Milestone Elements

FOURTH QUARTER 2014 NEWSLETTER

Branch Manager News

by Steve Booker BComm, CFP, CLU, CIM

In our Elements newsletters, we find ourselves frequently commenting on Federal Budget changes and the impacts of other revisions pertaining to the investment industry. There have, however, been some interesting changes occurring in the insurance industry. These are seldom reported on by mainstream media as the changes are often quite technical and in some cases targeting specific strategies that are considered by CRA to have been pursued overly aggressively by insurance applicants.

Recent proposed changes have received Royal Assent and will now take effect January 2017; the most notable of which is the reduction in the Maximum Taxable Actuarial Reserve (MTAR) of permanent life insurance products such as Whole Life and Universal Life policies. You can think of the MTAR as an effective ceiling on the amount of over funding, and thus tax sheltering, that you can accomplish inside a life insurance policy.

In tandem with MTAR changes, life insurance mortality tables have undergone revisions to modernize them with more current data on life expectancies. As you might guess, people on average have been living longer, creating more time for insurers to earn premiums. The result is that premiums should become lower. This is good for the consumer, but also factors in to the MTAR calculations, further reducing the amount of tax sheltering available.

The net result is that there is a bit of a double whammy impacting these permanent life insurance policies. It is generally understood that policies placed before the January 2017 date will be grandfathered under the old rules. In reality, from our lens it is rare to see a client over funding their policies to the maximum extent possible. As such, we don't expect a stampede of permanent life insurance applications to be submitted in the latter part of 2016. It is however a good motivator for anyone who has been sitting on the fence in making a decision to implement permanent coverage to do so, sooner than later.

As always, if you wish to learn more about these changes or want to discuss your insurance needs in general, please feel free to reach out to your Milestone advisor at any time.

New Testamentary Trust Rules May Affect Vulnerable Canadians

by Jamie Golombek, Renaissance Investments

In 2013, I wrote about government proposals to eliminate the graduated tax rate system for testamentary trusts and estates. The proposed measures will effectively eliminate a common estate planning technique used by some Canadians to reduce tax on the investment income earned from their assets after their death.

In August, the government followed up on the proposals originally announced in the 2014 federal budget, and released draft legislation to come into play starting in 2016. Under the proposed rules, flat top-rate taxation at 29 percent federally will apply to testamentary trusts – trusts arising as a consequence of death – and to estates. There are two notable exceptions to the proposed rules.

First, estates are only subject to flat top-rate taxation "after a resonable period of administration" of 36 months. Consequently,

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graduated rate taxation will still be available in the first three years of an estate.

A second exception applies to a "qualified disability trust," whose benefciaries are eligible for the federal disability tax credit (DTC), due to a severe and prolonged impairment to physical or mental functions. Graduated rate taxation will continue to be available for these trusts.

Despite these exceptions, the proposed rules have been criticized for being unfair in a number of respects.

For example, suppose a testamentary trust has DTC-eligible beneficiaries. Draft legislation to implement the proposed rules will require that the trust be created under a will to benefit from graduated rates. When funds are left in trust for a DTC-eligible individual via a designation on an insurance policy, RRSP, RRIF or TFSA, the trust would be subject to taxation at the top tax rate, rather than at graduated rates. We have drafted a submission to the Department of Finance and hope to have this issue favourably resolved in an upcoming redraft of the legislation.

Secondly, for individuals who have a disability but do not qualify for the DTC, no relief will be available and flat top-rate taxation would apply. It has been estimated that over 3.8 million Canadians[1] have a mental or physical impairment, yet less than 800,000 DTC certificates are estimated to be outstanding.[2]

Finally, in cases where a testamentary trust does not have DTC-eligible beneficiaries, the proposed rules may put the trustee in a difficult position. For example, with many trusts, the primary purpose is to allow the trustee to continue to control and manage the deceased's assets and protect them for the beneficiaries. If flat top-rate taxation applies, the trustee would have to choose between paying more taxes in the trust or paying out the income to beneficiaries, who may be in lower tax brackets but not capable of handling the funds. In addition, having income payable to them may render them ineligible from receiving various provincial income-tested disability benefits, which have less-stringent criteria for qualification than the DTC.

Insurance services provided through Canaccord Estate Planning Services Ltd.

[1] Statistics Canada's initial findings from the Canadian Survey on Disability reported that an estimated 3.8 million Canadians were limited in their daily activities due to a disability in 2012. The survey population was comprised of Canadians aged 15 or older as of May 10, 2011, who were living in private dwellings.

[2] According to CRA 2013 Preliminary Income Statistics for the 2011 taxation year, the disability amount, which is only available when a DTC has been issued, was claimed either for the taxpayer or a dependant on 756,500 income tax returns.

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