Dockets: 2012-1431(IT)G
2013-203(IT)G

BETWEEN:

THE STANDARD LIFE ASSURANCE
COMPANY OF CANADA,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on October 6, 7, 8, 9, 2014 and March 26 and 27, 2015, at Toronto, Ontario

Before: The Honourable Justice F.J. Pizzitelli

Appearances:

Counsel for the Appellant:	Hemant Tilak Pooja Samtani Al Meghji Alexander Cobb Victoria Creighton
Counsel for the Respondent:	Naomi Goldstein Stephen Oakey Jenna Clark

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JUDGMENT

The appeal from the reassessments made under the *Income Tax Act* for the 2006 and 2007 taxation years is dismissed with costs to the Respondent.

Signed at Ottawa, Canada, this 20th day of April 2015.

"F.J. Pizzitelli"

Pizzitelli J.

Citation: 2015 TCC 97
Date: 20150420
Dockets: 2012-1431(IT)G
2013-203(IT)G

BETWEEN:

THE STANDARD LIFE ASSURANCE
COMPANY OF CANADA,

Appellant,

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Respondent.

REASONS FOR JUDGMENT

Pizzitelli J.

[1] The Appellant, a Canadian resident corporation carrying on the business of life insurance in Canada, appeals from reassessments of the Minister of National Revenue (the "Minister") for the 2006 and 2007 taxation years, which effectively reduced the Appellant's cost base of its designated insurance property in both years resulting in increases in taxable income on such property pursuant to Part I of the *Income Tax Act* (the "*Act*").

[2] For the 2006 taxation year, the Minister reassessed the Appellant so as to reduce the cost base of the property in question by $1,160,214,582 resulting in an increase in taxable income from $66,550,675 to $78,966,698. For the 2007 taxation year, the Minister reassessed so as to increase the Appellant's taxable income as a result of the 2006 downward adjustment in cost base of the relevant property which carried over to 2007 and which I will discuss in more detail later. The change in cost base had of course consequential impact on not only taxable income but on reserve levels, interest accrued and related items, all of which flow from the same adjustment and are reflected in the reassessments in question.

[3] The parties entered into a Statement of Agreed Facts before trial which is attached as Appendix A to this decision. Most of the facts and evidence in dispute

relate to the factual issue as to whether the Appellant carried on business in Bermuda in 2006 and 2007 and will be discussed during analysis of that issue.

[4] The key issue to be decided in these appeals, which were heard at the same time and on common evidence, is whether the Minister correctly reduced the Appellant's cost base of certain of its properties on the basis that the Appellant was not entitled to a bump in its cost base due to the inapplicability of subsection 138(11.3) of the *Act*.

[5] Before discussing the position of the parties it is necessary to understand the provisions of subsection 138(11.3) of the *Act*, which reads as follows:

> **138(11.3) Deemed disposition**. Subject to subsection (11.31), where a property of a life insurer resident in Canada that carries on an insurance business in Canada and in a country other than Canada or of a non-resident insurer is
>
> (*a*) designated insurance property of the insurer for a taxation year, was owned by the insurer at the end of the preceding taxation year and was not designated insurance property of the insurer for that preceding year, or
>
> (*b*) not designated insurance property for a taxation year, was owned by the insurer at the end of the preceding taxation year and was designated insurance property of the insurer for that preceding year,
>
> the following rules apply:
>
> (*c*) the insurer is deemed to have disposed of the property at the beginning of the year for proceeds of disposition equal to its fair market value at that time and to have reacquired the property immediately after that time at a cost equal to that fair market value,
>
> (*d*) where paragraph (*a*) applies, any gain or loss arising from the disposition is deemed not to be a gain or loss from designated insurance property of the insurer in the year, and
>
> (*e*) where paragraph (*b*) applies, any gain or loss arising from the disposition is deemed to be a gain or loss from designated insurance property of the insurer in the year.

[6] The definition of "designated insurance property" is found in subsection 138(12) which reads as follows:

> **"designated insurance property"** – "designated insurance property" for a taxation year of an insurer (other than an insurer resident in Canada that at no time in the year carried on a life insurance business) that, at any time in the year, carried on an insurance business in Canada and in a country other than Canada, means property determined in accordance with prescribed rules except that, in its application to any taxation year, "designated insurance property" for the 1998 or a preceding taxation year means property that was, under this subsection as it read in its application to taxation years that ended in 1996, 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;

[7] In brief, the relevant portions of the subsection provide that where property of a life insurer resident in Canada that carries on an insurance business in Canada and in a country other than Canada, is designated insurance property of the insurer for a taxation year, was owned by the insurer at the end of the preceding taxation year but was not designated insurance property of the insurer for that preceding year, then the insurer is deemed to have disposed of that property at the beginning of the year for fair market value proceeds and to have reacquired it for such fair market value without having to realize a gain or loss from the deemed disposition. The result is a bump up in the cost base of the property in question at the beginning of the year to its fair market value for the purpose of calculating any gain or loss on it for the year in which a gain or loss is triggered.

[8] The Appellant takes the position that it has met all the conditions of the subsection; namely that it is a life insurer corporation resident in Canada that for both 2006 and 2007 carried on an insurance business in both Canada and Bermuda through a branch. It argues that it meets the conditions, as a matter of fact and as deemed under subsection 138(1). Further it argues that it designated property in each of 2006 and 2007 that was owned by it in the preceding year but not designated in the preceding year and hence argues on the basis of statutory interpretation that it qualified for the cost base bump up in question. In the alternative it argues that it was entitled to the cost base bump up on property designated in 2007 only.

[9] The Respondent argues that the provision does not apply to the Appellant for two reasons, namely:

1) that the Appellant did not carry on business in Bermuda either in 2006 or 2007, but only gave the "illusion" of doing so through transactions that were "window dressing" as set out in its Replies; and

2) that the subsection 138(11.3) did not apply even if it did carry on business in Bermuda in one or both of the years in question, so there could be no bump up in cost base. More specifically the Respondent says that for 2006 the properties in question could not have been "designated" in the preceding year since there is no dispute that in 2005 the Appellant admittedly did not carry on business in Bermuda. In effect, the Respondent is saying that an insurer cannot take a bump up in the first year of its branch operations in another country as an insurer must carry on the business of a multinational life insurer in both the year of designation and the preceding year. For 2007, the Respondent argues that the Appellant could only have taken a bump in cost base had there been a change in investment assets forming part of the designated insurance property in 2007 from those designated in 2006, which in fact there was not since the same such assets were designated in both years.

[10] As earlier indicated, most of the evidence, both in the Statement of Agreed Facts and from the testimony of several witnesses, deals with the factual dispute as to whether the Appellant in fact carried on a business in Bermuda in 2006 and/or 2007, by addressing generally the indicia of commerciality through positive acts or lack of activity or supporting documents entered into evidence; that is, the "window dressing" as referred to by the Respondent. Even though the issue may be moot if it is found subsection 138(11.3) did not apply to either 2006 or 2007, I intend to address the factual issue regardless of the outcome of the first legal issue.

A. The Legal Interpretation Issue

[11] As per the Statement of Agreed Facts, the Appellant did not carry on business in Bermuda, or any other country other than Canada, during its 2005 taxation year. In such prior year, the Appellant only carried on a life insurance business in Canada.

[12] If, as the Respondent contends, property can only be designated property for a year when the Appellant carried on business both in Canada and a country other than Canada in the preceding year, the Appellant would fail in its appeal for at least 2006 as it did not carry on a business in 2005. It will possibly fail in 2007 if it is also found, on the factual issue, that it did not carry on business in Bermuda in 2006 and 2007. The Respondent also argues that if the Appellant is not successful on the legal issue in 2006, then it might also fail in 2007 because there was no

change to the list of designated insurance properties so as to merit a bump up in cost base in 2007, which the Appellant disputes.

[13] The parties both argue that the plain meaning of the subsection's text supports their position and should be sufficient to decide the issue. In the event I find there is ambiguity as to the plain meaning of the text, they argue that regard must be had to the contextual and purposive approach which each argues also supports their position. Both rely on and agree that the rules for statutory interpretation were summarized by the Supreme Court of Canada in *Canada Trustco Mortgage Co. v Canada*, [2005] 2 SCR 601, 2005 SCC 54 at paragraph 10:

> … The interpretation of a statutory provision must be made according to a textual, contextual and purposive analysis to find a meaning that is harmonious with the Act as a whole. When the words of a provision are precise and unequivocal, the ordinary meaning of the words plays a dominant role in the interpretive process. On the other hand, where the words can support more than one reasonable meaning, the ordinary meaning of the words plays a lesser role. The relative effects of ordinary meaning, context and purpose on the interpretive process may vary, but in all cases the court must seek to read the provisions of an Act as a harmonious whole.

[14] If the textual, contextual and purposive ("TCP") approach renders an interpretation that is still ambiguous, the Appellant argues and the Respondent does not dispute that the provision must be interpreted in favour of the Appellant in accordance with the dictum that "… reasonable uncertainty or factual ambiguity resulting from lack of explicitness in the statute should be resolved in favour of the taxpayer," as stated by the Supreme Court of Canada decision of *Johns-Manville Canada Inc. v The Queen*, [1985] 2 SCR 46, 85 DTC 5373 at page 5384.

[15] I will start by an analysis of the textual or "plain meaning" of the subsection and thereafter with an analysis of the contextual and purposive approach referred to in *Canada Trustco* above.

1. Textual or "Plain Meaning" Approach

[16] The preamble of the subsection in question reads as follows:

> **138(11.3) Deemed disposition**. Subject to subsection (11.31), where a property of a life insurer resident in Canada that carries on an insurance business in Canada and in a country other than Canada or of a non-resident insurer is …

[17] The subject of the preamble is the "property" which is described as being "of" and thus effectively belonging to an owner having the following traits:

1) the owner must be a life insurer resident in Canada; and

2) that same owner, i.e. the "life insurer" must carry on an insurance business both in Canada and a country other than Canada.

[18] In other words, the owner of the property must logically be a multinational life insurer before the remaining requirements are met. In paragraph 138(11.3)(*a*) for example, the provision uses the words "the insurer" in each of the three phrases that set out the other conditions applicable to the subject property that must be met, namely:

1) the property of <u>the insurer</u> is designated insurance property for the taxation year;

2) the property was owned by <u>the insurer</u> at the end of the preceding taxation year; and

3) the property was not designated insurance property of <u>the insurer</u> in the preceding year.

[Underlined for Emphasis]

[19] In each case, <u>the insurer</u> refers to <u>the insurer</u> described in the preamble, the one who must, an absolute condition and not an optional one, carry on an insurance business both in Canada and another country. The "insurer" with these qualities flows to the phrases below the preamble in paragraph (*a*), which sets the three conditions pertaining to the <u>property</u> itself rather than the owner of it, who is already defined by the preamble. [Underlined for Emphasis]

[20] The French version of the subsection is as follows:

> **138(11.3) Présomption de disposition** – Sous réserve du paragraphe (11.31), lorsque le bien d'un assureur sur la vie résidant au Canada qui exploite une entreprise d'assurance au Canada et à l'étranger ou le bien d'un assureur non-résident remplit l'une des conditions suivantes:…
>
> a) il est un bien d'assurance désigné de l'assureur pour une année d'imposition qui, bien que lui appartenant à la fin de l'année d'imposition

précédente, n'était pas son bien d'assurance désigné pour cette année précédente,

b) il n'est pas un bien d'assurance désigné pour une année d'imposition, mais appartenait à l'assureur à la fin de l'année d'imposition précédente et était son bien d'assurance désigné pour cette année précédente,

les règles suivantes s'appliquent:

c) l'assureur est réputé avoir disposé du bien au début de l'année pour un produit de disposition égal à sa juste valeur marchande à ce moment et l'avoir acquis de nouveau immédiatement après ce moment à un coût égal à cette juste valeur marchande;

d) en cas d'application de l'alinéa a), le gain ou la perte éventuel découlant de la disposition est réputé ne pas être un gain ou une perte provenant d'un bien d'assurance désigné de l'assureur pour l'année;

e) en cas d'application de l'alinéa b), le gain ou la perte éventuel découlant de la disposition est réputé être un gain ou une perte provenant d'un bien d'assurance désigné de l'assureur pour l'année.

[21] I also agree with the Respondent that the French version of the text refers to the property as "son bien", with "son" being a possessive pronoun referring to the "l'assureur" or insurer, confirming the English interpretation that the property is that of the same insurer, the one who must be a multinational life insurer resident in Canada at all the relevant times.

[22] Accordingly, I cannot agree with the Appellant's contention that the Respondent's plain meaning interpretation would require we read into it the words found in requirement number 3 from paragraph [18] above "was not designated insurance property" as reading "was not designated insurance property but could have been designated insurance property". It is simply not necessary to read those words in as it follows that if we substitute the words describing "the insurer" in the preamble as the "life insurer resident in Canada that carries on an insurance business in Canada and in a country other than Canada" in requirement number 2 from paragraph [18] above so that the phrase reads "the property was owned by the life insurer resident in Canada that carried on an insurance business in Canada and in a country other than Canada at the end of the preceding taxation year", then such insurer must have been able to make the designation in the previous year for the purposes of the said requirement in number 3 above based on the definition of "designated insurance property" in subsection 138(12) above, which requires the insurer be a multinational life insurer resident in Canada to make the designation.

[23] It follows that, since the Appellant was not a multinational insurer in 2005, it did not and could not make any designation for that year and hence the property was not "designated or not designated" for the purposes of subsection 138(11.3) for the previous year. It simply did not fall within the scheme of the provision. The Appellant may have designated the property in 2006 once it was a multinational life insurer resident in Canada, but it did not and could not do so in 2005 as it was not a multinational then. I use the words the Appellant "may" have been a multinational life insurer in 2006 above because there is factual disagreement as to whether it was carrying on an insurance business in Bermuda in 2006, which remains to be decided at this point. Consequently the Appellant's position that the property must either be "designated" or "not designated" in the previous year is not accurate. I agree with the Respondent that there is a third option, namely that it is neither.

[24] I also agree with the Respondent that it is the Appellant's interpretation of the provision that would require adding words, as highlighted and underlined below, to the end of the provision so it would read "… was not designated insurance property of the insurer for that preceding year **even though the property was not owned by a multinational insurer in the preceding year**". Clearly no such wording exists.

