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DIGEST OF REPORTS ON TOPICS OF CURRENT INTEREST

CARTER COMMISSION REPORT

MR. WELBURN J. ADAMS: Because of the time limitation, all that I can do is to give you a very sketchy, itemized synopsis. I will do this in three parts. First, I will indicate some of the major principles upon which this revolutionary new kind of tax system is based. Second, I will try to point out the major points of impact with regard to these principles upon the taxation of life insurance companies, policyholders, and beneficiaries. Third, I will endeavor to illustrate what the life insurance companies are doing about it and the position that they are likely to take.

First, there are several major principles upon which the new kind of tax system is based.

1. *Comprehensive tax base.*—One paragraph in the Carter Report helps to convey its spirit and philosophy:

> If a man obtains increased command of goods and services for his personal satisfaction, we do not believe it matters from the point of view of taxation whether he earned it through working, gained it through operating a business, received it because he held property, made it by selling property, or was given it by a relative. Nor do we believe it matters whether the increased command over goods and services was in cash or kind. Nor do we believe it matters whether the increase in economic power was expected or unexpected, whether it was a unique or recurrent event, whether the man suffered to get the increase in economic power or it fell in his lap without effort. All of these considerations should be ignored either because they are impossible to determine objectively in practice or because they are irrelevant in principle, or both. By adopting a base that measures in power, whether exercised or not, to consume goods and services, we obtain certainty, consistency, and equity.

This means that there is no such thing as an income tax, estate tax, capital gain tax, or gift tax. They all are composed of one comprehensive base with no distinction between them.

2. *Integration of personal and corporation taxation.*—Each corporation will pay a flat 50 per cent on earnings. If a shareholder receives a $5 dividend, the corporation has paid a $5 tax. If the shareholder is a Canadian resident, he adds $10 to his taxable income and takes credit for the $5 tax paid by the corporation.

3. *Family units taxed, not individuals.*—A family unit may be a single person, but it also includes a wife and any dependent children under 21, with an extension to 25 for university students. Within a family unit all incomes are added together and the tax paid as a unit. Transfers are freely made within a family unit, but, when a child leaves the unit at 21, he must declare and pay tax on everything that he is taking out of the unit.

4. *Averaging.*—This alleviates violent fluctuations in income by averaging over short periods of years.

All these principles are tied in with the overriding principle of equity. They describe equity as two kinds—horizontal and vertical. Horizontal equity is making sure that two family units with the same economic power coming into them are taxed the same. Vertical equity is making sure that, as the economic power is higher in one family unit than another, there is a grading-up of tax in order to bring them together so that they have the same net power.

Second, let us look at some of the effects of this on life insurance.

1. Life insurance companies should be taxed like other corporations. Shareholders of life insurance companies would be treated as shareholders of other corporations, and they would gain from integration if their personal tax rate were less than 50 per cent. However, they go further and suggest that all policyholders to some extent, and participating policyholders to a considerable extent, should be treated as shareholders.
2. The company tax (and there is no life insurance company income tax in Canada at the moment) should be 50 per cent on retained earnings, as it is for other corporations. In defining retained earnings, they eliminate contingency reserves and disallow part of the required reserves by revaluing reserves on a basis of 4 per cent or higher.
3. They propose to give the policyholder credit for his share of the tax paid by the company. They have not worked this out but have left it for the companies to do.
4. Dividends in the hands of the policyholder, or credited to him, should be taxed.
5. The policyholder should pay a tax each year on the interest earned on the assumed reserve on his policy. The company would have to compute this each year and report it to the government and to the policyholder. This involves about 11 million policyholders but less than 6 million taxpayers.

6. There should be a tax on the mortality element. The mortality cost is treated as a trading loss if the policyholder survives. If he dies, the profit (difference between sum insured and reserve) is treated as taxable income, even if within the family unit. If it is business insurance, there can be four full taxes payable. This tax will not take effect immediately but will wait until things settle a bit.
7. On group insurance we have the same net effect but for a different reason. They have tried to develop it in the same class with disability and other employee benefit and income-replacement plans. The employer does not pay a tax on the premium that he pays and neither should the employee. However, this is a postponement of tax, and, as in other cases, the insurance company pays a 10 per cent penalty as a tax and presumably passes it along to the policyholder in the premium rate. When the man dies, the policy proceeds are taxable income because they are considered income replacement. This is to be effective immediately.

