
BETWEEN:

EQUITABLE ACCEPTANCE CORPORATION LIMITED ..... APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE ..... RESPONDENT.

1963
Sept. 27, 30
1964
Feb. 20

Revenue—Income tax—Income Tax Act, R.S.C. 1952, c. 148, ss. 11(1)(cb)(ii) and 12(1)(a) and (b)—Whether expense incurred to acquire an asset or to borrow money to be used to earn income from busines—Outlay of capital.

The appellant, a company incorporated under the laws of the Province of Ontario, was engaged in the business of purchasing conditional sales contracts and other commercial paper. In 1956 the company required additional funds in order to take advantage of business offered to it. It borrowed $200,000 from Triarch Corporation Limited on terms set out in a written agreement between the appellant, Triarch Corporation Limited and Emil E. Schlesinger, the president and controlling shareholder of the appellant who joined in the agreement as guarantor. Under the agreement, the guarantor agreed to assign to Triarch Corporation Limited, insurance policies on his life in the amount of not less than $150,000. He obtained and assigned to Triarch Corporation

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Limited two insurance policies totalling $200,000, Triarch Corporation Limited having insisted on the additional insurance when certain collateral security was not provided by the appellant. The appellant paid the premiums on the policies for 1956 and 1957 and used the proceeds of the loan in the course of its business. Subsequent to the taxation years in question, Schlesinger purchased the policies from the appellant at their cash surrender value.

The appellant claimed the premiums it paid on the two policies as deductions in computing its taxable income for 1956 and 1957.

Held: That the money borrowed by the appellant from Triarch Corporation Limited was used in the operation of the appellant's business and was an addition to the capital of the appellant, so that any payments made for the purpose of obtaining the money were outlays of capital within the meaning of s. 12(1)(*b*) of the *Income Tax Act* and are not deductible.

2. That the payment of premiums of the two policies was not an expense incurred in the course of borrowing money used by the taxpayer for the purpose of earning income from a business under s. 11(1)(*cb*)(ii) of the Act because the true nature of the transaction was that the appellant acquired an asset which was used as collateral security to borrow money to be used in its business.

3. Appeal dismissed.

APPEAL from a decision of the Tax Appeal Board.

The appeal was heard before the Honourable Mr. Justice Cattanach at Toronto.

D. K. Laidlaw and *D. Anderson* for appellant.

T. Z. Boles and *E. E. Campbell* for respondent.

The facts and questions of law raised are stated in the reasons for judgment.

CATTANACH J. now (February 20, 1964) delivered the following judgment:

This is an appeal from a judgment of the Tax Appeal Board[1] dismissing an appeal by the appellant from assessments of income tax for the taxation years ending December 31, 1956 and December 31, 1957.

The appellant is a company incorporated in 1952 pursuant to the laws of the Province of Ontario and is engaged in the business of purchasing commercial paper, particularly conditional sales agreements. It began the actual conduct of its business in 1953 and has continued to date.

The appellant was a family concern and until the year 1956 the capital used to carry on its business came from

[1] (1960) 25 Tax A.B.C. 225.

the subscription for shares of its capital stock and accommodation from its bankers.

In 1956 the appellant was unable to obtain any further money from its bankers and if the appellant were to take advantage of the opportunity of business offered to it, it was necessary to obtain substantial funds forthwith.

To this end the appellant entered into negotiations with Triarch Corporation Limited (hereinafter referred to as Triarch), which negotiations were begun in January, 1956 and culminated in an agreement dated April 30, 1956 filed in evidence as Exhibit I, between Triarch, the appellant and Emil E. Schlesinger as guarantor. At that time Emil E. Schlesinger was the president and controlling shareholder of the appellant.

This agreement provided that Triarch agreed to lend the appellant $200,000, bearing interest at the rate of 7½ percent on the principal amount from time to time outstanding, the principal to be repayable in annual instalments of $50,000 on the first day of May in each of the years 1957, 1958 and 1959 and the balance on January 1, 1960.

The agreement also provided that the appellant should assign to Triarch conditional sales agreements to an aggregate value of not less than 120 percent of the principal amount of the loan outstanding as security therefor.

In addition Emil E. Schlesinger by Clause 4 of the said agreement, undertook to pay or cause to be paid to Triarch the loan so made to the appellant.

