[2] The only issue in this appeal is whether the life insurance premiums were deductible for the subject taxation years.

[3] The Notice of Appeal provides as follows:

> 1. Policy J4398015 which is universal life single life coverage of $1,000,000 was acquired originally in the fall of 2002 when EMJO Holdings purchased the sales of Deneschuk Homes Ltd. To meet the financing condition of the Yorkton Credit Union Limited that the borrower (EMJO Holdings Ltd) had to carry a minimum of $500,000 Keyman Life Insurance. Note this policy was revised effective December 23, 2001.

2. Policy J3444752 which is term life coverage of $3,000,000 was acquired effective April 25, 2011 as a condition for Deneschuk Homes Ltd to obtain HeadStart on a Home program financing from the Cornerstone Credit Union. This policy is assigned to the Saskatchewan Immigrant Investor Fund Inc.

[4] The Minister argues that the loans were in fact personal loans of the principal shareholders for which the Appellant is not liable and consequently, that the life insurance premiums are not deductible.

[5] Lee Rusnak testified on behalf of the Appellant. The Respondent did not call any witnesses.

[6] The Appellant was incorporated under the laws of the Province of Saskatchewan on November 25, 2002. Lee Rusnak and his spouse, Jodie Rusnak, each held 50% of the voting shares. The purpose of the incorporation was to acquire the shares of an existing corporation known as Deneschuk Homes Ltd.

[7] Prior to the incorporation, Lee and Jodie Rusnak obtained a Commitment Letter (Exhibit A-1) from the Yorkton Credit Union Limited dated October 15, 2002 for a term loan of $300,000 and a second loan of $250,000, both to be amortized over a period of ten years.

[8] The loans were to be guaranteed by Lee Rusnak's parents who were required to provide a collateral mortgage on a jointly owned property. Other security to be provided included promissory notes from Lee and Jodie Rusnak as well as a corporate guarantee of $550,000 from Deneschuk Homes Ltd., supported by a general security agreement.

[9] The Commitment Letter included the following requirement:

> "The Borrowers agree to carry minimum $500,000 Keyman Life Insurance assigned to the Credit Union."

[10] The Commitment Letter was signed by a representative of the Credit Union and accepted on December 4, 2002 by Lee and Jodie Rusnak, as President and Secretary, respectively, of the Appellant. It was also accepted on the same date by Mr. Rusnak's parents. The corporate seal of the Appellant was affixed to the letter, on the left side of the signatures. On the copy remitted to the Court, the seal was crossed out by diagonal hand-written lines and initialed by one of the signatories.

Mr. Rusnak explained that this was likely done since the signatures included the guarantors.

[11] As indicated above, the loans were to be amortized over ten years. The Appellant produced an account statement (Exhibit A-4) issued by the Cornerstone Credit Union, (the successor to the Yorkton Credit Union Limited) for the one month period ending February 28, 2013. The statement indicated that a final payment of $66,152.05, being the balance owed on the commercial loan, was to be made on February 1, 2013. Mr. Rusnak testified that there was only one consolidated loan and that this was the balance owed on that date.

[12] The account statement also indicated that three payments equal to $713.00 per month were automatically withdrawn in favour of SunLife. There was no clear evidence on this matter but the Court must assume that these amounts were used as the basis for calculating the annual insurance premiums paid ($713.00 x 12 = $8556). The Court also finds that the first insurance policy was increased to $2 million effective December 23, 2011 and that monthly payments of $376.65 (Exhibit A-2) were included in the amount withdrawn.

[13] The Appellant was unable to provide documentary evidence to support the assignment of the life insurance policy but provided a copy of an email from a representative of the Credit Union (Exhibit A-3) indicating that: “Although I was not working for the Credit Union back in 2002; it is my understanding that this insurance was assigned to the Credit Union as indicated on the Commitment Letter.”

[14] According to Mr. Rusnak’s testimony, the second loan of approximately $2,400,000, was provided by “HeadStart on a Home”, a lending program created by the Province of Saskatchewan and financially supported by the Saskatchewan Immigrant Investor Fund Inc. This program was created to support builders in the construction of new homes.

