

2013 FEDERAL BUDGET PROPOSAL TO CLOSE 10/8s SABOTAGES ENTREPRENEURS



THE ISSUE

On March 21st 2013, the Federal government announced in its annual Budget that it is “*acting now to introduce legislative measures to prevent 10/8 arrangements from being used in the future.*”

Specifically, the Budget proposes to:

- Deny interest deductions on loans related to 10/8 policies after 2013
- Deny premium deductions on 10/8 policies after 2013
- Deny capital dividend account increases for the portion of death benefits paid after 2013 that are associated with 10/8 loans

The Budget also proposes a temporary exit strategy wherein 10/8 policyholders will be allowed to make a tax-free withdrawal of policy cash values to pay off their loans before 2014.

This Viewpoint offers our preliminary thoughts on the proposals.

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WESTWARD'S VIEWPOINT

10/8 Policyholders

These are early days and 10/8 policyholders should stay the course for the time being until legislation is finalized and the impact becomes certain. The proposals provide 10/8 policyholders with the ability to repay their loans with tax-free cash withdrawals from their policies any time before 2014. For most 10/8 policyholders, it should be advantageous to defer repayment of their loans to December 2013, if repayment becomes necessary.

Where's the Mischief ?

Closing 10/8 arrangements sabotages Canadian entrepreneurs who seek to simultaneously (1) fund their life insurance policies within existing tax limits and (2) finance their businesses.

The policies provide critical financial protection to entrepreneurs, their families and their businesses. They can face staggering tax liabilities upon death with little liquidity to pay the bill. Prepaying future premiums with business profits when times are good (much like the government seeks to do with its Budget when times are good), further protects the permanence of life insurance policies over the long run.

However, entrepreneurs are reluctant to rob their businesses of much needed capital for growth by prepaying life insurance premiums. If they do, and then seek business financing secured by the cash values, problems emerge. Traditional life insurance leverage programs limit financing to as low as half the policy cash, and prevent immediate access to policy cash through surrender charges. There's also the risk of unexpected margin calls by the lender if floating loan interest rates out-strip what the cash values earn. Borrowing under such terms has too many risks for many entrepreneurs, including the biggest risk of all: that the policy itself could be lost.

10/8's were rolled out in 2002 to solve the entrepreneurial risks of traditional life insurance leverage programs by enabling a 1:1 loan to cash value ratio, eliminating surrender charges, and avoiding margin calls on the loans. As a result, 10/8 arrangements enable entrepreneurs to both (1) fund their life insurance policies to permanently protect their families and businesses from financial catastrophe, and (2) finance their businesses on acceptable terms.

Conclusion

If enacted, the 10/8 Budget proposals will eliminate a valuable financial tool for entrepreneurs across the country, forcing them to go back to choosing between investing in their businesses, or investing in their financial protection. Either way, the country will suffer reduced economic growth from reduced business financing or from the economic fallout of uninsured deaths. It is ironic that this measure is sabotaging the very same entrepreneurs largely responsible for achieving the government's Budget goal of “*jobs, growth and long-term prosperity.*”

Next Actions

It is expected that a consultation process with all interested parties will provide an opportunity to address the government's underlying fiscal concerns while preserving this valuable financial tool. The life insurance industry will undoubtedly be fully engaged. In the meantime, 10/8 policyholders should stay the course and wait for the results of the consultation process. We will keep you apprised of developments as they occur through our Viewpoint newsletter.