WESTWARD ADVISORS

GOOD NEWS IN DRAFT LIFE INSURANCE LEGISLATION
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THE ISSUE

On August 29, 2014, the Department of Finance released draft legislation relating to 2012 Budget proposals affecting the taxation of life insurance policies. This draft significantly improves the first draft released on August 23, 2013, as a consequence of consultations between Finance, CALU[1] and the CLHIA[2].

The comment period ends September 29, 2014 and it is expected that final legislation will be passed into law before the end of 2014.

Most changes apply to policies issued after 2016, and grandfather policies issued prior to 2017.

1. Conference for Advanced Life Underwriting, representing life insurance advisors.
2. Canadian Life and Health Insurance Association, representing the life insurance companies.

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Strong Grandfathering

These changes will apply to policies issued after 2016. Policies issued before 2017 are "grandfathered" from the changes. This gives the insurers two years to modify their systems to accommodate the changes.

Grandfathered protection will generally be lost if a grandfathered policy adds insurance coverage as a result of medical underwriting undertaken after 2016. Grandfathered policies with riders that permit adding coverage based on pre-2017 medical underwriting will not lose their grandfathered protection. Grandfathered policies exercising a rider after 2016 to change a single life coverage to a joint coverage based on pre-2017 medical underwriting will not lose grandfathered protection.

Converting a grandfathered term insurance policy to a permanent insurance policy after 2016 will not result in grandfathered protection for the new permanent policy.

No Tax Avoidance Policy

The new draft legislation does not contain any rules relating to a "tax avoidance policy" as previously proposed in the August 2013 draft.

Capital Dividend Account Calculation

The draft does not contain any changes to the computation of the capital dividend account arising from the proceeds of a life insurance policy.

Life Insurance Trusts

The draft legislation includes the 2014 Budget measures to apply a flat top rate of tax to testamentary trusts. Graduated rates will only apply for the first 36 months of an estate that is a testamentary trust. A testamentary life insurance trust will not benefit from the 36 month deferral period and will be subject to the top rate of tax from the outset.

Exempt Test

There are no surprises in the proposals to amend the exempt test calculation that governs the amount of tax-free cash accumulation permitted inside a life insurance policy. Policies issued after 2016 will generally be permitted to make slightly larger deposits in the first eight years and slightly lower deposits thereafter. Universal life insurance policies issued after 2016 with a "face plus fund" death benefit will have significantly lower deposit room beyond the 20th policy year.

Multi-Life Policies

The draft preserves the previous proposal to limit the amount of cash value accumulation that can be paid as a tax-free death benefit under a multi-life policy issued after 2016 to the maximum amount of cash that could have accumulated if the deceased had been insured under a standalone policy.

Next Steps

CALU's Policyholder Tax Task Force will analyze the draft legislation in more detail and identify any issues or questions for further discussion with Finance. The comment period ends September 29 and it is our view that the final legislation will pass substantially the same as this draft legislation.