[25] I agree with the Respondent's argument that subsection 138(11.3) only applies to the property of multinationals that was designated or not designated, in a year when it was a multinational. In my opinion, there is simply no real and reasonable ambiguity at the textual level that merits any further analysis of the contextual and purposive approach referenced in *Canada Trustco*. The Appellant agreed it was not a multinational insurer in 2005 and hence could not satisfy the condition in the aforesaid requirement number 2 from paragraph [18] above that it owned the property in the preceding year as a multinational life insurer and could not have "not designated" the property in the previous year to comply with the requirement number 3 from paragraph [18] above as there was no way or ability to do so. Consequently, as the Appellant did not meet the requirements of subsection 138(11.3) in 2006, it could not rely on the deemed disposition rule in that subsection and its cost base for such property could not be bumped to the fair market value for the 2006 year, and its appeal for such year must fail.

[26] The next question to be asked is whether the plain meaning of the subsection would allow a bump up in cost base for the 2007 year if the Appellant is found to have carried on business in Bermuda in the 2006 year. In 2007 the Appellant designated virtually the same investment assets it designated in 2006, which

constituted 100 percent of its investment assets, so there was no actual change in the assets designated. The Respondent takes the position that subsection 138(11.3) operates to bump up cost base only when there has been a change in the designated assets or "change in use" of same; or in other words when different investment assets come into or leave the designated list. The Appellant argues that the bump occurs automatically once investments first become designated, so if it is found the Appellant carried on business in Bermuda and hence another country in 2006, so as to meet that condition, the designation that occurred in 2007 would bring those investment assets into "designated insurance property" and they would be deemed to have been disposed of on January 1, 2007 at fair market value and its cost base would be the same, leading to a bump in cost base.

[27] The Appellant is in fact using the same argument of interpretation it used to justify its position for the 2006 taxation year above, save and except that for 2007 it argues that the issue of whether it was a multinational in the previous year is no longer a factor. I do not agree with the Appellant's position with respect to 2007 either.

[28] It is clear to me the plain wording of subsection 138(11.3) requires that there be a change in the make-up of the investment assets forming part of the "designated insurance property". The Appellant itself argues in its Memorandum that the rule is a transitional rule that applies upon a change in the designated status of property and I agree. If the property was designated in 2006 and the same property is designated in 2007 there has been no change in the designated status of the property. This is consistent with the textual wording of paragraph (*a*) thereof that speaks of property that is "designated insurance property for a taxation year…was not designated insurance property for that preceding year" and with the textual wording of paragraph (*b*) that speaks of property that is "not designated insurance property for a taxation year…was designated for that preceding year". The wording does not include property that was designated in a previous year and is designated in a following year, nor does it include property that was not designated in a previous year and is not designated in the current year. [Underlined for Emphasis]

[29] Accordingly it is clear to me that assets first coming into designated insurance property in a year when the taxpayer is a multinational following a year when it was not, as in this case, would retain its existing cost base and be subject to gains or losses based on same as a result of any subsequent actual or deemed disposition in the *Act* that may otherwise apply. For example, the mark to market

rules in section 142 would trigger a disposition at fair market value for the 2007 taxation year.

[30] Having regard to the above only, the Appellant would not be successful in its appeals either for 2006 or 2007 based on the plain meaning of the provision.

[31] However, even if I were to have found that there is ambiguity in the plain meaning of the provision so that it is also capable of supporting the Appellant's position that the insurer need not be a multinational insurer in a preceding year or that there is no need for a change in the assets designated from year to year, the TCP approach would in my view also support the Respondent's interpretation over that of the Appellant's.

2. The TCP Approach

[32] The Appellant stated in opening argument that the purpose of section 138 is to provide that for the insurance business the general rule of taxing residents in Canada on worldwide income is modified so that insurance corporations are only taxed on a "territorial" basis or "Canada only" basis. The Respondent challenges the Appellant's categorization of the subsection, arguing no territorial or new system of taxation is created by the provision, which it argues creates special rules within the only system of taxation applicable in Canada under the *Act*.

[33] Regardless of the categorization of the provision by the parties, logically, the exception only comes into play when an insurer is operating in more than one "country" to use the exact word used in subsections 138(2) and (11.3) specifically. Without a particular exception, it is trite law that any increase in the cost base of a particular asset on acquisition is generally matched by an inclusion of a gain into income, whether capital or otherwise, in accordance with the general scheme of the *Act* to tax a taxpayer on a disposition of property in the year of disposition. Absent such specific exception, to permit a bump up in cost base without a corresponding gain into income by one of the parties would result in a windfall as the Respondent has alluded.

[34] Section 138 is found in Division F of the *Act* titled "Special Rules Applicable in Certain Circumstances". Section 138 itself is titled "Insurance Corporations", and thus it is clear so far that we are dealing with special rules applicable in certain circumstances to insurance corporations. Frankly, the Respondent is correct that Division F, as part of the same *Act*, does not create a new system of territorial or Canada only taxation, but creates a set of special rules

within the existing Canadian income tax system. There is no mention of a new "territorial" or "Canada only" system within any wording of the provision or in the *Act* itself as far as I am aware.

[35] The Respondent has in argument explained that the practice of the insurance industry to carry on business in another country as a branch instead of incorporating separate corporations or other legal entities in those jurisdictions is the reason such special rules exist. The rules ensure a Canadian resident insurer, that would otherwise be taxed on worldwide income under Section 3 of the *Act*, is not taxed on income from a foreign insurance business or on investment revenue attributable to such foreign business. The Appellant has not disputed this statement.

[36] The Appellant's description of these special rules or "Canada only" system as it describes them, is found in paragraph 103 of its Memorandum of Fact and Law, submitted as its initial written argument in this matter, which reads as follows:

> 103. The "Canada only" system is a departure from the general scheme of the Act. For a Canadian multinational life insurer, the rule is set out in paragraph 138(2)(a) and is supported by several specific rules. Paragraph 138(2)(a) specifies that the "Canada only" system applies to a Canadian resident life insurer that is a multinational life insurer. It provides that, if a life insurer resident in Canada is a multinational life insurer in a taxation year, its income or loss for the year from carrying on an insurance business is the amount of its income or loss for the taxation year from carrying on the insurance business in Canada.

[37] Subsection 138(2)(*a*) reads as follows:

> **138(2) Insurer's income or loss.** Notwithstanding any other provision of this Act,
>
> (*a*) if a life insurer resident in Canada carries on an insurance business in Canada and in a country other than Canada in a taxation year, its income or loss for the year from carrying on an insurance business is the amount of its income or loss for the taxation year from carrying on the insurance business in Canada;

[38] The above provision clearly states the overriding special rule for multinational life insurers resident in Canada; namely that its income or loss for the year is limited to its income or loss from carrying on the insurance business in Canada. The obvious corollary is that any income or loss from carrying on a life

insurance business in another country during that year is not included in its Canadian tax. In this sense, one might label the special rules as "territorial" or "Canada only" as the Appellant has done, but it is clear its income or loss is only determined by the portion of its insurance business that is carried on in Canada, and not in another country as reflected in these special rules.

[39] It is also clear that a life insurer resident in Canada does not fall into this special scheme or rules in any year unless it also carries on an insurance business in another country. Clearly, in 2005 the Appellant did not carry on business in another country and so its treatment of income and loss for that year would fall within the general scheme of taxing worldwide income including capital gains and losses on disposition only, deemed or otherwise and not be subject to this special scheme or set of rules.

[40] In my view the remaining provisions of section 138 clarify or provide specific treatment to types of income or deductions by addressing limits to inclusion of income, deductions taken of interest and inter-corporate dividends, deniability of foreign tax credits, the inclusion of prescribed amounts in the computation of income and, to deal with the provision in issue in this matter, the tax treatment of properties which go from designated in one year to not designated in another or *vice versa* while <u>in</u> this scheme or special set of rules. [Underlined for Emphasis]

[41] As an example of these clarifying or specific provisions, one need only look at paragraph 138(2)(*b*) also applicable to a multinational life insurer resident in Canada which is clearly stated to be for "greater certainty":

> (*b*) if a life insurer resident in Canada carries on an insurance business in Canada and in a country other than Canada in a taxation year, for greater certainty,
>
> (i) in computing the insurer's income or loss for the taxation year from the insurance business carried on by it in Canada, no amount is to be included in respect of the insurer's gross investment revenue for the taxation year derived from property used or held by it in the course of carrying on an insurance business that is not designated insurance property for the taxation year of the insurer, and
>
> (ii) in computing the insurer's taxable capital gains or allowable capital losses for the taxation year from dispositions of capital property (referred to in this subparagraph as "insurance business

> property") that, at the time of the disposition, was used or held by the insurer in the course of carrying on an insurance business,
>
> (A) there is to be included each taxable capital gain or allowable capital loss of the insurer for the taxation year from a disposition in the taxation year of an insurance business property that was a designated insurance property for the taxation year of the insurer, and
>
> (B) there is not to be included any taxable capital gain or allowable capital loss of the insurer for the taxation year from a disposition in the taxation year of an insurance business property that was not a designated insurance property for the taxation year of the insurer;

[42] As the Appellant has pointed out in its argument, subparagraph 138(2)(*b*)(i) above ensures that in computing income or loss of the multinational in carrying on business in Canada no amount is included in calculating its "gross investment revenue" from property used or held by it in the course of carrying on such business in Canada unless such property is designated property. It should be noted that this is the only applicable provision here since the parties agree the disputed bump in cost base applies only to this type of property.

[43] Clearly, two requirements stand out for inclusion of income specified in subparagraph 138(2)(*b*)(i), namely, in gross investment revenue: that the property giving rise to the income must be "used or held by it in the course of carrying on an insurance business" in Canada and that the property must be "designated insurance property". It logically follows that if, in the "Canada only" scheme described by the Appellant and referenced in paragraph 138(2)(*a*) above, only the multinational life insurer's income or loss from carrying on a business in Canada is included for taxation purposes and under paragraph 138(2)(*b*) gross investment revenue and capital gains or losses are calculated from property used or held in carrying on its business, that the reference to "its business" in the latter can only mean the insurance business carried on in Canada.

[44] It is, however, possible that such property may be used or held in carrying on such business in Canada but not be "designated property" for the year and hence would clearly not be included in calculating income or loss of the multinational life insurer in carrying on the insurance business in Canada. That is not to say that any such income would not be taxed in Canada at all, as the treatment of such income may be subject to tax as income from property or sources other than from business, which is what section 138 addresses, or taxed in another

jurisdiction in which the Canadian resident corporation also carries on business. That of course is not something in issue here.

[45] I make this distinction between “used and held” and “designated” at this time because it is relevant to resolving the dispute between the parties as to the purpose and meaning of subsection 138(11.3). The Respondent takes the position that such subsection is a “change in use” rule and in paragraph 274 of its Written Representations states:

> 274. The textual reading of the provision reveals that it applies to change in use of property of a multinational, not to the introduction of property into the multinational taxation regime. A purposive analysis reveals the purpose of the provision was to tax assets used in Canada, and a contextual analysis supports that this provision is meant to tax assets used in Canadian insurance business.

[46] The Appellant however takes the position in paragraphs 118 and 119 of its initial Memorandum of Fact and Law, relying on a 1996 historical Explanatory Note, that the subsection is a “transitional rule that applies upon a change in the designated status of an investment property” to “ensure that gains or losses from the property accrued prior to the particular taxation years are not taxed thereafter by deeming disposition at fair market value and a reacquisition at a cost equal to that fair market value at the start of a particular taxation year”. Moreover, in that case, the deemed gain or loss that arises in the particular year is expressly deemed not to be a gain or loss from designated insurance property for the particular year, thereby ensuring that the gain or loss is also not included in the multinational life insurer’s income from its insurance business in the particular taxation year under the “Canada only” system. Furthermore, argues the Appellant, there is no requirement that the property designated be factually used in the Canadian insurance business of the multinational.

[47] To some extent both parties are correct. The Respondent is correct in that the contextual analysis regarding subsection 138(2) above clearly demonstrates that the property giving rise to the specific gross investment revenue and/or capital gains or losses must “be used or held” in carrying on the multinational life insurer’s business in Canada to form part of the special rules. The Appellant refers to the historical wording of subsection 138(11.3), which included the phrase “used” in carrying on the business before amendments to the provisions introduced the “designated insurance property” concept. It is clear the historical reference to “use” has been retained in subsection 138(2) above, which informs 138(11.3), and

so I agree that the amendments to the latter are consistent with the historical purposes to some extent.

[48] However, as the Appellant has pointed out, such property must also be "designated" property and so I also agree with the Appellant's statement that the rule is a transitional rule that applies upon a change in the designated status of property. The definition of designated insurance property itself may not specifically contain the requirement of use, but it is clear subsection 138(2) requires it be "used or held" and so either requirement must be met for the property to fall within the special rules. In any event, as indicated later, the requirements for holding and listing designated insurance property as a form of financial backstop to cover the insurer's Canadian reserve liabilities or obligations suggests they would be automatically "used" for such Canadian business once designated and there is no question they are at least "held" for such purposes.

[49] Moreover, the Respondent agreed the property did not have to be used in the insurance business in Canada in the factual sense, and so it seems the Respondent's emphasis on this issue is misdirected.

[50] I fully agree with the Appellant's position that notwithstanding the historical requirement that such property be factually used in carrying on a Canadian business, the concept of "designation" replaced this wording for years after 1996 and it is clear that the investment assets no longer had to be factually used in the business in order to qualify as designated insurance property. This is also clearly evidenced by the definition of "investment property" in Regulation 2400, which includes reference in paragraph (*b*) to "land, depreciable property or property that would have been depreciable property if it had been situated in Canada and used or held by the insurer in the year in the course of carrying on an insurance business in Canada…". Likewise Regulation 2401(3), dealing with the Order of Designation of Properties, expressly references investment property to be designated for the year in respect of the insurer's business carried on by it in Canada as including investment property owned by the insurer other than Canadian investment property. It is clear that the property must be owned or held by the insurer, but need not be factually used in the business as previously required. Nevertheless such property is actually used in the business as a result of its designation.

[51] I also agree with the Appellant's argument that a review of the designation system is necessary to properly frame the competing positions of the parties. As mentioned earlier, subsection 138(12) defines "designated insurance property" for a taxation year of a multinational as meaning property determined in accordance

with prescribed rules. As the Appellant has pointed out in paragraph 106 of its Memorandum, "The definition does not apply to a Canadian resident life insurer that only carries on its business in Canada". I agree with this statement and have to logically conclude that there can be no "designated insurance property" before becoming a multinational and so there could not have been any designation for a previous year before becoming one and hence no change in designation at the time of first designation that would put subsection 138(11.3) into play.

