Docket: 2018-4815(IT)G

BETWEEN:

THE INDEPENDENT ORDER OF FORESTERS,

Appellant,

and

HIS MAJESTY THE KING,

Respondent.

Appeal heard on October 24, 25, 26, 27, and 31, 2022, November 1, 2022, February 17, 2023 and February 20, 2023 at Toronto, Ontario, Written submissions of both parties received on March 27, 2023

Before: The Honourable Justice Monica Biringer

Appearances:

Counsel for the Appellant:	Daniel Sandler Marie-Claude Marcil Osnat Nemetz
Counsel for the Respondent:	Craig Maw Jenna Clark Lalitha Ramachandran

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JUDGMENT

UPON hearing from the parties and upon reading the written submissions of the parties, filed;

AND in accordance with the Reasons for Judgment attached;

The appeal from an assessment made under the *Income Tax Act* in respect of the Appellant's 2014 taxation year is allowed and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment in accordance

with my attached reasons. More specifically, the Minister shall reassess the Appellant in respect of its 2014 Taxation Year on the basis that:

(a) World Surplus assets in the amounts of $110,116,000 for the 2013 taxation year CIF and $217,025,000 for the 2014 taxation year CIF are not to be included;

(b) assets and liabilities of the A&S Business in the amounts of $982,000 for the 2013 taxation year CIF and ($3,299,000) for the 2014 taxation year CIF are to be included; and

(c) the Appellant is correct in designating Investment Property in respect of its A&S Business pursuant to ITR paragraphs 2401(2)(b) and (d), including, pursuant to ITR paragraph 2401(2)(d), any additional Excess CIF determined in accordance with these reasons.

The Appellant has 30 days from the date of this decision to provide written submissions on costs, not to exceed 10 pages. The Respondent has a further 30 days to provide written submissions on costs in response to the Appellant's submissions.

Signed at Toronto, Ontario, this 17th day of August 2023.

"Monica Biringer"

Biringer J.

Citation: 2023 TCC 123
Date: 20230817
Docket: 2018-4815(IT)G

BETWEEN:

THE INDEPENDENT ORDER OF FORESTERS,

Appellant,

and

HIS MAJESTY THE KING,

Respondent.

REASONS FOR JUDGMENT

Biringer J.

[1] The Independent Order of Foresters ("Appellant") is a Canadian resident fraternal benefit society and a life insurer that provides fraternal benefits and individual life insurance to its members. The Appellant appeals an assessment for the 2014 taxation year[1] involving the taxation of investment income.

I. BACKGROUND FACTS

[2] The parties filed a partial agreed statement of facts ("PASF") which is reproduced in Appendix A.

[3] The Appellant called three fact witnesses – Mr. Frank Lochan, director[2], Mr. Stephen McDonald, Vice-President International Finance Officer and Mr. Peter Boyko, Vice-President Capital Management. The Respondent called two fact witnesses - Paul Reaburn, Chief Financial Officer and Sharon Giffen, CEO of the Canadian Division. I found all witnesses to be credible.

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[1] The Appellant has a December 31 taxation year. In computing the "mean Canadian investment fund" for the 2014 taxation year, the "Canadian investment fund" at the end of the 2013 taxation year and the end of the 2014 taxation year must be determined. Accordingly, the relevant period for this appeal spans the 2013 and 2014 taxation years ("Relevant Period").

[2] All references are to positions held during the Relevant Period.

[4] The Appellant was formed on May 16, 1913 under the *Federal Independent Order of Foresters Consolidated Act* (3&4 Geo. 5, c.113). It is owned by its members and has a representative form of government. Individuals who purchase insurance or an annuity from the Appellant become members of the fraternal benefit society. During the 2014 taxation year, the Appellant had approximately 1.2 million members in Canada, the United States and the United Kingdom.[3]

[5] The purpose of a fraternal benefit society is to provide benefits for its members who share a common bond.[4] For the Appellant, members obtain benefits through insurance products (life insurance and accident and sickness), community activities and various other personal development services.[5]

[6] Members who purchase a life insurance policy are entitled to various other benefits (e.g. an illness benefit) ("Fraternal Benefits")[6]. In addition to providing Fraternal Benefits to members, the Appellant spends money on various community and personal development projects (e.g. building playgrounds, providing scholarships) ("Good Works").[7]

[7] The Appellant is subject to the *Insurance Companies Act*[8] and is regulated by the Office of the Superintendent of Financial Institutions ("OFSI"). The Appellant operates insurance businesses in Canada and in the United States. During the Relevant Period, the Appellant carried on its life insurance business ("Life Business") and its accident and sickness insurance business ("A&S Business") in both Canada and the United States.[9] The Appellant carried on its fraternal operations in Canada and through branches in the United States and the United Kingdom.[10]

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[3] Fraternal Outcomes Report Card, Joint Book of Documents ("JBD"), page 130.

[4] October 24, 2022 Transcript, pages 60 and 164 – Testimony of Frank Lochan and Stephen McDonald.

[5] October 24, 2022 Transcript, pages 62-63 – Testimony of Frank Lochan.

[6] October 24, 2022 Transcript, page 165 – Testimony of Stephen McDonald.

[7] October 24, 2022 Transcript, pages 166, 180-182, 183 (lines 22-26) – Testimony of Stephen McDonald.

[8] S.C. 1991, c. 47.

[9] PASF, paragraphs 6-7.

[10] October 24, 2022 Transcript, page 162, lines 1-11; page 163, lines 1-10 – Testimony of Stephen McDonald.

[8] Subsidiaries of the Appellant, which are not fraternal benefit societies, carry on life insurance businesses in Canada, the United States and the United Kingdom[11]. The Canadian subsidiary is Foresters Life Insurance Company. Other subsidiaries of the Appellant carry on asset management businesses in the United States and the United Kingdom.[12]

II. TAXATION OF CANADIAN RESIDENT LIFE INSURERS

[9] The issues in this appeal involve rules in the *Income Tax Act* (Canada) ("ITA")[13] relevant to the taxation of a life insurer and those relevant to the taxation of a fraternal benefit society. I start with a brief overview of both.

[10] The Appellant is a Canadian resident "life insurer" and "life insurance corporation" for purposes of the ITA. The general rule – that Canadian residents are liable to tax on worldwide income – does not apply to life insurers. Pursuant to paragraph 138(2)(a), a Canadian resident multinational life insurance corporation/life insurer ("MNLI") that carries on an insurance business in Canada and elsewhere is taxable under the ITA on income from carrying on an insurance business only to the extent that the income is from carrying on the insurance business in Canada.

[11] MNLIs hold portfolio investments against all of their liabilities. Subject to regulatory requirements, the insurer may not hold investments in each country in which it operates in proportion to its liabilities, capital and surplus in that country. For example, a Canadian resident MNLI may hold all capital and surplus in support of worldwide operations, not only those in Canada. Accordingly, the ITA has special rules (the "designated property regime") to determine the appropriate level of investment revenue and gains and losses attributable to the Canadian resident MNLI's Canadian insurance businesses.

[12] Paragraph 138(9)(a) requires a Canadian resident MNLI to include in its income from carrying on an insurance business in Canada the "gross investment

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[11] PASF, paragraph 20; October 24, 2022 Transcript, pages 159 and 160, lines 15-28 and 1–21 - Testimony of Stephen McDonald.

[12] October 24, 2022 Transcript, page 124, lines 19-23 - Testimony of Frank Lochan.

[13] R.S.C. 1985, c. 1 (5th Supp.). All statutory references herein are to the ITA unless otherwise specified.

revenue" ("GIR")[14] from "designated insurance property" ("DIP")[15]. GIR from investment property that is not DIP is not included.[16] Paragraph 138(9)(b) requires a prescribed amount to be included in income, pursuant to a complex formula in Income Tax Regulations[17] ("ITR") section 2411, if, in general terms, the GIR from DIP that is to be included in computing income does not reflect the average GIR from all of the insurer's investment property. Paragraph 138(9)(b) is not in issue in this appeal.[18]

[13] DIP is defined in subsection 138(12) to mean property determined in accordance with prescribed rules.[19] The prescribed rules require an insurer to first determine its "Canadian investment fund" ("CIF")[20] at the end of the relevant taxation year and the end of the immediately preceding year to arrive at the "mean CIF"[21] for the year. The CIF represents the amount of the insurer's investment property that is considered to be used in the Canadian insurance businesses at the end of the year. The insurer must then designate "investment property"[22] ("Investment Property") equal in amount to the mean CIF (or the total of the "mean Canadian reserve liabilities" in respect of the insurer's insurance businesses, if greater).[23] A detailed discussion of the CIF and the designation rules is provided further below.

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[14] Defined in subsection 138(12). Sections 142.3 to 142.51 set out rules for the taxation of investment income of financial institutions (which include MNLIs); pursuant to subsection 138(10), those rules only apply to GIR from DIP.

[15] Defined in subsection 138(12).

[16] Paragraph 138(2)(b).

[17] *Income Tax Regulations* C.R.C., c. 945 ["ITR"].

[18] While this issue was raised in the pleadings, in a letter dated December 2, 2022 to the Court, the Appellant confirms that the excess amount under ITR subsection 2411(6) will be taken up with the CRA. No evidence or argument was provided at the hearing in respect of paragraph 138(9)(b).

[19] The prescribed rules are in ITR subsections 2401(2)-(7).

[20] Defined in ITR subsection 2400(1).

[21] Defined in ITR subsection 2412(1).

[22] Defined in ITR subsection 2400(1).

[23] ITR subsection 2401(2).

III. TAXATION OF FRATERNAL BENEFIT SOCIETIES

[14] Paragraph 149(1)(k) exempts from Part I tax payable the taxable income of a fraternal benefit society. Subsection 149(3) provides an exception to paragraph 149(1)(k) in respect of the taxable income of a fraternal society from carrying on a life insurance business. Subsection 149(4) provides that for the purposes of subsection 149(3), the taxable income of a fraternal benefit society from carrying on a life insurance business shall be computed on the assumption that "it had no income or loss from any other sources."

[15] Thus, a fraternal benefit society is taxable under Part I on taxable income from carrying on a life insurance business. If the fraternal benefit society is a Canadian resident MNLI, like the Appellant, this will be its taxable income from carrying on a life insurance business in Canada.

IV. THE ASSESSMENT

[16] For the 2014 taxation year, the Minister of National Revenue ("Minister") reassessed the Appellant to include in the Appellant's CIF the amount of its "World Surplus" assets which the Appellant had deducted in computing its CIF. The Minister says that the World Surplus assets were "used or held in the course of carrying on an insurance business". The Minister also reassessed the Appellant to exclude from the Appellant's CIF amounts in respect of the A&S Business and deny the Appellant's designation of Investment Property in respect of the A&S Business. All issues are raised in this appeal. I address the latter issues first.

V. ISSUE #1 – THE A&S BUSINESS – CIF AND DESIGNATION ISSUES

[17] This issue involves the possible impact of subsection 149(4) on the computation of the CIF and on the designation rules in ITR subsection 2401(2). There are two parts to this issue:

1. **Computation of CIF:** Whether the Appellant correctly included the assets and liabilities in respect of its A&S Business in determining its CIF or whether subsection 149(4) precluded the Appellant from doing so; and

2. **Designation under Regulation 2401:** Whether the Appellant correctly designated an amount pursuant to ITR paragraph 2401(2)(b) in respect of its A&S Business and any Excess CIF amount (later defined) pursuant to ITR

paragraph 2401(2)(d) in respect of its A&S Business or whether subsection 149(4) precluded the Appellant from doing so.

[18] The facts relevant to Issue #1 are not in dispute.

[19] Throughout the 2013 and 2014 taxation years, the Appellant carried on the Life Business and the A&S Business in Canada and the U.S. The premiums from the A&S Business policies and the Life Business policies and annuities were: $27,000 and $37,897,679, respectively, in 2013 and $ 24,000 and $40,291,370, respectively, in 2014. The A&S Business accounted for less than 0.1% and the Life Business accounted for more than 99.9% of the Appellant's premium income.[24] The A&S Business was being wound down.

[20] The Appellant included the following amounts of assets and liabilities in respect of its A&S Business in determining its CIF for the 2013 and 2014 taxation years:[25]

	Total A&S Business 2013	Total A&S Business 2014
Assets	$5,011,000	$3,966,000
Liabilities	$4,029,000	$7,265,000
Net	$982,000	($3,299,000)

[21] In reassessing the Appellant the Minister removed from the Appellant's CIF the items and amounts described in paragraph 20 above, because they were in respect of the A&S Business.

[22] In filing its tax return for the 2014 taxation year, the Appellant designated Investment Property of $516,923,660 under ITR paragraph 2401(2)(a), $843,728 under ITR paragraph 2401(2)(b) and $199,462,344 under ITR paragraph 2401(2)(d) (a total of $717,229,732). According to the Appellant, the designation under ITR paragraph 2401(2)(a) was in respect of the Life Business and the designations under

[24] PASF, paragraphs 23-24.

[25] CRA Proposed Adjustment #2014-14 for the 2014 taxation year. Amounts taken from CRA working papers. JBD, Tab 63, page 1560.

ITR paragraphs 2401(2)(b) and (d) (a total of $200,306,062) were in respect of the A&S Business.

[23] The Minister did not change the designation under ITR paragraph 2401(2)(a), designated nil under ITR paragraph 2401(2)(b) and designated $265,211,607 under ITR paragraph 2401(2)(d) "to the Appellant's Life Business".[26] The increase in amount designated under ITR paragraph 2401(2)(d) (from $199,462,344 to $265,211,607) arose from eliminating the designation under ITR paragraph 2401(2)(b), excluding the Appellant's net A&S Business assets and including the amount of the Appellant's net World Surplus assets that the Appellant had deducted in computing the CIF.[27] The World Surplus inclusion is addressed under Issue #2.

Issue 1A: Are the assets and liabilities of the Appellant's A&S Business correctly included in computing its CIF?

(1) <u>Canadian Investment Fund and Designated Insurance Property – Blend and Separate</u>

[24] The rules for allocating the investment income of a Canadian resident MNLI to its Canadian insurance business are complex. They include detailed definitions and intricate formulas.

[25] First, the insurer must determine its CIF and its "Canadian reserve liabilities"[28] ("CRL") at the end of the previous taxation year and the end of the current taxation year, to arrive at the mean CIF and mean CRL, respectively, for the current taxation year.[29] The insurer then determines its DIP by designating Investment Property in accordance with ITR subsections 2401(2)-(7).

[26] ITR subsection 2401(2) requires an insurer to make designations of Investment Property in respect of its insurance businesses equal in value to the mean

[26] PASF, paragraph 87.

[27] *Ibid.*

[28] ITR subsection 2400(1) definition of "Canadian reserve liabilities".

[29] ITR subsection 2400(1) definition of "mean Canadian reserve liabilities"; ITR subsection 2412(1) definition of "mean Canadian investment fund".

CRL of each business.[30] To the extent that the mean CIF in respect of all of its insurance businesses is greater than the total required to be designated, an insurer is required to make an additional designation.[31]

[27] GIR (defined to include taxable dividends, interest, mark-to-market gains and losses, realized capital gains and losses, and other income in respect of specified debt obligations)[32] derived from the DIP is included in computing the insurer's income for the year from carrying on its insurance businesses in Canada.[33]

[28] Both the CIF and the CRL definitions include items from life and non-life insurance businesses.[34] Paragraph (a) in the CIF definition, which applies to a life insurer resident in Canada, is relevant to the Appellant. As defined, a "life insurer", includes a corporation that carries on a life insurance business and a non-life insurance business.[35] The CIF definition, in "I", includes assets of the insurer used or held by the insurer "in the course of carrying on an insurance business" (i.e., any insurance business).

[29] The CRL definition[36] takes into account liabilities from various insurance businesses. It includes in "A", the total of the insurer's liabilities and reserves in respect of Canadian life insurance policies, fire insurance policies and insurance policies of any other class.

[30] The designation of Investment Property is done for each business. ITR paragraphs 2401(2)(a)-(c) require designations of Investment Property in respect of a life insurance business, an accident and sickness insurance business and another insurance business, respectively, based in part on the mean CRL for the year

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[30] ITR section 2401 prescribes other factors to be considered in determining the amount of Investment Property to be designated.

[31] ITR paragraph 2401(2)(d).

[32] ITA subsection 138(12) definition of "gross investment revenue".

[33] ITA subsection 138(9).

[34] Both definitions have a Canadian limiting aspect. The CRL definition includes liabilities and reserves referable to Canada. The CIF definition refers to CRL in (a)(i) and, in (a)(ii), includes items from insurance businesses carried on anywhere. However, the formulas in (a)(ii) pro-rate the amounts determined based on the amount of the insurer's weighted Canadian liabilities relative to the insurer's weighted total liabilities.

[35] ITA subsection 248(1).

[36] ITR subsection 2400(1) definition of "Canadian reserve liabilities".

in respect of the relevant business. ITR paragraph 2401(2)(d) prescribes that the excess of the mean CIF over the aggregate of designations required to be made pursuant to ITR paragraph 2401(2)(a) – (c) (“Excess CIF”) must also be designated “in respect of a particular insurance business”.

[31] This disaggregation of Investment Property – to produce DIP in respect of a particular insurance business and therefore GIR in respect of a particular insurance business - further demonstrates that the determination of an insurer’s CIF is on a blended basis, taking into account all of the insurer’s insurance businesses. The Respondent argues that subsection 149(4) effectively overrides that process.

