








JUST THE FACTS

2017 Life Insurance Tax Changes Series

The federal government has passed new tax legislation to revise and modernize the exempt test and related rules that determine how life insurance policies are taxed. These changes take effect on January 1, 2017 and will provide greater consistency in the tax treatment of life insurance products by Canadian insurance companies.

The key tax changes include:

 <p>A revised definition of the benchmark policy (also known as the exempt test policy or ETP) which limits the cash value a policy can accumulate.</p>	<p>Prescribed assumptions when calculating the maximum savings permitted in a policy, known as the Accumulating Fund (AF) of the benchmark policy.</p> 	 <p>Changes to the formula for the Adjusted Cost Basis (ACB) of a life insurance policy.</p> <hr/> <p>Updated mortality tables for calculating the Net Cost of Pure Insurance (NCPI).</p> 	 <p>Prescribed assumptions and changes to the reserve method when calculating the savings element of the actual policy known as the AF of the policy.</p>
 <p>Changes impacting policies insuring more than one life including potential taxation of a portion of death benefits.</p>	<p>Revisions to the 8% rule and the 250% test.</p>	<p>Changes to the taxation of the income of prescribed annuities.</p> 	

Grandfathering

Policies issued prior to January 1, 2017 will be grandfathered under the current tax rules. Preserving this status will be very important for policy owners. Any necessary policy changes that could cause a loss of grandfathering should be considered before the new rules start.

A policy will become subject to the new rules if at any time after December 31, 2016:	In some situations grandfathering will not be affected by changes to a policy, even if medical underwriting occurs. Some examples include:
<ul style="list-style-type: none"> ■ the policy is converted from one type of life insurance to another (i.e. a term policy that changes over to a permanent policy will be governed by the new rules) ■ additional coverage that requires medical underwriting is added to the policy ■ an additional deposit that requires medical underwriting is made on the policy 	<ul style="list-style-type: none"> ■ Reducing a rating ■ Switching from smoker to non-smoker rates ■ Underwriting to change a dividend option ■ Transfers of ownership ■ Changes to beneficiary designations

The primary consequences will be:

1. Greater consistency:

- Between life insurance companies
- Between life insurance products
- Common assumptions now used across the industry

2. ACB's will be higher and stay positive for longer

- Especially for older issue ages
- Advantage for policy owners contemplating withdrawals or policy loans
- Disadvantage for corporate-owned policies as Capital Dividend Account (CDA) credit resulting from death benefit payment may be lower

3. Lower optional deposit room

- Mostly after 10 –12 years
- Universal life policies with surrender charges will be impacted in all policy years as surrender charges are no longer recognized

4. Less efficient use of exempt room

- Will need more face amount to “shelter” a given amount of cash value
- Generally higher in the first 10 –15 years and significantly lower afterwards

5. Less tax free income from prescribed annuities

- Income received by the annuitant features higher taxable portions

Regardless of the new tax rules, life insurance policies will continue to deliver valuable insurance protection and tax-effective cash accumulation. Although the changes taking place in 2017 are important, their impact will not be material to most clients.

Prepare now

1

Get informed and look for new opportunities to provide value to your clients

Visit Manulife's 2017 Insurance Tax Education Centre on Reppsource regularly at www.reppsource.ca/2017taxchanges for new articles in this series and other materials to help you build your tax knowledge.

2

Get in touch

Perform a detailed review of your clients' current life insurance and estate-planning needs today to determine if it's in their best interest to make any policy changes or consider new options before 2017. This process can take some time; starting early sets your business and your clients up for success.