[52] The applicable regulations that define "designated insurance property" are found in Part XXIV of the Regulations to the *Act*, particularly in Regulation 2401 which sets out that "designated insurance property" means property that is designated in accordance with the rules set out in subsections 2401(2) to (7) of the Regulations. These provisions provide ordering rules for the designation of different types of investments as earlier mentioned and provide limits on the amounts so designated. As the Appellant has stated in paragraph 108 of its Memorandum:

> 108. In simple terms, the Act and the prescribed rules require that a multinational life insurer designate, in its return of income for each taxation year, "investment property" having a total "value" for the taxation year equal to the amount of the "mean Canadian investment fund" for the taxation year.

[53] The above terms in quotations are defined in Regulation 2400, and although detailed and complex, it is clear that the purpose of such designation, which may be done by the Minister if the taxpayer fails to do so or fails to do so in accordance with the rules, is to provide a minimum reserve of investment assets owned by the Canadian resident life insurer to ensure it can meet its Canadian liabilities under its policies of insurance, life, disability or otherwise. In this sense the designation is not optional as the insurer must designate a minimum amount and type of investment asset.

[54] As mentioned earlier, only a multinational life insurer resident in Canada is required to designate investment property in its tax return for a year as "designated insurance property", and this is accomplished by identifying the investment assets in a Schedule 150 attached to its tax return for the year.

[55] There is no question the Appellant filed the appropriate Schedule for its 2006 taxation year and that there was no change in the listed investments which were all similarly listed in the appropriate Schedule filed for 2007. There is also no question that the Appellant did not complete nor was required to complete such

Schedule for its 2005 year when the Appellant was, without dispute, not a multinational.

[56] What is clear from the above analysis of section 138 is that a Canadian resident life insurer that carried on business in Canada and in another country is mandated to designate a minimum level of certain investment assets it either uses in its Canadian operation or holds (i.e owns) as a reserve and to identify them in a Schedule to its tax return every year while it is a multinational. The purpose of the designation and the associated Schedule is to evidence that the insurer has met the financial requirements of the government in order to meet its insurance policy obligations, which may change from year to year depending on the level of policies in the insurer's portfolio. In this sense, the designated assets are "used" to meet the insurer's obligations in Canada, whether factually used in any other manner or not in its Canadian business operations and so it appears to me that the focus on whether there has been a change in "use" or "designation" is somewhat redundant in this context and becomes somewhat interchangeable. In any event subsection 138(2) clearly references that the property must be used or "held" as well and so the Respondent's contention in paragraph 192 of its Written Representations that, "The concept of designated insurance property goes hand in hand with the concept of taxing only property used or held to earn income taxable in Canada" is a valid one. Once "designated", section 138 dictates the tax treatment of such investment assets forming part of this list as taxed in Canada when they stop being designated.

[57] Contextually then, having regard to the provisions of section 138 in its entirety and the Regulations, subsection 138(11.3) applies in respect of property of a multinational life insurer that becomes designated insurance property or ceases to be designated insurance property or in a more general sense, that moves into or out of the designated insurance property list from year to year. This is consistent with the textual wording of paragraph (*a*) thereof that speaks of property that is "designated insurance property for a taxation year…..was not designated insurance property for that preceding year" and with the textual wording of paragraph (*b*) that speaks of property that is "not designated insurance property for a taxation year …was designated for that preceding year". In this sense it is a transitional rule but one that only applies when property is transitioned into and off of the list or from off the list and onto the list.

[58] Simply put, the property must get on the list while the insurer is already a multinational life insurer and was for the previous year before it can be taken off, or "designated" by a multinational insurer before it can be "not designated" by one, for the deemed bump in cost base to apply. As the Appellant itself states in

paragraph 112 of its argument in dealing with the instructions on page 1 of Form 150 itself, "only an insurer that carries on an insurance business in Canada and in a country other than Canada in the taxation year is required to designate investments and identify the designated investments in the Schedule."

[59] Additionally, it is not enough to trigger tax treatment under this subsection that the property simply got on the list. The tax consequence is triggered by it coming off the list, which is consistent with the purpose of the provision in taxing only gains or losses that accrued while the property was "designated". For the purpose of calculating such gain or loss when it comes off the list, the subsection deems the cost base of the property to be its fair market value when it came on the list only if the requirements of the subsection are met; namely that the taxpayer was already a multinational insurer resident in Canada and that it is an addition to the list that existed and was required to exist at the time.

[60] Accordingly, the Appellant's contention that the subsection is a transitional rule that applies upon a change in the designated status of the investment property is correct. The Appellant however is not correct in suggesting a change in designated status pursuant to subsection 138(11.3) can occur between years where a life insurer is not a multinational in both years and hence not required to file the list or have it mandated by the Minister for both years. Likewise there can be no change in designated status of the investment property while the same property remains on the list as it has between the Appellant's 2006 and 2007 Form filing.

[61] The Appellant's contention that the section or *Act* does not define what is meant by "not designated" is simply not correct. It is clear that what is meant by "designated" under the *Act* and the applicable Regulations is that the property must find its way onto the list so it is only reasonable that the meaning of "not designated" is that it was not put on the list, when it could have been, by a taxpayer who was mandated to create the list as the Respondent has argued and thus effect a change or it was intentionally removed from the list in a later year effecting a change. This interpretation accords with the general purpose of the subsection to only tax the gains or losses of designated insurance property, as clearly enunciated by subsection 138(2), the actual charging provision, by allowing changes to such property components or list as may be necessary or desired by the taxpayer or the Minister. This interpretation also respects the scheme of the *Act* to tax gains or losses on disposition or deemed disposition unless specifically otherwise provided. The Canadian resident insurer may still own the investment assets but may be deemed to dispose of them due to their addition or subtraction from the category of

"designated insurance property" with implications for the cost base in calculating the gain or loss at a future point.

[62] Again, if subsection 138(2) only taxes gross investment revenue and capital gains or losses of "designated insurance property", the property must already be designated before a subsequent triggering event occurs to create the gain or loss. The mechanism for calculating such gain or loss is found in the deeming provision of subsection 138(11.3), but the gain or loss only occurs at the time of actual disposition of the designated property or deemed disposition by coming off the list. The Appellant's interpretation of treating the mere act of becoming a designated investment under the designated insurance rules as the tax triggering mechanism would make the two provisions inconsistent with each other rather than harmonious as required by the dicta in *Canada Trustco*.

[63] Consequently, I do not agree with that portion of the Appellant's assertion that the rule is a transitional rule applicable to "ensure that gains or losses from the property accrued prior to the particular taxation years are not taxed" or to avoid taxation of property held before the Appellant became a multinational life insurer. Such interpretation is far too broad and not only runs counter to the normal rules of taxing such property on disposition but ignores the purpose of the rule to tax only changes in value during the time the property is held as designated insurance property. As the Respondent has pointed out, there is no wording in subsection 138(11.3) that speaks directly to realizing gains or losses solely as a result of first designation and that would run directly counter to the charging provision of subsection 138(2) that taxes only dispositions of designated insurance property, or, in other words, taxes gains that accrued in Canada. Accordingly, in the Appellant's case, the investment assets that were put on the designated list, in the first year the Appellant is required to have such list, would be at their historical cost base and not be subject to any bump up. Once they are actually disposed of or deemed to be disposed of, there would be a recognition of all capital gains accruing, including those that accrued before they were designated. The bump provisions of subsection 138(11.3) would not apply to bump up the cost base of such assets, as being put on the list alone is not enough for that provision to apply. This is the only harmonious interpretation I find reasonable in the contextual and purposive analysis.

[64] A further contextual analysis has also been offered by both parties. Both the Appellant and Respondent have used the analogies offered by section 128.1, although the Appellant uses the analogy of the tax treatment offered to an immigrant to Canada under subsection 128.1(1) while the Respondent uses the analogy of an emigrant leaving Canada under subsection 128.1(4). In simple terms

an immigrant into Canada is treated as if his property were disposed of at fair market value before entering Canada and such property is assigned a cost base equal to such fair market value for Canadian tax purposes going forward. If such immigrant disposes of such property after taking up residence in Canada, he is taxed on the increase in value or the gain that accrued while in Canada. Similarly, an emigrant who leaves Canada is treated as if he disposed of his property at fair market value and realizes any gain or losses for Canadian tax purposes. He is thereafter deemed to have reacquired the property at a cost equal to his deemed proceeds of disposition or fair market value for future purposes. Again, the emigrant is taxed in Canada on the increase in the value of his assets.

[65] The Appellant, in using the analogy of the immigrant to the workings of subsection 138(11.3), effectively argues that the deemed disposition is the tax triggering mechanism in Canada. Frankly, he is in my opinion using the wrong analogy or at least an incomplete one and misinterpreting the working of subsection 128.1(1). The immigrant is deemed to acquire a new cost base at fair market value, much like subsection 138(11.3) would deem a newly designated investment asset, as a result of a change in the list of investments, to acquire a cost base at fair market value. Such deeming provision however does not trigger a taxable event for Canadian income tax purposes. A subsequent sale of the immigrant's property or a deemed disposition, say as a result of him becoming an emigrant, would trigger those tax consequences in Canada. Likewise, the deemed bump up in cost base contemplated by subsection 138(11.3) does not trigger the taxable gain or loss on the property in Canada; the gain or loss is trigged by a subsequent event, like an actual disposition by the insurer or not designating the property on the list in a future year since only gains or losses on "designated insurance property" are effectively taxed in Canada under subsection 138(2).

[66] In my opinion, the better analogy to the circumstances of this case is found in the position of an emigrant who is deemed to sell his property that is subject to tax in Canada at fair market value. The insurer by analogy who actually disposes of property that was designated or who ceases to designate it in future years triggers the tax consequence at that time.

[67] The best analogy, in my mind, uses both the immigrant and emigrant analogies. The immigrant is deemed to dispose of his property before residing in Canada at fair market value and acquires a Canadian cost base for such property at such fair market value. If the immigrant decides to sell the property while residing in Canada or decides to leave Canada, he triggers another disposition at the fair market value to realize any gain or loss in the value of the property that accrued

while resident in Canada. Subsection 138(11.3) would treat the investments listed as the designated insurance property of a multinational, like that of the immigrant who brought his assets into the Canadian system by the act of his new residency. The multinational is assigned a cost base for such designated insurance property equal to its fair market value. Once the designated insurance property is sold or emigrates off the list, the disposition of such property occurs under subsection 138(2) and the gain or loss is calculated having regard to the cost base assigned on immigration pursuant to subsection 138(11.3), consistent with the policy to tax only income accrued while earned in the Canadian insurance business.

[68] The error in the Appellant's approach is that it treats the deemed disposition rule on immigrating to what he describes as the "Canada only" system for the purposes of establishing cost base as a disposition for the purposes of realizing the gain or loss in Canada which in the scheme is simply not provided.

[69] In the context of this analogy it is also useful to point out that if the person immigrating was unable to immigrate or changed his mind, the provisions of subsection 128.1(1) would have no effect on the cost base of his property for Canadian income tax purposes. He would simply not be subject to that rule. Likewise, if the insurer did not become a multinational as required under the *Act* or did not meet any other condition of subsection 138(11.3) to trigger the deeming provision, he would not be subject to that rule and the property of the otherwise Canadian resident insurer would be taxed according to the other rules of the *Act*, which clearly do not allow a bump in cost base without a realization of a gain.

[70] I appreciate the Appellant's argument that section 128.1 and other examples in the *Act* differ from subsection 138(11.3) with respect to the timing of the deemed disposition; namely whether it occurs immediately before immigrating or emigrating or at the end of the previous year as opposed to the first day of the year; however, such timing does not detract from the underlying policy or purpose of the provisions. The timing of the disposition is simply not relevant in my opinion.

[71] In my opinion the Appellant is simply trying to manipulate the clear and precise wording of the provision, supported by a contextual and purposive analysis, to create a windfall or benefit to which it is not entitled. I find that subsection 138(11.3) does not operate to bump the cost base of the Appellant's property to its fair market value in either 2006 or 2007 for the purpose of calculating its income in those years, regardless of whether the Appellant factually carried on business in 2006 and/or 2007 in Bermuda and that its appeal for both years must be dismissed.

B. Factual Arguments-Carrying on Business in another Country

[72] The Appellant argues it actually carried on business in Bermuda in both 2006 and 2007 because it was deemed to do so pursuant to subsection 138(1) of the *Act* and because it actually did so as a question of mixed fact and law. I will address the deeming provision first before addressing the second question.

1. Subsection 138(1) Deeming Provision

[73] The Appellant argues that subsection 138(1) deems the Appellant to have carried on business in Bermuda in 2006 and 2007 as a result of it having obtained the necessary business permits and registrations in Bermuda to carry on business and because it entered into reinsurance Treaties with Standard Life Assurance Company of Bermuda Limited in each of those years, regardless of the Respondent's position that they may have had no legal effect.

[74] Subsection 138(1) reads as follows:

> **138(1) Insurance corporations.** It is hereby declared that a corporation, whether or not it is a mutual corporation, that has, in a taxation year, been a party to insurance contracts or other arrangements or relationships of a particular class whereby it can reasonably be regarded as undertaking
>
> (*a*) to insure other persons against loss, damage or expense of any kind, or
>
> (*b*) to pay insurance moneys to other persons
>
> (i) on the death of any person,
>
> (ii) on the happening of an event or contingency dependent on human life,
>
> (iii) for a term dependent on human life, or
>
> (iv) at a fixed or determinable future time,
>
> whether or not such persons are members or shareholders of the corporation, shall, regardless of the form or legal effect of those contracts, arrangements or relationships, be deemed, for the purposes of this Act, to have been carrying on an insurance business of that class in the year for profit, …

[75] Although the provisions and effect of the Treaties in question are in dispute, even if I fully accept Treaties 1 and 2 were signed in those respective years and

that they provide for the assumption of liability for annuities payments so as "to pay insurance monies to other persons for a term dependent on human life", as an annuity would do without question, "regardless of the form or legal effect of those contracts" as stated in the above provision, I cannot conclude the provision establishes that the Appellant carried on business in another country. There is no language in the provision that speaks to where the business is carried on and it does not speak of any "branch" but just the corporation. There is no question the Appellant corporation carries on an insurance business and the above provision can at best be taken to confirm that agreed upon result but short of any binding authority supporting the Appellant's contention in this matter, none of which was offered in argument, such subsection cannot be relied upon to establish the Appellant carried on an insurance business in Bermuda. [Underlined for Emphasis]

[76] I appreciate the Respondent's submissions as to the historical versions of this provision to address mutual companies and fraternal benefit societies which may not be carrying on business for profit and agree same explains the purpose of the provision; however it is not necessary for me to consider the full TCP approach when the textual wording of the provision cannot in any way support a determination of where a corporation carries on business.