(2) <u>The Statutory Provisions</u>

[32] The CIF definition is in ITR subsection 2400(1). The definition has been amended several times, but during the Relevant Period read (in relevant parts) as follows:

> “Canadian investment fund” of an insurer at the end of a taxation year means
>
> (a) in the case of a life insurer resident in Canada, the total of
>
> (i) […]
>
> and
>
> (ii) the greater of
>
> (A) […]
>
> (B) the amount determined by the formula
>
> $$(I - J + K + L) \times (M / N)$$
>
> where
>
> I is the total of all amounts each of which is the amount of an item reported as an asset of the insurer as at the end of the year (other than an item that at no time in the year was used or held by the insurer in the course of carrying on an insurance business),

J is the total of all amounts each of which is the amount of an item reported as a liability of the insurer (other than a liability that was at any time in the year connected with an asset that was not used or held by the insurer in the course of carrying on an insurance business at any time in the year) as at the end of the year in respect of an insurance business carried on by the insurer in the year,

K […]

[33] Paragraph 149(1)(k), subsections 149(3) and (4) read as follows:

Miscellaneous Exemptions

149

(1) Miscellaneous exemptions No tax is payable under this Part on the taxable income of a person for a period when that person was

[…]

Labour organizations

(k) a labour organization or society or a benevolent or fraternal benefit society or order;

[…]

Application of s. (1)

(3) Subsection 149(1) does not apply in respect of the taxable income of a benevolent or fraternal society or order from carrying on a life insurance business or, for greater certainty, from the sale of property used by it in the year in, or held by it in the year in the course of, carrying on a life insurance business.

Idem

(4) For the purposes of subsection 149(3), the taxable income of a benevolent or fraternal benefit society or order from carrying on a life insurance business shall be computed on the assumption that it had no income or loss from any other sources.

(3) The Parties' Positions

[34] The Appellant submits that in determining its CIF, all assets and liabilities used in its insurance businesses must be considered. They submit that subsection 149(4) does not require it to ignore the A&S Business entirely, but only to disregard any income or loss from the A&S Business when computing its taxable income from the Life Business.

[35] The Respondent submits that the Appellant incorrectly included assets and liabilities of the A&S Business in computing its CIF. The Respondent says that subsection 149(4) requires the Appellant to compute both income and taxable income from the Life Business as if it had no other sources of income or loss. They say that in determining the Appellant's CIF the A&S Business must be disregarded entirely.

(4) Analysis

[36] Interpreting the provisions of the ITA requires a "unified textual, contextual and purposive" approach. This approach, and the dominant role that "precise and unequivocal" language plays in the interpretation of the provisions of the ITA was recently stated by the Supreme Court in *Canada v. Loblaw Financial Holdings Inc.*:[37]

> [41] This narrow question of statutory interpretation requires us to draw upon the well-established framework that "statutory interpretation entails discerning legislative intent by examining statutory text in its entire context and in its grammatical and ordinary sense, in harmony with the statute's scheme and objects" (*Michel v. Graydon*, 2020 SCC 24, at para. 21). Where the rubber hits the road is in determining the relative weight to be afforded to the text, context and purpose. Where the words of a statute are "precise and unequivocal", their ordinary meaning will play a dominant role (*Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601, at para. 10). In the taxation context, a "unified textual, contextual and purposive" approach continues to apply (*Placer Dome Canada Ltd. v. Ontario (Minister of Finance)*, 2006 SCC 20, [2006] 1 S.C.R. 715, at para. 22, quoting *Canada Trustco*, at para. 47). …

[37] The impact of subsection 149(4) on the determination of the Appellant's CIF is a matter of statutory interpretation. Accordingly, I consider the text, context and purpose of these statutory provisions.

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[37] 2021 SCC 51.

(a) ***Text – Does not say "no other sources"***

[38] The Appellant submits that the "source" principle, embodied in section 4, supports the position that in order to compute the Appellant's income from its Life Business, it must also compute its income from other sources, including its A&S Business. Section 4 provides, in general terms, that a taxpayer's income or loss is determined on a source-by-source basis, including the determination of income or loss from each separate business.

[39] While the Appellant determines income or loss from each separate business in accordance with section 4, that does not answer the question before me, which is the potential impact of subsection 149(4) in computing the Appellant's income and taxable income from carrying on the Life Business. The answer lies not in section 4, but in the detailed rules in sections 138 and subsections 149(3) and (4).

[40] Subsection 149(4) is a computational rule for determining the taxable income of a fraternal benefit society from carrying on a life insurance business. It provides that the taxable income "shall be computed on the assumption that it had no income or loss from any other sources."

[41] In the relevant parts of the CIF definition, under items "I" and "J" in subparagraph (a)(ii), a Canadian resident life insurer must include in computing the CIF amounts of items that are reported as assets and liabilities of the insurer (unless they are not used or held by the insurer in the course of carrying on an insurance business). The formula is based on assets and liabilities.

[42] As the assumption in subsection 149(4) is that there is "no income or loss" and the CIF definition is based on assets and liabilities, the text of both provisions support a conclusion that subsection 149(4) does not preclude including A&S Business assets and liabilities in determining the Appellant's CIF.

(b) ***Context – Does not suggest "no other sources"***

[43] The text of subsection 149(4) is unambiguous. It does not impose an assumption that the fraternal benefit society had no other sources of income, but rather that it had no income or loss from any other sources. By contrast, the definition of "attributed surplus" in ITR subsection 2400(1) (not applicable here, as it is only applicable to a non-resident insurer) requires the determination of amounts under subparagraph (a)(ii) of the definition of CIF "as if ... the insurer had been a life insurer resident in Canada and had not carried on any insurance business other than

a life insurance business or an accident and sickness insurance business". If similar words were in subsection 149(4), it would support the approach advocated by the Respondent – to assume that the Appellant had no A&S Business, and hence no A&S Business assets and liabilities. They are not.

(c) ***Text – "taxable income", not "income"***

[44] Subsection 149(1) provides an exemption from Part I tax on the taxable income of persons identified in that subsection. Subsection 149(3) provides an exception to the exemption in subsection 149(1) in respect of the taxable income of a fraternal benefit society from carrying on a life insurance business. Subsection 149(4) imposes an assumption in computing taxable income of a fraternal benefit society. The text of subsections 149(1), 149(3) and 149(4) provides that subsections 149(3) and 149(4) apply in determining taxable income.

[45] Taxable income, determined under subsection 2(2), is a taxpayer's income for the year plus the additions and minus the deductions permitted by Division C (Computation of Taxable Income). Division C includes, for example, the rules in section 111 relating to the deductibility of losses in computing taxable income. Thus, for example, subsection 149(4) applies to preclude the deduction of losses arising from a business other than a life insurance business in computing the taxable income from carrying on a life insurance business.

[46] Special rules for insurance corporations are in section 138, found in Division F (Special Rules Applicable in Certain Circumstances). Subsection 138(1) provides that for insurance corporations, income shall, except as otherwise provided in section 138, be computed in accordance with the income computation rules applicable for the purposes of Part I. Subsection 138(2) provides rules for computing income of an insurer, "[n]otwithstanding any other provision of this Act". Paragraphs 138(2)(a) and (b) provide rules for Canadian resident MNLIs and apply to the Appellant. These are income computation rules. Even if the assumption in subsection149(4) were applicable to the computation of income, which it is not, the "notwithstanding" language in subsection 138(2) expressly provides that the rules in subsection 138(2) have paramountcy.[38]

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[38] Ruth Sullivan, *The Construction of Statutes*, 7th ed. (Toronto: LexisNexis, 2022) at pages 345-346; Ruth Sullivan, *Statutory Interpretation,* 3rd ed. (Toronto: Irwin Law, 2016) at page 326; *Canadian Imperial Bank of Commerce v. The Queen*, 2021 TCC 71, paragraph 53, Aff'd, 2023 FCA 91.

[47] Subsection 138(9) is also an income computation rule applicable to MNLIs including the Appellant, requiring GIR from DIP to be included. Computing the CIF is necessary to determine DIP. Both are relevant when income is computed, not taxable income.

[48] The text of the relevant provisions in section 149 and section 138 supports a conclusion that subsections 149(3) and 149(4) do not affect the determination of the Appellant's CIF.

(d) ***Context – Income vs Taxable Income***

[49] The Respondent argues that since the determination of income must be done in order to determine taxable income, the assumption in subsection 149(4) applies to both the computation of income and taxable income. I disagree.

[50] It is helpful to contrast subsection 149(4) with subsection 149(5). Subsection 149(5) provides an exception to an exemption from Part I tax on taxable income, generally investment income, of certain otherwise tax-exempt clubs. Paragraphs 149(5)(e) sets out an assumption that is relevant to both the computation of income and taxable income:

> (e) the income and taxable income of the trust for each taxation year shall be computed on the assumption that it had no incomes or losses other than
>
> > (i) incomes and losses from property, and
> >
> > (ii) taxable capital gains and allowable capital losses from dispositions of property, other than property used exclusively for and directly in the course of providing the dining, recreational or sporting facilities provided by it for its members;
>
> [Emphasis added.]

[51] Paragraph 149(5)(f) provides an additional rule relevant in computing taxable income:

> (f) in computing the taxable income of the trust for each taxation year
>
> > (i) there may be deducted, in addition to any other deductions permitted by this Part, $2,000, and

(ii) no deduction shall be made under section 112 or 113; and

…

[Emphasis added.]

[52] The difference between the assumption in subsection 149(4) and the assumption in paragraph 149(5)(e) further supports a conclusion that the reference to the computation of taxable income in subsection 149(4) does not include the computation of income. Where an assumption is to apply to the computation of income, the statute provides for it.

(e) ***Purpose – Legislative History***

[53] The legislative history of subsections 149(3) and (4) further confirms that the provisions apply in computing taxable income, not income. Subsections 149(3) and 149(4), formerly subsections 62(1a) and 62(1b), were introduced in 1969.[39] Former subsections 62(1a) and 62(1b) read as follows:

> (1a) Subsection (1) does not apply in respect of the taxable income of a benevolent or fraternal benefit society or order from carrying on a life insurance business;
>
> (1b) For the purposes of subsection (1a), the taxable income of a benevolent or fraternal benefit society or order from carrying on a life insurance business shall be computed on the assumption that it had no income or loss from any other source.

The wording of subsections 149(3) and (4) remained largely the same from 1969 through the Relevant Period.[40]

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[39] *Income Tax Act*, R.S.C. 1952, c. 148, as amended by *An Act to amend the Income Tax Act*, S.C. 1968-1969, c. 44.

[40] Subsections 62(1a) and 62(1b) became subsections 149(3) and 149(4) by amendments in 1972: S.C. 1970-71-72, c. 63. These same amendments changed the final word of subsection 149(4) to "sources" from "source". Subsection 149(3) was amended in 1988 to add the words "or, for greater certainty, from the sale of property used by it in the year in, or held by it in the year in the course of, carrying on a life insurance business." S.C. 1988, c. 55. subclause 134(3).

[54] A reference to "taxable income" is found in the explanatory notes for 62(1a) and 62(1b):[41]

> This amendment is consequential upon the amendment proposed by clause 15 and would provide that the taxable income that a benevolent or fraternal benefit society earns from carrying on a life insurance is not exempt from tax under Part 1 of the Act.

[Emphasis added.]

[55] Subsections 62(1a) and 62(1b) were introduced in 1969 at the same time that significant changes were made to the taxation of Canadian life insurers. Canadian life insurers were virtually exempt from tax until 1969, when they first became subject to tax on Canadian source income. Prior to 1969, the taxable income of a life insurance corporation was determined under (former) section 30, which essentially taxed the corporation when it paid dividends.

[56] Prior to these amendments, in *British Pacific*,[42] the Exchequer Court determined that a "life insurance corporation" was any corporation that had a *bona fide* life insurance business, regardless of its size. Thus, despite the fact that the taxpayer's business was 2% life insurance and 98% non-life insurance, section 30 applied to all of the taxpayer's taxable income, not only to the source that was the life insurance business.

[57] Section 30 was repealed and section 68A introduced a complex regime by which life insurers (and other insurers) were taxed. One aspect was a system for MNLIs to allocate investment income between their Canadian and non-Canadian insurance businesses. The amendments included definitions of a "life insurer" and a "life insurance corporation" as an insurer who carries on a life insurance business and other insurance business.

[58] Subsections 62(1a) and 62(1b) were introduced and provided that a fraternal benefit society would no longer be exempt from tax under Part I in respect of taxable income from carrying on a life insurance business. In 1969, the taxable income of a corporation was, pursuant to subsection 2(3), its income less the deductions allowed

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[41] Bill C-191, *An Act to amend the Income Tax Act*, 1 Sess., 28 Parl., 1969, subclause 14(3) (first reading April 29, 1969) and Explanatory Note.

[42] *British Pacific Life Insurance Co. v. M.N.R.*, [1968] 2 Ex. C.R., pages 265-274.

under sections 27 and 28.[43] Paragraph 27(1)(e) permitted the deduction by a corporation of an amount for business losses. Section 28 permitted the deduction by a corporation of the amount of share dividends received from another taxable Canadian corporation; however, under section 68A this deduction was denied to “life insurers”. Instead, a similar deduction was allowed under subsection 68A(6) but only with respect to a portion of the “[life] insurer’s” “aggregate of dividends received”.

[59] Accordingly, due to subsection 62(1b), a “life insurer” which was a fraternal benefit society could not reduce its taxable income from its life insurance business by business losses from its other sources under paragraph 27(1)(e) or by a portion of its “aggregate of dividends received” from other sources of income under subsection 68A(6).

[60] These provisions in (former) sections 27 and 68A demonstrate that when paragraph 62(1b) was introduced, it had potential impact in computing taxable income of a life insurer that was also a fraternal benefit society.

(f) ***Conclusion***

[61] I have determined that the text, context and legislative history of subsections 149(3) and (4) support a conclusion that the assumption in subsection 149(4) is not relevant in determining the assets and liabilities to be included in determining the Appellant’s CIF. Accordingly, the Appellant correctly included A&S Business assets and liabilities in computing its CIFs for the 2014 taxation year.

Issue 1B: Whether the Appellant Correctly Designated Amounts Pursuant to ITR subsection 2401(2) in Respect of its A&S Business

[62] This issue turns on the interpretation of ITR subsection 2401(2) and whether subsection 149(4) applies to alter the designation of Investment Property. This is a matter of statutory interpretation. Accordingly, I consider the text, context and purpose of these statutory provisions.

(1) <u>The Statutory Provisions</u>

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[43] *Supra* note 39, at subsections 2(3) and 28(1) and paragraph 27(1)(e).

[63] The rules for determining DIP in ITR 2401 are prescriptive, mandating amounts and ordering the manner in which Investment Property is designated. The designation is made by the insurer in its tax return, unless the insurer does not designate according to the prescribed rules, in which case the Minister designates.[44]

[64] ITR subsection 2401(2) provides:

> Designation Rules
>
> 2401(2) For the purposes of subsection (1), an insurer, or the Minister if paragraph (1)(b) applies,
>
> > (a) shall designate for a taxation year investment property of the insurer for the year with a total value for the year equal to the amount, if any, by which the insurer's mean Canadian reserve liabilities for the year in respect of its life insurance business in Canada exceeds the total of the insurer's mean Canadian outstanding premiums and mean policy loans for the year in respect of that business (to the extent that the amount of the mean policy loans was not otherwise deducted in computing the insurer's mean Canadian reserve liabilities for the year);
> >
> > (b) shall designate for a taxation year investment property of the insurer for the year with a total value for the year equal to the amount, if any, by which the insurer's mean Canadian reserve liabilities for the year in respect of its accident and sickness insurance business in Canada exceeds the insurer's mean Canadian outstanding premiums for the year in respect of that business;
> >
> > (c) shall designate for a taxation year in respect of the insurer's insurance business in Canada (other than a life insurance business or an accident and sickness insurance business) investment property of the insurer for the year with a total value for the year equal to the amount, if any, by which the insurer's mean Canadian reserve liabilities for the year in respect of that business exceeds 50% of the total of all amounts each of which is the amount, as at the end of the year or as at the end of its preceding taxation year, of a premium receivable or a deferred acquisition expense (to the extent that it is included in the insurer's Canadian reserve liabilities as at the end of the year or preceding taxation year, as the case may be) of the insurer in respect of that business;
> >
> > (d) if

[44] ITR subsection 2401(1).

> (i) the insurer's mean Canadian investment fund for a taxation year
>
> exceeds
>
> (ii) the total value for the year of all property required to be designated under paragraph (a), (b) or (c) for the year,
>
> shall designate for the year, in respect of a particular insurance business that the insurer carries on in Canada, investment property of the insurer for the year with a total value for the year equal to that excess;
>
> [Emphasis added.]

(2) The Parties' Positions

[65] The Respondent makes the same "no source" argument with respect to the designation process under ITR 2401 as it makes in respect of the CIF. They submit that the Appellant should not include the A&S Business when designating Investment Property as this allows the A&S Business to affect the Appellant's income from the Life Business which is subject to tax, contrary to subsection 149(4).

[66] The Respondent also submits that ITR 2401 does not provide for assets to be designated to a particular insurance business, but rather designates assets to "fill the bucket" that is DIP. They say that the system is notional, not actual. The Respondent submits that the Appellant was not permitted, pursuant to ITR paragraphs 2401(2)(b) or (d), to designate assets "to" or "in respect of" the A&S Business.

