

# BUDGET 2016

## SOME FINE-TUNING OF LIFE INSURANCE TAXATION

### WESTWARD'S VIEW

The March 22, 2016 Federal Budget does not make any changes to the overall tax policy of the *Income Tax Act* in respect of life insurance.

The *Income Tax Act* **encourages** Canadians to acquire life insurance for long-term financial security by supporting tax exempt accumulation of policy cash values, and **discourages** the liquidation of these valuable long-term financial assets for short-term needs by permitting life insurance to be used as collateral for investment and business loans.

The Budget contains two long anticipated technical changes to the taxation of life insurance that correct unintended tax consequences by:

- Amending the corporate split beneficiary CDA calculation; and
- Amending the income inclusion calculation for non-arm's length policy transfers.

These two Budget tax changes represent "**fine-tuning**" adjustments to the *Income Tax Act*, and are expected to generate a relatively insignificant **\$65 million** of tax revenue, compared to projected tax revenue of **\$550 million** from eliminating the education and textbook tax credits, and **\$3.9 billion** from eliminating the income splitting credit, over the next two fiscal years.

### Split Beneficiary CDA Calculation

The Budget amends the calculation of the capital dividend account (CDA) credit upon receipt of a life insurance death benefit for deaths on or after March 22, 2016. The new formula will require that the corporate recipient credit the CDA for the amount received less the **policyholder's** adjusted cost basis (ACB) in the policy. The current formula requires that the corporate recipient credit the CDA for the amount received less the **recipient's** ACB in the policy.

As a result, the CDA credit arising from a death benefit payment will be the same regardless of whether the beneficiary is the policyholder or another corporation. The Budget does not provide any grandfathering for existing split beneficiary structures, and introduces information-reporting requirements where a split beneficiary structure exists.

### Income Inclusion for Non-Arm's Length Policy Transfers

The Budget amends the income inclusion formula for non-arm's length policy transfers. The new formula will deem proceeds of disposition equal to **the greater of** the cash surrender value and the fair market value of consideration received for the transfer. The current formula deems the proceeds of disposition to be **only** the cash surrender value of the policy.

As a result, for a non-arm's length policy transfer that occurs on or after March 22, 2016, the fair market value of consideration received in excess of the cash surrender value will now be included in, rather than excluded from, proceeds of disposition, and therefore taxable to the extent such amount exceeds the ACB of the policy at the time of the transfer.

For non-arm's length policy transfers prior to March 22, 2016 where a death occurs on or after March 22, 2016, the amount of fair market value consideration in excess of the cash surrender value at the time of transfer will reduce a corporate beneficiary's CDA credit that would otherwise arise as a consequence of death.

### Previous Changes Unaffected

The Budget does not amend any of the tax changes previously enacted by the Conservative government that will apply to policies issued (or, in some cases, modified) on or after January 1, 2017.

### The Performance Optimizer

Westward plans to review these changes in more detail and contact affected clients directly. In the meantime, clients and advisors are encouraged to contact us for more information.

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