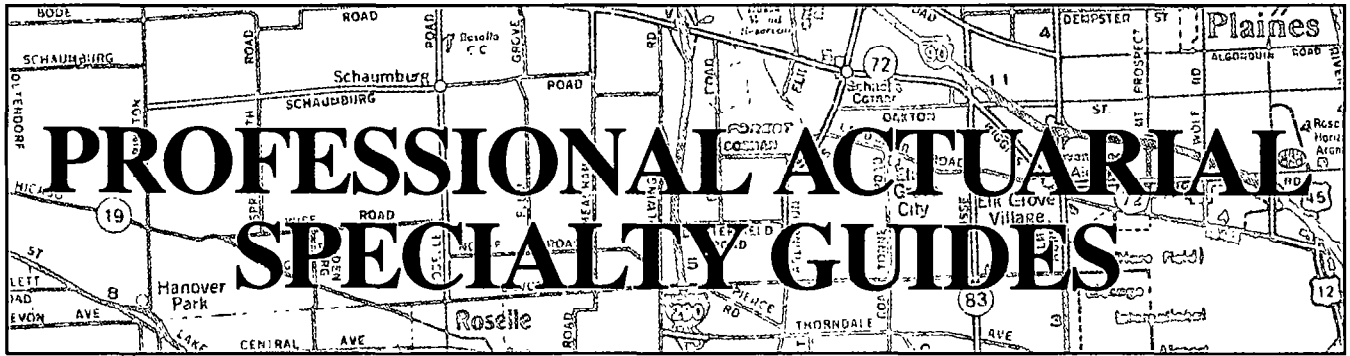


## SOCIETY OF ACTUARIES



## COMMITTEE ON CONTINUING EDUCATION

## CANADIAN TAXATION—LIFE INSURANCE

**Introduction**

As part of "tax reform" introduced effective at the beginning of 1988, a major revision of the taxation of life insurance companies operating in Canada occurred. The principal changes were the introduction of a controversial "investment income tax", intended to tax at the Company level investment earnings attributable to "exempt" life insurance business, a tightening of the rules for deductions from company taxable income for policy reserves, investment reserves, the policy dividend and group experience refund provisions, and more stringent allocation rules for investment income earned by multi-nationals.

**The Role of the Actuary in Taxation Matters**

The Investment Income Tax is a significant ingredient in the design and pricing of individual or ordinary life insurance products, and therefore falls very much in the domain of the actuary. Also, in determining company taxable income, an important element is the allowable policy reserve deduction, determined by rules specified in the tax legislation. Actuarial knowledge and expertise is required in interpreting and applying these rules, and in developing strategies to optimize the allowable reserve deduction.

In a broader sense, and going beyond the obviously actuarial issues, Canadian actuaries have traditionally been at the forefront of discussions within the industry and with government officials in matters relating to both general and detailed matters of tax policy and interpretation as they apply to life insurance companies and their policyholders.

**Canadian Taxation—An Introduction**

"Life Insurance in Canada—a guide to Corporate Taxation", by A.E. John Thompson and Steven H. Korszak (1989). Material available from Coopers & Lybrand, 145 King Street West, Toronto, Ontario, M5G 1V8. Tel. # (416) 869-1130.

This is written in booklet form, the primary audience being accounting and tax practitioners or life insurance management with little or no knowledge of life insurance taxation. It is a good introduction to this subject, and also incorporates the 1988 tax changes (to the extent that they were known at the time of writing).

Level: Basic

Pages: 89

**Company Income Taxes—Legislation**

Income Tax Act, Canada; Sections 138, 140, 142, 211, 219 (latest revision was effective 1988). Material available from CCH Canadian Ltd., 6 Garamond Court, Don Mills, Ontario, M3C 1Z5. Tel. # (416) 441-2992.

These are sections which relate specifically to the taxation of life insurance companies, covering the treatment of items such as policy reserves and dividends, capital gains and losses on bonds, policy loans, claim provisions, segregated funds, computation of investment income, and tax on non-resident life insurance corporations.

