T-2188-88

OTTAWA, ONTARIO, NOVEMBER 28, 1996

PRESENT: TREMBLAY-LAMER J.

BETWEEN:

**MUTUELLE DES FONCTIONNAIRES DU QUÉBEC**

Plaintiff

- and -

**HER MAJESTY THE QUEEN**

Defendant

**O R D E R**

The plaintiff's appeal is dismissed, with costs.

"Danièle Tremblay-Lamer"

J.

Certified true translation

Christiane Delon

T-2188-88

BETWEEN:

**MUTUELLE DES FONCTIONNAIRES DU QUÉBEC**

Plaintiff

- and -

**HER MAJESTY THE QUEEN**

Defendant

**REASONS FOR DECISION**

**TREMBLAY-LAMER J.**

The plaintiff, La Mutuelle des fonctionnaires du Québec, is appealing a decision of the Chief Judge of the Tax Court of Canada, who dismissed its appeal in relation to a notice of reassessment issued in regard to it for the 1983 taxation year. It is an appeal *de novo*.

## I. The facts

The plaintiff, La Mutuelle des fonctionnaires du Québec (hereinafter "La Mutuelle"), is an insurance company specializing in group insurance. Since January 1, 1976, La Mutuelle and Assurance-vie Desjardins have been co-insurers under a master group insurance contract (their respective responsibilities are 75% and 25%) covering the Fédération nationale des enseignants et enseignantes du Québec (hereinafter "the Fédération"). This contract has since 1977 been renewed on January 1 of each succeeding year.

In 1980 the master contract was revised. The concept of an experience credit calculation and a long-term disability insurance coverage refund was introduced at that time. A few years later, it was again revised. The refund credit was however maintained in its initial form. The contract, as revised at the beginning of 1983, stipulates that the

return is to be calculated during the 90 days following the end of the insurance period to which it pertains, and the years 1983, 1984 and 1985 constitute a single insurance period under the contract.

The major purpose of the return credit formula is to return to the policyholders the surpluses or profits realized during an insurance period. Under clause 3.1 of Schedule 1 of the master contract,[1] the surplus corresponds to the total premiums paid by the policyholders and the interest credits, minus (a) the amount of the claims paid, (b) the amount of the reserve for claims incurred but not reported, (c) the increase in the reserve for claims pending, (d) the increase in the other reserves, (e) the amount of the retention charges, and (f) the balance of any previously accumulated deficits. The remainder is a surplus which, under clause 3.1, must be deposited in a stabilization fund, which is defined in clause 3.10 of the Schedule. The stabilization fund may not exceed a maximum level. When it attains its maximum permissable level, any additional amount is considered a refund, which is to be returned to the policyholders. This refund bears interest at the rate prescribed in the schedule. At issue in this appeal is a refund of this nature.

Applying the principles in clauses 3.1 and 3.10 of schedule 1 of the master contract to its 1983 fiscal year, La Mutuelle established as an expenditure a refund of $820,907, which, as we previously noted, represented an amount that was to be returned to the policyholders. While the total amount of the refund was $1,026,133, La Mutuelle, being responsible for only 75% of the contract, retained only 75% of this amount, or $820,907, as an expenditure. By a notice of assessment dated July 10, 1985 the Minister of National Revenue disallowed the deduction. La Mutuelle filed an objection to this notice of assessment. On August 21, 1986 a notice of reassessment was issued, but the disallowance of the $820,907 deduction was maintained. La Mutuelle appealed this ruling to the Tax Court of Canada.

## II. Relevant statutory provisions

[1] Exhibit D-1.

The resolution of this dispute lies primarily if not exclusively in the construction of section 140 of the *Income Tax Act*[2] (hereinafter the "Act"), which at the relevant time provided:

> 140. In computing the income for a taxation year of an insurance corporation, whether a mutual corporation or a joint stock company, from carrying on an insurance business other than a life insurance business, there may be deducted every amount credited in respect of that business for the year to a policyholder of the corporation by way of dividend, refund of premiums or refund of premium deposits if the amount was, during the year or within 12 months thereafter,
> (a)paid to the policyholder,
> (b) applied in discharge, in whole or in part, of a liability of the policyholder to pay premiums to the corporation, or
> (c) credited to the account of the policyholder on terms that he is entitled to payment therof on or before expiry or termination of the policy.

