

**Federal Court of Appeal**



**Cour d'appel fédérale**

**Date: 20230228**

**Docket: A-94-19**

**Citation: 2023 FCA 42**

**CORAM: WEBB J.A.  
MONAGHAN J.A.  
GOYETTE J.A.**

**BETWEEN:**

**BARBARA PUDNEY**

**Appellant**

**and**

**HIS MAJESTY THE KING**

**Respondent**

Heard at Ottawa, Ontario, on February 23, 2023.

Judgment delivered at Ottawa, Ontario, on February 28, 2023.

**REASONS FOR JUDGMENT BY:**

**MONAGHAN J.A.**

**CONCURRED IN BY:**

**WEBB J.A.  
GOYETTE J.A.**

**Federal Court of Appeal**



**Cour d'appel fédérale**

**Date: 20230228**

**Docket: A-94-19**

**Citation: 2023 FCA 42**

**CORAM: WEBB J.A.  
MONAGHAN J.A.  
GOYETTE J.A.**

**BETWEEN:**

**BARBARA PUDNEY**

**Appellant**

**and**

**HIS MAJESTY THE KING**

**Respondent**

**REASONS FOR JUDGMENT**

**MONAGHAN J.A.**

[1] In 1991, Barbara Pudney purchased a life insurance policy. The policy required her to pay monthly premiums of \$64.89 for 22 years, which it appears Ms. Pudney faithfully did. In addition to the \$100,000 benefit payable to the named beneficiary on Ms. Pudney's death, the policy provided Ms. Pudney with a cash value. Under the terms of the policy, Ms. Pudney could

borrow an amount not in excess of the cash value or cancel the policy in exchange for a payment equal to the cash value.

[2] Ms. Pudney retired from the federal public service in January 2015. It appears she asked her employer to transfer a portion of her severance entitlement directly to her pension plan (to purchase additional pension credits) and/or to her registered retirement savings plan. Ms. Pudney claims this request, together with her request to the Canada Revenue Agency (CRA) for an exemption from withholding at source, resulted in a delay in her receiving the balance of her severance. Having retired, this delay led to Ms. Pudney experiencing financial difficulties and therefore, in spring 2015, Ms. Pudney surrendered her insurance policy in exchange for the cash value. The insurance company paid her \$32,859.18.

[3] In February 2016, the insurance company issued Ms. Pudney a T5 reporting that she had received \$27,225.14 of “Other Income” in her 2015 taxation year. In completing her 2015 income tax return, Ms. Pudney included that amount in income, but also deducted \$32,859—the cash value she received—as an “other deduction” in computing income. The CRA disallowed the deduction and reassessed Ms. Pudney’s 2015 taxation year, assessing additional taxes of approximately \$11,415, plus interest.

[4] Ms. Pudney asked the insurance company to explain the T5 and calculation of the taxable benefit to her. In a letter dated December 14, 2016, the insurance company explained the taxable gain was the difference between the proceeds of disposition—the cash value paid to her—and the adjusted cost basis (ACB) of the policy. The letter explained the ACB was \$5,634 and is the

difference between the total premiums she had paid (\$17,130.96) and the net cost of pure insurance (\$11,496.92). Ms. Pudney did not understand the terms the insurance company used in this letter.

[5] Ms. Pudney objected to the CRA's reassessment, enclosing the insurance company's letter with the notice of objection, and asked the CRA to explain why her cost of the policy was not what she paid, but an adjusted amount, and to explain the term "net cost of pure insurance".

[6] The CRA confirmed the reassessment. The notice of confirmation acknowledged that Ms. Pudney was seeking clarification of the terms used in the insurance company's letter, but it did not offer any explanation or clarification. This led Ms. Pudney to appeal to the Tax Court of Canada.

[7] The only issue addressed by the Tax Court was whether the CRA was incorrect in disallowing the \$32,859 deduction Ms. Pudney claimed. Before the Tax Court, Ms. Pudney explained the circumstances regarding her purchase of the policy and its surrender in 2015. She again asserted she did not understand why her cost was adjusted or why the T5 she received from the insurance company did not reflect the full amount she received. She asserted when she bought the insurance, she was told it was not taxable. But, she was unable to point to a rule that allowed her to deduct the \$32,859 in computing income.

[8] For reasons delivered orally on January 31, 2019, the Tax Court (*per* Pizzitelli J., in Tax Court File 2018-457(IT)I) dismissed her appeal. Ms. Pudney appeals that decision to this Court.

