Brief in Advance of the 2020 Federal Budget Presented to the House of Commons Standing Committee on Finance

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Summary

In order to preserve and grow the wealth of families and ensure the success of their businesses, the federal government should consider the three following actions:

1. Undertake a comprehensive review of the Income Tax Act, with the goal to support the growth and success of private corporations both domestically and internationally.
2. Until the review is complete, act now to remove unfair penalties and barriers that impede both the growth and succession of small businesses to the next generation of family members.
3. Ensure intergenerational equity by providing mechanisms to help Canadians fund their long-term care through retirement products which provide lifetime benefits which protect against the risk of living too long.

Overview

CALU is the only national professional organization dedicated to advanced planning issues related to life underwriting, tax planning and wealth management. CALU's 665 industry leading members include insurance and financial advisors as well as accounting, tax, legal and actuarial experts. Through a strategic partnership with Advocis, we advocate on behalf of more than 13,000 advisors in support of fair and competitive public policies to grow and preserve the financial well-being of Canadian family businesses.

We welcome the House of Commons Standing Committee on Finance invitation to share our priorities for the 2020 federal budget.

1. Tax Competitiveness

Issue – The last comprehensive review of the *Income Tax Act* (ITA) took place almost 50 years ago. Since then a number of countries have undertaken a comprehensive review and modernization of their tax legislation to keep pace with global change, most recently the United States and Australia. This has put Canadian business owners at a competitive disadvantage in relation to their counterparts in other countries.

CALU recommends the federal government undertakes a comprehensive review of the tax system with a focus on supporting the growth and success of private corporations both domestically and internationally.

In particular, we believe the tax rules governing private corporations should be modified or reviewed as follows:

- Repeal the current tax on split income (TOSI) rules and extend the pre-2018 TOSI rules (which only applied to minors) to include adult children who are under the age of 25 in the year;
- In the absence of providing grandfathering for passive investments accumulated before 2019, modify the "claw-back" of the small business deduction to take effect on a more gradual basis;
- Work in conjunction with provincial governments to restore tax integration across the provinces and territories in respect to all sources of income; and

- Consider the integrated business/individual tax rates in both Canada and the U.S. in determining the competitiveness of the Canadian tax system as it applies to private corporations and their shareholders.

2. Tax Fairness

Family Business Succession
Issue – Current rules in the *Income Tax Act* (section 84.1) governing private corporations can result in more taxes being paid by a business owner on the sale of shares to family members, than would be the case if those shares were sold to an arm's length purchaser. This has the effect of discouraging the transfer of a private business to the next generation of family members, at a time when many business owners are considering retiring and realizing on the value of their business.

CALU recommends that section 84.1 of the ITA be amended to remove tax disincentives that currently arise on the sale of a private corporation to the children of the owners.

ACB Double Counting
Issue – Recent changes to the definition of the capital dividend account inadvertently result in a lower credit where there is more than one beneficiary of a life insurance policy and at least one of the beneficiaries is a private corporation. This unintended change results in more of the death benefit being taxable when distributed to shareholders.

CALU recommends the government amend the definition of the capital dividend account to ensure that the ACB of an insurance policy is not "doubled counted" where there is more than one beneficiary of a life insurance policy in a corporate context.

Health and Welfare Trusts
Issue – Small business owners have relied on health and welfare trusts (HWTs) to provide employee benefits on a cost and tax-effective basis. Changes in the 2018 federal budget prevent the creation of new HWTs and will require existing trusts to be wound up or converted to employee life and health trusts (ELHTs) by 2021. ELHTs contain restrictions and administrative requirements that make them unsuitable for many small businesses.

CALU recommends the government review the tax rules and CRA administrative practices to ensure private corporations are not at a disadvantage in relation to other employers in providing cost and tax effective group benefits to key employees.

Life insurance in a Life Interest Trust
Issue – The Canada Revenue Agency has taken the position that the power to own life insurance in a life interest trust will "taint" the trust. This will result in the deemed disposition of capital property transferred into the trust as well as the application of the "21-year" deemed disposition rule to the trust. This effectively prevents life interest trusts from owning a life insurance policy on the life of the life interest beneficiary, to fund the tax liability which arises on the death of that person, and therefore may force the improvident sale of trust assets (including shares in private corporations) to fund this tax liability.

CALU recommends amendments be made to the rules governing life interest trusts to ensure the ownership of life insurance still permits that trust to qualify as a life interest trust.

Non-resident trust reporting

Issue – Starting in 2021 most trusts will become subject to new reporting rules relating to beneficiaries and other persons who have an interest in the trust. There is a specific exception from these reporting rules for trusts with assets of less than $50,000, provided these assets fall within a prescribed list of assets. An exempt life insurance policy is not currently included in the prescribed list of assets, which means that “life insurance trusts” will be subject to the new reporting rules even though the cash value of that policy and other prescribed assets in the trust may be less than $50,000.