[67] The Appellant submits that ITR 2401 involves a designation of Investment Property "in respect of" the different insurance businesses carried on by a taxpayer. They submit that the text of ITR 2401 and the legislative history of the designated property regime support this interpretation. They say that the Appellant was authorized to designate Investment Property under ITR paragraph 2401(2)(b) in respect of the A&S Business and that ITR paragraph 2401(2)(d) affords them full discretion to designate the Excess CIF amount in respect of either its Life Business or A&S Business. They chose the latter.

(3) Analysis - ITR para 2401(2)(b) - Designating Investment Property in respect of the A&S Business

[68] ITR paragraphs 2401(2)(a), (b) and (c) require an insurance company to designate Investment Property to the extent of its mean CRL for the year in respect of a particular insurance business (life, accident and sickness and "other",

respectively) less certain amounts, including premiums outstanding for the particular business. ITR paragraph 2401(2)(d) requires an additional designation to the extent an insurer's mean CIF for the year exceeds the total value of property required to be designated under paragraphs 2401(2)(a), (b) and (c). Paragraph 2401(2)(d) expressly requires the designation of this Excess CIF "in respect of a particular insurance business that the insurer carries on in Canada". While the designation process under ITR subsection 2401(2) determines a total amount of DIP, the text of ITR subsection 2401(2) supports a conclusion that the designation process in ITR 2401 also establishes amounts of DIP "in respect of" each particular insurance business that the insurer carries on.

[69] The context in the ITA and ITRs provides further support. ITR subsection 2401(5) which deals with property exchanges, refers to "designated insurance property of the insurer in respect of a particular business of the insurer". Also, subsection 138(11.1) provides that for the purposes of the identical property rules in section 47, property of a life insurance corporation can only be identical if both properties are:

1. DIP "of the insurer in respect of a life insurance business carried on in Canada"; or

2. DIP "of the insurer in respect of an insurance business in Canada other than a life insurance business".

[70] Further, the definition of "gross Canadian life investment income" in ITR subsection 2400(1) specifically requires the determination of an insurer's GIR from the DIP "in respect of" its life insurance business. Subparagraph 2400(1)(a)(i) of this definition includes "the insurer's gross investment revenue for the year, to the extent that the revenue is from Canadian business property of the insurer for the year in respect of the insurer's life insurance business." Paragraph 2400(1)(b) of the definition of "Canadian business property" provides that the Canadian business property of an MNLI means the "designated insurance property of the insurer for the year in respect of the business".[45]

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[45] The definitions of "gross Canadian life investment income" and "Canadian business property" are relevant only for the purpose of computing a life insurer's income from its participating life insurance business under ITR 2402; see Canada, Department of Finance, CCH Canadian Limited, *Draft Regulations and Technical Notes, Taxation of Insurance Companies, September 19, 1997: Canadian Tax Reports, Special Report No. 1332*, *Extra Edition* (North York, Ont.: CCH Canadian, 1997).

[71] The legislative history of the designated property regime reflects that designating Investment Property in respect of a particular insurance business has been an element of the system for decades.

[72] Under the system introduced in 1969, two methods of determining GIR attributable to the Canadian business were provided for MNLIs: the proportional method and the branch accounting method. An insurer could use the branch accounting method where their books and records were such that property used or held in the course of carrying on an insurance business in Canada could be identified and the gross revenue therefrom readily determined.[46] If not, and where the insurer carried on both a life insurance business and a non-life insurance business, the investment income would be allocated in accordance with the "life proportion" and the "non-life proportion" of the insurer's businesses.

[73] As part of the 1978 tax reform of the life insurance industry, the proportionate method for allocating investment income was eliminated. The branch accounting method was adopted, with significant modifications. The very complex rules had a simple objective: to determine the investment property used or held in the Canadian portion of a particular insurance business. The actual revenue from that investment property would be included in determining the income from the Canadian portion of each insurance business.[47]

[74] The historic distinction between insurance businesses, consistent with the "source principle", was also necessary because of the different taxation of life insurance and non-life insurance businesses at the time:

These definitions appear to have become redundant as of 2011, when ITR 2402 was repealed: *Technical Tax Amendments Act, 2012*, S.C. 2013, c. 34, section 391.

Nonetheless, these definitions existed together with ITR subsection 2401(2) since 1999 and thus provide relevant context when interpreting ITR subsection 2401(2) *Regulations Amending the Income Tax Regulations (Taxation of Insurers)*, P.C. 2000-1714, 30 November, 2000, SOR/2000-413, subsection 2(2), *Canada Gazette*, Part II, vol. 134, No. 26, pages 2529-2552, December 20, 2000.

[46] *Income Tax Act*, S.C. 1970-71-72, c. 63, subsection 138(9); *Consolidated Regulations of Canada*, 1978 (Ottawa: Statute Revision Commission, 1978): *Income Tax Regulations* subsection 2400(1).

[47] Ronald C. Knechtel, "*Taxation of the Life Insurance Industry*: *The 1978 Tax Reform"* (1980) Vol. 28, No. 1 *Canadian Tax Journal*, pages 9-31.

> The next step in ascertaining revenue, gains, and losses from investment property is to determine the investment property that will be considered to be used or held in the Canadian portion of a particular insurance business. The Income Tax Act treats the life insurance business as a separate business from the sickness and accident business. This distinction is required because of the different treatment of debt securities in each business and to restrict the deduction for policy dividends to the income from the participating life insurance business.
>
> …
>
> … To begin the process, the rules provide that the insurer must start with a determination of the investment property that is considered to be used or held in the sickness and accident business.[48]

[Emphasis added.]

[75] The 1988 designated property rules maintained the distinction.[49] ITR subsection 2400(1) at the relevant time required the designation of property "in respect of" a particular insurance business. Property used by an insurer or held by an insurer in the course of carrying on an insurance business in Canada – referred to as "the particular insurance business" meant property that was designated or required to be designated in accordance with the prescribed rules.

[76] The designated property regime changed again, effective for the 1999 and subsequent years.[50] As the definition of "designated insurance property" in subsection 138(12) reveals, the term now and during the Relevant Period means property determined in accordance with the prescribed rules. However, for the 1998 and preceding years, it meant "property used by it in the year in, or held by it in the year in the course of carrying on an insurance business in Canada". This was a factual determination.[51] For the 1999 and subsequent taxation years, a proxy system

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[48] *Ibid*; Jason Swales and Erdem Erinc, *Canadian Insurance Taxation*, 4 ed. (Toronto: LexisNexis, 2015), pages 51-52.

[49] *Regulations Amending the Income Tax Regulations (Taxation of Insurers)*, amendment, P.C. 1990-2002, 20 September, 1990, SOR/90-661, section 6, *Canada Gazette*, Part II, vol.124, no. 21, pages 4231-4259, October 10, 1990, applicable in respect of taxation years beginning after June 17, 1987 and ending after 1987.

[50] *Income Tax Regulations*, P.C 2000-1714, 30 November, 2000, SOR/2000-413, subsection 2(2), *Canada Gazette*, Part II, vol. 134, No. 26, pages 2529-2552, December 20, 2000, effective for 1999 and later taxation years

[51] Knechtel *supra* note 47.

for achieving a similar result is in the detailed rules in ITR 2401 prescribing the designation of Investment Property in respect of a particular insurance business.

[77] I have determined that the text, context and legislative history of ITR subsection 2401(2) confirm that the designation of property is "in respect of" a particular insurance business such that GIR is determined and included in computing income for each insurance business carried on by the insurer.

[78] The Respondent submits that even if ITR 2401 allows for a designation of Investment Property "to" or "in respect of" an insurance business, which they deny, subsection 149(4) effectively serves to remove any insurance business other than a life insurance business from the list of insurance businesses in ITR 2401. They say that to do otherwise allows the A&S Business to affect the Appellant's income from the Life Business, which is subject to tax, contrary to the purpose of subsection 149(4). I disagree.

[79] The import of the Respondent's argument is that a fraternal benefit society with a life business and an A&S business is taxable on all of its GIR, because it has no DIP attributed to its A&S business. There is no support for this result in the text, context or purpose of subsection 149(4) and ITR 2401.

[80] My reasons for rejecting the Respondent's argument are similar to those expressed regarding the CIF. The designation of Investment Property under ITR section 2401 feeds the definition of DIP in subsection 138(12) which in turn feeds the determination of GIR under subsection 138(9). Subsection 138(9) is a rule relevant to the computation of income for a life insurer that carries on an insurance business in Canada and outside. Subsection 149(4) applies for purposes of determining taxable income and thus does not apply to alter the designation process under ITR 2401.

[81] Accordingly, I have concluded that the Appellant properly designated Investment Property in the amount of $843,728 to the A&S Business pursuant to ITR paragraph 2401(2)(b) and that subsection 149(4) did not preclude that result. That same logic supports a conclusion that the Appellant also correctly designated $199,462,344 of Investment Property to the A&S Business pursuant to ITR paragraph 2401(2)(d). However, next I consider the text, context and legislative history of ITR paragraph 2401(2)(d) to determine whether a different conclusion is warranted. The designation of Excess CIF under ITR paragraph 2401(2)(d) appears to lie at the heart of the Respondent's concerns.

(4) Analysis - ITR paragraph 2401(2) (d) - Designating Excess CIF in respect of the A&S Business

[82] ITR paragraph 2401(2) (d) requires the insurer to designate Investment Property equal in value to the Excess CIF. It provides that the insurer “shall designate for the year, in respect of a particular insurance business that the insurer carries on in Canada”. There is no restriction on the particular business; the choice appears to be the insurer’s.

[83] The context of ITR paragraph 2401(2)(d) supports this conclusion. The rules in ITR paragraphs 2401(2)(a) to (c) lie in sharp contrast. They prescribe the insurance business in respect of which the designation must be made and the value of the Investment Property that must be designated. The amount is based on the mean CRL for the year in respect of the particular business.

[84] The legislative history of the designated property regime supports a conclusion that an insurer has discretion to designate Excess CIF in respect of any insurance business.

[85] Both the 1978 and 1988 designated property regimes set out rules for determining a taxpayer’s property used or held in the course of carrying on an insurance business (i.e., property to be designated). An insurer was required to designate property in respect of its “other than life” insurance businesses before its life insurance business. Both regimes required an insurer to make an additional designation to the extent that its CIF exceeded all other mandatory designations (i.e., an Excess CIF designation).[52]

[86] It appears that as early as in the 1978 regime, an insurer had the discretion to designate its Excess CIF, pursuant to ITR paragraph 2400(1)(d). The 1988 regime makes this clear. ITR paragraph 2400(1)(d) provided that Excess CIF “shall be designated by the insurer in respect of a particular insurance business for the year”. ITR subsection 2400(2) as it read at the time, provided that investment property designated pursuant to ITR paragraph 2400(1)(d) shall be “designated in respect of the insurance business in Canada of the insurer as specified by the insurer for the

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[52] *Income Tax Regulations* C.R.C. 1977, c. 148, as substituted by P.C. 1979-2483, then amended by P.C. 1990-2002, supra note 49.

year" (ITR subparagraph 2400(2)(c)(i)).[53] Applicable to 1999 and subsequent taxation years, ITR 2400 was modified and moved to become new ITR 2401.[54]

[87] I have concluded that the text, context and legislative history of the designation rules in ITR section 2401 support a conclusion that an insurer has discretion to designate Excess CIF in respect of any particular insurance business. In many cases, the designation in respect of a particular insurance business may be of no consequence because the GIR on all of the DIP is subject to tax. The result is dramatic in the case of a fraternal benefit society, because it is only taxable under Part I on its taxable income from carrying on a life insurance business.

[88] The Respondent does not argue that the designation of Excess CIF must be proportional to the size of the insurance businesses of a taxpayer, but in any event, there is no suggestion of this in the Regulation. To the contrary, prior to 1978 there was a proportionate allocation system, but that was replaced with the more prescriptive ordering rules now in ITR subsection 2401(2).

[89] The Respondent submits, as it does in respect of the Appellant's designation under ITR paragraph 2401(2)(b), that the A&S Business should be ignored. For the reasons expressed in respect of ITR paragraph 2401(2)(b) I conclude that paragraphs 149(3) and (4) do not provide for that result.

[90] I understand why the Respondent is concerned. The designation of approximately $200 million of Investment Property (equal in value to the Excess CIF) in respect of the A&S Business results in GIR on that DIP not being taxable in Canada. While the result may seem particularly skewed here, because the Appellant's A&S Business is small compared to the Life Business, the appropriate result is not to ignore the A&S Business entirely. The consequence would be a different, but skewed result if the A&S Business were much larger than the Life Business and the A&S Business were ignored.

[91] I agree with the Appellant's submission that if Parliament had, for example, intended for Excess CIF to be designated on a proportionate basis to the designations made under ITR paragraphs 2401(2)(a), (b) and (c), this could have easily been

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[53] *Ibid*.

[54] *Supra,* note 50.

written into ITR paragraph 2401(2)(d). In the alternative, Parliament might have chosen to enact a special designation rule for a fraternal benefit society. It did not.

[92] It appears that a special rule may have been considered but not adopted. In *Lutheran Life*[55], Mr. Ron Knechtel testified as the accountant and tax adviser to the appellant. Mr. Knechtel specialized in insurance taxation and had been a special adviser to the Minister of Finance and Minister of National Revenue from 1976 to 1979 with respect to the taxation of life insurance. The Court observed:[56]

> Regulation 2400 applies to multi-national life insurance companies doing business in Canada and provides a formula whereby a portion of their total assets and income therefrom are attributed to Canadian operations for tax purposes. Knechtel testified that this regulation had been adopted after regular branch accounting principles had been considered and rejected for purposes of assessing tax applicable to multi-national life insurers, <u>and though preliminary consideration had been given to extending the proposed regulation to the activities of fraternal societies in Canada, that had not been done when the regulation was adopted</u>.
>
> [Emphasis added.]

[93] Whether deliberate or not, there is no statutory rule for the designation of Investment Property specific to a fraternal benefit society. Adding words to expand the scope of legislation requires statutory amendment and is outside the court's jurisdiction.[57]

[94] I also note that the discretion to designate Investment Property equal in amount to Excess CIF in respect of any insurance business existed at a time when the taxation of a life business and an A&S business differed.[58] This supports a conclusion that, at that time, a non-fraternal life insurer could exercise the discretion

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[55] *Lutheran Life Insurance Society of Canada v. R.*, 1991 CarswellNat 525 (FCTD).

[56] *Ibid* at para 27.

[57] *Canada (Attorney General) v. Vorobyov*, 2014 FCA 102, paragraphs 29-30; *Olsen v. R.*, 2000 CarswellNat 859, paragraph 9.

[58] See, for example, the difference in taxing a "Canadian security": Jason Swales and Erdem Erinc, *Canadian Insurance Taxation*, 4 ed. (Toronto: LexisNexis, 2015) page 52; see also Morris Schnek, "Accounting and Tax Aspects of Risk Management," *Report of the Proceedings of the Thirty-Sixth Tax Conference*, 1984 Conference Report (Toronto: Canadian Tax Foundation, 1985), pages 699-714.

inherent in that designation to obtain a more favourable tax result. Similarly, here the Appellant had a choice between two tax results. They chose the more favourable.

[95] Although I recognize the Respondent's concern with the result, I find that the text, context and legislative history of ITR paragraph 2401(2)(d) support a conclusion that the Appellant had discretion to designate an amount of Investment Property under ITR paragraph 2401(2)(d) in respect of any insurance business. Subsection 149(4) does not alter that result.

[96] Accordingly, I have concluded that the Appellant correctly designated its Excess CIF, being $199,462,344, of Investment Property to the A&S Business pursuant to ITR paragraph 2401(2)(d). To the extent that my conclusions in respect of Issue #2 result in additional Excess CIF, I conclude that the Appellant was able to designate Investment Property equal in amount to such additional Excess CIF in respect of the A&S Business pursuant to ITR paragraph 2401(2)(d).

VI. ISSUE #2 – WORLD SURPLUS - THE "USED OR HELD" ISSUE

[97] Issue #2 is whether the Appellant correctly excluded the amount of World Surplus assets in determining its CIF. More specifically, whether the assets that comprise World Surplus were "used or held in the course of carrying on an insurance business". The size of the CIF becomes less significant in light of my conclusion on Issue #1, that the Appellant may designate Investment Property equal to any Excess CIF in respect of the A&S Business. The GIR on that DIP would not be taxable. However as most of the trial was spent on the World Surplus issue, I address it in full. The issue raises concepts of capital adequacy and surplus assets and so I begin with a review of the expert testimony.

(1) Facts

(a) The Experts

[98] The Appellant and the Respondent each called one expert witness to provide evidence regarding the supervision and regulation of capital management for insurance companies in Canada and the Appellant's capital management during the

Relevant Period. The Appellant called Mr. Les Rehbeli;[59] the Respondent called Mr. Hamdi Ozdemir.[60]

[99] Les Rehbeli is an actuary and a partner with Oliver Wyman Limited, the Canadian operation of Oliver Wyman Actuarial Consulting. He has over 25 years of experience in the life insurance industry in financial reporting, independent peer review, business appraisal, embedded value securitization, liquidation, solvency testing and product pricing. He has done consulting work for fraternal benefit societies.[61] He is a Fellow of the Canadian Institute of Actuaries, a member of the American Academy of Actuaries and a Fellow of the Society of Actuaries. He is currently the Appointed Actuary of five insurance/reinsurance companies.