2. Factual Issue-carrying on an insurance business in Bermuda

(a) Onus

[77] As indicated above the bulk of the trial was spent on the issue of whether the Appellant carried on business in Bermuda in 2006 and 2007. Before examining this issue I feel it is necessary to address the issue of which of the parties bears the burden or onus of establishing this fact. Although the Appellant made no reference to this in his oral closing argument, it did make reference to it in its opening argument and to some extent in its written argument.

[78] The Appellant argues that the Respondent did not in its pleadings assume that the Appellant did not carry on business in Bermuda and thus the Appellant is not put to the task of demolishing an assumption that does not exist.

[79] The Respondent however has pointed out that the Appellant itself assumed this fact in its Amended Notice of Appeal and that in the Respondent's Amended Reply, the Respondent denied this fact. The Respondent argues it is not necessary for it to state a negative assumption in its Reply when it denied the positive allegation of the Appellant who stated it carried on such business.

[80] Frankly, I would agree with the Respondent in this matter for two reasons. Firstly, as the Respondent has argued, it is clear it has denied in its Amended Reply the allegation that the Appellant so carried on business. The position of the Respondent is clear, and the Appellant had notice of the case it had to meet. I fail to see why such a fundamental denial must be repeated in a section called "Assumptions" in exact terms. Secondly, in my view, the Respondent has clearly assumed such fact in any event. As the Appellant itself acknowledged, the Respondent has assumed that the actions of the Appellant were mere "window dressing" to give the "illusion" it was carrying on business; in the Appellant's own words "a sham", although I do not necessarily agree the two are the same or that the Respondent has categorized it in the same manner. I fail to see what other conclusion can be drawn from such words other than the Appellant did not carry on business. In fact, such words are a stronger form of stating that same thing in my view. There is no question in my mind that the Appellant clearly was aware of the issue to be dealt with in this trial both because of these positive allegations of fact but also because of the Respondent's assumption found in paragraph 18(x) of the Reply in matter 2013-203(IT)G that "the appellant has not established that it carried on an insurance business outside of Canada in the 2006 or 2007 taxation years", the very requirement that is a condition of subsection 138(11.3) above discussed.

(b) The Test for Carrying on Business in another Country

[81] Before analysing the evidence to discern the facts that may or may not support the Appellant's position that it was carrying on business in Bermuda in 2006 and 2007, it would be useful to determine what legal test should apply as the Appellant has indicated it is a mixed question of fact and law.

[82] Although the parties appeared to take a somewhat different view in written argument, or at least focus on different cases and argument, it is clear both from their written argument and oral arguments in particular that there is really little dispute between the parties in this regard, both often relying on the same legal precedents. In short, both parties agreed that there is no single test in answering the question as to whether a business is carried out in another country and that one must look to all circumstances. The circumstances by their nature embody the issues of both whether a business was carried on and whether it was carried on in another country.

[83] In fact, both parties agree that an "essential elements" test is an appropriate approach to apply in this case, relying on the decision of Boyle J. of the Tax Court

of Canada in *Caballero v The Queen*, 2009 TCC 390, 2009 DTC 1249 who captured the essence of the test in paragraphs 6 to 8 thereof set out below:

> [6] It is possible to commence to carry on a business for purposes of the *Income Tax Act* (the "*Act*") before the business is operational. A business can be expected to have different types and different levels of activities throughout its course. What it does during its start-up or winding-down phases can be expected to differ significantly from what it does during its operational phase. It may even have periods of relative dormancy when its normal operations are interrupted.
>
> [7] In *Spasic v. The Queen*, 2009 TCC 193, I wrote:
>
>> [10] The Court's former Chief Justice Bowman in his 1998 decision in *Kaye v. The Queen*, 98 DTC 1659, described the test to be applied simply as "Is there or is there not truly a business?" Of this he went on to write:
>>
>>> ... One must ask "Would a reasonable person, looking at a particular activity and applying ordinary standards of commercial common sense, say 'yes, this is a business'?" In answering this question the hypothetical reasonable person would look at such things as capitalization, knowledge of the participant and time spent. He or she would also consider whether the person claiming to be in business has gone about it in an orderly, businesslike way and in the way that a business person would normally be expected to do.
>>
>> And:
>>
>>> Ultimately, it boils down to a common sense appreciation of all of the factors, in which each is assigned its appropriate weight in the overall context. One must of course not discount entrepreneurial vision and imagination, but they are hard to evaluate at the outset. Simply put, if you want to be treated as carrying on a business, you should act like a businessman.
>>
>> [11] The Supreme Court of Canada in *Stewart v. Canada*, 2002 SCC 46, 2002 DTC 6969, describes this as the need to look at the commerciality of the activity in question.
>
> [8] In the oft-quoted decision of the former Chief Justice Bowman in *Gartry v. The Queen,* 94 DTC 1947, Bowman C.J. had occasion to consider whether a taxpayer had started to operate his commercial fishing business in circumstances where the boat he was in the process of buying for that purpose sank before he took ownership of it. The taxpayer thereafter gave up on the business and sought to deduct the money he had spent on a number of things including intangibles

such as legal and accounting fees, insurance interest, etc. Bowman C.J. wrote in paragraph 16:

> ... In determining when a business has commenced, it is not realistic to fix the time either at the moment when money starts being earned from the trading or manufacturing operation or the provision of services or, at the other extreme, when the intention to start the business is first formed. Each case turns on its own facts, but where a taxpayer has taken significant and essential steps that are necessary to the carrying on of the business it is fair to conclude that the business has started. That is certainly the case here. The appellant had borrowed money, agreed to buy the boat, arranged for a crew, obtained the necessary licences, arranged with a substantial number of owners of boats with "G" licences to utilize his services when the boat became available, arranged and paid for modifications to be made to the boat and placed insurance. In my view the business had been commenced and was well underway when the expenses in question were incurred….

[84] It should be noted that Boyle J. found that the appellant in *Caballero* was carrying on a business and concluded in paragraph 11:

> [11] In this case it seems clear that Mr. Caballero's business efforts went well past the contemplation stage and he was pursuing the essential preliminaries, not merely hopefully reviewing business possibilities. **He was making serious and reasonable continuous efforts to begin normal operations**…. (Emphasis Added)

[85] It is clear to me from *Caballero* as well as other cases where similar sentiments have been expressed, that during the initial phase of a business, the taxpayer must have taken the essential steps to get his business going and do so on a continuous basis. These cases include *MNR v M P Drilling Ltd.*, 76 DTC 6028 (FCA) at page 6031 where the court referred to the taxpayer as being "engaged in doing the normal things that any new business must do to bring its wares to market" and the Federal Court of Appeal decision in *Harquail v The Queen*, 2001 FCA 320, 2001 DTC 5630 at paragraph 62 which referred to a range of activities that constitute carrying on business as falling on a spectrum. Although *Caballero* did not involve carrying on business in another country, its approach was informed by cases that did address that question, such as in *London Life Insurance Co. v The Queen*, [1988] 1 FC 46, a case similar to the one at hand in that the Court also had to decide whether the appellant was carrying on business in Bermuda. In that case Martin J. of the Federal Court, Trial Division stated at paragraph 40 in describing the taxpayers activities in Bermuda during its start-up year:

> **40** The fact that the plaintiff issued only two policies in Bermuda in 1976, and then only at the end of December, is of little consequence. The plaintiff put in

> motion its plan to operate in Bermuda in May and thereafter did all things necessary to implement that plan. Its intention to carry on its business in Bermuda was evident well before December 1976. It had, as early as August of 1976, embarked upon its business by having its agent solicit insurance contracts from Bermudian residents with the intention that the venture would continue indefinitely. **The operations of 1976 were but the beginning of a systematic or habitual series of activities which were intended to and did continue with a view to producing a profit**. (Emphasis Added)

[86] It is clear from *London Life* that Martin J. explored several of the tests for determining whether the taxpayer carried on business in Bermuda, including the "profit test" for determining whether profits arise from the operations in such country, the "place of sales or contracts" test and the legislative definition of business in such country. He concluded that in fact none are determinative and that the cumulative effect of all of them led to the conclusion the taxpayer was carrying on business in Bermuda. In paragraph 43 he concluded:

> **43** Thus, although no one of the several tests to which counsel have referred me is determinative, the cumulative effect of applying them all has been. The contracts of insurance issued in 1976 were made in Bermuda, a vital part of the company's business, its sales operations, was conducted in Bermuda through its agent, and the inducements to have residents of Bermuda enter into life insurance contracts clearly fell within the common, and also legislatively defined, meaning of carrying on the insurance business. Those circumstances, combined with the other activities carried on by the plaintiff's agent in Bermuda, to which I have already made reference, have satisfied me that in 1976 the plaintiff did carry on its business in Bermuda.

[87] Needless to say, the Court focused on the taxpayers activities in Bermuda to analyse whether in fact it did all things necessary to implement its plan and determined all the circumstances allowed it to conclude the company was carrying on business in Bermuda.

[88] Having regard to the above cases, I must agree with the Appellant's suggestion that the test in determining whether the taxpayer carries on an insurance business in another country, as subsection 138(11.3) requires, involves a two-step approach. First one must ascertain the intention of the parties to determine what the "business" is that the taxpayer intended to carry on, in this context what the "insurance business" is. Second one must determine whether it took serious and continuous steps to put in place the "essential elements" to carry on that intended business or in other words to carry out its plan.

(c) The Taxpayers Intention - What Business was Intended?

[89] While the Respondent argues the Appellant had no intention of carrying on any business, it would be appropriate in my view to examine the question from the perspective of the taxpayer, since it is his alleged business under examination. The Appellant was absolutely clear that its plan was to set up a reinsurance business in Bermuda chiefly to reinsure life insurance policies with the aim of reducing or creating a hedge against its large longevity risk from its Canadian insurance business which focused on annuities. The evidence is that its annuities business was about four times larger than its life insurance block of business, and each of the Appellant's former Chief Financial Officer, Tax Director and Accounting Advisor testified as to the major concerns of the Appellant with its longevity risk.

[90] As the witnesses alluded, the Appellant, due to the large size of its annuities book of business relative to its life insurance business, had risks serious enough to bankrupt the Appellant if its insured clientele lived longer than actuarial estimates. In such cases, it would be required to pay out annuities for the balance of their longer lives thus reducing or eliminating its profit base or worse. The evidence is that its accountants/actuaries, Ernst & Young, advised it to increase its book of life insurance which carries mortality risk; meaning that the longer clientele live, the longer it has to pay out funds on death, which would counter its longevity risk. Since the Canadian market was competitive and was a small market relative to the larger U.S. market, it was advised to focus on accessing the U.S market in the fastest and most cost efficient way by reinsuring life insurance blocks of business held by other life insurers rather than attempting to put boots on the ground by hiring salespeople to sell policies directly and build its life insurance business in that manner as was done in *London Life*.

[91] The aforesaid plan or intention of the Appellant was stressed in argument and evident not only from the oral evidence of witnesses composed of its former officers and advisors above, but also evident from the Directors and Shareholders Resolutions of the Appellant and of its ultimate U.K. parent corporation as well as its business plans, some of which were attached to such resolutions, or from documentary correspondence put into evidence.

[92] The intention of the Appellant to establish a life reinsurance business is strongly supported and stressed by the Appellant's written arguments and evidence, set out particularly in paragraphs 25 to 29 of its Memorandum of Fact and Law and bears repeating:

> 25. In 2006, SLAC [the Appellant] had approximately $10.7 billion in liabilities attributable to annuities and $1.8 billion in liabilities attributable to life

insurance products. Because the volume of its life insurance business was much smaller than the annuity business, SLAC had huge exposure to longevity risk and no effective hedge against it.

26. Increased longevity risk was a real problem that had real financial impacts on SLAC. It was not a problem that was going to fix itself. Life expectancy was trending upward and, in 2005 and 2006, there was no expectation that was going to change. Accordingly, it made good business sense to do something about the longevity risk problem. As Christian Martineau, the former CFO of SLAC put it, a cure for cancer or heart disease could have bankrupted the company in Canada. Accordingly, the sooner SLAC's longevity risk was addressed the better.

27. Longevity risk had been a problem for SLAC for some time, and the company had pursued various avenues to address it, including selling more life insurance and acquiring closed books of life insurance business. However, addressing the longevity risk problem by writing more life insurance was not a viable solution. SLAC would have been required to write four or five times as much life insurance as it had on the books at the end of 2006. That was simply not feasible. In fact, in 2006, SLAC was projecting that its life insurance business would shrink, not grow.

28. Reinsurance was the logical solution to the longevity risk problem. **By reinsuring life insurance, SLAC could essentially buy mortality risk without going through the capital-intensive process of originating life insurance policies.** (Emphasis Added)

29. Obtaining reinsurance business through a Bermuda branch was an idea that had been "tossed around" within SLAC for a long time. For example, Mr. Martineau asked Jim Doherty of Ernst & Young LLP ("E&Y) to examine the possibility of SLAC getting into the business of reinsuring life insurance in early 2005. Mr. Doherty considered various offshore markets that SLAC might consider entering, and provided his recommendations to Mr. Martineau in February 2005.

(Footnotes omitted)

[93] The point is that the intention or plan was clearly to establish a life insurance reinsurance business, not just a reinsurance business. This was confirmed in the Appellant's Reply Memorandum at paragraph 19:

19. The business carried on by the Branch was, is, and was always intended to be, a reinsurance business, and in particular, the reinsurance of life insurance by accessing the U.S. and other international markets from Bermuda….

[94] In fact, it was clear that access to the U.S. market, initially through Bermuda, was the priority as confirmed in paragraph 32 of the Appellant's Memorandum:

> 32. In order to effectively get into the reinsurance business in a way that would mitigate longevity risk, SLAC needed access to a bigger market than Canada. The result of E&Y's analysis, which is reflected both in the February 2005 memorandum and the business plan that was ultimately prepared for the Branch, was that SLAC had an opportunity to access the U.S. reinsurance market, and, in particular, to access it through Bermuda.

[95] In the Appellant's above arguments it should be noted it referred to the minutes of a director's meeting of its ultimate parent corporation, Standard Life PLC, held November 28, 2006 which approved the Appellant's proposal to establish a Bermuda branch that was attached to the minutes of such meeting. On the first page of the proposal after the cover page, under the heading "2. *Summary of key recommendations and proposals*", the main rationale for establishing the Bermuda branch, consistent with all of the Appellant's above referred to arguments, is clearly set out and reads:

> The Branch will support SCDA's [earlier defined as The Standard Life Assurance Company of Canada, the appellant herein] business plan by providing a profitable source of business without requiring capital injections from outside SCDA and will be consistent with achieving SCDA's overall business plan targets. Contribution to profits will be small initially.
>
> The Branch's business will include mortality risk which will help to mitigate SCDA's longevity risk exposure arising from its annuity business. Through its insurance and reinsurance offering, the Bermuda Branch will allow SCDA to mitigate some of its annuity longevity risk by concurrently managing the asset streams and duration on the books of the insurance and reinsurance business, versus those of the annuity business.

