WESTWARD ADVISORS

# 2016 LIFE INSURANCE PROPOSALS RELEASED AUGUST 23, 2013

## WESTWARD'S VIEWPOINT

A number of changes to the taxation of life insurance were proposed in the **2012 Federal Budget**. Draft legislation was released by the Department of Finance on August 23, 2013 and is summarized in this Viewpoint.

Finance says the changes are intended to *"modernize the exemption test and other life insurance policyholder taxation rules."*

The Finance consultation period ends November 6, 2013.

**The changes apply to policies issued after 2015. Policies issued before 2016 are grandfathered.**

CALU has announced that it will provide a detailed summary of the proposals after it has met with Finance to clarify industry questions in relation to the draft legislation.

This Viewpoint summarizes the measures we think are most relevant to our clients.

*This batch of draft legislation is not to be confused with the draft legislation released September 13, 2013 affecting 10/8 Policies and Leveraged Insured Annuities.*



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## SUMMARY OF PROPOSED CHANGES

### Tax Avoidance Policies

For policies issued after 2015, a transaction, arrangement or event in respect of a policy that increases the tax-exempt cash value limit of the policy and is not undertaken primarily for another *bona fide* purpose will cause the policy to become a "tax avoidance policy", triggering a deemed disposition of the policy and permanent loss of tax-exempt status such that accrual taxation will apply to income earned thereafter in the policy. A policy becomes a "tax avoidance policy" by CRA notification to both the insurer and the policyholder, followed by an absence of rectification within 60 days of the notice.

### Multi-Life Policies

For policies issued after 2015, the amount of cash value that can be paid out of a policy on a tax-free basis as a consequence of the death of a life insured who is not the last life insured will be limited to the maximum amount of cash value that would generally be payable on a tax-free basis if the life was insured alone under a single policy. Policies issued before 2016 are permitted to pay out the entire cash value on a tax-free basis as a consequence of the death of each and every life insured under the policy.

### Net Cost of Pure Insurance (NCPI)

For policies issued after 2015, the formulas for adjusted cost basis (ACB) and NCPI will include all amounts paid in respect of substandard health ratings. As a result, the NCPI deduction under paragraph 20(1)(e.2) will generally increase for policies insuring a substandard health risk. For policies issued before 2016, the computation of NCPI can vary amongst insurers depending on the methodology followed in determining the cost of the substandard health rating.

### Exempt Test Formula

The formula used to calculate a policy's maximum cash value accumulation while maintaining tax-exempt status will be modernized. Generally, cash value accumulation limits for policies issued after 2015 will be higher in the first eight years and lower thereafter. Surrender charges will no longer increase the accumulation room. The full impact of the draft legislation on tax-exempt limits is still being analyzed by the insurance companies.

### Investment Income Tax (IIT)

The changes are intended to be neutral on the 15% IIT that the insurer pays in respect of tax-exempt policy accumulations, except that it will now also apply to reserves in level cost universal life insurance policies, and to accumulations otherwise unavailable to the policyholder due to surrender charges. We await confirmation from the insurers that this intended result has been achieved.

### Grandfathering

Policies issued before 2016 are grandfathered from all these changes. However, grandfathered policies will lose their grandfathered status and become subject to the new rules if a change is made to the policy involving underwriting and such change has a particular schedule of premiums or cost of insurance. For example, grandfathering is lost by adding a life to a multi-life policy, or increasing the coverage on an insured life. Policy dispositions will not cause a loss of grandfathering.

We will update our comments when the insurers complete their impact analysis of the draft legislation.