Level: Intermediate

Pages: 58

Other recent legislation in course of enactment (a) Large corporations tax – Budget Papers April 1989, page 40; (b) Capital tax on life insurers – Budget Papers February 1990 – page 175; (c) Goods and Services Tax – Technical Paper August 1989 – page 141. Copies can be obtained from any major accounting firm.

These new taxes impact life insurers, and currently either have taken effect or are expected to take effect shortly.

Level: Basic

Pages: 17

Income Tax Act, Canada; Regulations 1400-4, 1900, 2400-5, 2410-2, and 8100-5. Note that with the exception of 1400-4, these new or revised regulations are effective from 1988 but are currently still in draft form. Material available from CCH Canadian Ltd., 6 Garamond Court, Don Mills, Ontario, M3C 1Z5. Tel. # (416) 441-2992.

Regulations 1400 thru 1404. These Regulations describe how policy reserves are to be calculated for the purpose of determining taxable income.

Regulation 1900. This Regulation (still in draft form) will describe the application of the investment income tax on interest earned by the company and deemed attributable to certain classes of life policies.

Regulations 2400 thru 2405. These Regulations (still in draft form) will describe, for a company operating inside and out of Canada, how investment income and earnings are to be allocated to Canadian business, including the principle of the “Canadian Investment Fund”. These Regulations also discuss the definition of par income in order to establish the deductibility of policy dividends.

Regulations 2410 thru 2412. These Regulations (still in draft form) will establish the basis for imputed income on real estate, the minimum yield on the Canadian Investment Fund, and the quarterly cashflow adjustment to the Canadian Investment Fund.

Regulations 8100 thru 8105. These Regulations (still in draft form) will discuss the “clawback” of the reduction resulting from the restatement of the 1988 policy, investment, and dividend reserves.

Level: Intermediate

Pages: 60

## Company Income Taxes – Discussion Papers

“Canadian Taxation of Non-resident Insurers”, by Sue Pennal (1989). Published in the Canadian Tax Journal, volume 37, number 4, copies of which can be obtained from Canadian Tax Foundation, 130 Adelaide Street West, Suite 1900, Toronto, Ontario M5H 3P5. Tel. # (416) 863-9784.

This article reviews in general terms some of the taxation issues, including the implications of recent legislative changes, that affect non-resident insurers carrying on Canadian business on a branch basis.

Level: Basic

Pages: 18

“An analysis of the Proposals for the Taxation of Life Insurance Companies”, by Jules Dukacz (1987). Published in the 1987 Conference Report of the Canadian Tax Foundation, 130 Adelaide Street West, Suite 1900, Toronto, Ontario M5H 3P5. Tel. # (416) 863-9784.

This paper looks at the life insurance income tax changes proposed by the 1987 Tax Reform, including the measurement of the investment income of multinational insurers, and the calculation of reserves. It also examines the government’s apparent concern about reinsurance.

Level: Basic

Pages: 48

Society of Actuaries Study Note. Course I-324C – “Investment Income Tax Revisited” by Peter S. Hutchison and Dianne Romano (1988).

This is a recently written study note which describes the investment income tax introduced, or reintroduced, effective at the beginning of 1988. The paper describes very effectively a somewhat complex system, but in the absence of final Regulations, is based on the form that this tax was at the time expected by the industry and authors to take.

Level: Advanced

Pages: 13

“The new Investment Income Tax in Canada” by Jules Dukacz (1990). At time of writing, not yet published. Meanwhile, copies may be obtained from the author at his yearbook address.

This proposed paper covers ground similar to the study note described above, but incorporates additional more recent developments.

Level: Advanced

Pages: 25

"The Taxation of the Investment Component of a Life Insurance Policy" by J.W. Welkoff (1989). Published in Canadian Tax Journal, volume 37, number 1, copies of which can be obtained from Canadian Tax Foundation, 130 Adelaide Street West, Suite 1900, Toronto, Ontario M5H 3P5. Tel. # (416) 863-9784.

This paper reviews the history of taxation of the investment component of a life insurance policy from the first form of investment income tax introduced in 1968 to the most recent investment income tax legislation effective in 1988.