[96] In fact, Jim Doherty of Ernst & Young emphasized at trial that the plan "was primarily to sell into the U.S. market". In fact, it is clear from page 6 of the Appellant's final business plan attached to the minutes of its Board of Directors meeting dated December 15, 2006 approving the Bermuda branch and the plan itself that although access to the prime U.S. market from a Bermuda platform is the goal, that "a physical presence will likely be needed within 5 years, either in New York or Chicago".

(d) The Essential Steps

[97] The Appellant claims that it took all the essential steps in Bermuda to follow its plan or, in other words, to give effect to its stated intention and did so on a continuous basis, ultimately resulting in a profitable branch operation that exists even to this day. Furthermore, the Appellant argues that one cannot separate the steps it took in 2006 and 2007 from the branch's successful operation today, as evidenced by the testimony of Mr. Martineau who agreed with the counsel's statement to that effect put to him in cross-examination and discovery.

[98] The essential steps the Appellant claims it took in Bermuda consist of obtaining the requisite permit to operate in Bermuda and sell reinsurance, the hiring of an employee and the solicitation of business, the execution of two reinsurance Treaties, one dated December 22, 2006 with an effective date of December 31, 2006, as amended March 30, 2007 with an effective date of December 31, 2006 and the second dated March 30, 2007 with an effective date of January 1, 2007, and the execution of other agreements such as a lease for space and other services. In fact, the Appellant argues that its situation is similar to that of the taxpayer in the *London Life* case above referred to save that it was not in the business of selling direct life insurance policies to Bermudians but rather in the reinsurance business.

[99] On first glance, looking at the veneer of the essential steps listed by the Appellant, one would be tempted to visualize a corporation that started to do the normal things one has to do to start a business and to presume they must have taken all the essential steps necessary because there they are today, operating what appears to be a successful branch in Bermuda with evidence after 2009 that it entered into reinsurance Treaties with arm's length parties to reinsure blocks of life insurance that satisfy its stated intention or goal of mitigating its longevity risk. However, in analyzing the steps referred to by the Appellant in meeting the test and looking to the substance beneath the veneer offered, I am not satisfied that the Appellant either took the essential steps nor did so on any continuous basis for several reasons in relation to each of the alleged essential elements which I will now address under the categories below.

i) Permits and Licences

[100] Firstly, I place little weight on the fact the Appellant obtained a licence to sell reinsurance by the Bermuda Monetary Authority on December 21, 2006. A condition was attached to such licence issued pursuant to the *Insurance Act, 1978* which reads as follows:

3. The Company shall not, without obtaining the prior written approval of the Bermuda Monetary Authority, write any business other than the reinsurance of an affiliate.

[101] Such a restrictive licence is hardly compatible with the stated intention of selling life reinsurance primarily to the U.S. market and nowhere was evidence tendered by the Appellant that such goals could be met by just selling to its affiliates. Moreover, if the Appellant could meet its intention of reinsuring life insurance to address the longevity risk problems that could potentially bankrupt it by relying solely on its affiliated company's book of business, then it could have logically done so directly without setting up a Bermuda branch. There is no evidence that the Appellant's intention was to limit the business of its branch to only dealing with its affiliates and such concept flies in the face of its broad statements to access the large U.S. market from Bermuda.

[102] While the Appellant argues that in 2009, on subsequent application to the Bermuda Monetary Authority, that such restriction was lifted, and so I should look at the initial limited licence as a stepping stone to such ultimate licence, I can hardly call a hiatus of 2.5 years a continuous effort to do business in accordance with its stated intention to be profitable within 3 to 5 years. When I also analyse this factor in light of the evidence that the Appellant had not hired an employee with knowledge of the reinsurance business until 2008 or later, which I will address in greater detail below, it is clear such restricted licence takes on even less significance.

[103] More to the point, the Bermuda Monetary Authority indicated before issuing its limited licence in its letter of November 17, 2006 to the Appellant that its application was approved subject to receipt of an undertaking that the branch would not write any unrelated insurance business without first hiring an experienced reinsurance underwriter and seeking approval of that underwriter and companion business plan from the authority. It is absolutely clear that the road to writing reinsurance with unrelated parties, namely most parties in the large U.S. market, was blocked by an obstacle requiring the right boots on the ground in Bermuda that was wholly within the ability of the Appellant to satisfy. It made no serious effort to and did not remove this obstacle until 2009.

(ii) Hiring Employees

[104] The evidence of the Appellant adamantly stressed it was to be in the business of reinsuring life insurance to mitigate its longevity risk and its own plans

and documents clearly indicated an experienced person would be required, yet it hired Elaine Furbert, who clearly from the evidence had no skill set in this particular field but was an accountant who worked for the Appellant's Bermuda solicitors affiliate beforehand. Even Mr. Doherty had assumed Ms. Furbert had such skills or had been trained in those skills in his testimony. I cannot reasonably or even remotely find that the Appellant met the essential element of hiring the proper personnel to execute it plan in Bermuda.

[105] The stated business the Appellant was in was to reinsure life insurance in Bermuda which had access to the primary U.S. market. Ms. Furbert did not testify as to her direct role. However, the evidence from the answers given pursuant to undertakings in the discovery process clearly indicates that not only did she work only about 2 days a week in the office, but that she did not report to work much in 2006 after being hired on December 18, 2006 because of the holiday season and the fact the office was not properly furnished. Frankly, the only credible evidence of her role is that she signed three standard letters prepared by Jim Doherty originally indicating they were to be signed by Mr. Messier and addressed to three of the Appellant's subsidiaries, none of which was a U.S. subsidiary I note, soliciting business for the branch and that she appears to have signed the Treaties for reinsurance above referred to, as required by her employer. Her résumé tendered into evidence gives no indication of any experience in the insurance industry other than as an accountant or bookkeeper, let alone life insurance or reinsurance sales, marketing or negotiation of any kind.

[106] In *London Life*, the Court found that the taxpayer's agent in Bermuda, a registered insurance broker in Bermuda, conducted activities with Bermudian residents, the target market, including assessing their ability to make payments and delivering the contracts to make them binding, as consisting of essential elements of selling the taxpayer's products in Bermuda. In other words, the taxpayer in *London Life* had the proper personnel to sell its product in Bermuda. In the case at hand, I cannot find Ms. Furbert was the proper person to do what was essential and thus the Appellant did not have the serious and essential means in Bermuda to carry on its insurance business in 2006 or 2007. With no experienced reinsurance personnel the Appellant simply could not have done so, and it is clear from the evidence no such personnel arrived on the scene until sometime after the start of 2008.

[107] Not only did the Appellant proceed to hire an employee who could not further its goals, it actually passed on an opportunity to hire a qualified person. The evidence not in dispute is that the Appellant retained the services of an employee

recruitment outfit, or head hunter as they are generally known, in Bermuda pursuant to a contract dated December 13, 2006 and signed by Sylvain Messier on December 18, 2006, an employee of the Appellant in Canada charged with executing the Bermuda branch plan, to identify prospective candidates who had reinsurance experience.

[108] Remarkably, on December 13, 2006 a representative of the recruiter emailed Mr. Messier and his colleagues at the Appellant's Canadian email address and identified three possible candidates for the position of General Manager and the times they were available, Bermuda time, for a conversation over the next two days. In an email from this representative to Mr. Messier and his colleagues, the representative effectively identified a Ms. Page Rouse as the preferred candidate and the terms of remuneration he discussed with her. On December 18, 2006 the Appellant had her sign an authorization for personal information as it indicated in testimony was its practice but also forwarded an employment agreement dated December 18, 2006 already signed by Mr. Messier that effectively would hire her as the General Manager with salary of $225,000 U.S. plus discretionary $50,000 bonus and a $72,000 housing allowance and details her duties in a detailed appendix to the agreement that, to say the least, encompass all marketing and sales and management as well as development of the branch. The duties were summarized at the top of the page in Role Summary as:

> Responsible for the conception, development and management of the marketing, sales and customer service strategy in order to achieve our market share, servicing and profitability targets which are in line with Standard Life's corporate plans. Establish and develop the Bermuda branch of Standard Life Canada.

[109] In paragraph 20 of the contract however, the Appellant included the following sentence:

> This offer is valid until Tuesday, December 19, 2006 at 9h00 (Bermuda Time).

[110] The candidate who appeared only one day after the recruiter was hired and who had the experience and qualifications to sell and market reinsurance in Bermuda to meet the Appellant's stated intention remarkably was only given less than 24 hours to accept a job for a business the Appellant described as intending to have a long and indeterminable duration.

[111] When invited to give the recruiter reasons for turning down the position, Ms. Rouse in an email to such representative, advised that she would have accepted "had it not been for the lack of transition time" and she could not transition from

her current job in one day. Moreover, she advised she "was also not able to obtain enough detail on the Standard Life Business Plan", the one referred to in the appendix to the Employment Contract above, "in this short time frame, and hence gain enough comfort".

[112] No explanation was given for the short acceptance period or the reasons why no effort was made to pursue this candidate by providing her a reasonable transition time or the information requested. Instead, the Appellant offered the job of General Manager to an accountant affiliated with its lawyer's office whose résumé admitted into evidence shows no connection or experience in the insurance industry other than working in an accounting capacity to configure and operate the general ledger and management reporting requirements of her former insurance company employer.

[113] Oddly enough, Ms. Furbert also signed an authorization for personal information also dated December 18, 2006, a date before she was even considered for the position and while the offer was pending to Ms. Rouse and she entered into a contract in similar form to the Rouse agreement also dated December 18, 2006 which defines her role as General Manager as well but with a salary of only $150,000 U.S. with no discretionary bonus or housing allowance and no appendix attached setting our her duties as in the case of the Rouse agreement. Again, oddly enough, Ms. Furbert is only given until 9:00 a.m. Bermuda time the following day to accept the offer and she appears to have also signed it on December 18, 2006 as did Mr. Messier. There was no dispute in the testimony of Mr. Messier that Ms. Furbert was hired because Ms. Rouse turned down the job, yet no explanation was offered to the date and textual inconsistencies. Frankly, I have some serious concerns about the credibility of the actions of the Appellant and the testimony of Mr. Messier which were not reconciled.

[114] It appears to me nothing more than a blatant attempt to manipulate dates and actions to give the impression the Appellant made serious efforts to hire the right person and settled for someone else who could administratively help it continue along the path to full operations until the right people were hired, when in fact it is evident it chose not to hire and pursue the candidate that could have helped it immediately fulfill its plans.

[115] When a party with a precise and emphatic plan says one thing and then acts in a deliberate manner as to foil such plans, as I find the Appellant did here with the hiring of staff in 2006 and 2007, it cannot be said such person took serious and continuous steps to give effect to or follow its plan.

(iii) Reinsurance Contracts

[116] Even though the Appellant has argued it actually entered into two reinsurance Treaties with Standard Life Assurance Company of Bermuda Limited ("SLBL"), a related corporation, as evidence of it conducting business in both 2006 and 2007, I am not satisfied it in fact did so.

[117] With respect to the Reinsurance Treaty dated December 22, 2006 with an effective date of December 31, 2006 ("Treaty 1"), there was a great deal of disagreement as to the circumstances of when or whether the true copy submitted into evidence and whose authenticity is disputed by the Respondent, was actually the Treaty 1 in the form it was allegedly signed on December 22, 2006. The signatures of the director of SLBL and that of Ms. Furbert are dated December 22, 2006, in the latter's case, only a few days after being hired. In clearly different type set and on a separate page the signature of Christian Martineau appears to have been signed on that same date. The evidence of Mr. Martineau is that the agreement was faxed to him in his Montreal office and he signed it, as was required by company procedure, on that date and Mr. Messier testified he was in the Montreal office that day and witnessed Mr. Martineau signing the document at his secretary's desk.

[118] The difficulty I have with the credibility of such oral testimony is that the true copy submitted into evidence clearly shows a Schedule 5 which is dated March 28, 2007 but Mr. Martineau was adamant the Schedule was attached at the time of signing. It begs the obvious question as to how a Schedule dated three months after the date of signing could have been appended to the form of Treaty 1 purportedly signed.

[119] Notwithstanding the oral testimony of both officers of the Appellant, the Appellant clearly knew the authenticity of this Treaty 1 was in question by the Respondent. The Respondent made demand for a copy of the original Treaty in a request for document disclosure dated February 4, 2013 wherein it requested in paragraph 27 of Schedule A to that letter that the Appellant:

> 27. Provide to the respondent at the commencement of the examination for discovery original versions of the Reinsurance Treaties found at numbers 16 and 18 of the appellant's list of documents.

[120] The Appellant never provided original versions for inspection, not even when again asked for at discovery.

[121] One would think that the different type set and date on the Schedule would be sufficient for the Appellant to want to provide evidence of the authenticity of its documents or provide an otherwise credible explanation, but none to my mind has been given. It is not only these inconsistencies which challenge the credibility and authenticity of the document having been signed on that date and in that form. Other evidence by former employees or consultants of the Appellant also suggest it may not have been possible to sign an agreement in final form on December 22, 2006.

[122] Mary Stock was the external actuary with Ernst & Young who was retained by the Appellant via a retainer agreement dated December 20, 2006. She testified that the process in formulating a treaty was that term sheets would be negotiated between parties (SLAC and SLBL) and a treaty would be signed usually within 90 days of year end when all data and information could be confirmed, including what exact liabilities were being assumed as at the effective date and what assets were to be transferred in consideration. This process was consistent with that described in the testimony of Jim Doherty, the Appellant's actuary and advisor.

[123] The evidence of a term sheet dated December 28, 2006 suggested to Mary Stock that there was ongoing negotiation between the parties as to the terms which had been narrowed down and that treaties would be done after all the terms had been agreed to. This suggests to me that the Treaty 1 could not have been signed in its form on December 22, 2006.

[124] Mary Stock also testified she did the bulk of her work for the Appellant in the first three months of 2007 and that she finalized the list of assets scheduled to be transferred as part of Treaty 1 in March of 2007, consistent with the date of the Schedule in that Treaty dated March 28, 2006. This certainly suggests the Schedule dated March 28, 2007 attached to the Treaty must have been added after Mr. Martineau alleges he signed it.

