August 24, 2016

Mr. Brian Ernewein
General Director
Tax Policy Branch
Department of Finance
90 Elgin Street
Ottawa, Ontario, K1A 0G5

Dear Mr. Ernewein:

On behalf of the Conference for Advanced Life Underwriting (CALU), I am writing to provide our comments on the Department of Finance ("Finance") draft legislation released on July 29, 2016 (the "draft legislation") relating to the tax treatment of certain transactions involving insurance owned by partnerships and corporations, which proposals were originally announced in the March 22, 2016 federal budget (the "budget proposals").

First of all, CALU is pleased that the draft legislation addresses several issues raised by CALU in our submissions of April 29, 2016 (the "April submission") and July 19, 2016 (the "July submission") in respect of the rules governing non-arm's length transfers of insurance policies.

However, we continue to be concerned with the effective retroactive application of the proposed changes to arrangements in place on March 22, 2016 in which a corporate owner of a life insurance policy has designated another corporation as the beneficiary under that policy, the policy was in force on March 22, 2016, and the beneficiary designation was made prior to that date. In the absence of grandfathering for such arrangements, we renew our request for a special transitional rule as outlined in our July submission.

As well, we continue to believe that the change to the definition of capital dividend account[1] that applies to non-arm's length policy transfers after 1999 and before March 22, 2016, needs to be further amended as contemplated in our submissions. In addition to the reasons outlined in our prior submissions, we make the following comments.

[1] New subparagraph (d)(v) of the definition of capital dividend account in subsection 89(1) of the Act.

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1. Tax vs. Economic Benefit of the Transfer

We understand the underlying premise for the amendment to the CDA definition relating to non-arm's length transfers before March 22, 2016[2] is that the shareholder previously received a benefit on the transfer (to the extent that the consideration paid exceeded the greater of the SV and ACB of the policy at the time of disposition) that should have been subject to tax.[3] Because not previously taxed, Finance is of the view that this benefit should be "recaptured" on death through a reduction in the transferee corporation's CDA credit arising from the receipt of the insurance proceeds.

As previously indicated, CALU believes the approach being taken by Finance is not appropriate, as the deemed proceeds of the disposition on the transfer has been taxed as prescribed by the existing subsection 148(7), and the transfer of property between related parties at fair market value does not, by any measure, represent "aggressive" tax planning. In this regard, it is noted that the tax result was not achieved by any type of election or other tax action, but was merely the result of the transfer (i.e., if a shareholder transferred a policy to a related corporation, for whatever reason, this was the required result under the legislation).

As well, we believe that using the CSV or ACB as the "measuring stick" for determining the amount of any benefit arising from such a transfer does not reflect the economic cost to the shareholder of acquiring the policy, which in turn influenced the fair market value of that policy. In our view, taking into account the economic cost (rather than the CSV or ACB) of the policy lends further support to CALU's recommendations as put forth in the July submission.

The following example illustrates this point:

> Mr. B, at age 45, acquired a $1 million Universal Life policy for an annual life-pay premium of $11,151.[4] Assume that Mr. B, at age 65, and prior to March 22, 2016, transfers the policy to his corporation for an amount equal to the cumulative premiums paid to date of $230,000. At that time the CSV of the policy is nominal, and the ACB of the policy $115,794 (see attached insurance ledger). The draft legislation would reduce the CDA credit on Mr. B's death by approximately $114,000. However, Mr. B was only reimbursed for the cumulative premiums that he had paid into the policy. In effect, he is no better off from an economic perspective (and the corporation is no worse off) than had this policy been acquired by the corporation from its inception.

2. Other Shareholders Could Be Adversely Impacted by these Changes

As noted, the draft legislation provides that the revised definition of the CDA applies to policy transfers made after 1999 and before March 22, 2016, and takes effect for deaths after March 21, 2016. Based on normal life expectancies, there is a high probability that any such CDA adjustment will arise decades

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[2] New subparagraph (d)(v) of the definition of capital dividend account in subsection 89(1) of the Act.

[3] This is so, even though the exisiting legislation resulted in no tax on the benefit, a result confirmed by the CRA in its interpretation of the provisions.

[4] Such premiums are typically funded with after-tax dollars.

after the actual policy transfer. It is also very likely that the transferor will no longer be a shareholder in the corporation, and/or new shareholders will own a significant interest in the transferee corporation.[5] Thus, while the fixed reduction in the CDA may be designed to recapture any benefit received by the transferor shareholder, the tax burden of these rules will actually fall upon the new shareholders.

While we don't believe it is appropriate to recapture any tax benefit in the manner proposed, it is particularly unfair to shift this tax liability onto different taxpayers.

3. Comparison with Other Tax Changes in the 2016 Federal Budget

We also note that there are other changes announced in the 2016 federal budget (in particular, those relating to corporate class mutual funds and indexed linked notes) that appear to be directed at planning arrangements where there are "unintended" tax benefits. However, the draft legislation does not attempt to recapture any prior tax benefits from taxpayers who participated in these arrangements, even though these taxpayers may continue to hold those or substituted investments.[6] We don't understand the policy rationale that accords different treatment for non-arm's transfers of life insurance that took place before March 22, 2016.