Finally, we in the life insurance business have had to take this seriously, and we have co-ordinated our study and research through the Tax Committee of the Canadian Life Insurance Association, involving several subcommittees, economic study groups, and so forth. Some of the points upon which it is becoming apparent that we should take a position follow:

1. The life insurance business is a unique kind of business, and policyholders cannot be regarded as shareholders in a corporation for tax purposes.
2. Any tax method which may be adopted for life insurance should avoid complexities which are actuarially unsound or which are costly to the public, the government, and to the companies, for example, computing interest on the reserves and retained earnings, and tax credits to individual policyholders.
3. Policy dividends, because of their nature and purpose, should not be treated as earned income like corporation dividends.
4. The insurance element should not be negated by treating the mortality element as a capital gain or as income replacement. Like the payment of a fire insurance claim, it should be treated as the capital replacement of an income producer and only the income which is produced subjected to income tax.
5. There should be protection against the retroactive effect of new taxes, especially with respect to nonparticipating insurance and annuities.
6. There should be no tax deterrent to the soundness of the decisions of management and supervisory authorities in providing solvency safeguards in the reserves; our business is unique in its long-term hazards.
7. The weight of premium taxes unique to life insurance as compared with other forms of savings must be taken into account in order to avoid double taxation.
8. Canadian taxes should not interfere with the substantial proportion of

Canadian life insurance companies' operations outside of Canada—and should not discriminate against the Canadian operations of nonresident companies as compared with Canadian companies.

With these guiding principles and others, we have the task of beginning to discuss these things with government authorities and getting a brief together by September. In case you wonder why a report which took five years to prepare, is so voluminous and complex, and has a bearing on the whole economic structure of our country has such a sense of urgency, business has pressed the government to come to a speedy decision, and the government proposes to introduce whatever changes it adopts in its tax legislation early next year. The reason for this is that, because of any major changes which this makes in the whole economic and investment structure of our country, any delay or uncertainty could slowly grind our economic life to a halt, due to the avoidance of major decision-making.

There is not time today to refer to the investment complications of this, insofar as life insurance companies are concerned. Obviously, there are many complications here. We are presently conducting several researches and studies into this field and hope to have some of this ready by the end of the year.

RECENT DEVELOPMENTS IN HEALTH INSURANCE PROGRAMS IN THE UNITED STATES AND CANADA

MR. MORTON D. MILLER reported on United States Medicare. A copy of his report is contained in *TSA*, XIX, D15.

MR. WILLIAM H. BURLING reported on health insurance in Canada to the same effect as his reports at the New York and New Orleans meetings, as contained in *TSA*, XIX, D17. In addition, he provided the following material.

The provinces have said that Ottawa is insistent that, because "public moneys" are to be paid, the role of any agent must be limited to "post office" functions and that in particular every claim must be referred to a provincial civil servant for "assessment" before it can be paid. When it is remembered that a dozen or so private carriers are paying public moneys under the United States Medicare plan with full responsibility to the citizens of the United States and to the satisfaction of all levels of government, this argument is seen to be specious even in theory. When it is also remembered that about 75 per cent of all Medicare claims are for doctors' visits and bill the "authority" for, say, $5 for a visit on a named day, the argument is also seen to be absurd in practice. It is difficult to understand how Canada can gain by dispersing the skills and staffs developed by private carriers in servicing almost 100 per cent of that portion of the population now prepaying for health services, usually through and with the help of employers, many of whom pay half the cost or more. Those same employers very often buy other group Medicare benefits not yet contemplated by Ottawa for cost-sharing, and the relative difficulty and cost of providing such benefits will necessarily be increased, so the residents of Canada might even be hurt in the aggregate.

In summary, the chances are conceded to be less than 1 in 10 that the federal government will be able to strike a political bargain with Ontario and Quebec (which together make over half of Canada) which will enable it to profit politically by releasing the very large part of the $350,000,000 or more of yearly tax money committed by Bill C. 227 to paying half of doctors' charges on the persons now paying their own way, with or without the help of an employer. This money is sorely needed by the provinces for educational costs. It can be a political handicap federally, as it adds

to present deficits. The need to match it will aggravate provincial fiscal problems and can make it a political handicap provincially. But it grew out of a long debate in Canada which started in the twenties and culminated with the espousal of the old-fashioned European approach by the 1961–64 Royal Commission (Hall) inquiry and report.

The Ontario, British Columbia, and Alberta plans meet the expressed demand of the public of Canada that no one shall lack medical care for financial or health reasons. They encourage and reward medical competence and encourage the medical profession as such to measure up to its responsibilities. They utilize to the full the tremendous drive which has been developed over the past ten years to make benefits even better by competition among unions for members, competition among employers for employees, and competition among carriers for business. They contain the essential seeds of future adaptability to needs and to desirable changes because of the susceptibility to pressures from the ultimate consumer of medical services which is created by all these types of competition.

These plans have the making of a distinctive and purely Canadian solution to the Medicare problem that could be a solid contribution to worldwide research and knowledge. They seem, however, to have arrived on the scene too late, and the architects of Bill C. 227 were familiar only with the old European approach and were not willing to study the new. The final die is not yet cast, but hope is dim that the native Canadian approach of the three provinces will be encouraged.