Intelligence MEMOS

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To: Canadian Ministers of Finance

Date: Insurance Premium Taxation is Archaic and Counterproductive

Re: May 28, 2018

With provincial elections looming in Ontario and Quebec, the time is ripe to consider reforming obscure, archaic, and inefficient taxes on insurance premiums.

Insurance premiums have been taxed by Canadian governments for so long – some provinces and municipalities collected small levies on bank capital and insurance premiums as early as the late 1800s – that they've become a fixture rarely if ever challenged in the literature and the financial press.

Yet they are obsolete in a modern tax system, arbitrarily apply multiple times on the same proceeds, are akin to a levy on the capital of insurance savers, and result in artificially higher prices for insurance products at a time when society would prefer more insurance and precautionary savings.

Indeed, at its roots, insurance protection against an uncertain outcome is a form of precautionary saving. Insurance providers create financial intermediation value by pooling similar risk exposures thus reducing the burden of precautionary savings on individual resources.

Since insurance is a financial service, premiums are exempt from GST/HST. But all provinces charge insurance providers a tax on premiums underwritten in the province, with rates varying from 2 to 5 percent depending on the type of risks insured. In addition, five provinces charge a retail sales tax ranging from 6 to 15 percent. In Quebec and Ontario, the RST rates of respectively 9 and 8 percent generally apply to group life and health insurance, and property and casualty insurance (although Ontario excludes auto insurance). Saskatchewan is the latest province to introduce an RST on all premiums effective August 2017, but a few months later rescinded its application to life and health insurance due to strong industry backlash.

Other savings instruments such as bank deposits and bonds are not taxed on the way in. Insurance purchasers are thus taxed more heavily for the same lifetime consumption.

So why do provinces tax insurance premiums? The most obvious reason is opportunism. Indeed, provinces raise more than $7 billion per year in premium-based taxes, representing about 7 percent of all provincial taxes collected on goods and services.

The tax system has evolved since premium taxes were introduced more than 100 years ago. Custom and excise taxes are no longer a primary source of government revenues. And insurers now pay as much in corporate income tax and capital taxes as they pay in insurance premium taxes – on top of many additional taxes and levies. Premium taxes are a strange animal in a modern tax system. The original intention of using premium taxes as an alternative way of taxing insurers' earnings is long gone.

There are other policy issues as well. Insurers pay GST/HST on their operating expenses and P&C claims, and these taxes are reflected in the gross premiums charged, on which premium taxes are applied. Those tax-inclusive premiums are then charged RST. Multiple taxation of the same premiums compounds to arbitrary effective rates of tax.

Insurers pool premiums from all insured persons, accumulating capital savings which will be paid out through future claims (minus operating expenses and profits). Taxes on the premiums are akin to a capital tax on insurance savers. Finally, higher tax-inclusive insurance premiums reduce consumer demand. Unlike taxes on carbon-intensive fuel, alcohol, and tobacco – all products for which reduced consumption yields societal benefits, financial protection against natural disasters or against mortality risks, make insurance societally beneficial.

Provinces need to think hard about the tax treatment afforded to insurance premiums. Time to bring the obsolete taxation of insurance into the 21st century.

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