[125] Moreover, her email letter of March 15, 2007 to Jim Doherty starts with the comment:

> Since I started with Treaty #1 and the treaties are almost identical the comments relevant to Treaty #1 are also relevant to Treaty #2 for the most part.

[126] Her comments included: "Items that must be changed. 1. Schedule 5 needs to be completed and attached" and later on under the heading "other items to consider", "1. A lot of language is relevant to life insurance not annuities".

[127] She testified that in her review of the Treaty that was originally drafted by Blakes law firm, that many of terms that referred to a life insurance situation had to be amended to reflect an annuities reinsurance contract. Thus it is clear the terms of the contract were not finalized before March 15, 2007 at the earliest and that the Treaty could not have been signed in final form on December 22, 2006 since it referred only to annuities at that time.

[128] Needless to say, it begs the question why the external actuary was reviewing drafts prepared by counsel referencing life insurance reinsurance in March 2007 with Schedule 5 not having been attached and suggesting changes to the Treaty document which according to Mr. Martineau was executed with the Schedule attached in December of 2006. I have some serious questions as to the credibility of Mr. Martineau on these issues.

[129] All of Ms. Stock's testimony points to issues that go beyond the role of making only simple refinements or adjusting amounts to actuals after the year end, which is *prima facie* evidence the Treaty was not finalized and hence not entered into in 2006.

[130] The testimony of Jim Doherty also raised concerns on the issue. He also testified that term sheets were significant documents evidencing what terms are first agreed to between the parties after negotiation and then sent to solicitors to draft the treaty.

[131] He also confirmed that the effective dates chosen are usually at month or year end to facilitate valuation of liabilities and assets to be transferred or ceded, which final valuation does not usually occur until 90 days later once there is actual data and values to make a true up or adjustment to the estimated numbers used in the Treaty. Given this, it is clear the Schedule dated March 28, 2007 may reflect this true up but it does not explain how it could have been attached to the original Treaty 1 as Mr. Martineau has suggested.

[132] When asked why the December 28 term sheet would be dated before the date of the Treaty 1 he testified he had no idea why that would be the case and testified he would have expected an earlier date. He also agreed he emailed France Boudreau, an assistant to Sylvain Messier, on December 18, 2006 asking to see a draft of the Treaty and was informed by reply email entered into evidence that the Treaty was not in the format to be signed. His testimony further suggests it was not likely Treaty 1 was signed on December 22, 2006. Surely even if prepared in the

interim, a draft would have been sent to the Appellant's key advisor on the transaction after a request for it.

[133] Mr. Martineau's other evidence also raises concerns as to the veracity of his testimony that he signed Treaty 1 in final form on December 22, 2006. He also testified that there was a Conduct Review and Nomination Committee whose purpose was to review substantial transactions and forward recommendations to the Board of Directors. He testified he executed an Executive Summary on December 22, 2006 for the purpose of obtaining the ratification and approval of Treaty 1 with SLBL and attended such a committee meeting as evidenced by minutes of that meeting that refer to his participation dated February 22, 2007 which resolved to submit the treaty agreement to the Board of Directors for ratification and approval. He did not directly answer a question asked of him in cross-examination as to whether the February 22, 2007 minutes meant that the directors did not ratify Treaty 1 in December and instead replied that as far as he was concerned the deal was done in December of 2006. He did not think he was on the Board of Directors in 2006 and could not recollect whether the Treaty was submitted to the Board along with the Conduct Review Committee Resolution, although he testified that the Board usually adopts the Conduct Committee Resolutions unless specific directors object. Frankly, his testimony was somewhat vague and evasive on these matters.

[134] Having regard to all the inconsistent and vague testimony pertaining to the finalization and execution of Treaty 1 I cannot agree that it has been clearly established that the Treaty dated December 22, 2006 was signed in final form on that date, let alone existed in final form for signature on that date. Moreover, the Appellant did not provide an original copy of the Treaty for review by the Respondent after requests to do so even though it was entirely within the sole power of the Appellant to do so in order to clear up the issue. I must agree with the Appellant itself that an adverse inference should be drawn when it is within the sole power of a party to call a witness or give evidence that might elucidate facts and such party does not do so according to the rationale of cases like *Levesque v Comeau* [1970] SCR 1010 at pages 1012 to 1013, followed by this Court in *Pièces Automobiles Lecavalier Inc. v The Queen*, 2013 TCC 310, 2014 DTC 1126 at paragraphs 48 to 52.

[135] Finally, a point to which I give great weight, is the fact that both reinsurance treaties referenced are, without dispute, treaties that reinsure annuities held by SLBL, not life insurance reinsurance treaties. After the detailed evidence and emphasis of the Appellant on the dire need to address longevity risk, the Appellant

enters into further obligations to reinsure annuities and suggests at best this had a neutral effect on the Appellant's longevity risk. I find this position incredulous. Moreover, even if those treaties did indeed have a neutral effect, and there was certainly no evidence their effect was only neutral but rather only of the possibility they might be neutral, how by any stretch of the imagination could the Appellant be arguing it helped address its longevity risk. The hard and obvious reality is that entering into reinsurance treaties for annuities was not consistent with the emphatic plan to address the longevity risk by focusing on life insurance reinsurance. Again, when a party does not follow its own plan and priorities, it cannot decry the lack of credibility given to its arguments.

[136] I am simply not swayed by the Appellant's arguments that it needed to get some volume on the books of the branch or that it could not go to other parties with nothing on its books. As the Respondent has clearly put forth, a third party would look to the underlying strength of the Canadian corporation, not its new branch, in evaluating the financial position of the Appellant. This was clear in the Appellant's own evidence and plans including in the Proposal to Establish a Bermuda Branch of SCDA put to the Appellant's U.K. Board of Directors. On page 4 of that Proposal following the cover page under the heading "*3. Rationale for Establishment of the Bermuda Branch*", it states:

> … An advantage of writing the proposed business in a Bermuda Branch of SCDA rather than in SLBL is that the Branch will then be able to rely on the financial strength and credit rating of SCDA in writing policies, underwriting the reinsurance business and in facing the global reinsurance marketplace.

[137] Moreover, in the Business Plan of October 30, 2006 filed with the Bermuda Monetary Authority in support of the Appellant's application to establish a branch in Bermuda under its *Insurance Act*, the Appellant makes the nearly identical statement under the heading "Business Purpose":

> …The business is being set up as a Bermuda Branch as it will then be able to rely on the financial strength and credit rating of SCDA in writing policies, underwriting the reinsurance business and in facing the global reinsurance marketplace.

[138] The Appellant even suggested in its Reply argument that it proposed to the Bermuda Monetary Authority in its plan of October 30, 2006 that part of its plan included taking over SLBL's existing business and hence the reinsurance Treaties entered into were already part of the plan. In fact, the Appellant points to a

provision found in paragraph 4 under the Description of Product offering in such plan which reads as follows:

> It is proposed that the Bermuda Branch will benefit from the existing SLBL book of business by offering SLBL its reinsurance services. The Bermuda Branch would therefore establish itself initially by reinsuring the existing Bermuda business of SLBL. This will assist the Bermuda Branch to further its reinsurance product strategy and realise its objectives.

[139] The “objectives” referred to above must surely mean the objectives of the Appellant to mitigate its longevity risk, as so emphatically stated by the Appellant throughout the trial. In fact, under the same heading only two paragraphs further, is the paragraph supporting the real objectives in my view:

> The Bermuda Branch will be instrumental in supporting SCDA’s business plan. In addition to providing a profitable source of business, the Bermuda Branch business will represent a natural hedge to SCDA’s longevity risk exposure arising from its annuity business. Through its insurance and reinsurance offering, the Bermuda Branch will allow SCDA to mitigate its annuity longevity risk by concurrently managing the asset streams and duration on the books of the insurance and reinsurance business, versus those of the annuity business.

[140] The latter paragraph makes it clear that the objective or plan of the Appellant was still to use the Bermuda branch to hedge its longevity risk, and so it follows that the only obvious way of benefiting from reinsuring the SLBL book of business in pursuance of those plans or objectives would have been to reinsure the existing life insurance business of SLBL, not its annuities business. The Appellant did the opposite through the Treaties.

[141] The Appellant points to the fact assets were transferred to the Appellant from the account of SLBL on December 28, 2006 as consideration for the book of annuities reinsured by the Appellant and that such transfer and assumption of liabilities is reflected on financial statements prepared for the branch. This would appear to be a significant step supporting the completion of Treaty 1. The problem I have with this evidence is that it is tendered in support of an act that was not consistent with the stated objective or intent of the Appellant and so it is difficult to give it any weight in that context. From a strictly evidentiary perspective however the Statement of Agreed Facts states, at paragraph 31:

> Treaty 1 states that Bermuda Branch assumed $15,384,662 of actuarial liabilities and premiums of $15,077,302 from Bermuda Limited.

[142] The difference may well be explained by the fact the Treaty requires a ceding commission to SLBL of $450,000 subject to actuarial adjustment. However, the Treaty requires in paragraph 5 dealing with reinsurance premiums, that:

> In consideration of the liabilities and obligations ceded to the Reinsurer in connection with the Annuities (the "**Ceded Liabilities**"), as at the Effective Time the Company shall transfer to the Reinsurer assets with a value equal to, and matched with, the Ceded Liabilities as at the Effective Time (the "**Transferred Assets**") and on that account shall, at the Effective Time, transfer the assets set out on Schedule 5 to this Agreement.

[143] There was no list of the ceded liabilities being the list of transferred annuities attached to the agreement. These policies of annuities were only added in the amending agreement of March 30, 2007 as Schedule 3.

[144] The Schedule 5 attached to the agreement is dated March 28, 2007 and indicates assets with a value of only $14,051,096.96 were transferred. Aside from the obvious question as to how one could transfer assets according to a list that was not yet prepared, no explanation was offered why if the Bermuda branch assumed liabilities of $15,384,662 that only assets of $14,051,096.96 were transferred by SLBL contrary to the Treaty requirement. The difference of $1.2 million far exceeds the ceding commission of $450,000 identified in the Treaty.

[145] The undated and unsigned 3 pages of Financial Statements tendered into evidence for both the 2006 and 2007 December 31 fiscal years for the branch indicate the branch assumed the same amount of net actuarial liabilities referred to in the Statement of Agreed Facts, but the list of assets, which totals more than the net actuarial liabilities, still does not show any total of asset types or combination within those listed types that equal $14,051,096.96. While I appreciate there may well be an explanation, such as an additional cash transfer on which the evidence is not clear, the financials, like much of the Appellant's arguments or evidence, seems to require me to assume a great deal of the facts not tendered into evidence.

[146] In the same light, as the Respondent has pointed out, aside from the fact the statements are unsigned and undated, there has been no evidence as to the purpose of preparing them nor any use demonstrated by them. There is evidence that they were not attached to any application made to the Bermuda Monetary Authority in 2009 or any other use. This of course does not mean there was no purpose to their preparation and it would seem they might be useful just for internal purposes on their own. The problem I have however is that they are of little assistance to me in

evaluating the reinsurance Treaty and the questions raised as to the inconsistencies above only add to the list of unanswered questions in my mind.

[147] What is also clear and not in dispute is that the Appellant managed the Bermuda corporation, SLBL, from Montreal and that SLBL had in fact a block of life insurance business totalling in excess of $640 million. The Appellant could just as easily have reinsured some or all of this block of business which would have been consistent with its stated plan yet did not, particularly where the large size of this life insurance book of business would have gone much further in alleviating the Appellant's longevity risk. No explanation was given as to why, with such great longevity risk exposure that threatened its viability, prompting it to spend its time and energy to access the large U.S. life insurance market through a Bermuda branch - all as stated repeatedly in resolutions, plans and testimony throughout this trial - the Appellant would enter into reinsurance Treaties that might not hurt, but surely can't help it meet its objectives or plans especially when it actually had the ability to do so in a much more significant way and chose not to. I simply cannot give any weight to the entering into of these reinsurance Treaties in 2006 and 2007, even disregarding the concerns of the Respondent and the evidence that suggests the 2006 Treaty may not have been the one entered into in 2006, in such circumstances.

(iv) Other Agreements or Indicia of Carrying on Business

[148] Aside from the employment agreements above referred to and Treaty 1, the only evidence of other agreements entered into in 2006 were the opening of a bank account with Butterfield's Bank, the execution of a lease to rent the small executive office that the Appellant itself admits was not a long term location, and of course the employee recruitment agreement, all signed by Mr. Messier, an employee of the Appellant's Canadian business. Since the evidence is that Elaine Furbert was not given bank signing authority until February of 2007 and email banking access until March of 2007, was not given a business card, did not have an email address until 2007, did not report to the office in 2006 due to the holiday season and the fact it was not properly furnished, it is difficult to give such factors any weight in analysing what acts took place in Bermuda.

[149] The Appellant also points to the solicitation letters prepared by Jim Doherty for Mr. Messier's apparent signature that were in fact signed by Elaine Furbert and sent out to three companies in the Standard Life Group, none addressed to any U.S. member. For a person who, Mr. Messier testified, was to be in charge of marketing, it appears she did nothing else from the evidence in terms of marketing

or sales calls, conferences, letters or other means to solicit business. I note the fact she had no reinsurance expertise obviously had something to do with that.

[150] I cannot find that any of these other agreements or acts demonstrate any serious and continuous efforts to do what a normal insurance company would do to start and build a life reinsurance business in 2006.

[151] As for 2007, the only other activities aside from an additional reinsurance Treaty for a smaller amount than the first that likewise reinsured annuities and the amendment to the first Treaty effectively increasing the amount of annuities reinsured and to which I attach little weight in regard to the question at hand, were the mailing of three additional standard letters to group members signed by Elaine Furbert on September 6, 2007; an amendment to the employment contract of Elaine Furbert dated November 28, 2007 which reduced her salary to US $40,000 and acknowledged she could work for others as well as provided a schedule to the agreement that set out her duties which clearly are those of accounting and bookkeeping and related records systems; the execution of a recruitment agreement with Elliot Partnership dated September 17, 2007 to find a new general manager that contemplated the branch would be expected to have a workforce of 6 people in the future; the execution of a lease for new office space and of an architectural contract to prepare plans for and project manage the renovation of same dated August, 2007; and the execution of a new employment agreement with a Mr. Michael Downie, dated December 5, 2007 and signed by Elaine Furbert as well as Sylvain Messier, who was hired as the new general manager effective January 1, 2008 and whose contract was much more detailed in form than past contracts with his duties set out in an detailed appendix to the contract, unlike in the case of Elaine Furbert initially, that include responsibility for the marketing and sales of reinsurance, a true essential element of the reinsurance business.