[100] Hamdi Ozdemir is a financial services risk management senior executive, consultant and researcher. He has worked in the banking, insurance and credit union industries where he held senior risk leadership roles, including as chief risk officer. He co-authored books on risk and capital management strategies including "ORSA: Design and Implementation". He holds a financial risk manager (FRM) designation, and an MBA and M.Sc Mech. Eng. degrees.

[101] At the hearing, each party addressed the criteria for admissibility of their expert's report set out in *Her Majesty the Queen v. Chikmaglur Mohan*[62] (the "*Mohan* criteria"). I concluded that the *Mohan* criteria were satisfied in each case: the expert reports are central to the issues of capital adequacy for insurers, outside the expertise of the Court, there is no relevant exclusionary rule and Messrs. Rehbeli and Ozdemir are professionally qualified to express the views in their respective reports, subject to one caveat.

[102] At the hearing, the Appellant raised a concern that the answer to Question 1 in the Ozdemir Expert Report draws conclusions about one of the "ultimate issues" - whether the Appellant "used or held" World Surplus to mitigate solvency risk and

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[59] Mr. Rehbeli provided an expert report dated July 26, 2022 (the "Rehbeli Expert Report", Exhibit A-1) and a surrebuttal report dated September 22, 2022 to the Ozdemir Rebuttal Report (the "Rehbeli Surrebuttal Report", Exhibit A-2).

[60] Mr. Ozdemir provided an expert report dated July 26, 2022 (the "Ozdemir Expert Report", Exhibit R-1) and a rebuttal report dated August 22, 2022 to the Rehbeli Expert Report (the "Ozdemir Rebuttal Report", Exhibit R-2).

[61] October 26, 2022 Transcript, page 88 – Testimony of Les Rehbeli.

[62] *Her Majesty The Queen v. Chikmaglur Mohan*, [1994] 2 S.C.R. 9.[*Mohan*].

operational risk in the insurance business. A concern arises where an expert report wades into territory that has the potential to usurp the function of the trial judge. An expert report is not needed where a determination falls within the knowledge and expertise of the trier of fact.[63] Mindful of this potential concern, I determined that the answer to Question 1 is within Mr. Ozdemir's area of expertise. While he employs "used or held" language, I determined that the report did not purport to interpret or apply a legal test, but rather used those terms in the vernacular. I reminded the Respondent that the interpretation and application of the "used or held" test were determinations for this Court to make, not Mr. Ozdemir.

(b) ***Regulation of Insurers by OSFI***

[103] OSFI regulates insurers to ensure policyholder protection. As a part of the regulatory scheme implemented by OSFI, insurers have to meet certain capital and surplus requirements. Expert witness Les Rehbeli summarized the various capital requirements of insurers as follows:[64]

> a. First, insurers must hold enough capital to cover their reserve liabilities using best estimates. Reserve liabilities are actuarially calculated liabilities accrued from the obligation to pay future death benefits. Various estimates go into these calculations. "Best estimates" are assumptions, which lead to capital levels sufficient to meet future policyholder obligations approximately 50% of the time.
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> b. In addition, insurers must hold additional capital as "provisions for adverse deviations" ("PFADs"). These provide an additional buffer to the best estimate assumptions, to protect for adverse deviations from the best estimates. When PFADs are used, the capital levels are expected to be sufficient to meet future policyholder obligations approximately 70-90% of the time.
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> c. OSFI mandates further capital requirements in addition to best estimates and PFADs. When implemented, these will be sufficient to meet future policyholder obligations over 99% of the time.

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[63] *Mohan* at pp. 15-16.

[64] Rehbeli Expert Report, pages 18-20.

[104] During the Relevant Period the OSFI *Guideline A: Minimum Continuing Capital and Surplus Requirements*[65] ("MCCSR") and *Guideline A-4: Regulatory Capital and Internal Capital Targets*[66] provided the framework for capital adequacy.

[105] Guideline A provides that an insurer's "MCCSR Ratio" (typically expressed as a percentage) is a fraction, the numerator of which is the total available capital, and the denominator of which is the required capital. Required capital is an actuarial calculation that involves the quantification of certain risks affecting the insurer's business. These include asset default risk, mortality/morbidity/lapse risk, interest rate risk, environment risk, segregated funds risk, and foreign exchange risk.

[106] Guideline A-4 sets out specific regulatory capital thresholds for an insurer, expressed in terms of an MCCSR Ratio. Life insurers must maintain an MCCSR Ratio above 120%; if an insurer were to fall below this threshold, OSFI would take control of the company to ensure policyholder protection.[67] Insurers are required to maintain a buffer to the minimum MCCSR Ratio to ensure they do not regularly fall below the minimum threshold. This "supervisory target" is set at an MCCSR Ratio of 150%; falling below the supervisory target attracts increased supervisory attention from OSFI.[68]

[107] OSFI also mandates that insurers self-assess an "internal target" MCCSR Ratio. During the Relevant Period the process for determining this internal target was changing. Up until the fourth quarter of 2014, OSFI mandated that insurers compute their internal MCCSR target pursuant to former *Guideline A-4: Internal Target Capital Ratio for Insurance Companies*.[69] However, by the end of 2014

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[65] Canada, The Office of the Superintendent of Financial Institutions, *Guideline A: Minimum Continuing Capital and Surplus Requirements*, (Ottawa: The Office of the Superintendent of Financial Institutions, 2014).

[66] Canada, The Office of the Superintendent of Financial Institutions, *Guideline A-4: Regulatory Capital and Internal Capital Targets*, (Ottawa: The Office of the Superintendent of Financial Institutions, 2014) [Guideline A-4 2014].

[67] October 25, 2022 Transcript, page 34 – Testimony of Stephen McDonald.

[68] *Ibid*.

[69] Canada, The Office of the Superintendent of Financial Institutions, *Guideline A-4: Internal Target Capital Ratio for Insurance Companies*, (Ottawa, The Office of the Superintendent of Financial Institutions, 2011) [Guideline A-4 2011]; online at: https://studylib.net/doc/7948087/internal-target-capital-ratio-for-insurance-companies.

insurers were required to compute their internal target pursuant to OSFI *Guideline E-19: Own Risk and Solvency Assessment* ("ORSA").[70] As set out in *Guideline E-19:*

> The ORSA should serve as a tool to enhance an insurer's understanding of the interrelationships between its risk profile and capital needs. The ORSA should consider all reasonably foreseeable and relevant material risks, be forward-looking and be congruent with an insurer's business and strategic planning.

[108] The internal target that results from an ORSA is based on the insurer's assessment of all the material risks it faces, including the results of the enterprise risk management process.[71]

[109] OSFI requires that insurers undergo stress testing from time to time to ensure capital adequacy under specific risk assumptions or "stresses". *Guideline E-18: Stress Testing*[72] provides:

> Stress testing is a risk management technique used to evaluate the potential effects on an institution's financial condition, of a set of specified changes in risk factors, corresponding to exceptional but plausible events.

[110] OSFI expects insurers to operate with qualifying regulatory available capital ("Available Capital") above the internal target.[73] OSFI understands that on unusual and infrequent occasions Available Capital levels may fall below the internal target level. If an insurer falls below an internal target level, they are required to inform OSFI.[74] Thus, insurers operate at a level higher than their internal target, known as an "operating target".

(c) ***The Appellant's Capital Management***

[111] The Appellant, like other insurers, engages in an ongoing process of capital management to determine and maintain the quantity and quality of capital

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[70] Canada, The Office of the Superintendent of Financial Institutions, *Guideline E-19: Own Risk and Solvency Assessment* (Ottawa: The Office of the Superintendent of Financial Institutions, 2014) [Guideline E-19].

[71] *Ibid*, page 3.

[72] Canada, The Office of the Superintendent of Financial Institutions, *Guideline E-18: Stress Testing* (Ottawa: The Office of the Superintendent of Financial Institutions, 2009).

[73] Guideline A-4 2014 *supra* note 66, page 5.

[74] October 25, 2022 Transcript, page 171 – Testimony of Peter Boyko.

appropriate to support its planned operations. The Appellant's objective with respect to capital management is to maintain a consistently strong capital position, comply with local solvency requirements in all jurisdictions in which they operate and to take advantage of business and investment opportunities as they arise.[75]

[112] In accordance with the capital management policy set by management and approved by the board of directors ("Capital Management Policy"), the Appellant establishes internal capital adequacy targets at both a consolidated and a divisional level. On a quarterly basis, management monitors performance against internal capital targets and its capital plans and initiates action when appropriate.[76]

[113] The Appellant determined its internal target (the "Internal Target") as 280% MCCSR for all of 2013 and the first three quarters of 2014, and 290% MCCSR for the fourth quarter of 2014.[77] The Appellant's Internal Targets were above the total (actual) MCCSR ratios for other Canadian insurance companies of a similar or larger size (which ranged from 200% to 250% during the Relevant Period).[78] The Appellant's Internal Targets would be significantly higher than those of its publicly traded peers, in part because, as a fraternal benefit society, the Appellant did not have the same access to capital markets as those publicly traded insurers.[79]

[114] The Appellant maintained its operating target (the "Operating Target") at 20% MCCSR greater than these Internal Targets: 300% MCCSR and 310% MCCSR, respectively, during the Relevant Period.[80]

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[75] Appellant's 2013 and 2014 consolidated financial statements, Note 14, JBD, Tab 27, page 382 and Tab 29, page 491, respectively.

[76] Appellant's 2013 Capital Management Policy and the Appellant's 2014; Capital Management Policy, JBD tabs 44 and 45, respectively.

[77] Appellant's capital management reports, JBD, tabs 47-54. For simplicity, the Internal Target for the Relevant Period is referred to as 280%/290% MCCSR.

[78] Rehbeli Expert Report, page 30.

[79] Appellant's 2014 Own Risk Solvency Assessment (ORSA) (the "Appellant's 2014 ORSA"), JBD, Tab 39, page 1134.

[80] Appellant's 2013 Capital Management Policy and the Appellant's 2014 Capital Management Policy, JBD, Tab 44, page 1302 and Tab 45, page 1316 respectively. For simplicity, the Operating Target for the Relevant Period is referred to as 300%/310% MCCSR.

[115] In addition, the Appellant set divisional requirements for its operations in Canada, the US and the UK (the "Divisional Targets") based on local capital requirements, as explained in the Capital Management Policy:

> Operating division target MCCSR levels are set at 200%. However, capital is allocated to each division at the higher of divisional MCCSR target or the local capital requirement; this amount is held in local currency in the surplus funds of each country. Foresters surplus in excess of those amounts is referred to as World Surplus; it is held in U.S currency.[81]

[116] For example, the US local capital requirement was higher than 200% MCCSR and therefore capital above 200% MCCSR was allocated to the US branch (approximately 380% to 390% MCCSR). In Canada the local capital requirement was the OSFI supervisory target of 150% MCCSR and therefore capital of 200% MCCSR was allocated to the Canadian branch. The aggregate of the Appellant's Divisional Targets during the Relevant Period was approximately 290% MCCSR,[82] which was, coincidentally, almost the same as the Appellant's Internal Target for the Relevant Period.

[117] The Appellant's actual MCCSR Ratio during the Relevant Period was approximately 408% in 2013 and 409% in 2014.[83] In 2011, it was 336% and in 2012, it was 376%.[84]

(d) ***World Surplus and World Surplus Assets/Liabilities***

[118] The amount of capital that the Appellant had (on a consolidated basis) in excess of the sum of the Divisional Targets is referred to by the Appellant in its Capital Management Policy as "World Surplus".[85] The term is also used in reference to the amount of assets, net of liabilities, reflected in the "Corporate" column on the Appellant's segmented statement of financial position and under "World Surplus" in the Appellant's Working Papers to the consolidated financial statements.

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[81] Appellant's Capital Management Policies, JBD, Tab 45, pages 1302 and 1316.

[82] Rehbeli Expert Report, pages 39-40.

[83] The Appellant's MCCSR Annual Return for Canadian Life Insurance Companies & Fraternal Benefit Societies, JBD, Tabs 25-26.

[84] Appellant's 2014 ORSA, JBD, Tab 39, page 1024.

[85] Appellant's 2013 Capital Management Policy and the Appellant's 2014 Capital Management Policy, JBD, Tabs 44, pages 1302 and Tab 45, page 1316 respectively.

[119] The Appellant files both consolidated and non-consolidated financial statements with OSFI as part of its LIFE-1 Annual Return and Quarterly Returns. Note 20 to the consolidated audited financial statements shows segmented information for the Appellant's five operating segments and the "Corporate" segment.

[120] The five operating segments are: United States Division and Canadian segment, both part of North American Life Insurance, First Investors CC United Kingdom and Fraternal. The "Corporate" segment holds surplus assets – "above those required to satisfy management's internal capital targets for each of the five operating segments."[86]

[121] The net amount of World Surplus assets, as reflected in the "Corporate" segment on the segmented balance sheet (World Surplus assets less liabilities) was $273,969,000 for 2013 and $378,154,000 for 2014.[87] In this decision, when I refer to amounts of World Surplus in the Relevant Period, it is to these amounts.[88]

[122] In determining the mean CIF for the 2014 taxation year, the Appellant deducted these net amounts of World Surplus assets [89] in determining its CIF for 2013 and 2014. The Minister reassessed the Appellant to include the net amounts, on the basis that the World Surplus assets were used or held by the Appellant in the course of carrying on an insurance business.

[123] Total surplus is the excess of assets over liabilities. The Appellant allocates part of total surplus to specific operations (Divisional Surplus). World Surplus is a component of the Appellant's total surplus. It is surplus not allocated to specific operations.[90] The Appellant's total surplus on a consolidated and non-consolidated

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[86] Appellant's 2013 Consolidated Financial Statements, JBD, Tab 27, page 0324.

[87] PASF, paragraph 87. Note 20 to the Appellant's 2013 and 2014 Consolidated Financial Statements, JBD, Tabs 27 and 28, pages 0392-393 and 500-501 respectively reflect a minor variance, but I rely on the numbers in the PASF.

[88] While these amounts should equal the amount of the Appellant's capital in excess of the sum of its Divisional Targets, no reconciliation was provided.

[89] Schedule III CRA Proposed Adjustment working papers, JBD, Tab 63, page 1560.

[90] PASF, paragraphs 35-36.

basis was $1,681,691,000 in 2013 and $1,905,546,000 in 2014, indicating that all surplus for the consolidated group was held by the Appellant.[91]

[124] World Surplus assets were maintained and managed by State Street in a fund separate from the Appellant's fund related to its insurance businesses and its fraternal operations.[92] The Appellant had an investment strategy for World Surplus that differed from the strategy for Divisional Surplus (Divisional Surplus is sometimes called Country Surplus).[93]

(2) The Statutory Provision - The CIF Definition

[125] The relevant parts of the CIF definition read as follows:

> **I** is the total of all amounts each of which is the amount of an item reported as an asset of the insurer as at the end of the year (other than an item that at no time in the year was used or held by the insurer in the course of carrying on an insurance business),
>
> **J** is the total of all amounts each of which is the amount of an item reported as a liability of the insurer (other than a liability that was at any time in the year connected with an asset that was not used or held by the insurer in the course of carrying on an insurance business at any time in the year) as at the end of the year in respect of an insurance business carried on by the insurer in the year

[Emphasis added.]

[126] The central issue is whether the Appellant's World Surplus assets are included in determining the Appellant's CIF under term "I" or whether they fit within the words in parentheses, which provide an exception.

[127] The liabilities that the Appellant deducted in computing the net amount of World Surplus assets (which net amount the Appellant deducted in determining the CIF) were in the amounts of $4,075,000 for the 2013 taxation year and $3,265,000 for the 2014 taxation year. Neither party asserted nor provided evidence that these amounts were not to be deducted in computing the CIF. Accordingly, I have

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[91] For 2013, JBD, Tab 33, page 619, 746 (Life 1); for 2014, JBD, Tab 34, pages 786 and 915.

[92] Appellant's State Street Consolidated Holdings Report Book, JBD, Tab 39 and 2014 Investment Policy, JBD, Tab 75, page 1789; October 25, 2022 Transcript, McDonald at page 18, lines 20-21.

[93] 2014 Investment Policy, JBD, Tab 75, pages 1788-1789.

proceeded on the basis that only the inclusion or exclusion of the amount of World Surplus assets under term "I" is at issue.

[128] First the appropriate legal standard must be determined for when potentially surplus assets are not "used or held" by an insurer in the course of carrying on an insurance business. Then it must be determined if the Appellant's World Surplus assets meet the standard.

(3) **The Case Law**

ACTRA

[129] The Appellant relies on the majority's decision in *ACTRA*[94], a decision of the Federal Court of Appeal. In *ACTRA*, the Court considered whether income from surplus assets held in a life insurance fund by a fraternal benefit society was taxable income from carrying on a life insurance business and therefore within the subsection 149(3) exception to the exemption from Part I tax. The case did not concern the "used or held" language in the CIF definition that is relevant in this appeal but examined whether the investment income was part of the appellant's taxable income from carrying on a life insurance business.

[130] *ACTRA* maintained three funds to provide benefits to its members: a life fund, providing life insurance benefits, an accident and sickness fund, providing accident and sickness insurance benefits and a fraternal fund, providing additional benefits such as addiction rehabilitation services. *ACTRA* decided to adopt a new method for determining investment income attributable to the life insurance business and determined, based on actuarial calculations, that surplus had accumulated in the life fund that was not required for the life insurance business. With the approval of the Superintendent of Insurance, surplus assets were transferred out of the life fund. *ACTRA* took the position that investment income earned on these surplus assets in the life fund was not taxable as it was not income from carrying on a life insurance business; the Minister disagreed.