Before concluding, we feel it is important to note that CALU continues to be supportive of the budget proposals (and the draft legislation) relating to life insurance as they apply to arrangements put in place after March 21, 2016. Our focus continues to be on the fair and equitable treatment of insurance policyholders in relation to transactions entered into before March 22, 2016.

Thank you again for your attention to our various submissions relating to budget proposals and the draft legislation.

Yours truly,

Kevin Wark, LLB, CLU, TEP
President, CALU

cc. Clay Gillespie, CALU Chair
Warren Blatt, Chair, Government Relations
Robert Demeter, Acting Director, Tax Legislation Division, Finance Canada
Grant Nash, Tax Legislation Division, Finance Canada

[5] For example, if the original shareholder implemented an estate freeze and had the corporation purchase life insurance to redeem the freeze shares remaining on death, it is quite possible that the freeze shares may be partially or fully redeemed by the time the original shareholder dies.
[6] And in the case of the changes for corporate class mutual funds and indexed linked notes, the application of the rules has been deferred to a date after the budget date.

MALE 45 NON-SMOKER, $1M Death Benefit

Year	Age (End of Year)	Annual Premiums Paid	Death Benefit	Total Surrender Value	Total Cost	Adjusted Cost Basis (ACB)
1	46	11,551.20	1,000,013	13	11,551.20	10,511
2	47	11,551.20	1,000,027	27	23,102.40	20,832
3	48	11,551.20	1,000,041	41	34,653.60	30,934
4	49	11,551.20	1,000,056	56	46,204.80	40,795
5	50	11,551.20	1,000,071	71	57,756.00	50,386
6	51	11,551.20	1,000,086	86	69,307.20	59,697
7	52	11,551.20	1,000,101	101	80,858.40	68,668
8	53	11,551.20	1,000,117	117	92,409.60	77,230
9	54	11,551.20	1,000,134	134	103,960.80	85,291
10	55	11,551.20	1,000,150	150	115,512.00	92,762
11	56	11,551.20	1,000,168	168	127,063.20	99,593
12	57	11,551.20	1,000,185	185	138,614.40	105,744
13	58	11,551.20	1,000,203	203	150,165.60	111,166
14	59	11,551.20	1,000,222	222	161,716.80	115,817
15	60	11,551.20	1,000,241	241	173,268.00	119,598
16	61	11,551.20	1,000,260	260	184,819.20	121,669
17	62	11,551.20	1,000,280	280	196,370.40	122,561
18	63	11,551.20	1,000,301	301	207,921.60	122,022
19	64	11,551.20	1,000,322	322	219,472.80	119,823
20	65	11,551.20	1,000,343	343	231,024.00	115,794
21	66	11,551.20	1,000,365	365	242,575.20	109,845
22	67	11,551.20	1,000,388	388	254,126.40	101,857
23	68	11,551.20	1,000,411	411	265,677.60	91,728
24	69	11,551.20	1,000,434	434	277,228.80	79,289
25	70	11,551.20	1,000,459	459	288,780.00	64,260
26	71	11,551.20	1,000,484	484	300,331.20	46,261
27	72	11,551.20	1,000,509	509	311,882.40	24,933
28	73	11,551.20	1,000,535	535	323,433.60	0

29	74	11,551.20	1,000,562	562	334,984.80	0
30	75	11,551.20	1,000,590	590	346,536.00	0
31	76	11,551.20	1,000,618	618	358,087.20	0
32	77	11,551.20	1,000,647	647	369,638.40	0
33	78	11,551.20	1,000,676	676	381,189.60	0
34	79	11,551.20	1,000,707	707	392,740.80	0
35	80	11,551.20	1,000,738	738	404,292.00	0
36	81	11,551.20	1,000,770	770	415,843.20	0
37	82	11,551.20	1,000,802	802	427,394.40	0
38	83	11,551.20	1,000,836	836	438,945.60	0
39	84	11,551.20	1,000,870	870	450,496.80	0
40	85	11,551.20	1,000,905	905	462,048.00	0
41	86	11,551.20	1,000,941	941	473,599.20	0
42	87	11,551.20	1,000,978	978	485,150.40	0
43	88	11,551.20	1,001,016	1,016	496,701.60	0
44	89	11,551.20	1,001,055	1,055	508,252.80	0
45	90	11,551.20	1,001,095	1,095	519,804.00	0
46	91	11,551.20	1,001,136	1,136	531,355.20	0
47	92	11,551.20	1,001,177	1,177	542,906.40	0
48	93	11,551.20	1,001,220	1,220	554,457.60	0
49	94	11,551.20	1,001,264	1,264	566,008.80	0
50	95	11,551.20	1,001,309	1,309	577,560.00	0
51	96	11,551.20	1,001,355	1,355	589,111.20	0
52	97	11,551.20	1,001,403	1,403	600,662.40	0
53	98	11,551.20	1,001,451	1,451	612,213.60	0
54	99	11,551.20	1,001,501	1,501	623,764.80	0
55	100	11,551.20	1,001,552	1,552	635,316.00	0