[152] There was no explanation as to why the Appellant waited so long to search for a new general manager but the recruitment agreement was signed in September of 2007, hardly consistent with the Appellant's claim that it took continuous steps to find the right person. Moreover, there is no evidence they found Mr. Downie through the Elliott Group although that appears to be the inference I am asked to make, nor any résumé that speaks to his qualifications, although the evidence is clear he was not an insurance underwriter and so hired those qualified people necessary as a condition of its amended licence.

[153] There is obviously evidence the Appellant intended to secure new office space in the summer of 2007 and hired an architect to prepare drawing and

supervise renovations at such new address in August of that year, but the evidence is that the Appellant entered into an agreement in August of 2007 to lease and renovate space in a building to be erected at the new address and actually entered into a lease for the space on April 9, 2008 for a term of 5 years and a Certificate of Occupancy was issued to the Appellant on such date as well. It is clear from the documentary evidence the tenant had committed to new office space in a building to be erected by the landlord, upon its completion that occurred in April of 2008. Such evidence points to carrying on business in 2008.

[154] In any event, there is no evidence of any other efforts to bring in new contacts, execute or negotiate other reinsurance contracts or make sales of any kind after the execution of the second Treaty in March of 2007, nor even to attended any conferences, meetings or other events with a view to marketing reinsurance or any insurance for that matter, other than the three standard form letters signed and dated September 6, 2007, hardly evidence of continuous efforts. In fact, the only inquiry from the group's Asia branch, which was redirected by Elaine Furbert to the Canada office, was turned down for shifting reasons, from not being able to meet the Asia's branch timetable, to the pricing was not good, to the Appellant's branch did not undertake such type of accident reinsurance, all leading me to question the credibility of the Appellant's evidence when it came to the actions of Elaine Furbert and the Appellant in general pertaining to its explanation of the business it says it carried on.

[155] The evidence shows that after Mr. Downie was hired, he in fact did hire experienced insurance underwriters and support staff in 2008 and afterwards. This suggests the Appellant started serious efforts to be able to carry out a life reinsurance business, including the essential elements of sales, marketing, and hiring qualified staff, all of which in fact led to the Appellant applying for and receiving changes to its licence which allowed it to do business with unrelated persons. This resulted in the execution of at least 5 life reinsurance contracts with unrelated parties from 2009 to 2011. However, it is also clear these serious efforts, including the hiring of qualified staff and moving to new offices in 2008 that could accommodate them, all predominantly occurred in 2008, the first year the Bermuda branch appears to have had its own letterhead, and afterwards, but not before, nor can they be said to be continually linked to the limited efforts and acts of 2006 and 2007 which appear more supportive of the fact there was no serious intention to carry on the life reinsurance business at such time. For whatever reason, the Appellant switched gears and direction in my view beginning in 2008.

<u>Conclusion on Carrying on Business Issue</u>

[156] On the evidence before me I cannot find that the Appellant was factually carrying on business in Bermuda in 2006 or 2007 as during those years the Appellant did not meet the essential elements test referred to in *Caballero* or the other cases above. The Appellant did not have qualified and experienced employees or staff to enable it to market or obtain life reinsurance business through activities in Bermuda in either year, nor did it have the proper office space from which to do so and made no continuous efforts to obtain same. In fact, failing to hire an appropriate and qualified general manager in Ms. Rouse, when it had the opportunity to do so but for its own self-imposed and unrealistic timetable, suggests the Appellant had no intention to hire same or had abandoned any such intention. Moreover, the contracts for reinsurance entered into and described as Treaties 1 and 2 throughout the trial were not consistent with furthering the goals and objectives of the Appellant to mitigate longevity risk through the reissuance of life insurance despite what was clearly and emphatically stated on many occasions in the evidence. I cannot regard these activities or other ancillary activities in support of these agreements as carrying out essential elements in furtherance of the Appellant's stated intention. Moreover, notwithstanding the stated goal of accessing the larger U.S. market and the need to have a physical presence there within 5 years, absolutely no evidence was tendered to suggest this essential element was acted upon in any other way. Unlike in *London Life* where the taxpayer's activities were in furtherance of its stated plan, the Appellant's here were not nor were they sufficient. The Appellant has quite frankly in my opinion overwhelmingly failed the test and in my view its actions were nothing more than "window dressing", as the Respondent has argued, to give the illusion it was doing so, or more appropriately, to be able to argue it was when it really was not.

Window Dressing

[157] While it is not necessary for me to explore any further the Respondent's argument about window dressing, it would be appropriate to state that I found that the Appellant did not conduct the essential elements of a life reinsurance business. For example the Appellant did not have the proper experienced employees who would have enabled it to conduct the life reinsurance business it testified it intended to conduct. In addition, its actions were completely opposite to its stated intention by pursuing annuities reinsurance contracts. All of the preceding occurred in a context when it had the ability to hire the appropriate staff and enter into life reinsurance contracts instead.

[158] As the Respondent has argued, the Supreme Court of Canada has distinguished a "sham" from "window dressing", which was recognized in *Ludco*

Enterprises Ltd. v Canada, [2001] 2 SCR 1082, 2001 SCC 62, *Backman v Canada*, [2001] 1 SCR 367, 2001 SCC 10 and *Spire Freezers Ltd. v Canada*, [2001] 1 SCR 391, 2001 SCC 11, as a deception that is not about the legal validity of a transaction, as in sham, but about the taxpayers intention for entering into the transaction. In determining how the Courts should go about identifying whether the stated intention or purpose is present or what standard should be applied, Iacobucci J stated in *Ludco* at paragraph 54:

> ..In the interpretation of the Act, as in other areas of law, where purpose or intention behind actions is to be ascertained, courts should objectively determine the nature of the purpose, guided by both subjective and objective manifestations of such purpose…

[159] The Respondent has captured the situation quite precisely in my view in paragraph 170 of its Written Representation:

> 170. None of the appellant's stated purposes in the business plans/proposals in 2006,or other objectives stated at trial, are consistent with its actions. As noted previously, each of the witnesses said SLAC wanted to hedge or reduce SLAC's longevity risk but the way to do that was to obtain life insurance policies. The appellant did the opposite-it acquired annuity policies which only increased its longevity exposure. Whatever may have been the appellant's eventual goals, its actions in 2006 and 2007 were not done in furtherance of those goals.

[160] Based on an objective review of the entire evidence, I cannot find that the few activities of the Appellant in 2006 and 2007 can suggest a reinsurance business was being carried on in Bermuda. I agree with the Respondent that these activities were designed to give the appearance the Appellant was carrying on such business for profit, when in fact, its only supportable purpose was to obtain a tax benefit. I do not agree in the circumstances that the tax benefit was but one of the purposes and frankly agree with Mr. Faille's testimony, the only witness called by the Appellant and the former Tax Director and VP Finance of the Appellant, who conceded in his view the only purpose was to obtain the tax benefit of the subsection 138(11.3) bump. The evidence does not point to any other purpose.

[161] In my view the evidence is clear that the Appellant was aware of the pending changes to the *Act* as a result of mark to market rules effective January 1, 2007 that would have required it to realize a capital gain on its investment assets up to their fair market values and that the Appellant embarked on a rushed and unbusiness like scheme, taking actions contrary to its own stated intention, to put itself in a position to argue it was carrying on a business outside of Canada in 2006 and thus

argue the application of subsection 138(11.3) would bump up its cost base to fair market value on a tax free basis, which of course I have concluded did not apply to it regardless. I find that its actions as such were mere window dressing designed to mislead the Minister into believing that it was carrying on a business in Bermuda for profit, when its true objective was only to obtain a tax benefit.

Decision

[162] Subsection 138(11.3) does not apply to bump the Appellant's cost base of the assets in question in 2006 nor 2007, both because the Appellant did not meet the legal requirements of the subsection in 2006 or 2007 and because the Appellant did not factually carry on business in Bermuda, and hence another country, in 2006 or 2007.

[163] The Appellant's appeals are dismissed with costs to the Respondent. However if either party is not satisfied with such decision on costs, they may make written submissions to me on costs within 30 days of the date of this decision for my reconsideration.

Signed at Ottawa, Canada, this 20th day of April 2015.

"F.J. Pizzitelli"

Pizzitelli J.

APPENDIX A

2012-1431(IT)G, 2013-203(IT)G

TAX COURT OF CANADA

BETWEEN:

THE STANDARD LIFE ASSURANCE COMPANY OF CANADA

Appellant

\- and -

HER MAJESTY THE QUEEN

Respondent

STATEMENT OF AGREED FACTS

The parties to these proceedings admit, for the purposes of these proceedings only, the truth of the following facts and to the authenticity of the documents referred to in this Statement of Agreed Facts ("**Agreed Statement**"), subject to the caveats below. The parties may challenge the accuracy of any of the statements contained in these documents.

A. The Appellant

1. The Standard Life Assurance Company of Canada (the "**Appellant**") is a corporation governed by the *Insurance Companies Act* (Canada).

2. It is a taxable Canadian corporation, a financial institution and a life insurance corporation for purposes of the *Income Tax Act* (Canada) (the "**Act**").

3. The Appellant is, and has always been, resident in Canada for purposes of the Act. It currently carries on, and has always carried on, a life insurance business in Canada.

4. The Appellant is an indirect subsidiary of Standard Life plc, a leading provider of long-term savings and investments.

5. Standard Life plc is headquartered in Edinburgh, Scotland. It has around six million customers worldwide and operates in several countries, including the United Kingdom, Canada, Europe, Asia and the Middle East.

6. In 2004, the Appellant became a wholly owned subsidiary of Standard Life Financial Inc. ("**SLFI**"). SLFI is a holding company that was incorporated in Canada in 2004. It is a wholly owned subsidiary of Standard Life Oversea Holding Company, a UK incorporated and resident company, which, in turn, is wholly owned by Standard Life plc, listed on the London Stock Exchange.

7. The Appellant's taxation year ends on December 31 (the "**Taxation Year**").

8. Before the 2006 Taxation Year, the Appellant did not carry on an insurance business outside Canada.

9. As of December 31, 2005, the Appellant reported that it had investment assets that it used in the course of carrying on its life insurance business in Canada, which had a book value (cost) of $13,197,890,996 and a tax cost of $12,059,979,282.[1] These assets included mortgage investments, bonds, mutual funds, segregated fund investments, real estate investments and joint venture investments.

10. As of January 1, 2006, the Appellant reported that its investments had a fair market value which exceeded their tax cost by the following amounts:[2]

Asset	Amount
Mortgage Investments	$285,754,263
Bonds	$668,914,712
Mutual Fund Investments	$1,739,214
Segregated Fund Investments	$936,749

[1] The Canada Revenue Agency has not verified these values, however the fair market value of these assets in 2006 and 2007 is not being challenged and is not in issue in this appeal.

[2] See footnote 1.

Asset	Amount
Real Estate	$130,611,288
Joint Venture Investments	$49,955,488

B. Bermuda Limited

11. Standard Life Assurance Company Bermuda Limited ("**Bermuda Limited**") is an indirect subsidiary of Standard Life plc. Its direct parent company in 2006 was SLFI.

12. Bermuda Limited is related to the Appellant and is, therefore, deemed not to deal at arm's length with the Appellant for purposes of the Act.

C. The Bermuda Branch

13. On October 19, 2006, at the request of the Appellant, Appleby Hunter Bailhache, a provider of offshore legal, fiduciary and administration services, sent the Appellant a memorandum setting out the process for obtaining the requisite permits to become a licensed insurer in Bermuda.[3]

14. On October 30, 2006, the Appellant made an application to the Bermuda Monetary Authority (the "**BMA**") to establish a Bermuda branch of the Appellant (the "**Bermuda Branch**") as a long-term insurer.[4]

15. Prior to October 2006, Mr. Doherty of Ernst & Young LLP was retained to do work for the Appellant and Bermuda Limited. In October and November of 2006, Mr. Doherty also retained Assurage Actuariat Consulting Inc. to assist him with his work.[5]

16. By way of a shareholder resolution dated November 10, 2006,[6] Standard Life plc. ratified, confirmed, and approved in principle:

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[3] Memorandum, Joint Book of Documents, Tab 1.

[4] Letter, Joint Book of Documents, Tab 2.

[5] Invoices, Joint Book of Documents, Tab 3.

[6] Resolution, Joint Book of Documents, Tab 4.

(a) the establishment of the Bermuda Branch;

(b) the business plan submitted to the Board;

(c) the appointment of Mr. Doherty of Ernst & Young LLP as an Approved Actuary pursuant to Bermuda laws;

(d) the injection of capital into the Bermuda Branch; and

(e) the appointment of auditors of [the Appellant] as auditors of the Bermuda Branch.

17. By letter dated November 17, 2006,[7] the BMA wrote to Appleby Hunter Bailhache to advise that the Appellant's application had been approved subject to and review of:

(a) confirmation that the Appellant would accept a restriction on its license stating that the Company shall not, without obtaining the prior written approval of the BMA, write any business other than the reinsurance of an affiliate; and

(b) an undertaking that, prior to writing any unrelated reinsurance business, the Appellant will hire an experienced reinsurance underwriter and seek approval of that underwriter and the companion business plan (which will include a detailed explanation of the unrelated reinsurance business to be written) from the BMA.

18. On November 21, 2006, the Appellant replied to the BMA to provide the confirmation and undertaking requested in the November 17, 2006 letter. In particular, the Appellant undertook to hire an experienced reinsurance underwriter, who could be an individual or a firm, seek approval by the BMA of that underwriter and to seek approval by the BMA of a companion business plan that would include a detailed explanation of unrelated reinsurance business, before it wrote any unrelated reinsurance business.[8]

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7 Letter, Joint Book of Documents, Tab 5.

8 Letter, Joint Book of Documents, Tab 6.

19. On November 28, 2006, a paper relating to the establishment of the Bermuda Branch was presented for approval at a meeting of the Board of Directors of Standard Life plc.[9]

20. On December 7, 2006, pursuant to sections 134 and 136 of *The Companies Act 1981* (Bermuda), the BMA issued the Appellant a permit.[10]

21. On December 7, 2006, the Appellant sent letters to Swiss Re Life and Health Canada, Lincoln National Life Insurance Company and RGA Reinsurance Company of Canada,[11] ceding companies with which Bermuda Limited had previously entered into Reinsurance Agreements.

