

# What is a reasonable amount of loan interest – The 10/8 saga continues

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When things seem too good to be true, they probably are.

## A bit of history

Prior to 2013, 10/8 policies - universal life insurance policies that linked credited interest within the policy (at 8%) to borrowing made (at 10%) from the insurer – were selling like hot cakes. The end for 10/8 policies came in the 2013 Federal Budget.

The tax benefits of 10/8 policies were eliminated effective for taxation years ending after March 20, 2013. For a policy meeting the definition (section 248(1) definition of “10/8 policy”) interest is not deductible (subsection 20(2.01)), there is no collateral insurance deduction (subparagraph 20(1)(e.2)(ii)) and no capital dividend account (CDA) credit (subsection 89(1) definition of CDA at subparagraph (d)(iv)). This effectively meant that policyowners of these plans had to get out of them or they’d lose those tax benefits going forward.

## That was then, this is now

The CRA has continued to challenge 10/8 policies that existed prior to these amendments. In the recent case of *Honey v. The King* 2026 TCC 170, the Tax Court upheld the Minister’s reassessments for the 2009-2013 taxation years finding a reasonable amount of loan interest was at a rate of 4.18%, not 10%. For Glenn and Greg Honey, this meant disallowed interest deductions of over \$1.3 million for each of them.

The Court referred to the Supreme Court of Canada decision in the *Shell Canada Limited v. The Queen*, [1999] 3 S.C.R. 622 where it was stated: “where an interest rate is established in a market of lenders and borrowers acting at arm’s length from each other, it is generally a reasonable rate...”

The Minister took note of various public market loan yields and arrived at 4.18% (a range between Benchmark Canada 10-year bond yields at 4.00% for August and September 2006 when the 10/8 policies were purchased, and Canada Corporate AA 10-year bond yields as of September 6, 2006 at

4.68%). Why 10-year bond yields? A 10-year period with a 10-year renewal option was part of the 10/8 loan terms.

The basis of the taxpayers' argument was that "the 10/8 life insurance policies themselves constitute a market" so 10% was reasonable. The Court questioned "that any market influence was involved. These rates were established as part of the total 10/8 package, not as a result of public market influence."

It also questioned "whether 10/8 arrangements constituted transactions at arm's length."

Notwithstanding that the parties were not related, were they factually not dealing at arm's length? The Court concluded that "with circular movement of funds" borrowed by the Honey brothers from their corporation, deposited into the 10/8 plan, then promptly borrowed from the insurer and then invested in the corporation, "arm's length parties including RBCLIC (the insurer/lender) appear to be dealing with each other at non-arm's length...." The Court found this relevant to the test in the Shell decision since a reasonable amount of loan interest is to be determined in a market of lenders and borrowers *acting at arm's length* from each other.

Finding the Minister's reassessment was correct, the Court found that the taxpayers had not met the Shell case "requirements for market rates, having similar terms of years, and degrees of risk, as being comparables in establishing that their 10% rate, ...was reasonable in contrast to 4.18%."

## **Our thoughts**

Life insurance is a unique financial asset with unique tax attributes. These attributes are appropriate when solving for funding estate liquidity needs, facilitating business succession and post-mortem planning, or providing equitable distributions to beneficiaries to name a few. These purposes can be served creatively and progressively and need not be aggressive. The option to use life insurance as collateral security for a borrowing, also, need not be employed aggressively.

10/8 plans were a structured product, designed to produce tax-exempt growth at 8% and interest deductions at 10%. 10% was not commercially reasonable and neither was 8%. It is unclear how many pre-2014 reassessments of this nature were made and are still unsettled. As in this case, it can take a long time for these matters to reach the courts and be finally determined.

As well, audit activities have ramped up significantly in recent years with enhanced CRA audit powers and more information reporting and disclosure – both mandatory and voluntary – being central to these activities. Insurance ownership is regularly a part of questionnaires used in CRA global high wealth audit requests.

When considering life insurance "strategies" and "concepts", that get into surplus stripping, value shifting or evaporation, professionals should listen to that feeling they get when something seems too good to be true or too clever by half.

**FOOTNOTE:**

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