[15] It appears that this loan was more in the nature of a credit facility that could be drawn down, as required. A statement was tendered as evidence (Exhibit A-5) to indicate that the balance outstanding on December 31, 2012, was $417,554. Also tendered as evidence was a letter from HeadStart on a Home (Exhibit A-6) dated February 7, 2012. It provides as follows:

> Please be advised that the Saskatchewan Immigrant Investor Fund Inc. ("SIIF"), has requested an Assignment of key man life insurance in the amount of $500,000.00 on the life of Lee Rusnak.
>
> The Assignment is therefore limited to $500,000.00.

[16] An Assignment of Policy from the Appellant as policy owner to HeadStart on a Home, as lender, signed by Lee Rusnak as President and dated September 9, 2002 was adduced as evidence (Exhibit A-7) as well as a similar form in favour of the Saskatchewan Immigrant Investor Fund, as lender (Exhibit A-8). Both were prepared using SunLife Financial standard forms.

I. The Law

[17] The applicable legislative provision is paragraph 20(1)(e.2) of the *Income Tax Act*, R.S.C., 1985, c. 1 (5th Supp.) (the "Act") which provides as follows:

> 20 (1) Notwithstanding paragraphs 18(1)(a), 18(1)(b) and 18(1)(h), in computing a taxpayer's income for a taxation year from a business or property, there may be deducted such of the following amounts as are wholly applicable to that source or such part of the following amounts as may reasonably be regarded as applicable thereto
>
> (…)
>
> (e.2) the least of the following amounts in respect of a life insurance policy (other than an annuity contract or LIA policy):
>
> (i) the premiums payable by the taxpayer under the policy in respect of the year, if
>
> (A) an interest in the policy is assigned to a restricted financial institution in the course of a borrowing from the institution,
>
> (B) the interest payable in respect of the borrowing is or would, but for subsections 18(2) and 18(3.1) and sections 21 and 28, be deductible in computing the taxpayer's income for the year, and
>
> (C) the assignment referred to in clause 20(1)(e.2)(i)(A) is required by the institution as collateral for the borrowing
>
> (ii) the net cost of pure insurance in respect of the year (other than in respect of a period after 2013 during which the policy is a 10/8 policy), as determined in accordance with the regulations, in respect of the interest in the policy referred to in clause (i)(A), and

> (iii) the portion, of the lesser of the amounts determined under subparagraphs (i) and (ii) in respect of the policy, that can reasonably be considered to relate to the amount owing from time to time during the year by the taxpayer to the institution under the borrowing;
>
> (My Emphasis.)

[18] Accordingly, life insurance premiums may be deducted where (i) an interest in a life insurance policy is assigned to a lending institution in the context of a borrowing transaction; (ii) interest on the loan is otherwise deductible to the borrower and finally; (iii) the assignment is required by the lending institution as collateral for the borrowing.

[19] The amount that may be deducted is the lesser of the premiums actually paid and the "net cost of pure insurance" (as set out in subparagraph 20(1)(e.2)(ii)) to distinguish between universal or whole life insurance policies that would typically include a savings component.

[20] The other proviso is that the amount of the premium that can be deducted must "reasonably be considered to relate to the amount owing from time to time" during the year by the taxpayer "to the lending institution". Since a borrower will typically make payments of principal and interest over time, a calculation would be required to determine the principal outstanding from one year to the next. In other words, the deduction that may be available during the first year of the term of the loan, will generally be reduced as the principal is reimbursed over time.

[21] In *Louise C. Norton v. The Queen*, 2010 TCC 62, Wyman J. (as he then was) concluded that life insurance premiums were not deductible since the taxpayer had not established that the assignment was actually "required" by the lending institution. In particular, the evidence was contradictory in that the bank documents clearly indicated that life insurance was voluntary and was not a condition for the loan.

[22] In *Lloyd Quartz v. The Queen*, [2003] 1 C.T.C. 2714, the Court considered two letters tendered as evidence of the assignment. McArthur J. found that there was no evidence that upon the taxpayer's death, the life insurance company would be obligated under a contract of assignment to pay the proceeds to the financial institution and further that:

> [7] (…) This is not a legal contractual assignment of the policy. The legislation is clear. I cannot change the wording of the Act. I am bound by what happened. It would be stretching reality too far to find that he met the requirements of the Act because an assignment could have or should have been made. The fact remains, there was no assignment of an interest in the insurance policy to a restricted financial institution in the course of borrowing. This issue in the appeals is dismissed.