22. As of December 12, 2006, the Appellant finalized a business plan relating to the establishment of the Bermuda Branch, which was presented to, and ultimately approved by, its Board of Directors at a meeting held on December 15, 2006. In that meeting, the Board of Directors also approved the delegation of authority to the not yet hired "General Manager" of the Bermuda Branch to sign documents on behalf of the Appellant in Bermuda.[12]

23. On December 21, 2006, effective December 19, 2006, the Appellant was registered by the Registrar of Companies in Bermuda.[13]

24. On December 21, 2006, effective December 19, 2006, the Appellant was registered as a long term insurer pursuant to the *Insurance Act 1978*, subject to the conditions attached thereto.[14]

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9 Minutes of Board of Directors and Proposal to Establish a Bermuda Branch of The Standard Life Assurance Company of Canada, dated November 28, 2006, Joint Book of Documents, Tab 7.

10 Permit, Joint Book of Documents, Tab 8.

11 Letters, Joint Book of Documents, Tab 9.

12 Minutes of Board of Directors, Business Plan - 2006-2010, dated December 12, 2006, Joint Book of Documents, Tab 10.

13 The registration was dated December 21, 2006.

14 Certificate of Registration dated December 21, 2006, Joint Book of Documents, Tab 11.

25. Pursuant to an engagement letter dated December 20, 2006, the Appellant retained Ernst & Young LLP to provide services to the Bermuda Branch. In this letter, the Bermuda Branch agreed that Ms. Mary Stock would act as the Independent Actuary.[15]

26. On December 21, 2006, Mr. Doherty of Ernst & Young LLP was designated and approved by the Bermudian authorities as an actuary for purposes of the *Insurance Act 1978* (Bermuda).[16]

27. On December 21, 2006, three letters were sent to three foreign entities within the Standard Life Group regarding the Bermuda Branch.[17] The authenticity of these letters is not admitted.

28. A document dated December 22, 2006 between Bermuda Limited and the Bermuda Branch was titled Reinsurance Treaty (the "**Treaty 1**").[18] The authenticity of this document is not admitted.

29. Treaty 1 states that, Bermuda Limited agreed to reinsure, with the Bermuda Branch, 25% of the liabilities and obligations under the Canadian dollar annuities issued prior to December 1, 2006 by Bermuda Limited.

30. The Treaty 1 states that it is effective at the close of business on December 31, 2006, and provided for the transfer of assets with a value equal to the ceded liabilities.

31. Treaty 1 states that Bermuda Branch assumed $15,384,662 of actuarial liabilities and premiums of $15,077,302 from Bermuda Limited.[19]

32. On March 30, 2007, Treaty 1 was amended in Bermuda, with such amendments stated to be effective on December 31, 2006.[20]

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15 Engagement Letter, Joint Book of Documents, Tab 12.

16 Certificate, Joint Book of Documents, Tab 13.

17 Letters, Joint Book of Documents, Tab 14.

18 Treaty in its current form, as certified on July 9, 2013, Joint Book of Documents, Tab 15.

19 Unaudited Financials for 2006, Joint Book of Documents, Tab 16.

20 Amendment to the Treaty, Joint Book of Documents, Tab 19.

33. On March 30, 2007, effective January 1, 2007, the Bermuda Branch and Bermuda Limited signed a new "**Treaty 2**" for the Bermuda Branch to reinsure additional annuities issued by Bermuda Limited prior to December 31, 2006.[21]

34. Pursuant to Treaty 2, the Bermuda Branch reinsured and assumed a further $12,018,000 of actuarial liabilities and a further $11,801,000 of premiums from Bermuda Limited.[22]

35. On September 6, 2007, three letters were sent to three foreign entities within the Standard Life Group regarding the Bermuda Branch.

D. Office Space

36. In October 2006, the Appellant, through Ms. France Boudreau, external consultant to the Appellant based in Montreal, commenced its search for office space in Bermuda.[23]

37. On December 18, 2006, a services office agreement with FSC Management Bermuda Limited was signed for the provision of office accommodations, and related facilities and services to the Bermuda Branch. The agreement was signed, and accepted on behalf of, "Standard Life Assurance Company of Canada, Bermuda Branch." As a part of this agreement, the Bermuda Branch also obtained a telephone number.[24]

38. On December 18, 2006, an agreement to lease an executive office with "Channel House" was signed, which was located at Suite 3-104, Longfield Road, Southside, St. David's in Bermuda. The agreement was signed, and accepted on behalf of, "Standard Life Assurance Company of Canada, Bermuda Branch."[25]

39. On December 22, 2006, the Appellant on behalf of the Bermuda Branch, paid three and half a month's rent in advance for use of the St. David's office.[26]

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[21] Treaty 2, Joint Book of Documents, Tab 17.

[22] Unaudited Financials for 2007, Joint Book of Documents, Tab 18.

[23] Memo to File, Joint Book of Documents, Tab 20; Select Documents from Search for Property, Joint Book of Documents, Tab 21.

[24] Services Office Agreement, Joint Book of Documents, Tab 22.

[25] *Ibid.*; Photographs of the St. David's Office, Joint Book of Documents, Tab 23.

[26] Account Ledger, Joint Book of Documents, Tab 24.

40. In July 2007, the Bermuda Branch agreed in principal to lease new office space located at 131 Front Street, Hamilton in Bermuda.[27]

41. On August 10, 2007, the Bermuda Branch entered into an agreement with a contractor to complete a "fit out" of the new office space,[28] and it entered into the lease agreement on August 29, 2007.[29]

42. Effective April 8, 2008, a Certificate of Use and Occupancy Permit was issued to the Bermuda Branch.[30] It entered into an amended lease agreement on April 9, 2008 and was open at its new location on that date.[31]

E. Employees

43. On December 13, 2006, the Appellant retained a Bermuda-based recruitment firm, "bermudaREcruit Ltd." to identify a suitable candidate to serve as the "General Manager" of the Bermuda Branch.[32]

44. On December 18, 2006, the Bermuda Branch entered into an employment agreement[33] with Ms. Elaine Furbert, who was also a consultant with Appleby Hunter Bailhache.[34]

45. Ms. Furbert was paid salary, health insurance and fringe benefits during the course of her employment with the Bermuda Branch.[35]

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[27] Agreement in Principle, Joint Book of Documents, Tab 25.

[28] Agreement, Joint Book of Documents, Tab 26.

[29] Lease Agreement, Joint Book of Documents, Tab 27.

[30] Certificate of Use and Occupancy Permit, Joint Book of Documents, Tab 28.

[31] Amended Lease Agreement, Joint Book of Documents, Tab 29.

[32] Recruitment Agreements, Joint Book of Documents, Tab 30.

[33] Employment Agreement, Joint Book of Documents, Tab 31.

[34] Ms. Furbert qualified as a chartered accountant in 1981 and is an associate of the Institute of Chartered Accountants of England and Wales. Ms. Furbert provided consulting services for Reid Management Limited since 1999. This company has served as the principal representative of the Bermuda Branch and specializes in the provision of legal, fiduciary and administration services. Effective August 31, 2008, Reid Management Limited changed its legal name to Appleby Management (Bermuda) Ltd.

[35] Employment Agreement, Joint Book of Documents, Tab 31.

46. On November 28, 2007, Ms. Furbert's employment agreement was modified.[36]

47. The Appellant retained the services of Elliott Partnership towards the end of 2007 to find a Managing Director.[37]

48. On December 5, 2007, the Bermuda Branch entered into an agreement to employ Mr. Michael Downie in the capacity of Managing Director.[38] He commenced working for the Bermuda Branch effective January 1, 2008. Ms. Furbert continued to work for the Bermuda Branch until August 26, 2010.

F. Banking Arrangements & Regulatory Filings

49. On December 8, 2006, the Appellant opened a bank account in Bermuda with the Bank of N.T. Butterfield & Son Limited.[39]

50. On December 27, 2006, the Appellant transferred $427,955.15 USD to that bank account.[40]

51. In February 2007, the Appellant obtained the requisite approvals from its Board of Directors to authorize the Bermuda Branch to open any new bank accounts as may be necessary subject to specified monetary limitations.[41] The "General Manager" of the Bermuda Branch was also specifically authorized to operate such bank accounts.

52. The Appellant filed Annual Returns with the Insurance Division of the BMA in respect of 2006 and 2007.[42]

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36 Modification to Agreement signed December 18, 2006, Joint Book of Documents, Tab 32.

37 Letter, Joint Book of Documents, Tab 33.

38 Employment Agreement, Joint Book of Documents, Tab 34.

39 Authorization to Open Bank Account & Documents from Opening Account, Joint Book of Documents, Tab 35.

40 Transfer, Joint Book of Documents, Tab 36.

41 Extract from Minutes of a Meeting of the Board of Directors of The Standard Life Assurance Company of Canada held February 22, 2007, Joint Book of Documents, Tab 37.

42 Annual Returns, Joint Book of Documents, Tab 38.

G. 2006 Property Subject of this Appeal

53. In its return of income under Part I of the Act for the 2006 Taxation Year, the Appellant listed certain property on "Schedule 150" and on the basis that it was designated property for the 2006 Taxation Year in accordance with section 2401 of the *Income Tax Regulations* (the "**Regulations**") for the year (the "**2006 Designated Property**").

54. Some of the property that the Appellant reported as "designated" property was owned by the Appellant at the end of the 2005 Taxation Year (the "**2006 Property**"). In the 2005 taxation year, the Appellant did not complete the portion of the Schedule 150 dealing with Reserve Liabilities and the Summary of Investment Property.[43]

55. The 2006 Property included bond investments, mortgage investments, mutual fund investments, segregated fund investments, real estate investments and joint venture investments. None of the 2006 Property was a "mark-to-market property" of the Appellant for the 2005 Taxation Year (as defined in subsection 142.2(1) of the Act).

56. The Appellant was not able or entitled to designate insurance property or not designate insurance property for the 2005 Taxation Year since the prerequisite to making a designation in accordance with Regulation 2401 for purposes of the definition of "designated insurance property" in subsection 138(12) is that the insurer carries on an insurance business in Canada and in a country other than Canada in the year.

H. 2007 Property Subject to this Appeal

57. In its return of income under Part I of the Act for the 2007 Taxation Year, the Appellant listed certain property on "Schedule 150" on the basis that it was designated property for the 2007 Taxation Year pursuant to Regulation 2401 (the "**2007 Designated Property**").

58. Some of the 2007 Designated Property was property that was owned by the Appellant at the end of the 2006 Taxation Year (collectively, the "**2007 Property**"). The 2007 Property included bond investments, mortgage investments, mutual fund investments, segregated fund investments and real estate investments.

[43] Schedule 150 from the 2005 Income Tax Return, Tab 39.

59. None of the 2007 Property was a "mark-to-market property" of the Appellant for the 2005 Taxation Year (as defined in subsection 142.2(1) of the Act).

I. Reassessments

60. By way of reassessments, notice of which was dated December 6, 2011 and June 28, 2012 (the "**Reassessments**"),[44] the Minister of National Revenue (the "**Minister**") reassessed the Appellant to change the amounts included or deducted in computing its income and tax payable under Part I of the Act for the 2006 and 2007 Taxation Years.

61. The basis of the Reassessments was that subsection 138(11.3) was not applicable in the 2006 and 2007 Taxation Years.

62. Specifically, by way of the Reassessment for the 2006 Taxation Year, the Minister changed the amounts included or deducted in respect of the 2006 Property in computing the Appellant's income under Part I of the Act for the 2006 Taxation Year as follows:

2006 Property	As Filed	Income Inclusion (or Deduction) per 2006 Reassessment	Increase (or Decrease) in Income from As Filed
Bond Investments	$41,897,089	$51,119,655	$9,222,566
Mortgage Investments	($9,852,496)	$nil	$9,852,496
Mutual Fund Investments	$1,076,046	$2,472,986	$1,396,940
Segregated Fund Investments	$801,011	$1,771,856	$970,845
Real Estate:			
Recapture	$184,083,638	$4,661,155	$(179,422,483)
Terminal Loss	$42,983,633	$(104,841)	$42,878,792
Capital Cost Allowance	($37,149,340)	$(26,050,743)	$11,098,597
Capital Gains	$7,586,697	$11,193,706	$3,607,009

44 Reassessments, Joint Book of Documents, Tabs 40 and 41.

63. Similarly, by way of the Reassessment for the 2007 Taxation Year, the Minister adjusted the amounts included (or deducted) by the Appellant in computing its income under Part I of the Act for 2007 Taxation Year in respect of the 2006 Designated Property and 2007 Designated Property as follows:

2006 & 2007 Designated Property	As Filed	Income Inclusion (or Deduction) per 2007 Reassessment	Increase (or Decrease) in Income As Reassessed from Income (or Deduction) As Filed
Bond Investments	$36,893,653	$41,031,970	$4,138,317
Bond; Transitional Amounts[45]	($14,335,485)	$103,199,822	$117,535,307
Mortgage Investments	($41,220,684)	$(626,268)	$40,594,416
Segregated Fund & Mutual Fund Investments	($11,954,022)	$19,121,005	$7,166,982
Real Estate:			
Recapture	$1,906,037	$11,234,408	$9,328,371
Capital Cost Allowance	($33,668,653)	$(23,043,493)	$10,625,160
Capital Gains	$11,678,776	$8,870,955	$(2,807,781)

J. Objections

64. By way of Notices of Objection dated January 4, 2012 and September 25, 2012, the Appellant duly objected to the Reassessments.[46]

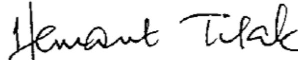
45 Transitional amounts affected by subsections 142.5(2), 142.51(3), and 142.51(5) of the Act.

46 Objections, Joint Book of Documents, Tabs 42 and 43.

The parties hereto agree that this Agreed Statement does not preclude either party from calling evidence to supplement the facts agreed to herein, it being accepted that such evidence may not contradict the facts agreed.

DATED at the City of Toronto, in the Province of Ontario, this 30th day of September, 2014.

Osler, Hoskin & Harcourt LLP



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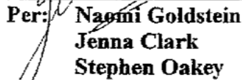
DATED at the City of Toronto, in the Province of Ontario, this 30th day of September, 2014.

Deputy Attorney General of Canada



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CITATION:	2015 TCC 97
COURT FILE NOs.:	2012-1431(IT)G; 2013-203(IT)G
STYLE OF CAUSE:	THE STANDARD LIFE ASSURANCE COMPANY OF CANADA AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Toronto, Ontario
DATES OF HEARING:	October 6, 7, 8, 9, 2014 and March 26 and 27, 2015
REASONS FOR JUDGMENT BY:	The Honourable Justice F.J. Pizzitelli
DATE OF JUDGMENT:	April 20, 2015

APPEARANCES:

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Counsel for the Respondent:	Naomi Goldstein Stephen Oakey Jenna Clark

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