BY KEVIN WARK

Policy Changes

How new government proposals will affect your clients' insurance planning

As most members are aware, the 2016 federal budget contained two changes that affect certain life insurance planning arrangements involving shareholders and private corporations (see also Glenn Stephens' article in the June/July issue of *FORUM*). Since that time CALU has engaged in discussions with various stakeholder groups relating to these measures, and we have met with Department of Finance officials to discuss our position on these proposals. I'll briefly summarize the impacted planning arrangements, the Budget proposals, and recent changes contained in draft legislation released on July 29, 2016.

1. CORPORATE OWNER – DIFFERENT BENEFICIARY

Under existing rules, where the corporate beneficiary of an insurance policy is different from the owner of the policy, the capital dividend account (CDA) addition will be equal to the full amount of the life insurance death benefit. This is due to the fact that the corporate beneficiary does not have an adjusted cost basis (ACB) in the insurance policy.

Under the Budget proposals, the ACB of the policyholder's interest will reduce the CDA addition to the beneficiary corporation. In other words, the CDA credit arising from the receipt of life insurance will be the same whether or not the corporate beneficiary is the owner. The proposed changes will apply to any life insurance proceeds received as a result of a death after March 21, 2016, including beneficiary arrangements put in place before the Budget.

CALU has indicated to Finance that we are generally supportive of this change as it applies to beneficiary arrangements put in place after March 21, 2016. However, CALU has expressed strong concerns with the impact of these proposals on arrangements in place before the Budget day. If full grandfathering is not provided, we recommended a delay in the application of the rule to permit sufficient time for clients and their advisors to consider their options.

The draft legislation makes no substantive changes to the Budget proposals, and CALU will continue to make representations to Finance on the retroactive application of these rules.

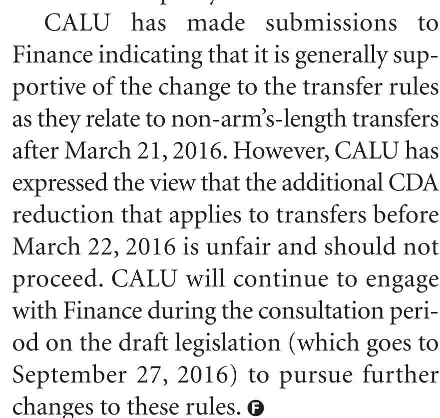
2. POLICY TRANSFERS BETWEEN SHAREHOLDERS AND THEIR CORPORATIONS

Under existing rules, where a life insurance policy is transferred from an individual shareholder to a non-arm's-length corporation, the Income Tax Act deems the proceeds of disposition to the shareholder, and the acquisition cost to the corporation, to equal the cash surrender value (CSV) of the policy.

These rules permit a shareholder to transfer a life insurance policy to his or her corporation for an amount equal to its fair market value, and only recognize a gain to the extent the CSV exceeds the ACB of the policy. In turn, the ACB of the policy to the corporation will only equal the CSV of the policy, not the actual consideration paid. Finance has been aware of this generous tax result for a number of years.

Under the Budget proposals, for non-arm's-length policy transfers after March 21, 2016, the deemed proceeds will equal the greater of the consideration paid and the CSV of the policy. However, the draft legislation makes a further adjustment, so the deemed proceeds will be equal to the greatest of the consideration paid, the CSV of the policy *and the ACB of the policy*. The transferee corporation's cost of the policy will also be equal to the highest of these three amounts.

For non-arm's-length policy transfers that took place before March 22, 2016, where the life insured was still alive on that date, the Budget proposed to reduce the CDA credit on the death of the life insured by the difference between the consideration paid and the CSV of the interest in the policy at the time of transfer. The draft legislation makes three changes to these proposals. First, the rules will only apply for transfers taking place after 1999; originally the rules would have applied to any non-arm's length transfer taking place since 1972. Second, the rule will not apply if the transferor was a taxable Canadian corporation. And finally, the additional reduction in the CDA credit that arises on the death of the life insured will equal the difference between the consideration paid on the transfer and the greater of the CSV and the ACB of the policy immediately before the transfer. This will reduce the CDA "grind" to the extent the ACB of the policy exceeded the CSV of the policy at the time of transfer.



CALU has made submissions to Finance indicating that it is generally supportive of the change to the transfer rules as they relate to non-arm's-length transfers after March 21, 2016. However, CALU has expressed the view that the additional CDA reduction that applies to transfers before March 22, 2016 is unfair and should not proceed. CALU will continue to engage with Finance during the consultation period on the draft legislation (which goes to September 27, 2016) to pursue further changes to these rules.

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