II. Analysis and Conclusion

[23] In this instance, I am satisfied that the Commitment Letter, although addressed to Lee and Jodie Rusnak, was in the nature of a pre-incorporation contract that was later adopted by the Appellant, as evidenced by their signatures as President and Secretary, after the date of incorporation.

[24] I also conclude that the Appellant actually borrowed money from Yorkton Credit Union Limited in accordance with the Commitment Letter, the terms of which included a requirement that keyman insurance be assigned as collateral.

[25] I also accept Mr. Rusnak's oral testimony that the life insurance was in fact assigned to the lender. On the facts of this case, I am satisfied that the assignment of life insurance was required and that it was carried out.

[26] Despite the foregoing, I have several concerns. Firstly, the Notice of Appeal suggests that the policy amount was $1 million (later increased to $2 million) when the Credit Union only required life insurance of $500,000. As a result, the amount of the deduction would have to be adjusted accordingly.

[27] Secondly, the statutory provision requires that the deduction must be correlated to the amount of the loan "owing from time to time". Since the amount owed had been reduced to approximately 10% of its original amount, the Appellant would only be entitled to a corresponding deduction of the life insurance premium which could be calculated as follows:

$$\frac{\$66,152}{\$2,000,000} \times (\$376.65 \times 12) = \$149.50$$

[28] Thirdly, the Bank statement indicates that the balance outstanding was to be repaid in full by February 1, 2013. The Appellant's year end was February 28 suggesting that for the 2014 and 2015 taxation years, the balance owed to the

lender was nil. As such, the Appellant would not be entitled to a deduction of life insurance premium for those years.

[29] The final concern is that the Appellant has not adduced any evidence to distinguish between the cost of the "universal life" policy in question and "the net cost of pure insurance", the cost of which would be deductible pursuant to subparagraph 20(1)(e.2)(ii).

[30] With respect to the second loan transaction, I accept that a credit facility was made available to the Appellant through the HeadStart on a Home lending program, that an assignment of life insurance was required as collateral and that the assignment was effectively carried out.

[31] The difficulty with the second loan is that Mr. Rusnak indicated that the credit facility was never fully drawn down, suggesting that the Appellant only borrowed what was required from time to time. It is likely that as homes were built and sold by the Appellant, the credit facility was repaid on a rolling basis.

[32] The evidence suggests that the balance outstanding on December 31, 2012 was $417,554, but there is no evidence of any indebtedness for the 2013, 2014 and 2015 taxation years. In other words, with regards to the second loan transaction, it is not possible for the Court to correlate the life insurance premiums paid with the balance due on a loan for the taxation years in question.

[33] The Appellant's agent argued in closing that the proceeding was governed by the informal procedure and that, all things considered, sufficient evidence had been adduced to support the expenses being claimed.

[34] In essence, the Appellant is arguing that the Court should consider the evidence on a less onerous and technical standard in accordance with the objective of the informal procedure: subsection 18.15(3) of the *Tax Court of Canada Act*, R.S.C. 1985, c. I-2. While that provision governs the admissibility of evidence in the informal procedure, it has been held that "it does not entitle the appellant to a more favourable weighing of certain portions of his evidence — i.e. the oral evidence": *Barnwell v. Canada*, 2016 FCA 150 (para. 13).

[35] In this instance, the oral testimony focused on the lending transactions but fell short of addressing all the requirements of the Act for the taxation years in issue.

[36] In the end, a minimum of evidence is required, particularly where the Court is dealing with a statutory provision that contains technical rules governing a taxpayer's entitlement to a deduction.

[37] For all the foregoing reasons, the appeal must be dismissed.

Signed at Ottawa, Canada, this 22nd day of May 2018.

"Guy Smith"

Smith J.

CITATION:	2018 TCC 97
COURT FILE NO.:	2017-2613(IT)I
STYLE OF CAUSE:	EMJO HOLDINGS LTD. v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Regina, Saskatchewan
DATE OF HEARING:	May 10, 2018
REASONS FOR JUDGMENT BY:	The Honourable Justice Guy R. Smith
DATE OF JUDGMENT:	May 22, 2018

APPEARANCES:

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