VIEWPOINT 2021 APR 23

The 2021 Federal Budget

WESTWARD ADVISORS

WESTWARD'S VIEW

The April 19, 2021 Federal Budget does not make any changes to the Income Tax Act regarding the taxation of life insurance policies.

Thus, the Income Tax Act continues to encourage 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. There is one Budget proposal that may affect interest deductibility on certain leveraged life insurance plans.

The Budget proposes to limit interest deductibility for large corporations for tax years starting in 2023, and could possibly limit a corporation's interest deduction on a loan secured by a corporate-owned life insurance policy.

This Viewpoint summarizes this particular Budget proposal. Any clients with concerns that this proposal may apply to their plan are encouraged to contact us for a review.

INTENT OF NEW INTEREST DEDUCTIBILITY RULE

The new rule is categorized as an "International Tax Measure" and is targeting *"excessive debt or interest expense placed in Canadian businesses in a way that erodes the tax base, for example, through interest payments to related non-residents in low-tax jurisdictions."*

The Budget says *"it is expected that standalone Canadian corporations and Canadian corporations that are members of a group none of whose members is a non-resident would, in most cases, not have their interest expense deductions limited under the proposed rule".*

INTEREST DEDUCTIBILITY LIMITS

The new rule would limit the amount of net interest expense that a corporation, trust or partnership may deduct in computing its taxable income to no more than a fixed ratio of ***"tax EBITDA"***, which is that corporation's taxable income before taking into account interest expense, interest income, income tax, and deductions for depreciation and amortization, where each of those items is as determined for tax purposes. Interest expense would include related financing expenses and amounts that are economically equivalent to interest, such as the cost of discounted debt instruments. Canadian members of a "group" would be able to share their deductible interest capacity.

DENIED INTEREST DEDUCTIONS

Denied interest deductions would be able to be carried forward up to twenty years or back for up to three years. Denied interest can be carried back to taxation years that begin prior to the effective date of the rule.

EXEMPTIONS

Exemptions from the new rule would be available for:

- Canadian-controlled private corporations that, together with any associated corporations, have taxable capital employed in Canada of less than $15 million; and
- Groups of corporations and trusts whose aggregate net interest expense among their Canadian members is $250,000 or less.

A "group ratio" rule would allow a taxpayer to deduct interest in excess of the fixed ratio where the taxpayer is able to demonstrate that the ratio of interest expense to book EBITDA of the group members in aggregate is higher than the fixed ratio, in which case the higher group ratio should apply.

IMPLEMENTATION

The rule would be phased in as follows:

- The fixed ratio is **40%** for tax years beginning on or after **January 1, 2023,** and
- The fixed ratio is **30%** for tax years beginning on or after **January 1, 2024.**

Draft legislation is expected to be released in Summer 2021.

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