[131] The Tax Court Judge found in favour of the Minister. Since the taxpayer had chosen to keep the surplus assets in the life fund, they were considered necessary for the taxpayer to carry on its life insurance business. It was a matter of business judgment. The Tax Court Judge found it unnecessary to deal with the jurisprudence

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[94] *ACTRA Fraternal Benefit Society v. Canada*, [1997] 3 FC 441.

outlining the tests to be applied in determining whether assets are used or held in the course of carrying on a business (including *Ensite*[95] and *Marsh & McLennan*[96]).[97]

[132] The Federal Court of Appeal allowed the taxpayer's appeal. Robertson J.A. for the majority refers to the decisions in *Ensite* and *Marsh & McLennan* and frames the legal test as whether the investment assets were "employed and risked" in or "necessary" for the taxpayer's life insurance business:

> I pause here to note that the test outlined in the two cases noted above is expressed in terms of whether property is "employed and risked in the business". In turn, for a property to be so employed and risked it is generally accepted that it must be integral to the continued operation of the business in question. For purposes of deciding this appeal, and for reasons which will be made evident, I shall continue to pursue the principal issue as stated at the outset in terms of whether all of the assets in the life fund were "necessary" to the taxpayer's life insurance business.[98]

[Emphasis added.]

[133] The majority held that in determining the assets that were "necessary" to the life insurance business, the taxpayer's business decision not to remove assets from the life fund and the taxpayer's financial filings with OSFI allocating all of the investment income to the life insurance fund were factors to consider, but not determinative. Ultimately, the majority relies on the taxpayer's actuarial calculations establishing what assets were necessary for the life insurance business.[99]

[134] Macdonald J. dissented, finding that *Ensite* was not applicable as the issue at hand was not whether the income on surplus assets was active business income, but whether income on assets in the life fund was taxable. Macdonald J. concludes, as the trial judge did, that where the taxpayer makes a business decision to keep assets in the life fund, the interest income is *prima face* income from the life insurance business. The dissent observes that the taxpayer benefitted from decreased risks by

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[95] *Ensite Limited v. The Queen*, [1986] 2 S.C.R. 509 [*Ensite*].

[96] *R. v. Marsh & McLennan Ltd.*, 1981 C.T.C. 410 [*Marsh & McLennan*].

[97] The Tax Court and the Federal Court of Appeal also considered the impact of subsection 81(1) of the *Insurance Act* and whether there was a statutory charge on the surplus assets. That issue is not relevant in this appeal.

[98] *ACTRA supra* note 94, at paragraph 11.

[99] *Ibid,* paragraphs 30-34.

having excess reserves in the life fund "not only for its own piece *sic* of mind, but that of the Superintendent of Insurance as well" and cited a witness who said "the greater the surplus, the better the people in the Superintendent's office would sleep".[100]

[135] Next, I address *Ensite* and *Marsh & McLennan* to provide further context to the test that the majority of the Federal Court of Appeal applies in *ACTRA*.

Ensite and *Marsh & McLennan*

[136] Ensite was in the business of manufacturing automobile parts, and decided to open a manufacturing plant in the Philippines. Under Philippine law, Ensite was required to finance the plant with foreign currency. In order to hedge its currency risk, Ensite entered into an elaborate series of swap transactions that included the deposit of US dollars with commercial banks to secure peso loans. It was not essential to the swap transactions that Ensite make the US dollar deposits, but the result was more favourable interest rates that reduced Ensite's cost of borrowing.

[137] The Supreme Court considered whether the US dollar deposits were "used or held by the corporation in the year in the course of carrying on a business" for the purposes of subsection 129(4). If so, the interest income on the deposits would be active business income, and not foreign investment income, reducing the dividend refund claimed by Ensite.

[138] A unanimous Court held that the deposits were used or held in the course of carrying on a business. The Court adopted the test from the decision of Le Dain J. in *Marsh & McLennan*, which held that assets are used or held in a business when they are "risked and employed" in the business. Citing the decision in *March Shipping Ltd.*[101], the Court held:[102]

> If "risked" was the right test, then all property would meet the test since ultimately all property is available to the creditors of a corporation. But "risked" means more than a remote risk. A business purpose for the use of the property is not enough. The threshold of the test is met when the withdrawal of the property would "have a decidedly destabilizing effect on the corporate operations themselves".

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[100] *Ibid*, paragraph 50.

[101] *March Shipping Ltd. v. M.N.R.* [1982] 2 F.C. 313 (TD), reversed [1984] 1 F.C. 609 (FCA).

[102] *Ensite*, pages 519-520.

[139] The Court in *Ensite* continued:[103]

> This would distinguish the investment of profits from trade in order to achieve some collateral purpose such as the replacement of a capital asset in the long term (see, for example, *Bank Line Ltd. v. Commissioner of Inland Revenue* (1974), 49 T.C. 307 (Scot. Ct. of Session)) from an investment made in order to fulfil a mandatory condition precedent to trade (see, for example, *Liverpool and London and Globe Insurance Co. v. Bennett*, [1913] A.C. 610 (H.L.), and *Owen v. Sassoon* (1951), 32 T.C. 101 (Eng. H.C.J.) Only in the latter case would the withdrawal of the property from that use significantly affect the operation of the business. The same can be said for a condition that is not mandatory but is nevertheless vitally associated with that trade such as the need to meet certain recurring claims from that trade: see for example *The Queen v. Marsh & McLennan, Ltd.*, *supra*, and *The Queen v. Brown Boveri Howden Inc.*, …
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> … The test is not whether the taxpayer was forced to use a particular property to do business; the test is whether the property was used to fulfil a requirement which had to be met in order to do business. Such property is then truly employed and risked in the business. Here the property was used to fulfil a mandatory condition precedent to trade; it is not collateral, but is employed and risked in the business of the taxpayer in the most intimate way. It is property used or held in the business.

Munich Re

[140] The Respondent submits that *ACTRA* is not applicable to this appeal and that *Munich Re.*[104] is most directly applicable. They submit that in *Munich Re* the Federal Court of Appeal determined that *Ensite* is of limited application to the taxation of life insurance businesses.

[141] In *Munich Re*, the Courts considered whether an income tax refund of overpaid tax installments was property used by the non-resident insurer in the year or held by it in the year in the course of carrying on an insurance business in Canada, for the purposes of ITR paragraph 2400(1)(e) as it read at the relevant time. If so, the refund interest would be taxable as part of the appellant's insurance business as GIR pursuant to subsection 138(9). The Tax Court, relying on *Ensite* and the "employed and risked" test adopted from *Marsh & McLennan*, determined that the overpaid tax installments were not "employed and risked" in the taxpayer's business. The Tax Court Judge nonetheless concluded that the interest income was taxable

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[103] *Ensite*, pages 520-521.

[104] *Munich Reinsurance Company (Canada Branch) v. The Queen*, 2001 FCA 365 [*Munich Re*].

under Part I, as income from a business carried on in Canada and dismissed the appeal.

[142] The Federal Court of Appeal considered the application of subsection 138(9)/ITR paragraph 2400(1)(e) and disagreed with the Tax Court's reliance on *Ensite*. The Federal Court of Appeal describes *Ensite* as a case concerning a manufacturer with investment activities and the issue being whether the latter activities were part of the manufacturing business. The Court in *Munich Re* holds:[105]

> In this case, the appellant is an insurer. The appellant does not argue that the practice of overpaying tax instalments is an investment or a business apart from its insurance business. What the appellant is arguing is that overpaying one's tax instalments is never a business activity at all. On the facts, that is the only argument open to it.

[143] The Federal Court of Appeal determines that there was no factual basis for concluding that the appellant's right to a tax refund did not arise as part of its insurance business. The genesis of the refund was the income earned in its insurance business in respect of which there was an obligation to pay tax, including installments. The refund was a right acquired and held in the course of carrying on the business and therefore the income was within the scope of subsection 138(9).

[144] I do not take the Court's comments in *Munich Re* to be a rejection of the application of *Ensite* to insurers. The Court in *Munich Re* determines that the case is not relevant to the situation before it, on the basis that there were no investments separate from the insurance business.

[145] The principles in *Ensite* must however be adapted when applied to insurers, taking into account that the very business of an insurer includes the making and holding of investments to meet its liabilities. This does not mean that an insurer can never have surplus investments that are not used or held in carrying on an insurance business. As the Court acknowledges in *Munich Re:*[106]

> While I accept that an insurer must engage in investment activities as an essential aspect of its insurance business, it is nevertheless possible for an insurer to have investments that are not part of its insurance business.

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[105] *Munich Re*, paragraph 31.

[106] *Munich Re*, paragraph 32.

[146] While *Ensite* dealt with a different statutory scheme and a different type of taxpayer than at issue here, the "employed and risked" test adopted in *Ensite* derives from *Marsh & McLennan* and, in turn from *Liverpool and London*[107], both cases involving insurance. In *Marsh & McLennan*, the Federal Court of Appeal determined that an insurance broker's income from investing premiums collected but unremitted was income from property used or held in the business. The decision of Le Dain, J. in *Marsh & McLennan*, which is relied on by the Supreme Court in *Ensite*, cites *Liverpool and London* and *Bank Line Ltd.*[108], the former bearing facts analogous to those here. In *Liverpool and London*, the House of Lords considered whether interest on an insurer's surplus assets was a separate business from the insurance business. The Court found that the interest income was insurance business income. The income was "fruit derived from a fund employed and risked" in the business; the investments were required to support the often inconsistent revenues of the insurance business and the surplus amounts were needed to back reserves and attract new customers.

[147] Accordingly, I conclude that the "employed and risked" standard adopted in *Ensite* and relied on in *ACTRA* is applicable to determine whether an insurer's investment assets are used or held in carrying on an insurance business.

(4) <u>Conclusion on the Legal Test</u>

[148] Based on the foregoing case law, I summarize the applicable principles in determining whether the Appellant's World Surplus assets are used or held by the Appellant in the course of carrying on an insurance business:

1. Whether an item is "used or held by the insurer in the course of carrying on an insurance business" is a question of fact, once the legal standard is defined. (*Munich Re*, *Marsh & McLennan*, *Liverpool and London*)

2. The legal test for whether an item is "used or held by the insurer in the course of carrying on an insurance business" is whether the investment assets are "necessary" for the insurance business, "employed and risked in the business" in the sense of being "linked to some definite obligation or liability of the business" or "integral to the continued operation of the business".

[107] *Liverpool and London and Globe Insurance Co. v. Bennett (Surveyor of Taxes)*, [1913] A.C. 610 (H.L.).

[108] *Bank Line Ltd. v. Commissioners of Inland Revenue* (1974), 49 T.C. 307 (Eng. Ct. of Sess.-1st Div.)

(*ACTRA*, majority, citing *Ensite* and *Marsh & McLennan*) Determining this would involve actuarial calculations and expert testimony at trial. Insurers often maintain excess reserves and it will be a matter of expert opinion as to when surplus assets are not necessary or integral to the continued operation of the business.

3. The test is objective. (*ACTRA*, majority)

4. While an insurer must engage in investment activities as an essential aspect of its insurance business, it is possible for an insurer to have investments that are not "part of"[109] its insurance business. (*Munich Re*)

5. In determining, whether as a matter of fact, an investment asset is used or held by an insurer in the course of carrying on an insurance business, it is appropriate to consider: whether the assets are held as part of an insurance fund/account or held separately, whether the insurer's filings with the regulator (e.g. OSFI) indicate income on the investments as income from the insurance business; whether actuarial calculations indicate the investment assets are necessary to satisfy future liabilities to policyholders. (*ACTRA,* majority**,** *Lutheran Life*)

6. It may be appropriate to draw an inference, where investments are within an insurance fund/account (or outside) that the assets are necessary (or not) for the relevant insurance business, which can be met with objective evidence to the contrary. (*ACTRA***,** majority)

(5) <u>The Parties' Positions</u>

[149] The Appellant relies on the Federal Court of Appeal majority decision in *ACTRA* and submits that for an asset to be "used or held" in an insurance business it must be "employed and risked" or "necessary" to the business. The Appellant also relies on *Ensite* and submits that for an asset to be "risked and employed" in the business, the removal of the asset must have a "decidedly destabilizing effect on the corporate operations".

[150] The Appellant's position is that the Internal Targets (280%/290% MCCSR) were an appropriate measure of surplus necessary to support its consolidated operations (including its Life Business, its A&S Business, fraternal operations and

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[109] The Federal Court of Appeal in *Munich Re* uses this phrase interchangeably with "used or held". *ACTRA* dealt with whether investments were "part of" the insurance business.

non-insurance businesses), as confirmed in the Rehbeli expert reports. Since World Surplus assets were not required for the Appellant to operate at these Internal Targets for "virtually all" of the Relevant Period, they meet the test of not being necessary for the business. The Appellant submits that removal of the World Surplus assets would not have a "decidedly destabilizing effect" on the Appellant's insurance business operations.

[151] The Appellant submits in the alternative that even if the Respondent demonstrates that some of the World Surplus assets are used or held in the course of carrying on an insurance business, an equivalent amount should still be excluded from the CIF. The Appellant suggests that surplus assets exist at the divisional levels that are not used or held in the course of carrying on an insurance business and could therefore be excluded in computing the CIF in lieu of any "tainted" World Surplus assets.

[152] The Respondent maintains that all World Surplus assets were used or held by the Appellant in the course of carrying on the insurance business. They rely on the Federal Court of Appeal's decision in *Munich Re* in support of the position that the determination is a fact-driven analysis based on the actual use and holding of assets. They say that the Appellant's Internal Targets and Operating Targets are irrelevant to the determination, because they are calculated on a consolidated basis. They take the same position in respect of all OSFI MCCSR-based thresholds.

[153] The Respondent submits that World Surplus assets were in fact used or held by the Appellant in the course of carrying on the insurance business. They maintain, based in part on the Ozdemir expert reports, that World Surplus assets were required to mitigate both the operational risk and solvency risk of the Appellant's insurance business. They also identify various uses of World Surplus assets which they say demonstrate use or holding in the course of carrying on an insurance business.

(6) <u>Analysis</u>

A. The ORSA, the Appellant's Internal Targets and Operating Targets

[154] In 2013, the Appellant had a capital management policy which it revised in 2014 to reflect the OSFI ORSA Guideline, effective January 1, 2014. The ORSA process conducted in 2014 resulted in a small increase in the previously established Internal and Operating Targets but did not materially change the Appellant's capital

management approach or targets.[110] I start by considering the Appellant's ORSA. It sets out the Internal Targets and Operating Targets that the experts addressed in providing opinions on capital that was necessary for the Appellant's insurance business. There was no suggestion that lesser amounts, such as the OSFI thresholds of 120% MCCSR or 150% MCCSR, reflected the capital that was necessary for the Appellant's insurance business.

[155] As stated in the Appellant's ORSA, the process determines an insurer's capital requirements based on all the material risks it faces:

> This report has been prepared in accordance with the requirements of OSFI's Guideline E-19, "Own Risk and Solvency Assessment, (ORSA)". The guideline outlines OSFI's expectations with respect to an insurer's own assessment of its risks, capital needs, and solvency position, and for setting Internal Targets, based on an insurer's own risk and solvency assessment.
>
> This report documents the own risk and solvency assessment of Foresters consolidated position. The ORSA analysis conducted and documented herein is proportionate to the nature, scale and complexity of Foresters business and risk profile. In conducting the ORSA Foresters has determined its own capital needs and established its Internal Targets based on an internal assessment of all material risks, including the results of the enterprise risk management process. The assessment is forward-looking and is consistent with Foresters' business and strategic planning.
>
> . This report is updated at least annually and presented to the Board for review and approval.[111]

[Emphasis added.]

[156] Both experts agree that the purpose of the ORSA is for the insurer to determine the amount of capital that it needs.[112] Mr. Ozdemir describes the process in his Rebuttal Report:

> The objective in ORSA is not about simply staying above the minimum regulatory capital requirements with some margin, but about ensuring capital adequacy to be able to execute the firm's business and strategic plans. More specifically, it is a self-

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[110] Rehbeli Expert Report, page 39.

[111] ORSA, JBD, Tab 39, page 1023; see also October 25, 2022 Transcript, page 163, lines 14-15 – Testimony of Peter Boyko.

[112] Rehbeli Expert Report, page 33; Ozdemir Rebuttal Report, lines 139-142, lines 229-252.

> assessed, compressive, risk-based capital budgeting process to be able to execute business and strategic plans even under adverse circumstances.[113]

[157] The OFSI Guideline lists five elements key to the analysis: comprehensive identification and assessment of risks, relating risk to capital, oversight, monitoring and reporting, and internal controls and objective review. The most important item is to determine the amount of capital that should be attributed to risk.[114]

[158] The Appellant's expert confirmed the reasonableness of the Appellant's capital management policy and the reliability of the Appellant's ORSA. Mr. Rehbeli reviewed the calculations including the methodology and assumptions to arrive at the internal targets (both the Internal Targets and Operating Targets). He found the approach reasonable. He noted that the Appellant's estimates were conservative. For example, they addressed the inability to raise capital by taking a high reserve for expense overrun risks.[115]

[159] The ORSA requires that the insurer undergo "Dynamic Capital Adequacy Testing" ("DCAT"). The DCAT exercise projects the financial statement and capital positions of the insurer over a 5-year horizon, under a base scenario consistent with the business plan and a number of plausibly adverse scenarios relevant to the insurer. The DCAT is generally used to confirm that the chosen internal targets are reasonable.[116] In addition to DCAT testing, the Appellant did *ad hoc* stress testing of its Internal Target, with assumptions specified by OSFI. This stress testing affected the calculation of the Appellant's Internal Target.[117]

[160] The Respondent's expert took issue with the Appellant's ORSA. Mr. Ozdemir noted that the Appellant's ORSA failed to incorporate the Appellant's economic capital needs and business plan, which are both required to meet the forward-looking aspects of the ORSA. Mr. Ozdemir observed that the Internal Target was computed

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[113] Ozdemir Rebuttal Report, lines 248-252.