Level: Basic

Pages: 34

"The Effects of the Proposed Investment Income Tax and Minimum Corporate Tax on the Life Insurance Industry", by A.E. John Thompson (1987). Published in 1987 Conference Report of the Canadian Tax Foundation, 130 Adelaide Street West, Suite 1900, Toronto, Ontario M5H 3P5. Tel. # (416) 863-9784.

This paper examines the nature and effects of the investment income tax proposed by the 1987 Tax Reform, and the minimum corporate tax proposed by the Commons Finance Committee.

Level: Basic

Pages: 18

### Discounting of Deferred Income Taxes

"Deferred Income Taxes and Discounting" by Neil L. Haynes. Presented at Canadian Institute of Actuaries June 1989 Meeting. Material available from Canadian Institute of Actuaries, 360 Albert Street, Suite 1040, Ottawa, Ontario, K1R 7X7. Tel. # (613) 236-8196.

The ability of life insurance companies, and others, under GAAP to discount deferred income taxes for interest is a subject of current active debate. This paper examines the issue from an actuarial standpoint.

Level: Intermediate

Pages: 16

### Policyholder Taxation

CIA Transactions Volume XV-3 (1984): "Notes on the Taxation of Life Insurance Policies and Annuity Contracts" by James S. Witol. Material available from Canadian Institute of Actuaries, 360 Albert Street, Suite 1040, Ottawa, Ontario, K1R 7X7. Tel. # (613) 236-8196.

Rather than the taxation of companies, it discusses the taxation of individual policyholders, and in particular the application of the then new rules whereby, for policies which do not qualify as "exempt", interest deemed credited to life policies is treated as taxable to the policyholder.

Level: Advanced

Pages: 16

"Taxation—A Handbook for Insurance and Estate Planners" (1986) published by the Life Underwriters Association of Canada, 41 Lesmill Road, Don Mills, Ontario, M3B 2T3. Tel. # (416) 444-5251. Note that the new updated edition (in 2 volumes) is expected to be available during 1990.

As the title implies, this is written with the agent in mind, and is a discussion of tax issues arising from insurance and annuity contracts. It is a detailed document and subjects covered include such items as tax on disposition of a policy, taxation of annuity payments, treatment of variable products, registered retirement plans, and partnerships and corporations.

Level: Basic

Pages: 338

### Canadian Taxation—History

Society of Actuaries Study Notes (1989). Course I-324C—"Taxation of Insurance Companies in Canada" by Graham R. McDonald.

This study note provides an excellent technical explanation of the history and principles underlying the Canadian taxation system as it applies to life insurance companies. Unfortunately, the material has not been updated for some time, and does not reflect recent changes. Nonetheless, it provides a very valuable basis for anyone wishing to understand the historical development of the system.

Level: Advanced

Pages: 42

*Transactions of the Society of Actuaries, Volume XXII (1970)–“Taxation of Insurance in Canada” by Raymond L. Whaley.*

This paper outlines the history of taxation of life insurance in Canada, which was quite limited until 1969 when major legislation was introduced. It describes and analyses the changes introduced at that time.

Level: Advanced

Pages: 45

*Transactions of the Society of Actuaries, Volume XXVI (1974)–“The Taxation of Insurance in Canada – II” by Raymond L. Whaley.*

This is an update of a paper presented by this author in 1970, and reflects the 1972 and 1973 changes to the legislation, together with the derivation of marginal tax rates.

Level: Advanced

Pages: 34

## Compliance Manuals

“Tax Manual”, developed by the Canadian Life and Health Insurance Association, 20 Queen Street West, Suite 2500, Toronto, Ontario M5H 3S2, Canada. Tel. # (416) 977-2221. Most recent version issued in 1977, and currently in course of being updated.

This document is written largely as a compliance aid, and comprises sections on company taxation, source reporting of income, and policyholder taxation. However, until the manual is updated, it is of somewhat limited current application.

Level: Basic

Pages: 159

This Actuarial Specialty Guide on Canadian Taxation – Life Insurance was developed under the auspices of the Professional Actuarial Specialty Guides Committee on Continuing Education by

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