2017: A New Era for Insurance

Changes to the Exempt Test

Effective January 1, 2017, significant changes are coming to the insurance industry in Canada which will affect the tax treatment of life insurance and prescribed annuities. It's important to note that insurance will continue to play a valuable role in financial planning. What's more, for many advisors, the changes to the tax rules may not have a significant impact on their practice but all advisors should be aware of them and the potential implications that they may have on their clients' objectives.

Take note of the following terms:

Policy Tax Generations

"G1" Policies last acquired prior to December 2, 1982
"G2" Policies issued or last acquired after December 1, 1982 and before 2017
"G3" Policies issued after 2016 or which have lost their G1 or G2 status

Tax Exempt Test: this is an annual test that determines whether the fund value in the policy can remain exempt from accrual taxation. If the policy fails the test, any excess funds must be withdrawn out of the policy (taken in cash or put into a taxable side account). Alternatively, the amount of life insurance can be increased (within limits) to maintain the policy's tax exempt status and therefore pass the test.

Here's a snapshot of the changes related to the exempt test.

Anticipated impact of the new rules:

- Maximum funded strategies (such as insured retirement or asset transfer plans) will still be valuable planning ideas (compared to other taxable investments).
- Depending on the level of funding and the type of cost of insurance, the difference in long term fund values will differ between the current (G2) and new (G3) tax environments. Most notably, the amount of money that can grow on a tax-deferred basis with Level COI will be significantly reduced while the impact of the new tax exempt test on YRT COI will not be as significant.
- "Single deposit" scenarios will require much more insurance *or* several more years for the same amount of money to be deposited into the tax-deferred account of a universal life policy.
- There's little impact to clients who fund their policies with a minimum premium schedule unless they wish to overfund their policies at a later point in time.

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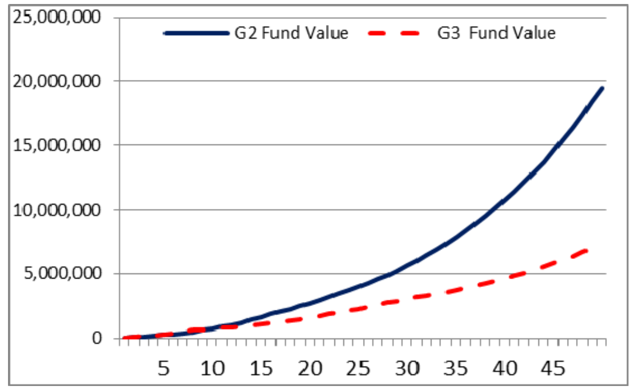
Example 1: Male 50 Non-smoker

- $1,000,000 Sum Insured plus Fund Value Death Benefit
- Maximum funded Level COI
- 5% illustration rate in a Low Fee UL

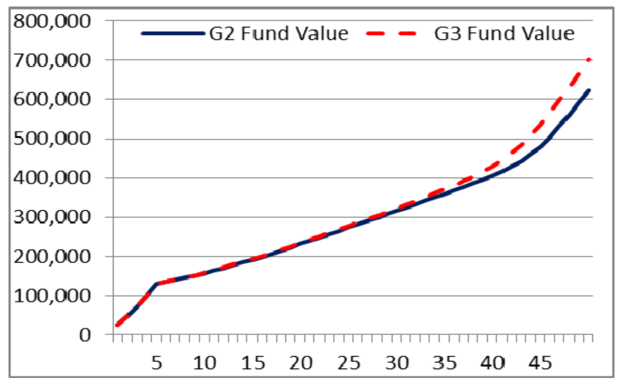
With Level COI, the long term maximum fund value under the new G3 rules will be significantly reduced compared to current values under the G2 rules.



Example 2: Male 50 Non-smoker

- $500,000 Level Death Benefit
- 5 Pay[#]
- YRT 100 COI
- 5% illustration rate in a Low Fee UL

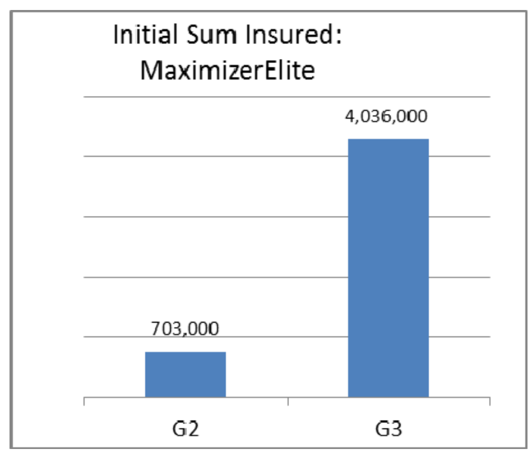
In this example with YRT COI (with the same stream of premiums in each projection[#]), the long term fund values *could* actually be slightly <u>higher</u> in the new G3 tax environment. This difference will vary depending on the level of funding in the policy as well as other assumptions, such as the interest earned on the fund value.



Example 3: Male 50 Non-smoker

- Level Death Benefit with BMO Insurance's "MaximizerElite" option
- YRT 100 COI
- $250,000 deposit followed by two further annual deposits of $3,639
- 5% illustration rate in a Low Fee UL

In this scenario, the initial sum insured required under current (G2) rules to tax defer the stream of deposits would be $703,000 whereas under the new (G3) rules, the same client would have to purchase about $4,036,000 of coverage (almost 6 times more!) to be able to tax-defer the same amounts. This additional amount of coverage would increase the COI and therefore drag down the fund value of the policy over the long term.



Note: The information described here is general in nature and should not be construed as legal or tax advice. Each policyholder's financial circumstances are unique and they must obtain and rely upon independent tax, accounting, legal and other advice concerning the structure of their insurance, as they deem appropriate for their particular circumstances. BMO Life Assurance Company does not provide any such advice to any policy owner or insurance advisor.

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Points to keep in mind:

With new plans sold after 2016, long term cash values in many scenarios may still be attractive, although not as high in some cases as in the current environment. Some maximum premium/quick pay strategies are still projected to provide an advantage over alternative taxable investments but "lump sum" or single deposit strategies will be a thing of the past.

Get ready for 2017!

Learn more about the impact of the new tax rules by contacting your BMO Insurance Business Development Manager today.

Let's connect

To find out more about BMO Insurance products, please call your MGA, contact the BMO Insurance regional sales office in your area, or call 1-877-742-5244.

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Ontario Region	Quebec – Atlantic Region	Western Region
1-800-608-7303	1-866-217-0514	1-877-877-1272

These comparisons are based on the same product features and do not reflect any changes to rates or features between the G2 and G3 scenarios.

[#]For example 2, the following stream of premiums was used in both the G2 and G3 scenarios: Year1: $27,335; Year 2: $22,634; Year 3: $22,510; Year 4: $24,670; Year 5: $25,804

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