CASE IN POINT

Sales Tax Estate Planning Underwriting & Product Newsletter

When a beneficiary may not be liable for taxes on deceased's investment

I have frequently spoken about limitations and misunderstandings which may occur when naming beneficiaries on certain investment and insurance policies. One topic deals with creditor protection and the general exception applying to the Canada Revenue Agency (CRA) when it feels income taxes are owed. The CRA relies on s 160(1) of the Income Tax Act (Canada). This provision states that when a person transfers property directly or indirectly to a person not dealing at arm's length, the transferee and the transferor are jointly and severally liable to pay the transferor's tax.

Does it always apply? Let's look at the case of Higgins vs. The Queen, 2013 TCC 194 (CanLII)

Arthur Higgins named his two adult daughters, Karen and Sandra, as equal and revocable beneficiaries of a non-registered segregated fund investment in 1999.

He had made a series of monthly withdrawals from this investment prior to passing in 2002. The balance passing on to the daughters was $10,192.

Arthur died without a will. His estate was quite simple, holding no assets other than a bank account. The bank funds were used to cover funeral expenses. There was no administration of the estate.

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Peter works with independent advisors and other professionals raising awareness on issues and concerns faced by affluent individuals, professionals and business owners. He supports efforts in researching and developing optimal solutions for clients aimed at improving their financial well-being and supporting their personal wishes and lifestyles. He annually provides 100's of workshops, seminars and technical support throughout the country on tax, retirement income and estate planning issues, concepts and strategies to both advisors and consumers. As a Registered Financial Gerontologist, a good deal of his time is spent on building awareness and educating people of all professions who work with or specialize in the needs, expectations and issues of elders. Comprehensive lifestyle planning is an important element of these processes.

The Sales, Tax, Estate Planning, Underwriting & Product (STEPUP) team provides internal and broker support, including seminars, education, advanced concept illustrations & Client case technical consultations.

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Empire Life Investments

Case in Point

A family member told Karen that Arthur may have owned an insurance policy. Karen followed up and discovered that there was a Registered Retirement Income Fund (RRIF) and an investment with an insurance company. The monies were paid out to Karen and Sandra. The advisor told Karen that there would be no income tax owing on the investment since they were "life insurance policies". Karen held back some of the money just in case this wasn't correct. She had a series of discussions with the CRA about income taxes owed. The CRA said that no income tax was payable on proceeds from a life insurance policy.

The CRA did ask Karen to file a tax return on behalf of her father. Karen sent in some documentation but did not prepare and file a tax return. Discussions continued from 2004-07, during which time Karen was advised that CRA would not pursue the collection of income taxes due to the small amount owing. Things went quiet until 2010. A CRA agent then informed Karen that Arthur Higgins' account was in arrears. The amount owing under the assessment on the non-registered account alone was $5096. The daughters appealed the assessment and the matter eventually went to the Tax Court of Canada.

The CRA took the position that a transfer of a non-registered insurance segregated fund had occurred from Arthur's estate and therefore tax was owed. Additionally, the CRA felt that the non-registered investment did not fall under the category of life insurance.

Arthur's daughters argued that they, not Arthur's estate were the beneficiaries of this segregated fund investment under the contractual terms of the contract. The proceeds passed directly to them. The investment issued by the insurance company, in their opinion, was similar to a life insurance policy.

Justice Rowe concluded that the segregated fund was both a regular investment and a life insurance policy. The right to name a beneficiary who would receive the balance of any remaining funds on the death of the owner was an integral feature of the segregated fund. As such, the funds that the daughters received as beneficiaries were considered life insurance proceeds and did not form part of Arthur's estate. The court found that the segregated fund contract was protected under the preferred class provisions of the B.C. Insurance Act. The CRA could not hold the daughters jointly and severally liable for their father's income tax liability on that investment.

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