Under Clause 5 of the said agreement the guarantor, Emil E. Schlesinger, undertook to transfer and assign to Triarch life insurance policies on his life of not less than $150,000. Clause 5 reads as follows:

> 5. The Guarantor further covenants and agrees to transfer and assign unconditionally to Triarch as an assignee for value, a policy or policies of insurance on the life of the Guarantor to an aggregate amount of not less than $150,000, such policy or policies to be issued by an insurer or insurers acceptable to Triarch.

Despite the fact that the obligation to transfer and assign life insurance policies on the life of the guarantor to Triarch was that of the guarantor, Emil E. Schlesinger, the appellant applied for and obtained two policies of insurance on the life of Emil E. Schlesinger, copies of which were introduced in evidence as Exhibits "A1" and "A2", which were subsequently assigned to Triarch by the appellant.

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The particulars of the two insurance policies so applied for and obtained by the appellant are as follows:

(1) *First Policy*

Insurer—The Manufacturers Life Insurance Company.
Policy No. 1370963
Amount, $150,000

Plan of Insurance—	Preferred Whole Life—annual dividends. Double Indemnity Accident Provisions.
Premium payable—	$6,811.50 of which $247 50 covers double indemnity.
Life insured—	Emil E. Schlesinger
Beneficiary—	the Appellant

Date of application by appellant—March 14, 1956
Date of issue of policy—April 2, 1956
Date of assignment by the appellant to Triarch—May 2, 1956.

(2) *Second Policy*

Insurer—The Manufacturers Life Insurance Company.
Policy No. 1374450
Amount, $50,000

Plan of Insurance—	Preferred Whole Life—annual dividends.
Premium payable—	$2,188
Life insured—	Emil E. Schlesinger
Beneficiary—	the Appellant

Date of application by the appellant—April 26, 1956
Date of issue of policy—May 1, 1956
Date of assignment by the appellant to Triarch—March 20, 1957.

Each policy upon being in force acquired a cash value calculated upon the length of time in effect in accordance with tables set forth in each policy. At the end of 1957 the cash values of the policies were respectively, $1350 and $450, a total of $1800.

Emil E. Schlesinger underwent the requisite medical examinations prescribed by the insurer and executed an assent to the application being made by the appellant for insurance on his life.

Triarch advanced the loan to the total amount of $200,000 agreed upon to the appellant in stages, $100,000 on May 2, 1956, $50,000 on July 31, 1956 and $50,000 on August 23, 1956.

In addition, the appellant borrowed a further $50,000 from Triarch on October 23, 1956 for a six month term which loan was repaid on April 1, 1957.

Clause 5 of the agreement, Exhibit I, provided for the assignment and transfer by the guarantor of life insurance policies on the guarantor's life "to an aggregate amount of not less than $150,000." However, the policies above de-

scribed which were obtained and assigned by the appellant to Triarch were in the aggregate amount of $200,000. It was explained in evidence that Triarch had insisted on other additional collateral security from the appellant which the appellant was unwilling to provide and accordingly, by agreement between the appellant and Triarch, the amount of the insurance on the life of the guarantor, Emil E. Schlesinger was raised to $200,000.

The appellant paid the premiums on the above described insurance policies in the taxation years 1956 and 1957 and used the loan advanced to it by Triarch to purchase conditional sales agreements and like negotiable paper in the course of its business.

In compiling its income tax returns for the years ending December 31, 1956 and 1957 the appellant sought to deduct from income the premiums it had paid upon the life insurance policies above described.

The Minister disallowed as a deduction the appellant's claim of the amount of the life insurance premiums it had paid. No exception was taken to the disallowance by the Minister of the double indemnity accident assurance premiums amounting to $247.50 in each of the years ending December 31, 1956 and 1957 as a deduction, but by notice dated November 26, 1958 the appellant objected to the disallowance of the deduction of the balance of the life insurance premiums which it had paid.

By notification dated May 19, 1959 the Minister confirmed the assessments as having been made in accordance with the *Income Tax Act* and in particular on the ground that,

> insurance premiums amounting to $8,999 50 in 1956 and $7,869.48 in 1957 claimed as deductions from income were not outlays or expenses incurred by the taxpayer for the purpose of gaining or producing income within the meaning of paragraph (*a*) of subsection (1) of section 12 of the Act; that the said premiums were not expenses incurred in the course of borrowing money used for the purpose of earning income within the meaning of paragraph (*cb*) of subsection (1) of section 11 of the Act.

The Tax Appeal Board dismissed an appeal and upheld the relevant assessments. It is from that decision the appellant now appeals to this Court.