[9] I have sympathy for Ms. Pudney. The rules in the *Income Tax Act*, R.S.C. 1985, c. 1 (5<sup>th</sup> Supp.) governing insurance are complicated. Ms. Pudney certainly understood some aspects of her policy. She understood that there was an investment element to the policy, explaining to this Court that was one of the reasons she purchased the type of policy she did. She understood the policy had a cash surrender value. What Ms. Pudney did not understand is why her ACB of the policy was not what she paid for it and what was meant by net cost of pure insurance.

[10] The insurance policy did not help her with these questions. The policy document states that it is an exempt policy—a term, the policy explains, that is found in the *Income Tax Act*. The policy document explains that, because it is an exempt policy, the owner (here Ms. Pudney) is not required to include in income any amount relating to the periodic accrual of income within the policy. This means, as Ms. Pudney recognizes, there is an investment element of the policy. The policy document also warns that, notwithstanding that it is an exempt policy, if the owner surrenders the policy for cash or takes a loan against the cash value, it may be necessary to include an amount in income. Unfortunately, the policy document does not explain how that amount is calculated.

[11] The *Income Tax Act* provides that if an owner of a life insurance policy disposes of it by surrendering it to the insurance company, as Ms. Pudney did, the difference between the amount received from the insurance company and the ACB of the policy is taxable: subsection 148(1) and paragraph 56(1)(j) of the *Income Tax Act*.

[12] The ACB of an insurance policy is defined in subsection 148(9) of the *Income Tax Act* and is based on a formula. That formula describes a number of additions and subtractions that must be made to determine the ACB. Ms. Pudney is correct that the premiums she paid are added to ACB—this is found in factor B of that formula. However, by virtue of paragraph (a) of factor L in that formula, she must deduct the net cost of pure insurance “as defined by regulation and determined by the issuer of the policy in accordance with the regulations”.

[13] Net cost of pure insurance is defined in section 308 of the *Income Tax Regulations*, C.R.C., c. 945 and includes another formula. While explaining the details is unnecessary for purposes of this appeal, it is perhaps useful to note that the net cost of pure insurance is determined based in part on the probability that an individual with the same relevant characteristics as the person whose life is insured (in this case Ms. Pudney) will die in a particular year.

[14] In Ms. Pudney’s case, as required by the definition of ACB in the *Income Tax Act*, her insurance company calculated the net cost of pure insurance of her policy in 2015 as \$11,534. As required by the *Income Tax Act*, that amount was deducted from the total premiums she had paid to calculate her ACB of her policy.

[15] The difference between what Ms. Pudney received on surrendering the policy and that ACB had to be included in her income. This she did. However, the *Income Tax Act* does not permit her to deduct the \$32,859 she received. The only available deduction is her ACB. The insurance company deducted her ACB from the \$32,859 she received to determine the amount

included in her income and reported on the T5. Therefore, I see no error in the Tax Court's decision to dismiss the appeal of her reassessment.

[16] I acknowledge that before the Tax Court, and this Court, Ms. Pudney advanced several other issues of concern to her, including that her employer failed to adjust her T4 or to pay her amounts she claims she was entitled to receive following her retirement (including a lump sum amount following the signing of a new collective agreement). However, the Tax Court correctly explained that it had no jurisdiction to consider those issues. It could only address the correctness of her reassessment.

[17] Similarly, on appeal from the Tax Court's decision, we cannot consider those issues. We can only address the correctness of the Tax Court's decision. Any other claims she might have could only be advanced elsewhere.

[18] For these reasons, I would dismiss the appeal. As the respondent seeks no costs, I would award none.

"K.A. Siobhan Monaghan"

---

J.A.

"I agree  
Wyman W. Webb J.A."

"I agree  
Nathalie Goyette J.A."

**FEDERAL COURT OF APPEAL**

**NAMES OF COUNSEL AND SOLICITORS OF RECORD**

**APPEAL FROM A JUDGMENT OF THE HONOURABLE JUSTICE PIZZITELLI  
DATED JANUARY 31, 2019, NO. (2018-457(IT)I)**

**DOCKET:** A-94-19

**STYLE OF CAUSE:** BARBARA PUDNEY v. HIS  
MAJESTY THE KING

**PLACE OF HEARING:** OTTAWA, ONTARIO

**DATE OF HEARING:** FEBRUARY 23, 2023

**REASONS FOR JUDGMENT BY:** MONAGHAN J.A.

**CONCURRED IN BY:** WEBB J.A.  
GOYETTE J.A.

**DATED:** FEBRUARY 28, 2023

**APPEARANCES:**

Barbara Pudney FOR THE APPELLANT  
ON HER OWN BEHALF

Linsey Rains FOR THE RESPONDENT

**SOLICITORS OF RECORD:**

Shalene Curtis-Micallef FOR THE RESPONDENT  
Deputy Attorney General of Canada HIS MAJESTY THE KING