



Life's brighter under the sun

**Scotti v. Agence du Revenu du Quebec, 2019 QCCQ 7579 – Quebec Court finds policyholder must pay tax on rebate**

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In *Scotti v. Agence du revenu du Quebec, 2019 QCCQ 7579*, the Quebec Court found that a rebate paid to a policyholder was taxable to the policyholder. The Court agreed with several of the revenue authorities' rulings on this issue. This case is a reminder that rebated commissions, whether permitted or not in the province governing the insurance purchase, must be included in the policyholder's income.

### **The Facts**

An insurance advisor, Mr. Chabot, persuaded his clients to purchase insurance policies so that he could earn substantial bonuses. These bonuses were significantly higher than the amount of premiums his clients paid on their policies.

In this case, Mr. Scotti was one of Mr. Chabot's clients. Mr. Scotti purchased a \$5 million Universal Life policy (the "policy") in March 2008. Mr. Chabot's plan was to have Mr. Scotti pay the premiums for two years of \$1,500/month (or just over \$19,000 annually). After a two year period, the built up cash values in the policy could pay for the remaining premiums or Mr. Scotti could lapse the policy. The policy needed to be in force for two years so that Mr. Chabot did not have to reimburse the commissions to the insurance carrier.

From March 2008 to May 2009, Mr. Chabot paid \$90,000 of his commissions received on the sale of the policy to Mr. Scotti. The Quebec Revenu Agency (the "Agency") assessed Mr. Scotti. The Agency took the position that the \$90,000 was taxable to him under section 87(w) of the *Quebec Taxation Act* ("TA"). The equivalent is paragraph 12(1)(x) of the *Income Tax Act (Canada)* (the "Act"). Both Acts are similar in that they require the taxpayer to include in income amounts that

they receive in the course of "earning income from a business or property". As explained below, the policy is the income earning property.

Revenu Quebec also argued that the amounts were taxable incentives. Mr. Scotti unsuccessfully argued that the amounts were non-taxable incidental gains.

### **CRA and Revenu Quebec Positions**

In several technical interpretations, the CRA has stated that, where a rebate is paid to a policyholder, the insurance advisor should include the full amount of the sales commission in business income. The advisor can deduct the rebate paid to the policyholder as a general business expense. The policyholder must include the full amount of the rebate in income. (See CRA Technical Interpretations 2008-0271381E5, dated February 11, 2009 and 2010-0359401C6, dated May 4, 2010). The CRA rulings also state that a life insurance policy is generally a property and/or asset acquired for the purpose of earning income from property. There is also a similar Revenu Quebec ruling.

### **The Court's Findings**

The Court found that the policy is "property" where Mr. Scotti's view was to obtain profits and income from it (that is, the rebate in this case). The Court approved and agreed with the above CRA Technical interpretations which state that "the holder of a policy that includes both a life insurance component and a saving component holds property that is a source of income". The Court also cited CRA Documents 2002-0151645, dated October 25, 2002; 2004-006699117, dated April 28, 2004. The Court also relied on ARQ interpretation letter 13-017776-001, dated October 7, 2013 which arrives at the same conclusion.

The Court also made the following findings:

- Mr. Chabot paid Mr. Scotti rebates as an inducement to keep the policy in force for two years. This was so that Mr. Chabot did not have to reimburse the bonuses and commissions paid to him by the insurance carrier.

- The payments were made and received on an incentive basis. They cannot therefore, be their very nature, be fortuitous gains. The Court followed the Federal Court's reasoning in *French Shoes Ltd. v. The Queen*, 86 DTC 6359: "An inducement is not a windfall, it is an incentive, a reason for doing something."
- As a seasoned businessperson, Mr. Scotti knew, or ought to have known, that the amounts paid to him by Mr. Chabot greatly exceeded that annual premium of the policy. This enabled him to benefit from a surplus.
- Mr. Scotti had no need for the insurance policy and agreed to purchase the policy solely to receive rebates.

### **Provincial rebating and sanctions**

Rebating or inducements to purchase insurance are prohibited under the *Insurance Acts* of all provinces except Alberta and British Columbia. In provinces where rebating is prohibited, an insurance advisor caught rebating can lose their license and/or face fines. In this case, Mr. Chabot's licence was subsequently revoked. In Ontario, agents can be subject to fines of up to \$200,000 and/or have their license suspended, revoked or cancelled.

Although Alberta does not restrict rebating, insurance agents still have a duty to act in good faith and in the clients' best interests. The Life Insurance Court of Alberta has fined an agent who acted in an untrustworthy and dishonest manner. The agent repeatedly induced clients to purchase insurance. She also assured clients that she would pay the premiums in the event they needed assistance.

In British Columbia, regulations under the *Financial Institutions Act* [RSBC 1996] Chapter 141 currently permit rebating up to a maximum amount equal to 25% of premiums. However, B.C.'s rebating rules are under review. Agents must also act in a trustworthy and competent manner.

It is also important to note that provincial insurance regulators are now sharing information on insurance advisors who have been found to be in contravention of a specific province's insurance regulations. This will likely result in the licensing or registration of that advisor being denied or revoked in all other provinces. Also, in addition to any provincial prohibitions, insurance companies can take separate disciplinary action for agent activities which are in breach of their contractual requirements and related codes of conduct.

## Key Takeaways

The following are some of the key takeaways from this decision:

- It is important to disclose the taxability of a premium rebate or inducement to a client or prospective client during the sales process to ensure they're aware of their tax-reporting obligations.
- Consulting the codes of conduct of the relevant insurance companies to determine their stance on rebating and any required policyholder disclosure is also a good practice.
- Contravention of provincial or insurer rules and guidelines could result in the imposition of fines or the suspension/termination of the advisor's insurance licence or contract.
- Presently, *Insurance Acts* in all provinces except Alberta and B.C. prohibit "rebating". However, in Alberta, insurance agents have a duty to act in good faith and in the clients' best interest. Similarly, in B.C., insurance agents must act in a trustworthy and competent manner and B.C.'s rebating rules are under review.

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