## III. Decision of the Tax Court of Canada judge[3]

Chief Judge Couture explained, first, that the fact the refund is calculated during the 90 days after the end of the insurance period does not contravene the letter or spirit of section 140 of the Act, in his opinion. Equally consistent with the letter of section 140 of the Act is the fact that a refund was determined on December 31, 1983 notwithstanding clause 3.1 of the contract, according to which 1983, 1984 and 1985 are supposed to constitute only a single insurance period. Nor was it contrary to section 140 that the refund was determined not only under the formula set out in the contract but also under the rules of the Canadian Institute of Actuaries. In the opinion of Chief Judge Couture, the difficulty for the plaintiff lies in the term requiring that the amount must have been, during the 12 months following the end of the insurance period, paid to the policyholder, applied in discharge of his liability to pay premiums, or credited to his account on terms that he is entitled to payment thereof on or before expiry or termination of the policy. In fact, he says he is of the opinion that this requirement was not met:

> The evidence has established clearly that the $820,907 was part of the appellant's liabilities and constituted an obligation under the contract for the appellant, but there is no evidence to the effect that this amount was credited to the insured.... No one from the Fédération testified that during the twelve months following 1983 this sum was either:

---

[2] R.S.C. 1952, c. 148, as amended by S.C. 1970-71-72, c. 63 and subsequent amendments.

[3] *La Mutuelle des Fonctionnaires du Québec v. The Minister of National Revenue (Respondent)*, (August 4, 1988), 89 D.T.C. 504.

(a)paid to the insured;
(b) applied in discharge, in whole or in part, of a liability of the insured to pay premiums to the corporation; or
(c) credited to the account of the insured on terms that he is entitled to payment therof on or before expiry or termination of the policy, pursuant to section 140. [emphasis added by Couture C.J.T.C.]

The refund was not, during the 12 months following December 31, 1983, paid to the policyholder, applied in discharge of its liability to pay premiums, or credited to its account. On the contrary, in the opinion of Couture C.J.T.C., the evidence shows that the refund was paid to the policyholders only in 1986. Since the plaintiff had failed to demonstrate that it was entitled to the deduction under section 140 of the Act, its appeal was dismissed.

## IV. Parties' submissions

The plaintiff's submissions are as follows. It explains, first, that the refund was calculated in accordance with the formula in the contract. The $820,907 was its contributory share (75%) in the refund. In determining the refund, the rules of the Canadian Institute of Actuaries were followed. For accounting purposes this refund ought to be considered an expense and accordingly appear in the liabilities column of the financial statements. The refund is determinate, it bears interest, it is payable at the end of the contract and the terms of payment are those provided for in the *Civil Code of Québec* and the contract.

Plaintiff's counsel argues that the $820,907 belonged to the policyholder (as representative of all the insured) from 1983 on, since the evidence shows unequivocally that the debt was owing to it at that date. Any other interpretation would create a distortion since it would effectively increase La Mutuelle's income for 1983 by $820,907, although that money did not belong to it. The refund, as determined by the actuaries, was correctly deducted, in accordance with the requirements of the Act.

The defendant submits that the amount was not credited to the policyholder since there was no obligation under the contract to calculate this amount each year. On

the contrary, the evidence simply testifies to "an illustration of experience" in 1983. The calculation of the refund will be made only at the end of the insurance period.

Furthermore, under the contract the surpluses must be deposited in a stabilization fund. When this fund attains the maximum level, any additional amount will be considered a refund. In 1983 it was impossible to know what the amount of the refund would be at the end of the insurance period. A deficit was even possible at the end of this period, and this would have had to be paid by the plaintiff.

The words "credited to the account of" the policyholder must be given to mean "put at the disposal of". But there is no evidence in the record that at the end of 1983 the amount was in fact at the disposal of the policyholder.

## V. The issue

This dispute bears solely on the construction of paragraph 140(c) of the Act. Was the refund credited to the account of the policyholder in 1983 or within 12 months thereafter?

## VI. Analysis

The plaintiff argues that when determining whether a sum has been credited to the account of the policyholder, it is necessary to refer to generally recognized accounting principles. Under those principles, once a sum, because it constitutes a contractual liability, appears in the liabilities column of the financial statements, it must be considered as having been credited to the account of the person to whom it is destined.