The issue in the case is a very narrow one, namely, whether the amounts of the premiums paid by the appellant on the insurance on the life of its president, Emil E.

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Schlesinger constituted an expense incurred in the year in the course of borrowing money used by the appellant for the purpose of earning income from its business within the meaning of section 11 (1) (*cb*)(ii) of the *Income Tax Act* which provides:

> 11. (1) notwithstanding paragraphs (*a*), (*b*) and (*h*) of subsection (1) of section 12, the following amounts may be deducted in computing the income of a taxpayer for a taxation year;
>
> . . .
>
> (*cb*) an expense incurred in the year,
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> . . .
>
> (ii) in the course of borrowing money used by the taxpayer for the purpose of earning income from a business or property . . .

It was contended alternatively on behalf of the appellant that the payment by it of the life insurance premiums constituted an outlay or expense made or incurred by it for the purpose of gaining or producing income from its business within the meaning of the exception expressed in section 12(1)(*a*) of the Act and is, therefore, outside the prohibition of the section and that the payments were not capital outlays within the meaning of section 12(1)(*b*).

The provisions of section 12(1)(*a*) and 12(1)(*b*) are as follows:

> 12. (1) In computing income, no deduction shall be made in respect of
>
> (*a*) an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from property or a business of the taxpayer,
>
> (*b*) an outlay, loss or replacement of capital, a payment on account of capital or an allowance in respect of depreciation, obsolescence or depletion except as expressly permitted by this Part,
>
> . . .

The evidence clearly established that the money borrowed by the appellant from Triarch was forthwith deposited in the appellant's bank account and was used in the operation of the appellant's business. The loan was not comparable to mere temporary accommodation from the appellant's bankers, but was rather an addition to the capital of the appellant.

Any payments for the purpose of obtaining capital are outlays of capital within the meaning of section 12(1)(*b*).

Therefore, it is quite clear the payment of premiums on the life insurance policies is not deductible unless it falls within the express terms of section 11(1)(*cb*)(ii) of the

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Act and the issue for determination is whether the said payment of the life insurance premiums constituted an expense incurred in the year in the course of borrowing money.

Section 11(1)(*cb*) was enacted by section 1(1) of chapter 54, Statutes of 1954-5 and made applicable to the 1955 and subsequent taxation years and enables the deduction of expenses normally incurred in raising funds by borrowing which were not previously deductible because they were not directly related to the earning of income and were of a capital nature.

In my view the cost of the purchase of the two life insurance policies and the maintenance in force thereof by the payment of premiums is not an expense incurred in the year in the course of borrowing money used by the taxpayer for the purpose of earning income from a business. While it is true that the purchase of these life insurance policies and their assignment to Triarch was a condition imposed by Triarch before making the loan to the appellant, nevertheless the true nature of the transaction was that the appellant acquired an asset which could be used, and was in fact used, as a collateral security necessary to borrow money to be used in its business. In short, the appellant, by the purchase of the two insurance policies, merely enhanced its position as a reliable lending risk.

If the insured, Emil E. Schlesinger, had died while the policies were in force and before the repayment of the loan, the appellant would then be in the position of the loan being fully paid from the proceeds of the insurance policies and the amount of the loan received by the appellant would become part of the appellant's assets without any corresponding debit entry. Again if the proceeds were in excess of the amount required to repay the loan, then any such excess would have accrued to the appellant's assets. Further when the loan was repaid, as it was, there was nothing to prevent the appellant from securing another loan from the same or a different source on the strength of the security of the two life insurance policies, if the necessity arose.

It is interesting to note that subsequent to the taxation years and upon repayment of the loan made by Triarch to the appellant, Triarch reassigned the life insurance policies, to the appellant and when, in 1962, the controlling

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share interest in the appellant changed hands, the insured, Emil E. Schlesinger, purchased the life insurance policies on his life from the appellant at the cash surrender value of that time, the appellant thereby realizing upon the asset acquired by it.

For the foregoing reasons, I am of the opinion that the premiums paid by the appellant under the terms of the insurance policies on the life of its president, Emil E. Schlesinger, did not constitute an expense incurred in the course of borrowing money within the meaning of section 11(1)(*cb*)(ii) of the Act from which it follows that those payments are not deductible.

The Minister was, therefore, right in assessing the appellant as he did and its appeal herein must be dismissed with costs.

Judgment accordingly.