2016 Federal Budget & Life Insurance

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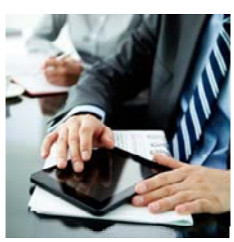
Agenda

1. 2016 Federal Budget
   - Two key items of interest:
     A. CDA credit and life insurance proceeds
     B. Transfer of life insurance policy to a corporation
2. Buy Sell Case Study



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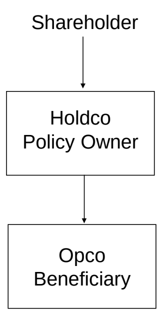
CDA Credit and Life Insurance

- Generally CDA credit equals
  - death benefit minus
  - adjusted cost basis (ACB)
- Prior to March 22, 2016
  - CDA credit reduced by ACB of "the policy **to the corporation**"
- After March 21, 2016
  - CDA credit reduced by ACB of "**a policyholder's interest in the policy**"
  - Potential double grind in split dollar situations
- New reporting obligation where beneficiary is different than policyholder



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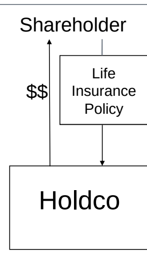
LI Policy Transfers to Related Corporation

- Prior to March 22, 2016
  - Transferor's proceeds = CSV (ss 148(7))
  - Transferee's ACB = CSV
  - Allowed shareholder to extract FMV proceeds above CSV tax free
  - Transferor policy gain where CSV > ACB
- After March 21, 2016
  - Transferor's proceeds = CSV **plus** consideration received in excess of CSV
  - Transferee's ACB = transferor's proceeds
  - All proceeds in excess of ACB now fully taxable



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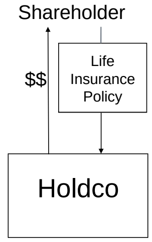
LI Policy Transfers to Related Corporation

- Where
  - Policy transferred before March 22, 2016, and
  - Excess consideration > CSV was taken tax free
- Then
  - Eventual CDA credit at death reduced by excess consideration
- CRA always said they considered the "tax-free-excess-consideration" manoeuver inappropriate
  - So this is an unusual "catch-up" proposal to "fix" those situations where excess consideration was previously taken



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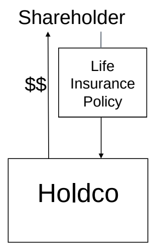
LI Policy Transfers to Related Corporation

- Shareholders who took excess consideration on a pre-March 22 transfer will be disappointed
  - But better to get your money out tax free early while living rather than later at death
- Reduced CDA means potentially more trapped corporate surplus
  - Could lead to more taxable dividends
  - "Pipeline" planning could reduce taxes to capital gains tax rates
  - Estate Freeze and Wasting Freeze techniques can generally help reduce taxes at death
  - Consider more life insurance to replace lost CDA



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LI Policy Transfer to Related Corporation - Example

- Consider the following fact pattern
  - Mr X owns a Term-100 life insurance policy
    - $500,000 death benefit
    - ACB and CSV are nil
    - An independent actuary values policy at $100,000
  - Mr X
    - owns 100% of Holdco
    - transfers policy to Holdco
    - takes $100,000 of consideration

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Budget 2016 – Transfer of LI to Related Corp

	Pre Budget	Post Budget	
Implications to:	Transfer & Death Before March 22, 2016	Transfer Before & Death on or after March 22, 2016	Transfer & Death After March 21, 2016
Mr X			
Proceeds	$0	$0	$100,000
Policy Gain	$0	$0	$100,000
Tax-free amount	$100,000	$100,000	$0
Holdco			
Initial ACB	$0	$0	$100,000
Maximum future CDA credit	$500,000	$400,000	$500,000

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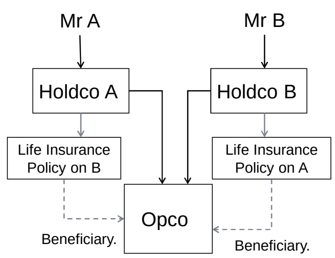
Unwinding a Criss Cross – Post Budget

- Assume FMV of policies is greater than CSV
- A & B are brothers, thus dealing at non-arm's length
- Want to unwind criss cross arrangement and hold own policies
- New 148(7) will deem proceeds to Holdco A equal to CSV of Policy B plus FMV of Policy A in excess of Policy B CSV
- Policy gain in Holdco A
- Similar result for Holdco B