CALU recommends expanding the list of prescribed assets in paragraph 150(1.2)(b) of the ITA to include exempt life insurance policies and that the fair market value of the life insurance policy be equal to its cash surrender value.

3. Intergenerational equity

Compassionate Benefits Program

Issue – Many Canadians will face costly health care problems which could both shorten their life and drain their wealth. In the case of owners of permanent insurance policy this could mean they may have to surrender their life insurance policy or try to sell that policy in an unregulated market to obtain financial support.

CALU recommends the government ensure that tax rules support insurance companies in providing a lending facility against the death benefit of the insurance policy, to assist policyholders with shortened life expectancies and who are in financial need. This will provide policyholders with access to funds while preserving the insurance policy for the long-term benefit of family members. This program would also be supportive of government initiatives relating to elder care and support.

Quality Long Term Care Support for Canadians

Issue – Providing quality long-term care support is one of Canada’s fastest growing priorities. As Canadians live longer, the more likely they will be managing a chronic disease and will need some degree of long-term care support, whether in the home or in an institutional setting.

According to Statistics Canada, the chances of requiring long-term care are one in 10 by age 55, three in 10 by age 65 and one in two by age 75. It is estimated that by 2036 more than 750,000 Canadians over the age of 65 will reside in health care institutions (compared to about 300,000 today).

Many Canadians have the mistaken belief that their long-term care needs will be met through programs and services funded by provincial governments. While government programs aimed at assisting Canadians with long-term care needs currently exist, these programs vary by jurisdiction and are at least partly dependent on the income and/or assets of the infirm person. Based on future funding requirements for long-term care, it is anticipated that Canadians will become responsible for an increasing portion of the overall costs, either directly or through increased taxes.

CALU recommends that the federal government:

- Develop a national seniors' strategy which would include a review of the impact of an aging population on government policies
- Convene a federal, provincial and territorial ministers joint committee to identify and develop common approaches for dealing with long-term care funding issues
- Hold a national symposium of stakeholder groups to discuss and debate seniors' issues and help develop appropriate recommendations
- Work with provincial and territorial governments to develop a national approach to informing Canadians as to the need to plan for their long-term care funding expenses, and
- Modify tax rules to support the development of financial products which are geared towards helping individuals and families fund the growing costs of long-term care support.

Copycat annuities

Issue – Section 147.4 of the ITA allows members of registered pension plans who are entitled to commute their pensions to acquire a registered annuity with the Commuted Value (CV) (referred to as a "copycat annuity"), if permitted by the terms of the pension plan. The transfer to a copycat annuity helps avoid a potentially large tax bill that arises because the Maximum Transfer Value rules cap the portion of the CV that can be transferred to a locked-in RRSP or RIF. However, the rules in section 147.4 are both strict and subject to CRA interpretation. Should the CRA determine that the annuity does not meet the requirements of section 147.4, the tax consequences can be very punitive.

CALU recommends that government clarify the types of annuities that will qualify for a tax-free transfer from a registered pension plan.

Longevity insurance

Issue – Further to recommendations by the Canadian Life and Health Insurance Associations and the C.D. Howe Institute, retirees who are not members of a defined benefit pension plan should be able to secure a lifetime income stream on a tax-effective basis. The provision of longevity insurance is an essential component for making this happen. CALU supports this approach.

CALU recommends tax rules be modified to permit the design of financial products to assist Canadians to finance their needs later in life through longevity insurance.

CALU also recommends that tax rules be modified to permit the ownership of "deferred payout" annuities in registered plans, and avoid accrual taxation where such products are held in non-registered plans.

Pharmacare
Issue – As Canadians age, their reliance on prescription drugs will increase. According to Statistics Canada, 83 per cent of 65 to 79-year-olds use prescription drugs enabling them to manage disease and lead productive lives. While many Canadian seniors have prescription drug plans through extended health benefits or provincial coverage, there are important gaps in coverage. Moreover, Canada faces one of the highest drug costs among the countries of the OECD and drug costs are one of the fastest growing components of employee benefit plans. The federal government is considering options to implement national pharmacare.

CALU believes the current system of private drug coverage works well for millions of Canadians. The gaps in coverage for many should be addressed but must be done in line with existing programs and not put a risk what works well today. Moreover, any improvement on prescription drug coverage should be fiscally responsible and sustainable in the long term.

Conclusion

We thank the Committee for the opportunity to present our priorities and welcome the opportunity to meet when Parliament convenes following the 43rd Federal Election.