[114] Rehbeli Expert Report, page 33.

[115] October 26, 2022 Transcript, page 153, lines 18-28; page 154, lines 1-9 – Testimony of Les Rehbeli.

[116] Rehbeli Expert Report, pages 34-35; October 26, 2022 Transcript, page 126, lines 16-23 – Testimony of Les Rehbeli.

[117] October 26, 2022 Transcript, pages 126 and 127, lines 24-28 and 1-9 – Testimony of Les Rehbeli.

at a confidence level of the 99.5 percentile that, in his opinion, is low by ORSA standards.[118] Mr. Rehbeli stated that the level is consistent with the industry.[119]

[161] I conclude that Mr. Rehbeli's opinion on the reliability of the ORSA should prevail over Mr. Ozdemir's concerns. Mr. Rehbeli is an actuary who has experience with numerous insurance companies, including fraternal benefit societies. Mr. Ozdemir is not an actuary and has no experience with fraternals. Mr. Rehbeli's testimony was clear and consistent throughout. Mr. Ozdemir's testimony was inconsistent and at times factually incorrect. Mr. Ozdemir opined in his report that all of the Appellant's World Surplus was necessary for its insurance business whereas in oral testimony, he admitted on cross-examination that "[w]hether all of this [World Surplus] is required or not, I cannot tell."[120] This material inconsistency undermines my reliance on Mr. Ozdemir's reports and testimony.

[162] I do not accept Mr. Ozdemir's conclusion that all of the Appellant's World Surplus was necessary for the Appellant's insurance business and he did not offer an alternative. I conclude that the Internal and Operating Targets reflected in the Appellant's ORSA provide a reliable measurement of the capital required to operate its insurance business. While the ORSA is the Appellant's own assessment, given the requirements for the process established by OSFI and the confirming opinion of Mr. Rehbeli, the targets meet an objective standard. Although the ORSA process was undertaken for 2014 only, Mr. Rehbeli's opinion is confirming of the conclusions reached by the Appellant in respect of 2013 and 2014. Accordingly, I do not distinguish between the years.

[163] Mr. Rehbeli concludes that the Appellant's capital in excess of the greater of the Internal Target of 280%/290% MCCSR and the Divisional Targets is "Free Surplus".[121] Mr. Rehbeli concludes that during the Relevant Period, the total capital allocated to the operating divisions (including capital necessary to meet local requirements) was approximately 290% MCCSR, which was coincidentally almost the same as the Appellant's Internal Target for the period.[122] According to

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[118] October 31, 2022 Transcript, page 155, lines 12-15, 27-28; page 156, lines 1-7 – Testimony of Hamdi Ozdemir.

[119] Rehbeli Expert Report, page 42.

[120] November 1, 2022, Transcript, page 52, line 17 – Testimony of Hamdi Ozdemir.

[121] Rehbeli Surrebuttal Expert Report, page 7.

[122] Rehbeli Expert Report, page 39.

Mr. Rehbeli, capital exceeding that threshold is considered redundant or excessive relative to the risks borne by the insurer.[123]

[164] The Respondent submits that this conclusion does not properly take into account the "buffer" between the Appellant's Internal Target and Operating Target. As explained in Guideline A-4, OSFI expects insurers to have operating targets so they do not regularly fall below their internal targets. As stated in the Appellant's ORSA:

> An operating level of 310% is established to provide some cushion over and above the internal target so as to remain above the internal target. The operating level of 310% provides a cushion for coverage against not only adverse economic swings but also non-financial risks (operational risk, regulatory regime changes etc.). Given that Foresters has limited access to raise additional equity capital it is necessary that the operating target provide an appropriate level of cushion that Foresters remains above its internal target level.[124]

[165] Maintaining capital at an operating target level reduces the possibility of dropping inadvertently below the internal target level. Even an inadvertent and temporary drop below the insurer's internal target at a quarter-end would require reporting to OSFI, which insurers try to avoid.[125] Several fact witnesses testified about the importance of the Operating Target "cushion" to Foresters, to guard against adverse economic events and given the Appellant's limited ability to raise capital.[126]

[166] As the Appellant's expert states in his report, insurers typically establish a buffer above the Internal Target to ensure a greater likelihood of remaining above the Internal Target even after experiencing a small to modest adverse event. "The internal target is what is needed, and the operating target is what the insurer chooses to operate at."[127]

[167] The Respondent's expert concludes that maintaining capital at the Operating Target level is "economically necessary" for the Appellant to dynamically stay over

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[123] Rehbeli Surrebuttal Expert Report, page 7.

[124] Appellant's 2014 ORSA, JBD, Tab 39, page 1135 – Testimony of Les Rehbeli.

[125] October 26, 2022 Transcript, page 123, lines 3-10 – Testimony of Les Rehbeli.

[126] October 24, 2022 Transcript, page 134 – Testimony of Frank Lochan; page 31-34; October 25, 2022 Transcript, page 171 – Testimony of Peter Boyko.

[127] Rehbeli Expert Report, page 33.

the regulatory minimums with a safe margin.[128] According to Mr. Ozdemir, the excess over the regulatory minimum includes divisional surplus and that portion of World Surplus required to stay at the Operating Target level.

[168] The Respondent's expert concludes that Uncommitted Surplus is also required to provide a third layer of cushion. "Uncommitted Surplus" is an amount calculated to provide management and the Board of Directors with a sense of surplus capital available for business expansion, particularly business acquisitions.[129] Uncommitted Surplus was computed as the excess of total available capital over the sum of, for each of the Appellant's divisions, the greater of 280%/290% MCCSR and the local capital requirement.[130]

[169] Mr. Ozdemir describes Uncommitted Surplus as necessary to replenish capital levels to the operating level in support of divisions as necessary, provide capital to execute the business and strategic plans, and obtain and maintain external ratings.

[170] I do not accept Mr. Ozdemir's conclusion that Uncommitted Surplus was required in the sense of being necessary to the continued operation of the business. While Uncommitted Surplus could be used for the purposes listed by Mr. Ozdemir (discussed in further detail below), he does not establish necessity. Mr. Macdonald testified that Uncommitted Surplus was used for special acquisitions and Mr. Boyko testified that the appellant preferred to keep Uncommitted Surplus below $60 million.[131] The Uncommitted Surplus was $279 million at the end of 2013 and $303 million at the end of 2014,[132] suggesting an excess over what was desirable even for special acquisitions. The evidence undermines Mr. Ozdemir's conclusion.

[171] The Appellant was not required to maintain capital at an Operating Target level, although it was expected by OSFI. The Appellant states in its ORSA, that given its limited access to the capital markets, the Operating Target is "necessary" to provide an appropriate level of cushion to stay above the Internal Target level.

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[128] Ozdemir Expert Report, page 28.

[129] Giffen Memo, JBD, Tab 43, page 1285; October 24, 2022 Transcript, page 100, lines 9-27 – Testimony of Stephen McDonald.

[130] Appendix 2 to the quarterly capital management reports, JBD, Tabs 46-58.

[131] October 25, 2022 Transcript, McDonald at page 43; Peter Boyko at page 196.

[132] JBD Tab 50 re 2013 at page 1376; JBD Tab 54 re 2014 at page 1426.

[172] Based on the evidence, I have determined that maintaining capital at the Operating Target level of 300%/310% MCCSR was necessary for the Appellant to carry on its insurance business. I have drawn my conclusion, in part, on the Appellant's status as a fraternal benefit society, and the statement in the Appellant's ORSA about its limited access to capital markets and the necessity of maintaining an operating target level buffer.

[173] Based on Operating Target levels of $1,173,000,000 at the end of 2013 and $1,384,150,000 at the end of 2014, there would be an operating target surplus (total available capital less Operating Target level required capital) of approximately $428,000,000 at the end of 2013 and $440,850,000 at the end of 2014.[133] This surplus, which based on expert testimony is not necessary for the Appellant to carry on its insurance business, is greater than the amount of World Surplus assets in issue ($277,231,000 in 2013 and $382,228,000 in 2014).[134]

[174] The Respondent has additional concerns with Mr. Rehbeli's approach. They submit that Mr. Rehbeli's conclusion on unnecessary capital is based on consolidated ratios (MCCSR) and therefore does not assist with the CIF calculation, which is based on items on the non-consolidated balance sheet. While that distinction is correct, I do not accept that it makes Mr. Rehbeli's conclusions inapplicable. I have already concluded that the amount of World Surplus assets in issue is less than the amount of surplus that Mr. Rehbeli concludes is unnecessary to the Appellant's insurance business. Further, the World Surplus assets (and other surplus assets) are held by the Appellant.

[175] I do however agree that Mr. Rehbeli's conclusions do not completely answer the question before me. To be clear, I rely on Mr. Rehbeli's reports and testimony to support a conclusion that maintaining capital at the Operating Target level (300%/310% MCCSR) on a consolidated basis was necessary for the Appellant's insurance business. While this conclusion suggests that capital in excess of those levels was not necessary, it is a separate determination whether World Surplus assets

[133] Calculated pursuant to an MCCSR analysis as shown in the appendices of the Capital Management Reports. Based on Internal Target levels of $1,094,800,000 at the end of 2013 and $1,295,850,000 at the end of 2014, there would be an internal target surplus (Total Available Capital less Required Capital at Internal Target Level) of approximately $506,200,000 at the end of 2013 and $530,150,000 at the end of 2014.

[134] These are the amounts of World Surplus assets as reflected in the "Corporate" segment of the segmented statement of financial position (before subtracting World Surplus liabilities). Net of liabilities the amounts are $273,969,000 in 2013 and $378,154,000 in 2014.

which comprise part of that excess were in fact used or held by the Appellant in carrying on an insurance business.

[176] I do not rely on Mr. Rehbeli's reports and testimony on this latter issue. Mr. Rehbeli reviewed the capital management reports that reflected transfers in and out of World Surplus but acknowledged that he did not separately examine the use of specific World Surplus assets.[135]

[177] Next, I review the World Surplus assets to determine, as a matter of fact, whether they were used or held in the course of carrying on the Appellant's insurance business.

B. The Appellant's Use and Holding of World Surplus Assets

1. Onus

[178] The Appellant bears the burden of proof on assumptions of fact made by the Minister.[136] The Appellant must establish the facts needed to demolish the Minister's factual assumptions, on a balance of probabilities. These include assumptions that World Surplus (and Country Surplus) were used or held in the Appellant's life insurance business and, more specifically, were used or held for the purpose of contending with any contingency or possible default in meeting its liabilities to life insurance policyholders.[137]

2. World Surplus Assets

[179] The parties agree that the relevant non-consolidated balance sheets are those filed with the Life-1 Return. Here we have the 2013 Life-1 Annual Return and the 2014 Life Quarterly Return & Annual Supplement[138] filed with OSFI. World Surplus

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[135] October 27, 2022, Transcript, page 6, lines 5-9, page 23 lines 1-6 – Testimony of Les Rehbeli.

[136] *Hickman Motors Limited v. R.*, [1997] 2 S.C.R. 336, paras 92-95; *House v. The Queen*, 2011 FCA 234, para 30.

[137] Amended Reply to the Notice of Appeal, paragraphs 16(j), (k).

[138] 2013 Life-Annual Return, JBD, Tab 33, pages 745-746; 2014 Life Quarterly Return & Annual Supplement, JBD, Tab 34, pages 914-915.

is included in total surplus on the Appellant's non-consolidated balance sheet filed with OSFI.[139]

[180] The CRA, in computing the Appellant's CIF, started with the total asset amounts reflected on the Appellant's non-consolidated balance sheet.[140] The Appellant deducted the net amount of World Surplus assets in determining its CIF. The non-consolidated balance sheet does not provide any information about the identity or amounts of World Surplus assets. To determine this, we look to the Notes to the Consolidated Financial Statements that provide segmented information[141] and the Working Papers to the Consolidated Financial Statements.[142] The Foresters World Surplus column in the latter reflects the following assets:[143]

World Surplus Assets	2013	2014
Cash Equivalents	$11,420,000	$5,647,000
Bonds and Other Fixed Term Securities	$42,008,000	$130,183,000
Notional Assets – Notional Bond Transfer*	$27,268,000	$147,063,000
Notional Assets - Notional Frat Ops. WS*	$(24,959,000)	$(23,158,000)
Stocks	$57,552,000	$82,279,000
Other Invested Assets	$15,925,000	$15,984,000
Accrued Investment Income	$211,000	$853,000
Interbranch Receivable*	$101,925,000	$(4,852,000)
Intangible Assets	$45,881,000	$28,150,000
Total	$277,231,000	$382,228,000

[139] PASF, paragraph 61.

[140] CRA Proposed Adjustment #2014-04, JBD, Tab 63, page 1560.

[141] 2013 Consolidated Financial Statements, JBD, Tab 27, page 392; 2014 Consolidated Financial Statements, JBD, Tab 29, pages 501-502.

[142] Consolidated Financial Statements, JBD, Tab 28, pages 397-398; 2014 Consolidated Financial Statements, JBD, Tab 30, pages 507-508.

[143] Consolidated Financial Statements, JBD, Tab 28, page 397; Consolidated Financial Statements, JBD, Tab 30, page 507.

*The * indicates inter-branch amounts within the Appellant, that net to zero in the "Total Foresters" column.*

[181] The cash equivalents, bonds and other fixed term securities, stocks and other invested assets (partnership interests) are held in a segregated account at State Street.[144]

3. *Use of World Surplus Assets*

[182] World Surplus assets are distinct from assets allocated to specific operations. They appear separately on the segmented balance sheet, most are held in a separate investment account at State Street and are subject to a separate investment policy. This separation might be considered to give rise to an inference that the World Surplus assets are not necessary to the Appellant's insurance business. In *ACTRA*, the majority of the Federal Court of Appeal wrote that it would have been open to the Tax Court to draw an inference that because the assets were in the life fund they were necessary to the life insurance business.[145]

[183] Similarly, the allocation of assets to the insurance divisions (Canada and the US) (i.e., Country Surplus or Divisional Surplus) might be considered to give rise to an inference that those assets were necessary for the Appellant's insurance business. An inference can be displaced with evidence to the contrary. I do not however rely on inferences as this second stage of the analysis requires a consideration of all relevant facts, to determine whether, despite the separation, World Surplus assets were used or held by the Appellant in carrying on an insurance business.

[184] The parties took very different positions on the use of World Surplus assets.[146] Based on the evidence, I conclude that during the Relevant Period, the Appellant used World Surplus assets:

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[144] Appellant's State Street Consolidated Holdings Report Book, JBD, Tab 40.

[145] *ACTRA*, paragraph 21.

[146] Written Submissions of the Appellant, paragraph 64; Written Submissions of the Respondent, paragraph 58.

1. to cover the annual costs associated with the Appellant's fraternal operations, being Fraternal Benefits, community Good Works and the administrative costs of its fraternal operations;[147]

2. to invest in various business opportunities both insurance and non-insurance;[148]

3. to top up divisional capital (of an insurance division or the fraternal division) if the division's capital allocation fell below the Divisional Target;[149] and

4. to pay for the cost of Elixir.[150]

[185] Next, I consider whether the deployment of World Surplus assets described above and other arguments regarding use made by the Respondent constitutes use or holding by the Appellant in carrying on an insurance business.

4. Use of World Surplus Assets to top up Divisional Targets

[186] On a quarterly basis, management monitors the Appellant's performance against internal capital targets and initiates action when appropriate.

[187] If a division falls below its Divisional Target, assets from World Surplus (e.g. bonds) are transferred to "top up" the division.[151] Transfers are made to World Surplus when a division has capital in excess of its Divisional Target.[152] Where the Divisional Target is the local capital requirement (i.e., local capital requirement > 200% MCCSR), real assets are transferred to top up capital to the Divisional Target.

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[147] October 24, 2022 Transcript, page 76, lines 5-6 – Testimony of Frank Lochan; October 25, 2022 Transcript, page 132, lines 4-6 – Testimony of Stephen McDonald; October 25, 2022 Transcript, page 180, lines 8-12 – Testimony of Peter Boyko; October 31, 2022 Transcript, page 40, lines 22-26 and page 41, lines 4-13 – Testimony of Sharon Giffen.

[148] October 24, 2022 Transcript, page 92, lines 4-11 – Testimony of Frank Lochan; October 25, 2022 Transcript, page 180, lines 19-21 – Testimony of Peter Boyko; ; October 31, 2022 Transcript, page 44, lines 6-10, page 45, lines 15-17 – Testimony of Sharon Giffen; October 27, 2022 Transcript, page 128, lines 8-22 – Testimony of Paul Reaburn.

[149] PASF, paragraphs 48-49.

[150] PASF, paragraphs 44-46.

[151] PASF, paragraph 49.

