



Shareholder benefits and corporate life insurance - How would CRA know?

For those of you who have asked the question “how would CRA know?”, this case is a reminder that it’s not worth it to try something edgy and later find out they do know.

In the *LePalme et al v. the Queen*, 2011 CCI 396 the Tax Court of Canada upheld the assessment of shareholder benefits and imposed interest and penalties for gross negligence on the taxpayers allowing reassessment beyond the normal reassessment period.

The taxpayers were the shareholders and directors of a company. The company purchased life insurance, paid the premiums and was named the beneficiary of policies on each of the shareholders. The agent who sold the insurance made payments to each of the taxpayers very close to the amount of premiums for each of the policies “mere days after the life insurance policies were purchased.”

The taxpayers did not report the payments as income. These amounts were added to each taxpayer’s income as shareholder benefits under subsection 15(1) of the Act. Penalties and interest were imposed for gross negligence under subsection 163(2) of the Act.

The taxpayers argued that subsection 15(1) should not apply because there was no appropriation of Company property by the shareholders and that the Company was not entitled to the amounts paid to the shareholders by the broker and was therefore, not impoverished. They argued that the payments were a gift at the personal discretion of the broker and were not subject to any verbal or written agreement.

The Court disagreed. Favreau J. found as follows (unofficial translation):

In the case in point, there is an arrangement or plan for conferring on shareholders in their capacity as shareholders. By purchasing life insurance policies from Transamerica through the broker...the members of the Company’s board of directors and, by virtue of that fact, the Company itself, were perfectly aware, or at the very least should have known, that payments would be made to the shareholder by the broker...

The amounts paid to the Company’s shareholders by (the) broker... were too large and too regular to be a simple gift or favour.

How did the CRA find this out? The case cited the following information:

It was not until after an audit of the affairs of the broker...that she (the CRA auditor) was informed that refunds had been received by shareholders of the Company in connection with the life insurance policies purchased by the Company. She did not have access to the audit file connected with the broker... nor to the copies of the refund cheques. She had, however, seen a list of cheques given to the Company’s shareholders. On the basis of this information she sent...a request for information...to the appellants.

Omissions on tax returns (i.e. not reporting income that should be reported) can be found, taxed and made subject to penalties and interest.

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September 2011

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