Life and Health Insurance

# Overview of tax changes affecting life insurance – effective January 1, 2017

Following a series of measures adopted in the 2012 federal budget, a number of changes will be made to tax rules affecting life insurance, effective January 1, 2017. These changes are primarily aimed at standardizing the tax treatment of products as well as provide greater consistency among life insurance products offered by insurance companies.

These changes will have an impact on all products, particularly universal life insurance policies. Prescribed annuity contracts will also be affected.

## Tax change highlights for policies issued on or after January 1, 2017

<table>
<tr><th>Key change</th><th>What is changing?</th><th>What does this mean for your clients?</th></tr>
<tr><td>1. Exempt test policy (ETP)</td><td>Updates are made to the mortality/interest rate assumptions used to determine the maximum savings allowed in a life insurance policy to maintain its tax-exempt status.</td><td rowspan="2">Basically, the ETP changes will mean more room for the savings component in the first few years but less room thereafter. However, the change in the policy value calculation means that the policy value will generally be higher. Overall, the potential tax-exempt accumulation in life insurance policies will be similar during the first 10 to 12 years, but the maximum savings permitted will be lower thereafter.<br><br>Throughout the lifetime of the policy, the potential amount of tax-exempt accumulation will be reduced. This impact will be more noticeable with universal life insurance policies, particularly for level cost of insurance policies with an increasing death benefit.</td></tr>
<tr><td>2. Policy value calculation</td><td>The formula and assumptions used to determine the policy value are modified.</td></tr>
<tr><td>3. 250% test</td><td>The test requirements have been eased. Should the test fail, the policyowner now has 7 years to rectify the situation.</td><td>The new requirements apply to all policies, including those issued prior to January 1, 2017.</td></tr>
<tr><td>4. Net cost of pure insurance (NCPI)</td><td>The NCPI represents the mortality cost of an insurance policy. The NCPI calculation has been modified to reflect the most recent mortality assumptions. Among other things, the NCPI is used to calculate the adjusted cost basis of a policy (ACB). The ACB is used in turn to determine the taxable amount upon disposition.</td><td rowspan="2">The NCPI will be lower for most clients (standard cases with no rating). As a result, their ACB will be higher.<br>• A higher ACB could be advantageous if the client plans to make a withdrawal, take out a policy loan or dispose of the policy (because the taxable amount will be lower).<br>• However, a higher ACB could also be unfavourable if the beneficiary is a corporation (because the credit applied to the capital dividend account will be smaller).</td></tr>
<tr><td>5. Adjusted cost basis (ACB)</td><td>The ACB is used to determine the taxable amount upon disposition. The ACB calculation has been modified.</td></tr>
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| Key change | What is changing? | What does this mean for your clients? |
|---|---|---|
| **6. Multi-life policies** | New rules apply when paying out the value of the fund or a portion thereof upon each death for insurance policies covering more than one life. A portion of the value of the payout may be taxable in the hands of the policyowner. | In most situations, universal multi-life policies are more advantageous now than they will be after January 1, 2017. |
| **7. Non-registered prescribed annuities** | When calculating the non-taxable portion of the annuity, the most recent mortality tables will be used. | The annuity portion deemed to be taxable interest income will increase. |

## Grandfathering rights for policies issued prior to January 1, 2017

Policies issued prior to January 1, 2017, will not be affected by these changes, **UNLESS** certain changes are made to these policies on or after January 1, 2017. Should this be the case, the new tax rules will apply to these policies. Here are the main changes that will result in the loss of grandfathering rights for existing policies:

1. Addition of or increase in life insurance coverage with evidence of insurability (e.g., term insurance coverage is added).
2. Term insurance is converted into permanent insurance.

Smoker status changes, rating reductions, transfers of ownership, changes to beneficiary designations and increases in the insurance amount without evidence of insurability will not result in the loss of grandfathering rights for existing policies.

## What should you do?

### Check whether now is the time to make changes to existing policies

It may be a good opportunity to meet with your clients to discuss whether it is in their interest to make changes to their existing policy or take out a new policy now. A detailed analysis of their needs and situation will help you to determine whether it would be best to make certain changes in 2016 or in future years.

**The changes stemming from the new tax rules are significant. You are advised to contact your clients and to review their current needs. However, these changes will not have a major impact on most clients.**

## Beneva products and tools

You will be receiving information in the near future on changes stemming from these new legal requirements that will affect Beneva products and tools.

## Please take this opportunity to review your clients' needs and to ensure that they are taking advantage of Beneva products!

## For more information, go to beneva.ca

This document is intended to provide an overview of changes stemming from the federal budget; it is not meant to be exhaustive. For more detailed information on the tax changes that will be taking effect on January 1, 2017, please consult Section 148 of the Income Tax Act, in addition to Parts III and IV of the Income Tax Regulations.

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