[152] October 25, 2022, page 117, lines 2-28; page 118, lines 1-28; page 119, lines 1-8 - Testimony of Stephen McDonald.

Where the Divisional Target is 200% MCCSR (i.e., 200% MCCSR > local capital requirement) then a notional transfer of assets occurs to top up capital to the Divisional Target.[153] These actual and notional transfers are recorded every quarter in the Appellant's Capital Management Report.[154] During the Relevant Period only notional transfers occurred.

[188] The Respondent submits that the notional transfers of bonds, at the end of each quarter, both to and from each insurance division, reflect use of the underlying bonds in the insurance business. According to the Respondent, the bonds were used in the insurance business either immediately before a notional transfer to World Surplus, or immediately after a transfer from World Surplus. According to the Respondent, these totals are $86 million for 2013 and $161 million for 2014. The Respondent has taken the sum of all quarter-end transfers in and out of the Canadian and US insurance branches.[155]

[189] I agree that transfers of assets (notional or real) from World Surplus to the insurance divisions to top-up divisional capital results in those assets being used in the course of carrying on an insurance business. However, the Respondent's approach counts the same notional capital amounts multiple times, resulting in an overstatement. The Respondent adds every dollar of assets that "goes into" a division and "goes out of" a division, even if it is the same notional amount of capital and even if the same notional amount of capital goes in and out of an insurance division multiple times a year. It also inaccurately assumes that all amounts transferred into an insurance division come from World Surplus.

[190] The Appellant submits that these notional transfers to the insurance divisions do not affect their position on the World Surplus assets. According to the Appellant, the transfers reflect use of the underlying bonds in the insurance business but only after the notional transfer takes place, at which point, they are no longer a World Surplus asset. I disagree with the Appellant's approach. The year-end non-consolidated balance sheet of the Appellant, on which the CIF computation is based,

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[153] Capital Management Policy, JBD, Tab 44, pages 1321-1322; October 25, 2022 Transcript, pages 36-40; October 26, 2022 Transcript, pages 10-17 - Testimony of Stephen McDonald and Peter Boyko.

[154] Appellant's capital management report, JBD, Tabs 47-54.

[155] Written Submissions of the Respondent, paragraphs 157-160.

will not reflect the transactions in and out of World Surplus during the course of the year. That information is in the Capital Management Reports.

[191] A review of the Capital Management Reports[156] reveals that the maximum amount transferred from World Surplus to the Canadian and US insurance divisions in 2013 was $17 million and in 2014 was $18 million. On this basis, I have concluded that $17 million of World Surplus assets (bonds) were used or held in the course of carrying on the Appellant's insurance business in 2013 and $18 million in 2014.

5. *Items not on the Non-Consolidated Balance Sheet*

[192] Notional transfers between divisions may be reflected in the Appellant's segmented information but do not affect the year-end non-consolidated balance sheet.[157]

[193] The Appellant removed from its CIF all of the items (listed above) that comprise World Surplus. These assets and amounts were based on the segmented financial statement. There is however, a problem with World Surplus assets that were not reported on the Appellant's non-consolidated balance sheet.

[194] Term "I" in the CIF definition only excludes an item that was not used or held by the insurer in the course of carrying on an insurance business if it would otherwise be included in "I" as an amount of an item reported as an asset of the insurer. ITR subsection 2400(3) provides that a reference to an amount or item reported as an asset or liability at the end of a taxation year means an amount or item reported on the non-consolidated balance sheet. In this case, it is the non-consolidated balance sheet accepted by OSFI. Similar words, the term "amounts reflected in the balance sheet" have been interpreted in the context of subsection 181(3) (large corporations tax) to have its accounting meaning, "recorded" or "included in".[158] While the context is different, I see no reason to depart from this principle in determining whether an amount or item is reported on the Appellant's non-consolidated balance sheet for purposes of ITR subsection 2400(3). In order to be included in term "I" of

[156] Q4-14 Capital Management Report, JBD, Tab 54, page 1420.

[157] October 25, 2022 Transcript, page 51, lines 24-28; page 52, lines 1-3– Testimony of Stephen McDonald.

[158] *Royal Trust Co. v. R.*, [2001] 3 C.T.C. 2268 (TCC).

the CIF, an asset must appear (or be included in an item that appears) on the non-consolidated balance sheet.

[195] As noted above, certain World Surplus assets appear on the segmented financial statement but do not appear on the Appellant's non-consolidated balance sheet (or in the "Total Foresters" column on the segmented balance sheet). That is because these entries reflect transactions between divisions and "net out" to zero. These World Surplus "assets" are listed above as the Notional Assets – Notional Bond Transfer, Notional Assets-Notional Frat Ops. and the Interbranch Receivable.

[196] Accordingly, I have determined that these are not assets to be excluded from the CIF computation under the parenthetical in "I": "other than an item that at no time in the year was used or held…" because they were not included in the CIF computation as "the amount of an item reported as an asset of the insurer as at the end of the year" on the non-consolidated balance sheet. There can be no carve out, pursuant to the language in parentheses in "I", if the amounts of the assets would not be included in the first place.

[197] The amounts for 2013 are $27,268,000 and ($24,959,000) as notional assets and $101,925.000 as an inter- branch receivable (total $104,234,000) and for 2014 are $147,063,000 and ($23,158,000) as notional assets and ($4,852,000) as an inter-branch receivable (total $119,053,000).

6. Use of World Surplus Assets for the A.M. Best Credit Rating

[198] The Respondent submits that including World Surplus assets in the formula used by A.M. Best to produce a credit rating for the Appellant means that the assets are used or held in carrying on an insurance business. I disagree.

[199] Various witnesses testified about the Appellant's A.M. Best credit rating. A.M. Best gives financial strength and credit ratings to insurance companies. One of the Appellant's guiding principles set out in its Capital Management Policies is to maintain its "Excellent" or "A" rating from A.M. Best. [159] The Appellant uses the rating in promotional materials to attract new members and maintain existing

[159] October 25, 2022 Transcript, page 88 – Testimony of Stephen McDonald; the Appellant's 2014 ORSA Report, JBD, Tab 39, page 1045.

ones.[160] The Appellant wanted to have an "A" level A.M. Best rating to ensure distribution channels were comfortable with the Appellant's solvency.[161]

[200] A.M. Best uses the BCAR formula in determining an insurer's credit rating. The BCAR formula takes into account the insurer's balance sheet capital at a consolidated level. BCAR = (Available Capital – Net Required Capital/Available Capital) x 100.[162] That formula would include all of the Appellant's capital, including that in World Surplus.

[201] The evidence regarding the A.M. Best rating is not persuasive on the issue before me. Including World Surplus assets in "available capital" in the BCAR formula does not mean that those assets are used or held in the course of carrying on an insurance business.

[202] As discussed above, the test for whether assets are "used or held" is not whether they are helpful to the business or "nice to have". As the Supreme Court stated in *Ensite*, "risked" is not the right test. If it were, then all of the Appellant's property would meet this standard since, ultimately, it is all available for creditors. The test is whether the assets are necessary for the business.

[203] The Respondent's logic, naturally extended, is that all assets that go into the BCAR formula and therefore affect the A.M. Best rating are used or held in the insurance business. This could include an unlimited amount of the Appellant's assets. It would also include the Appellant's fraternal assets, which (consistent with the CRA's assessing position)[163] are not used or held in the course of carrying on an insurance business.

[204] I have determined that the inclusion of World Surplus assets into the BCAR formula for purposes of the A.M. Best credit rating does not cause those assets to be used or held in the course of the Appellant's insurance businesses.

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[160] October 25, 2022 Transcript, page 126 – Testimony of Stephen McDonald; see, for example, the Appellant's brochure at Tab 68 of the JBD.

[161] November 1, 2022 Transcript, page 13 – Testimony of Hamdi Ozdemir.

[162] PASF, paragraphs 68-71.

[163] CRA Proposed Adjustment #2014-14 for the 2014 taxation year, JBD, Tab 63. CRA's assessing position excludes all fraternal assets and liabilities in computing the CIF.

7. Use of World Surplus to Fund Growth

[205] The Respondent submits that World Surplus assets were needed to fund organic growth of the Appellant's insurance businesses, as additional capital is required when policies are sold. The evidence does not support this.

[206] Stephen McDonald testified[164] that new sales would not require capital from World Surplus. Assets are purchased with the premiums received; a liability is set up, corresponding to the policy. While new capital is required for new policies, that new capital comes from divisional surplus (e.g., included in a Divisional Target of 200% MCCSR or local capital requirement). There was no evidence of amounts transferred out of World Surplus to support the sale of policies.

[207] On a quarterly basis, if a division's MCCSR ratio falls below the Divisional Target, there may be a transfer to the division out of World Surplus.[165] This quarterly "top up" use of World Surplus assets has already been addressed.

8. Use of World Surplus to Fund Future Capital Expenditures

[208] The Appellant used World Surplus assets to fund capital expenditures and acquisitions for the insurance business, asset management business and fraternal operations.[166] World Surplus assets could be used for capital expenditures, provided various capital management objectives were satisfied, including that there be sufficient World Surplus assets retained to maintain the Appellant's Internal Targets and fund fraternal operations.[167] In 2013, the Appellant acquired the Children's Mutual in the United Kingdom, using funds from World Surplus. Children's Mutual was to be part of the asset management business.[168]

[209] The holding of World Surplus assets to fund future acquisitions even if relevant to the insurance business does not make those assets "used or held" in the course of carrying on an insurance business. Both *Ensite* and *Bank Line*[169] establish

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[164] October 25, 2022 Transcript, page 76-77 – Testimony of Stephen McDonald.

[165] October 25, 2022 Transcript, page 76-77 – Testimony of Stephen McDonald.

[166] October 25, 2022, Transcript, page 208, lines 5-15 - Testimony of Peter Boyko.

[167] October 24, 2022 Transcript, page 101 – Testimony of Frank Lochan; October 25, 2022 Transcript, pages 43-44 – Testimony of Stephen McDonald.

[168] October 24, 2022, Transcript, page 97 - Testimony of Frank Lochan.

[169] *Ensite* at page 520, citing *Bank Line Ltd.*

that reserve funds for future capital expenditures are not used or held in the course of business, even if the acquisitions directly relate to that business. The assets are not currently used and their withdrawal would not affect the continued operation of the business.[170]

[210] Accordingly, I conclude that the potential use of World Surplus assets to fund future capital expenditures, even if in the insurance business, does not cause those assets to be used or held in the course of carrying on an insurance business.

9. Use of World Surplus to fund cost of Intangible Assets - Elixir

[211] In the years leading up to and including 2014, the Appellant was developing a new administrative technology system for its entire organization referred to as "Foresters in Transformation". This included a software program called "Elixir", a program intended to manage in-force life, annuity and A&S insurance policies in Canada and the US, as well as fraternal certificates.[171] Elixir was not implemented and was ultimately abandoned.[172]

[212] World Surplus assets were used to fund the cost of Elixir. The cost was between $20 million and $30 million, incurred in the 2011-2014 taxation years. The costs were initially capitalized, but then written off, including in 2013 and 2014, for accounting purposes.[173]

[213] The Elixir software was shown (in the segmented working papers for both 2013 and 2014) as an intangible asset in World Surplus,[174] but no evidence was introduced on what portion of the amounts reflected ($45,881,000 for 2013 and $28,150,000 for 2014) was the cost of Elixir that was not written off or when Elixir was abandoned. It appears that there are other intangible assets reflected in these

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[170] *Ensite* at page 520.

[171] PASF, paragraph 40; October 24, 2022 Transcript, at page 131, lines 15-20 – Testimony of Frank Lochan; October 27, 2022 Transcript, page 80, lines 24-26 - Testimony of Paul Reaburn.

[172] PASF, paragraph 43.

[173] Management Discussion and Analysis report for the year ended December 31, 2014, JBD, Tab 42, page 1244; PASF, paragraphs 44-46.

[174] ITR subsection 2400(6) deems, for the purposes of the CIF, goodwill to be not used or held by the insurer in the course of carrying on an insurance business. This provision applies to goodwill as reflected on the non-consolidated balance sheet and not to intangible assets separately reported.

entries on the balance sheet.[175] Based on the evidence that Elixir was never used I might have concluded that Elixir was not an asset used or held in the Appellant's insurance business. However, the Appellant has not established that any portion of the World Surplus intangible assets was not used or held in carrying on an insurance business.

10. Use of Income on World Surplus Assets to Fund Fraternal Operations

[214] The Appellant used World Surplus assets to cover the annual costs of its fraternal operations, being Fraternal Benefits, community Good Works, and administrative costs.[176] During the Relevant Period, the Appellant spent over $30M annually on these fraternal purposes.[177]

[215] The Appellant submits that World Surplus assets needed to support the expenses (which they calculate at approximately $375 million of World Surplus assets, generating a return of 8%) should not be considered to be used or held in the insurance business. I disagree.

[216] The "used or held" test is negative. To be excluded, an asset must at no time in the year be used or held by the insurer in the course of carrying on an insurance business. A non-insurance use does not mean that an asset will be excluded, if the asset also has an insurance business use, at any time in the year. Here, the non-insurance use of income from World Surplus assets does not mean that the assets are excluded in computing the CIF if the assets are also used in the insurance business (e.g., to top up capital to Divisional Targets) at any time in the year. The Appellant's argument on the use of World Surplus assets to fund fraternal operations may explain

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[175] Appellant's 2013 and 2014 consolidated financial statements, JBD, Tabs 27 and 29, respectively.

[176] October 24, 2022 Transcript, page 76, lines 5-6 – Testimony of Frank Lochan; October 25, 2022 Transcript, page 132, lines 4-6 – Testimony of Stephen McDonald; October 25, 2022 Transcript, page 180, lines 8-12 – Testimony of Peter Boyko; October 31, 2022 Transcript, page 40, lines 22-26 and page 41, lines 4-13 – Testimony of Sharon Giffen.

[177] Note 20 to the Appellant's Consolidated Financial Statements, JBD, Tab 27, page 390 (for 2013) Tab 29, page 499 (for 2014); Fraternal Expenses, JBD, Tabs 15 – 16, pages 189-191; October 24, 2022 Transcript, page 76, lines 5-6 – Testimony of Frank Lochan; October 24, 2022 Transcript, page 197, lines 21-28, page 198, line 1, page 202, lines 4-24 – Testimony of Stephen McDonald; October 25, 2022 Transcript, page 180, lines 8-20 – Testimony of Peter Boyko; October 31, 2022 Transcript, page 40, lines 16-26 – Testimony of Sharon Giffen.

why it has investment assets surplus to the insurance business but does not result in the exclusion of World Surplus assets in computing the CIF.

11. The Appellant's "in lieu of" Submission - Assets not in World Surplus

[217] At the hearing, Appellant's counsel submitted that if I were to determine that certain World Surplus assets were used or held by the Appellant in carrying on the insurance business that the amount of World Surplus assets should nonetheless be deducted from the Appellant's CIF. The Appellant's position was that there were surplus assets in the Divisions (Divisional Surplus or Country Surplus) that could be substituted. There are several problems with the Appellant's argument.

[218] First, the Appellant did not include this argument or any material facts in support of this argument in their pleadings. The Appellant's Notice of Appeal seeks to exclude World Surplus from the CIF computation. The Notice of Appeal identifies World Surplus not just as an amount, but as surplus assets separate and distinct from the assets supporting the divisions. There is no mention of Divisional Surplus or Country Surplus assets being substituted as an alternative argument. On this basis alone, the Appellant's alternative argument fails. It is fundamental to the trial process that an appellant plead material facts in sufficient detail to support the claim and relief sought.[178]

[219] Second, the Appellant did not introduce sufficient evidence in support of its position. The notional bonds in World Surplus might reflect Divisional Surplus/Country Surplus that "belongs" in World Surplus and has been notionally transferred to World Surplus from the operating divisions. However, the Appellant did not introduce evidence on this point and did not identify specific assets held in the operating divisions that could be considered to be not used or held in the insurance business.

[220] Accordingly, in the circumstances, I do not accept the Appellant's argument to "swap in" allegedly surplus assets at the divisional levels for the amount of World Surplus assets that I have determined were used or held in carrying on the Appellant's insurance business.

C. Summary – Issue #2

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[178] *Mancuso v. Canada (Minister of National Health and Welfare)*, 2015 FCA 227; *Zelinski v. R.* (2001) 2002 DTC 1204 (TCC), aff'd 2002 FCA 330.

[221] I have determined, based on a legal standard of what is “necessary” for the continued operation of the insurance business, and the facts particular to the Appellant, that capital at the level of the Appellant’s Operating Targets was necessary. Accordingly, I concluded that assets surplus to these levels were not “necessary”. This might have included World Surplus assets provided those assets were not, as a matter of fact, “used or held in the course of carrying on an insurance business”.

[222] On a review of the particular assets which the Appellant submits comprise World Surplus amounts, I conclude that the Appellant has not established, on a balance of probabilities, that all such World Surplus assets are to be excluded.

[223] More particularly, I have concluded that the Appellant has not established that the following World Surplus assets are to be excluded:

	2013	2014
Total World Suplus Assets in issue[179]	$277,231,000	$382,228,000
“Assets” Not on Balance Sheet	$104,234,000	$119,053,000
Divisional Top Up	$17,000,000	$18,000,000
Intangible Asset	$45,881,000	$28,150,000
Total not excluded from CIF	$167,115,000	$165,203,000
Total excluded from CIF	$ 110,116,000	$217,025,000

[224] I am satisfied that the Appellant has demonstrated that the balance of the World Surplus assets – largely the cash equivalents, bonds and other fixed term securities, stocks and other invested assets (partnership interests) held in a segregated account at State Street Bank - were not used or held by the Appellant in carrying on an insurance business. Accordingly, the amounts of $110,116,000 for the 2013 taxation year and $217,025,000 for the 2014 taxation year were incorrectly included by the Minister in computing the Appellant’s CIF.

