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MULTI-LIFE AND JOINT LAST-TO-DIE INSURANCE POLICIES:
REVIEW OF TAX CHANGES

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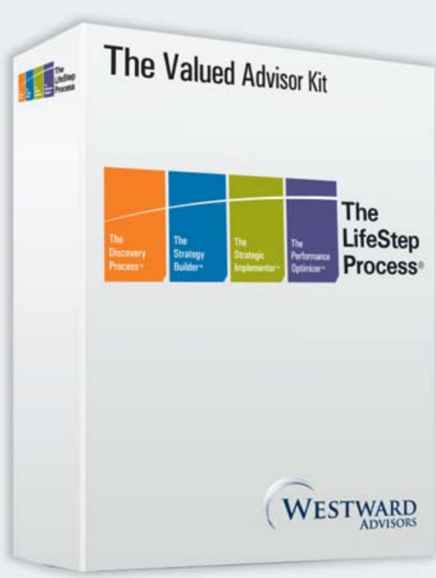

PPI Advisory provides actuarial, tax, estate planning, and technical support in all aspects of life insurance to advisors serving the high net-worth insurance marketplace.

There have been many changes to the taxation of life insurance in the past few years including changes to the calculation of the adjusted cost basis (ACB) of an insurance policy, to the determination of deemed proceeds of disposition and to the addition to the capital dividend account (CDA). Some or all of these changes affected multi-life and joint last-to-die policies and also situations with more than one beneficiary. While some changes only apply to policies issued after 2016, one change applies to all policies regardless of the date of issue.

A multi-life policy is a policy that insures two or more lives under separate coverages and a death benefit is paid out on each coverage. Whereas, under joint last-to-die (JLTD) coverage, two or more lives are insured under one coverage but the insurance benefit is not paid out until the last death.

Multi-life policies were often used in corporate settings. Often the administration of a multi-life policy contract was simpler and only subject to one policy fee. The other benefit was that on the death of an insured, not only was the deceased's portion of the face amount paid out but the entire cash surrender value of the policy immediately before death was also paid out. In addition, if the ownership of the policy was separated from the beneficiary of the policy, the full amount of the proceeds would be added to the CDA. These last two benefits have been removed with the changes.

There were four separate tax changes that affected multi-life policies:

For policies issued after 2016:

1. On the death of an insured, taxable proceeds may arise where the amount of fund value paid out under the policy exceeds the amount that would have been paid under a separate stand alone "face plus fund" exempt policy on the individual's life.
2. To determine the amount of any income gain arising from such an excess fund value payout, the ACB of the policy is prorated by the amount that the proceeds of disposition is of the policy cash surrender value.
3. There is a complicated adjustment to the ACB (called variable O) of the policy for benefits paid. Basically there is a reduction related to the fund value payment and the portion of the policy ACB attributable to the coverage on the deceased's life — if the amount is negative then it is nil.

For policies issued at any time:

4. The ACB of the policy is now attributed to the beneficiary, and not the owner, for the purposes of determining the CDA credit.

For JLTD policies, there was a change to the calculation of the ACB, which is positive for corporate policies but negative for personal. For policies issued after 2016, if an optional life benefit (OLB) is received on the first death, the ACB after the first death will now be reduced by the amount of the OLB payout.

Some examples will highlight these changes:

Multi-Life

Holdco owns a multi-life policy **issued before 2017** on two lives each insured under separate coverages. Opco, a wholly-owned subsidiary of Holdco, is the policy beneficiary. The policy permits the fund value to be paid out at each death. Assume Mr A (age 50 at issue) is insured for $1M and his mother, Mrs A (age 85 at issue) is insured for $100,000. Mrs A dies 5 years after policy issue and the fund value of the policy is $75,000, and the policy's ACB is $100,000. Holdco elects to pay out the full fund value and Opco receives $175,000 (the $100,000 coverage and the $75,000 fund value).

	Policy issued before 2017
Fund value plus coverage	$175,000 received tax free
CDA credit to Opco	$75,000 ($175,000 - $100,000*)
Policy ACB after death of Mr A	$100,000

* *Note that the CDA is reduced by the entire ACB — doesn't matter when the policy was issued. Before the change to track the ACB to the beneficiary, the CDA credit would have been $175,000 since Holdco was the owner.*

If instead the policy is **issued after 2016**, the deemed proceeds of disposition and potential income gain must be determined. In order to determine the proceeds, the maximum fund value for Mrs A must be determined as if there had been two separate policies issued in respect to Mr A and Mrs A. In this case the maximum fund value permitted under Mrs A's policy would have been $45,900.

	Policy issued after 2016
Deemed proceeds (Fund Value - Maximum permitted)	$29,100 ($75,000 - $45,900)
Prorated ACB (ACB × Proceeds ÷ Fund Value)	$100,000 × $29,100 ÷ $75,000 = $38,800
Taxable income gain	Nil ($29,100 - $38,800)
CDA credit to Opco	$75,000 ($175,000 - $100,000*)
Updated policy ACB (ACB - Proceeds + Gain - Variable O**)	$100,000 - $29,100 + Nil - $12,070 = $58,830

* *Note that the CDA is reduced by the entire ACB — doesn't matter when the policy was issued. Before the change to track the ACB to the beneficiary, the CDA credit would have been $175,000 since Holdco was the owner.*

** *Variable O is complex but basically consists of an amount related to the $75,000 fund value payment and the portion, immediately before the death, of the policy ACB which is attributable to the $100,000 coverage on Mrs A's life. Variable O must be calculated by the insurance company since the net premium reserve is required.*

Joint Last-to-Die

Holdco owns a JLTD policy on two lives insured, Mr and Mrs A. Opco, a wholly-owned subsidiary of Holdco, is the policy beneficiary. The policy permits fund value to be paid out at each death. Assume that Mr A (age 85 at issue) and Mrs A (age 82 at issue) are insured for $1M of JLTD coverage. Mr A dies today and the fund value of the policy is $75,000 and the policy's ACB is $100,000. Holdco elects to pay out the full fund value as an OLB and Opco receives $75,000.

	Policy issued before 2017	Policy issued after 2016
OLB of $75,000	Tax free	Tax free
CDA credit to Opco	Nil ($75,000 - $100,000*)	Nil ($75,000 - $100,000*)
Policy ACB after death of Mr A	$100,000	$100,000 - $75,000 = $25,000

* *Note that the CDA is reduced by the entire ACB — doesn't matter when the policy was issued. Before the change to track the ACB to the beneficiary, the CDA credit would have been $75,000 since Holdco was the owner.*

Split Beneficiaries

Holdco and Opco are each 50% owners and beneficiaries of a $1M policy on the life of Mr C. On Mr C's death, $500,000 is paid to each of Holdco and Opco. The ACB at death is $80,000. What is the addition to the CDA?

It does not matter that the proceeds are split on Mr C's death — each of Holdco and Opco have to use the full policy ACB to calculate their respective CDA credits. The addition to the CDA of each Holdco and Opco is $420,000 (ACB is double counted). This issue has been brought to the attention of the Minister of Finance.