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Buy Sell Case Study

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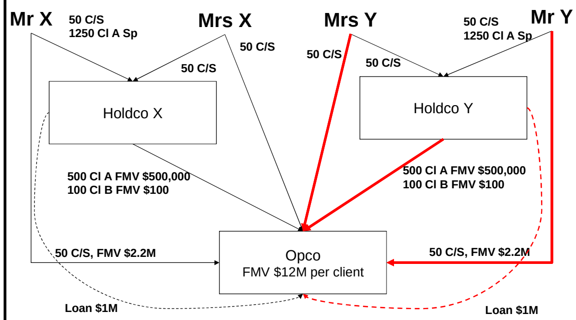
Case Background



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Buy-sell funding methods

- Personal owned insurance can provide funding for
  - Promissory Note (Criss-Cross) Purchase Buy Sell
- Corporate owned life insurance can provide funding for
  - Promissory Note Purchase Buy-Sell
  - Corporate Redemption Buy-Sell
  - Hybrid Buy-Sell
    - Combination of Promissory Note and Corporate Redemption methods

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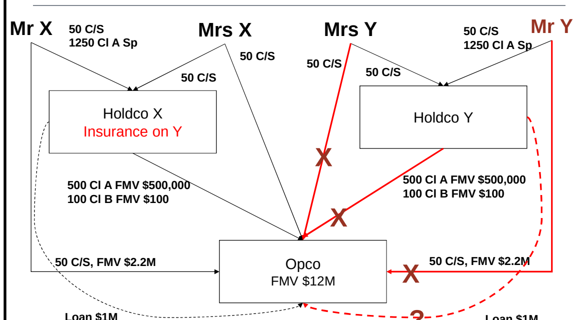
Current Structure – Criss Cross / Single Will



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Implications of Criss Cross / Single Will

- Assume Mr Y dies first:
  - Opco shares worth $5M and
  - Loan receivable by Holdco Y of $1M
- Sold to Mr X or Holdco X
  - **Net after tax to Mrs Y = $4.8M**
- Mr X ACB in Opco shares increased to $5M / Loan Receivable $1.0M
  - Future tax savings = $1.4M

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Steps

- Advisor gathered facts –
  - ACB, FMV, PUC, S/H Agreement, Art of Incorp for Holdco Y, Art of Amend for Opco, F/S, Accountant's Reorg Memo
- TEPG Consultant analyzed information provided and drafted detailed memorandum
- Memorandum provided to client's accountant
- Accountant agreed with plan and the suggested revisions to S/H agreement

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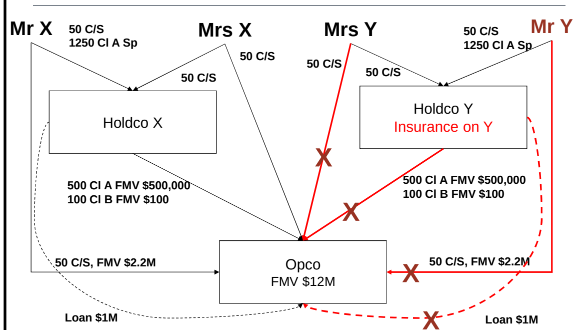
Revised Structure – Hybrid w Rollover / Dual Will



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Implications of Hybrid, Rollover / Dual Will

- Assume Mr Y dies first:
- **Net to Mrs Y = $5.6M (INCREASE OF $800K)**
- Mr X no ACB increase but CDA available of $2.6M
  - Future tax savings = $614K to $863K

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Solution Implemented

- **<u>Holdco Y</u>**
- purchased $4M Innovision
- annual min. premium $43,334
- Actually paying $113,390 / yr for 10 years

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General conclusions

- Review Agreement
  - make sure insurance ownership and agreement match
  - Model out the alternatives to ensure results consistent with client's expectations
- Involve the client's tax advisors
- Timing of surviving shareholder's disposition?
- Tax rates change!!!
- Equity to shareholders?
- Watch out for "most tax effective" wording
- Consider use of a hybrid method where CGE available

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What we think leads to successful cases

- Information is powerful
- Try and obtain as much information as you can about the client's situation
- Connect with the client's accountant early in the process
- Collaboration leads to success
- Remember that the accountants are as protective of their clients as you are of your clients

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For More Information

- See Tax Topics on Manulife's Tax & Estate Planning Site
  - www.manulifetep.ca

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Thank you