VII. CONCLUSION

[179] The amounts of World Surplus assets before deducting the amounts of World Surplus liabilities, as the latter are not in issue.

[225] For the foregoing reasons, the appeal of the Appellant is allowed and the matter referred back to the Minister for reassessment in accordance with my reasons. More specifically, the Minister shall reassess the Appellant in respect of its 2014 Taxation Year on the basis that:

(a) World Surplus assets in the amounts of $110,116,000 for the 2013 taxation year CIF and $217,025,000 for the 2014 taxation year CIF are not to be included;

(b) assets and liabilities of the A&S Business in the amounts of $982,000 for the 2013 taxation year CIF and ($3,299,000) for the 2014 taxation year CIF are to be included; and

(c) the Appellant is correct in designating Investment Property in respect of its A&S Business pursuant to ITR paragraphs 2401(2)(b) and (d), including, pursuant to ITR paragraph 2401(2)(d), any additional Excess CIF determined in accordance with these reasons.

The Appellant has 30 days from the date of this decision to provide written submissions on costs, not to exceed 10 pages. The Respondent has a further 30 days to provide written submissions on costs in response to the Appellant’s submissions.

Signed at Toronto, this 17th day of August 2023.

“Monica Biringer”

Biringer J.

Appendix A

2018-4815(IT)G

TAX COURT OF CANADA
COUR CANADIENNE DE L'IMPÔT
Filed / Déposé
14/10/2022
Registry Officer/
agent du greffe

TAX COURT OF CANADA

BETWEEN:

THE INDEPENDENT ORDER OF FORESTERS

Appellant

- and -

HIS MAJESTY THE KING

Respondent

PARTIAL AGREED STATEMENT OF FACTS

EY Law LLP
The EY Tower
100 Adelaide Street West
P.O. Box 2
Toronto, Ontario M5H 0B3

Daniel Sandler
Marie-Claude Marcil
Osnat Nemetz

Tel: (416) 943-4434 / (514) 879-8208 / (416) 932-4864
Fax: (416) 943-2735

Counsel for the Appellant

Attorney General of Canada
Department of Justice
Ontario Regional Office
Tax Law Services Section
120 Adelaide Street West
Suite #400
Toronto, Ontario M5H 1T1

Jenna Clark / Craig Maw
Lalitha Ramachandran

Tel: (647) 256-7351 / (647) 256-7416

Fax: (416) 973-0810

Counsel for the Respondent

Received / Reçu 14/10/2022

2018-4815(IT)G

TAX COURT OF CANADA

BETWEEN:

THE INDPENDENT ORDER OF FORESTERS

Appellant

- and -

HIS MAJESTY THE KING

Respondent

PARTIAL AGREED STATEMENT OF FACTS

The parties to this proceeding admit, for the purposes of this proceeding only, the truth of the following facts referred to in the Partial Agreed Statement of Facts

The parties agree that this Partial Agreed Statement of Facts does not preclude either party from calling evidence to supplement the facts agreed to herein or to establish other facts not set out herein, it being accepted that such evidence may not contradict the facts agreed to herein.

Background

This appeal concerns the Appellant's taxation year ending December 31, 2014 (the "2014 taxation year"). The following statements refer to the Appellant's 2014 taxation year and its taxation year ending December 31, 2013 (the "2013 taxation year", collectively, with the 2014 taxation year, the "Relevant Period") unless stated otherwise.

1. The Appellant is a fraternal benefit society that was formed on May 16, 1913, under the *Federal Independent Order of Foresters Consolidated Act* (3 & 4 Geo. 5, c. 113).

2. The Appellant's address is 789 Don Mills Road, Toronto, ON M3C 1T9.

3. The Appellant's year end is December 31.

4. The origins of the Appellant precede its constitutive act and stretch back to the 1834 formation of the Ancient Order of Foresters, a United Kingdom friendly society with which the Appellant was previously affiliated.

5. The initial purpose of the Appellant was to provide mutual aid for its members and to undertake benevolent activities.

Insurance Business

6. The Appellant operates an insurance business in Canada and through a branch in the United States.

7. The Appellant's businesses comprise a life insurance business (the "Life Business") and an accident and sickness ("A&S") insurance business (the "A&S Business").

8. The Appellant's operations include the sale of insurance, including life and A&S products (the latter also known as accident & health or A&H products).

9. The Appellant was carrying on the Life Business and the A&S Business in Canada continuously throughout the Relevant Period.

10. The Appellant has subsidiaries in Canada, the United States and the United Kingdom that also sell insurance products.

11. The Appellant is subject to the *Insurance Companies Act* and is regulated in Canada by the Office of the Superintendent of Financial Institutions ("OSFI").

12. The Appellant is a "life insurer" as defined in s. 248(1) of the *Income Tax Act* (the "Act").

13. The Appellant has a Canadian life insurance business as well as a US life insurance business.

14. The Appellant sells participating life insurance policies.

15. The Appellant's participating life insurance policy holders receive dividends as declared by the Appellant in accordance with its dividend policy.

16. The appellant has a block of A&S policies in Canada.

17. The Appellant did not promote, sell or issue any new A&S policies in Canada in the Relevant Period, or thereafter.

18. As at December 31, 2014, there were 478 A&S policies remaining in force in Canada.

19. The Appellant attracts new policy holders by word of mouth, through its website and through use of promotional materials.

20. The Appellant sells its products through brokers and independent agents.

21. As at December 31, 2014 in Canada, the Appellant's total A&S insurance contract liability was about $750,000.

22. Total investment income for the Appellant's A&S policies in Canada for the 2013 taxation year was approximately $226,000 and for the 2014 taxation year was about $82,000.

23. The Appellant earned the following approximate amounts of premiums from its A&S, life insurance policies and annuities in the Relevant Period:

Year	A&S policies	Life policies and annuities	Total
2013	$27,000	$37,897,679	$37,925,274
2014	$24,000	$40,291,370	$40,314,438

24. The Appellant's life insurance business accounted for over 99.9% of its premium income in Canada during the Relevant Period.

25. The Appellant's A&S Business accounted for less than 0.1% of its premium income in Canada during the Relevant Period.

26. As set out in s. 149(3) of the Act, the Appellant is subject to Part I tax under the Act only in respect of its taxable income from the Life Business, which under s. 149(4) is computed on the assumption that it had no income or loss from any other sources.

Fraternal Activities

27. Individuals who purchase life insurance from the Appellant become members of the fraternal benefit society.

28. The Appellant provided additional benefits (i.e. fraternal benefits) to persons who bought its life insurance policies.

29. The Appellant was engaged in fraternal activities during the Relevant Period.

30. Fraternal activities included volunteer projects such as building playgrounds.

31. For Canadian income tax purposes, the Appellant did not include any income or loss from fraternal activities during the Relevant Period.

32. The Appellant's fraternal activities were not taxable and any expenses from fraternal activities could not be deducted against taxable income.

33. The Appellant's policy was to allocate up to 3% of consolidated surplus annually to fraternal operations.

34. In the Relevant Period, the Appellant allocated and used 1.9% of consolidated surplus for its fraternal operations.

World Surplus

35. In the Relevant Period, the Appellant had amounts in its books and records that were not allocated to specific operations, which were referred to as "World Surplus".

36. The "World Surplus" is a portfolio of assets owned by the Appellant.

37. The "World Surplus" was reported in the management statements prepared by the Appellant as "surplus assets".

38. The Appellant attributed expenses to "World Surplus" that were not specific to any particular division, but rather corporate wide expenses.

39. Some expenses incurred for the benefit of the Foresters group of companies were satisfied directly or indirectly by "World Surplus".

40. In the years leading up to and including the 2014 taxation year, the Appellant was developing a back-office system called collectively "Foresters in Transformation ("FIT"), including a program called "Elixir" which was intended to manage in-force life, annuity and A&S insurance policies in Canada & the US, as well as fraternal certificates.

41. The FIT development costs expensed by the Appellant in its financial statements totaled between $20M and $30M during the 2011-2014 taxation years.

42. The Appellant planned to use "Elixir" in respect of its US & Canadian insurance policies and certificates.

43. "Elixir" was not implemented and was abandoned.

44. In its books and records, the Appellant attributed the expenses relating to "Elixir" to "World Surplus".

45. The assets in "World Surplus" were used to satisfy the cost of "Elixir".

46. Reimbursements from "World Surplus" were made to cover the expenses incurred during the development of "Elixir".

47. The Appellant did not designate any of the property described as "World Surplus" to an insurance business it carried on in Canada.

48. In the event that the Appellant's capital used in support of its insurance business in Canada was approaching or below the internal targets set by the Appellant, amounts from the "World Surplus" could be transferred to its Canadian operating division.

49. Transfers could be made out of the "World Surplus" in order to bring capital adequacy ratios within divisional operating targets.

50. Transfers could be made from the "World Surplus" to the Canadian branch when capital and surplus levels fell below internal thresholds set in the Appellant's capital management policy.

Computation of CIF

51. The Appellant's reported mean "Canadian investment fund" ("CIF"), as that term is defined in s. 2400(1) of the *Income Tax Regulations* ("ITR"), for its 2014 taxation year was $717,204,813.

52. In calculating its mean CIF for its life insurance business in the 2014 taxation year, the Appellant did not include "World Surplus".

53. The Appellant calculated its CIF for its life and non-life insurance businesses together and not separately.

54. In computing its CIF at the end of the 2014 taxation year and at the end of the preceding taxation year, the Appellant included its assets and liabilities (including the Canadian reserve liabilities) associated with the A&S Business in various elements in the CIF computation, specifically:

    a. The Canadian reserve liabilities of the A&S Business in term "A" in subparagraph (a)(i); and

    b. The assets and liabilities of the A&S Business in terms "I", "J", "L", "M", and "N" in subparagraph (a)(ii).

55. In the 2014 taxation year, the Appellant designated the following amounts for its life insurance business and non-life insurance business:

	Life	Non-life	Total
Designated Amount	$516,923,660	$200,306,062	$717,229,722

56. The Appellant restricted the amount of investment property designated to its life insurance business to the mean Canadian Reserve Liabilities for the life insurance business.

OSFI

57. There are minimum regulatory capital and surplus requirements for Canadian insurers. During the Relevant Period, the minimum requirement was defined within the OSFI Minimum Continuing Capital and Surplus Requirements ("MCCSR") guideline.

58. For the Relevant Period, the Appellant maintained an internal MCCSR target that was higher than that required by OSFI.

59. The Appellant was required to provide OSFI with its financial information relating to its insurance operations, including its consolidated and non-consolidated balance sheets and statements of income and loss.

60. The Appellant reported its consolidated and non-consolidated balance sheet and statement of income and expenses to OSFI on the Life 1 form.

61. "World Surplus" was reported to OSFI by the Appellant as part of its consolidated assets and non-consolidated assets.

62. Beginning in the 2014 taxation year, OSFI also required regulated insurers to develop and report an Own Risk and Solvency Assessment ("ORSA").

63. The Appellant filed its ORSA with OSFI in the 2014 taxation year.

64. The Appellant represented to OSFI in its 2014 ORSA that one of its guiding principles was to "maintain strong external ratings at a level that allows Foresters to maintain its (Excellent) rating from A.M. Best".

Credit Rating

65. One of the Appellant's guiding principles set out in its Capital Management Policy is to "maintain strong external ratings at a level that allows Foresters to maintain its (Excellent) rating from A.M. Best".

66. A.M. Best gives financial strength ratings and credit ratings to insurance companies.

67. A.M. Best's Credit Rating ("BCAR") is an opinion regarding an insurer's relative creditworthiness.

68. A.M. Best uses BCAR to assist in its determination an insurer's credit rating.

69. A.M. Best's BCAR depicts the quantitative relationship between an insurer's balance sheet and its operating risks.

70. A.M. Best's BCAR ratio takes into account the balance sheet strength at a consolidated level.

71. A.M. Best's BCAR formula is as follows:

$$\text{BCAR} = \frac{\text{Available Capital} - \text{Net Required Capital}}{\text{Available Capital}} \times 100$$

72. A.M. Best was the only rating agency that the Appellant applied to in 2013 and 2014.

73. A.M. Best was the only rating agency that rated the Appellant in 2013 and 2014.

74. A.M. Best gave the Appellant, a "Best's Financial Strength Rating of A" and "Best's Issuer Credit Rating of a+".

75. A.M. Best describes a "Best's Financial Strength Rating of A" as being "excellent".

76. A.M. Best describes a "Best's Issuer Credit Rating of a+" as "excellent".

77. The Appellant issued press releases stating what its A.M. Best ratings were and had been for the last number of years.

78. The Appellant's promotional materials include reference to its ratings with A.M. Best.

79. The Appellant included A.M. Best's ratings in marketing materials to attract new members or to maintain current members.

80. A.M. Best gave the Appellant a high rating for financial strength based in part on the strength of its consolidated balance sheet, including the assets in "World Surplus".

81. In 2013 and 2014, the Appellant presented its consolidated balance sheet, including the assets in "World Surplus" to A.M. Best to enable it to give the Appellant a credit rating and a financial strength rating.

82. An AM Best "a+" credit rating was beneficial to the Appellant.

83. An AM Best "A" financial strength rating was beneficial to the Appellant.

Reassessment at Issue

84. The Minister of National Revenue (the "Minister") assessed the Appellant's 2014 taxation year and issued a Notice of Reassessment dated March 16, 2018.

85. The Minister assessed the Appellant's 2014 taxation year to include investment income of $11,835,090 under ss. 138(9)(a) and 142.5 of the Act.

86. The Minister assessed the Appellant's 2014 taxation year to add minimum net revenue on US assets of $13,557,891 under s. 138(9)(b) of the Act.

87. This increase to the Appellant's income was primarily the result of the Minister designating an additional $265,211,607 of property pursuant to ITR s. 2401(1)(b) on the basis that:

    a. The Minister included the amount of $378,154,000, being the value of property in the Appellant's "World Surplus" net of liabilities associated with World Surplus, in the computation of the Appellant's CIF the 2014 taxation year;

b. The Minister included the amount of $273,969,000, being the Appellant's World Surplus net of liabilities associated with World Surplus for the prior taxation year (i.e., the 2013 taxation year), in the computation of the Appellant's mean CIF (as computed under ITR s. 2412) for the 2014 taxation year; and

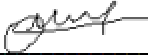
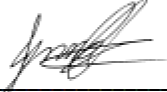
c. The Minister designated additional "investment property" (as defined in ITR s. 2400(1)) in the amount of $265,211,607 to the Appellant's Life Business in Canada under ITR s. 2401(2)(d).

88. In computing the amount included in income under s. 138(9)(b) of the Act (which was also the result of the Minister's designation of an additional $265,211,607 of property pursuant to ITR s. 2401(1)(b)), the Minister deducted the amount of $4,046,799 in term "C" of the formula in ITR s. 2411(1), being the Minister's computation under ITR s. 2411(6) of the Appellant's "cumulative excess account" at the end of the 2014 taxation year.

89. The Appellant claimed consequential and permissive adjustments including dividend deductions that became available under ss. 112 and 238 of the Act and additional capital cost allowances and additional Maximum Tax Actuarial Reserves claimed to reduce taxable income to $100.

90. The Appellant objected to the reassessment and filed a Notice of Objection dated June 5, 2018.

91. The Appellant then appealed to the Tax Court of Canada.

DATED at the City of Toronto, in the Province of Ontario, this 13th day of October 2022.	DATED at the City of Toronto, in the Province of Ontario, this 14 day of October 2022.
	
EY Law LLP	**ATTORNEY GENERAL OF CANADA**
The EY Tower 100 Adelaide Street West P.O. Box 2 Toronto, Ontario M5H 0B3	Department of Justice Ontario Regional Office Tax Law Services Section 120 Adelaide Street West Suite #400 Toronto, Ontario M5H 1T1
Per: Daniel Sandler/ Marie-Claude Marcil / Osnat Nemetz	**Per: Jenna Clark / Craig Maw / Lalitha Ramachandran**
Counsel for the Appellant	**Counsel for the Respondent**

CITATION:	2023 TCC 123
COURT FILE NO.:	2018-4815(IT)G
STYLE OF CAUSE:	THE INDEPENDENT ORDER OF FORESTERS v. HIS MAJESTY THE KING
PLACE OF HEARING:	Toronto, Ontario
DATE OF HEARING:	October 24, 25, 26, 27, 31, 2022, November 1, 2022, February 17 and 20, 2023 and written submissions of both parties received on March 27, 2023
REASONS FOR JUDGMENT BY:	The Honourable Justice Monica Biringer
DATE OF JUDGMENT:	August 17, 2023

APPEARANCES:

Counsel for the Appellant:	Daniel Sandler Marie-Claude Marcil Osnat Nemetz
Counsel for the Respondent:	Craig Maw Jenna Clark Lalitha Ramachandran

COUNSEL OF RECORD:

For the Appellant:

Name:	Daniel Sandler
Firm:	EY Law LLP Toronto, Ontario
For the Respondent:	Shalene Curtis-Micallef Deputy Attorney General of Canada Ottawa, Canada