

Investor Insight

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Changes Ahead: Tax-Exempt Insurance Policies

If you hold life insurance or annuities, you likely haven't given much thought to the fact that they are often tax-exempt. Most Canadian life insurance policies are tax-exempt if they are considered to be protection-oriented and not savings-oriented. Under the Income Tax Act, the "exemption test" is used to determine whether investment earnings associated with the cash-value accumulation held within the life insurance policy are taxable.

In an exempt life insurance policy, the policyholder is not taxed on annual investment growth that occurs within policy limits. This exemption has allowed these types of policies a degree of flexibility in the amount and duration of the funding, as well as investment accumulation.

Over recent years, the Canadian government has been working to revise the exemption test as the existing rules were put in place in 1982. Since that time, life expectancies have been increasing and many new insurance products have been developed.

The Department of Finance's latest proposal to update the exemption test includes changing the assumptions used in determining the tax-exempt savings component of certain life insurance policies to limit how much individuals can hold in the cash portion of their policies on a tax-exempt basis. It also extends the date of implementation for changes to the exemption test to January 1, 2017, from the originally proposed date of January 1, 2016. In general, the maximum tax-exempt funding room for the same policy offered today will be lowered after the end of 2016.

How Does This Affect Me?

It is currently proposed that already issued life insurance policies and annuities will be grandfathered under the existing exemption test rules. However, policy holders should be aware that if changes are made to existing policies after legislative changes are made on January 1, 2017, there may be a loss of grandfathering privileges. Therefore, if you need to make changes to policies that you currently hold, you may wish to consider doing so before the end of 2016.

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“A regular review of your insurance coverage is always helpful when considering your overall wealth management plan to ensure that your current and future needs are covered”

If you are in need of additional insurance and want to maximize the potential tax-exempt deposit room currently available, based on the grandfathering privileges proposed, there may be tax-sheltering opportunities available through the funding of a tax-exempt insurance policy purchased prior to 2017.

Seek Assistance

A regular review of your insurance coverage is always helpful when considering your overall wealth management plan to ensure that your current and future needs are covered. If we can help you in this regard, please don't hesitate to call.