The expression "credited to" has been the subject of several decisions rendered by the Tax Court of Canada.

They show, in my view correctly, how the expressions "to credit" or "credit to the account" should be construed.

A finance company, when it adds the interest it owes a client to his account each month, credits the sums to that client's account. That is what was held in *Solomon Hart Green v. Minister of National Revenue*.[4] The judgment notes the importance of the positive act by which the sums are placed at the disposal of a third person.

The Tax Court of Canada expressed itself similarly in *La Compagnie Minière Québec Cartier v. Ministre du Revenu National*.[5] The issue in that case involved determining whether a sum had been credited to a third party. Tremblay J. expressly rejected the argument that is being advanced by the plaintiff in the case at bar:

> [*Translation*]
> The Court instead regards an accounting system as a form for describing business transactions. By saying "credited to", was Parliament trying to focus on the form? Or was it trying to focus on the substance?
>
> I am rather inclined to think it was the latter. And the substance of "crediting to" or "crediting" seems instead to be "an operation by which someone puts a sum of money at the disposal of someone else."

Can one conclude, from the mere fact that, in the case at bar, the $820,907 appears in the liabilities of La Mutuelle and bears interest, that in 1983 that sum was in fact at the disposal of the policyholder?

I do not think so. The policyholder (for its insured) had no control over this sum in 1983 or during the 12 months thereafter. The evidence discloses that the sum in question is but an "illustration of experience".[6] The plaintiff's witnesses confirmed that the approximate amount for 1983 was cumulative with that of subsequent years, so that the exact amount of the refund could not be definitively known until the end of the insurance period. In fact, it was possible that the amount of the refund would be equal to zero if the claims paid out happened to eliminate the stabilization fund. The estimated amount in 1983 would yield a right to payment only if there was a surplus.

---

[4] 50 D.T.C. 320.

[5] 84 D.T.C. 1349 at 1366.

[6] See clauses 3.1 to 3.10 of schedule 1 of the master contract (Exhibit D-4).

As my colleague Noël J. stated, in *J.L. Guay Ltée v. Minister of National Revenue*:[7]

> In most tax cases only amounts which can be exactly determined are accepted. This means that ordinarily provisional amounts or estimates are rejected, and it is not recommended that data which is conditional, contingent or uncertain be used in calculating taxable profits.

Furthermore, it is conceded that in the event of a deficit in the stabilization fund,[8] it is La Mutuelle and not the policyholder (acting on behalf of the insured) that would have had to dig into its own funds to honour its obligations under the contract. It is hard for me to see how, in such a situation, it can be stated that back in 1983 the money had been credited to the policyholder's account.

The fact that a sum is included in the liabilities as a "provision for refund" is not, *per se*, a sufficient positive act to warrant a finding that this sum was in fact credited to the policyholder's account.

I do not think it is necessary to linger on the distinction between the policyholder and the insured, since the sum was not, in my opinion, credited to the account of either the policyholder or the insured.

For these reasons, the plaintiff's appeal is dismissed with costs.

---

[7] 71 D.T.C. 5423 (F.C.T.D.).

[8] Testimony of Mr. Twedell.

OTTAWA, Ontario
November 28, 1996

"Danièle Tremblay-Lamer"

J.

Certified true translation

Christiane Delon

**FEDERAL COURT OF CANADA**
**TRIAL DIVISION**

**NAMES OF COUNSEL AND SOLICITORS OF RECORD**

FILE NO. T-2188-88

STYLE:MUTUELLE DES FONCTIONNAIRES DU QUÉBEC
v.
HER MAJESTY THE QUEEN

PLACE OF HEARING:QUÉBEC, QUEBEC

DATE OF HEARING:OCTOBER 24-25, 1996

REASONS FOR DECISION OF TREMBLAY-LAMER J.

DATED:NOVEMBER 28, 1996

APPEARANCES:

JACQUES CÔTÉFOR THE PLAINTIFF

ROGER ROYFOR THE DEFENDANT

SOLICITORS OF RECORD:

Jacques RoyFOR THE PLAINTIFF
HICKSON, MARTIN
BLANCHARD, S.e.n.c.
1170, chemin St-Louis
SILLERY, Quebec
G1S 1E5

George ThomsonFOR THE DEFENDANT
Deputy Attorney General of Canada
Ottawa, Ontario