2017: A New Era for Insurance

Grandfathering Rules for Life Insurance

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

Here's a summary of the types of changes on in force policies that may be impacted by the new rules.

Policies issued prior to 2017 will be grandfathered (i.e. will continue to use tax rules in effect when the policies were issued) but will lose this status if, after 2016:

- The policy is converted to "another type of life insurance" or
- Any life insurance is added to the policy which requires medical underwriting

A loss of grandfathering will likely occur on an in force policy (with an issue date prior to 2017) if any one of the following takes place after 2016:

- A term life insurance policy (or rider) is converted to permanent life insurance
- A substitution of life provision is exercised on the policy
- A new life is added to an existing life insurance coverage onto the policy
- A term insurance rider is added to the policy
- A new (additional) universal life insurance coverage is added to the policy
- Any other medically underwritten transaction that increases the amount of life insurance coverage or net amount of risk on the policy.

Require medical underwriting

Advisors and their clients should consider the tax impact of a change on an in force policy and weigh the pros and cons of proceeding. With any of the above transactions, a policy will need to switch to the new G3 tax rules which will have a direct impact on the amount of tax-deferred room in the policy as well as its Adjusted Cost Basis (ACB) and Net Cost of Pure Insurance (NCPI).

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. Information contained in this document is for illustrative purposes and is subject to change without notice.

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It's important to note that certain transactions will *not* cause a loss of grandfathering.

For example:

- A reduction or elimination of substandard ratings
- Policy reinstatements
- A request to switch from smoker to non-smoker rates
- Adding the following riders onto a policy (even though medical evidence of insurability may be required):
    - Accidental Death Benefit
    - Critical Illness rider
    - Waiver of Premium
    - Any other "non-life insurance" benefit or rider
- An increase in coverage on a universal life policy that is a result of the exempt test (as long as the increase is within limits prescribed by the insurance company and doesn't require medical underwriting). These increases are sometimes called "(Maximum Tax Actuarial Reserve) MTAR increases" or "exempt test increases"
- Increase in coverage as a result of Paid-Up Additions (PUA) on Participating Whole Life policies
- A switch from Yearly Renewable Term (YRT) to Level COI on the same UL policy.

Points to keep in mind:

Any increase in life insurance coverage (which requires medical underwriting) or exercising a term conversion option on an existing policy issued before 2017 will cause a loss of grandfathering and necessitate a switch to the new tax regime. On the other hand, there are other types of transactions that will not cause a loss of grandfathering, despite the need for medical underwriting. It will therefore be important to check with the insurer to determine the general implications of a transaction. Based on this information, you, your clients and their tax advisors should determine the advantages and disadvantages of a transaction before proceeding with any change.

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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