Life Insurance Tax Rules Changing

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Starting in January 2017, the allowable cash value build up under tax rules in life insurance policies will change. The federal government introduced changes in December 2014 that are designed to modernize life insurance exempt testing rules as they have discovered that people are living longer and that their insurance policies will pay out later.

As a result of this new legislation, the affected demographics are middle-class consumers, business owners and wealthier Canadians looking to pre-fund their estate tax bills using cheaper life insurance dollars at death.

The key effect of the rule changes will be to provide less exempt room over the long run, meaning that individuals, corporations and other parties doing estate planning, tax planning and advanced corporate tax planning will have to, in future, pay more into their insurance programs than is currently the case. Consequently, this results in less tax sheltered cash build-ups in their policies for those seeking to pay for their policies in a shorter time-frame.

According to the Ministry of Finance, quick-pay policies with less than eight deposits will no longer be compliant with the new exempt rules.

In addition to the changes for new policies purchased after 2016, the rules can also affect existing permanent life insurance policies, which may result in having their grandfathering status as an in-force policy removed and may reduce the amount of tax-exempt cash-value that can build up in the contract.

Policies are grouped as follows:

- G1 if they are issued or last acquired before December 2, 1982.
- As G2 if they are issued after December 1, 1982 and before January 1, 2017.
- Finally as G3 for policies issued after 2016, or policies that have lost their G1 or G2 status due to the lack of grandfathering.

Several tax planning strategies for corporations will also be affected, including the use of the Capital Dividend Account, strategies such as Corporate Asset Transfers, Corporate Insured Retirement Plans or Insured Financing Strategies (which allow for immediate financing arrangements).

Under the new rules, it will take much longer for the Adjusted Cost Basis (ACB) of a corporate-owned policy to reach zero – up to 18 years more according to a report by BMO Insurance. As a result, the amount of tax free money that can be withdrawn from a corporation using the CDA will be reduced, adding expenses to the corporation for the purchase of more life insurance than is the case under current tax rules.

The bottom line is, if a corporation needs to implement corporate-owned life insurance policies, it is advisable to take advantage of the situation sooner rather than later.

The most important aspect to remember is that changes to the tax regime will not change the role that life insurance plays in meeting the financial needs associated with pre-mature death for the average Canadian.

There are many other technical rules that you may need to review with your advisor, such as the increased taxation of “prescribed annuities” which are used to provide retirement income and to mitigate the risk of outliving your money.

Call us today to see how these changes may affect your current and future life insurance portfolio!

Do you have questions about your investment strategies?

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