Intelligence MEMOS

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To: Canadian Ministers of Finance

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Re: **INSURANCE PREMIUM TAXATION IS ARCHAIC AND COUNTERPRODUCTIVE**

Canadian governments should reassess the cascading taxes imposed on insurance premiums. In our new C.D. Howe Institute report we find that premium-based taxes increase the price of insurance products and lower the demand for them.

Most consumers do not know that a provincial insurance premium tax (IPT) ranging from 2 percent to 5 percent is levied on their premiums for many life, health, and property and casualty insurance products. On top of these premiums, many provinces collect retail sales taxes (RST) on several products for a combined total of $7.3 billion in tax revenues. That figure does not include an additional $4.4 billion in other taxes, like corporate income tax, that insurers also pay. This tax regime makes insurance one of the most heavily taxed financial services in Canada.

Little literature exists specifically on the rationale for provincial taxation of insurance premiums. Originally, IPTs were seen as an alternative to taxing the earnings of insurers. They can also be seen as an attempt to tax consumption, or as an indirect attempt to tax increases of net worth. But the most compelling reason seems to be simply that these provincial taxes provide significant revenues while being largely invisible to consumers and savers.

Taxes on insurance premiums have been a fixture of the Canadian tax system since the early 1900s when insurance companies were subject to very little other tax. They remain a source of considerable revenue for provincial governments in particular.

Multiple transaction taxes paid or remitted by insurers increase the cost of insurance for consumers. First, GST/HST paid by insurers on intermediate inputs and claims cannot be recovered since financial services are exempt. To the extent the result is higher premiums, these higher premiums are then charged an IPT. And then these tax-embedded premiums are sometimes charged RST. Overall, we calculate that the burden of transaction taxes represent about 51 percent of value added for the P&C sector, about 59 percent for health insurance and about 17 percent for life insurance.

We calculate that an increase of one percentage point in the provincial insurance premium tax rate leads to a 10 percent decrease in the number of life insurance contracts sold. Fewer people purchasing insurance coverage has the potential to increase long-term cost pressures on government budgets. Reduced insurance coverage for natural disasters such as floods and earthquakes, relief to a deceased's family, or relief of the financial burden of illness and disability may lead to increased cost pressures on government budgets down the road.

Our report recommends:

- The provinces eliminate their insurance premium taxes or, at a minimum, make them creditable against corporate income tax liabilities, partly restoring their original role as a substitute for taxing profits.
- The provinces that impose RST on IPT-inclusive premiums should lead the way and eliminate this form of double taxation.
- Offsetting fiscal losses; a more ambitious reform would remodel the patchwork of transaction taxes for insurance services to a comprehensive and broad-based, value-added system, bringing down the insurance industry's high transaction tax burden and ensuring greater comparability with other industries.

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