Canadian Life
and Health Insurance
Association Inc.

Association canadienne
des compagnies d'assurances
de personnes inc.

Submission on the

2012 Federal Budget

to the

House of Commons
Standing Committee on Finance

by the

Canadian Life and Health
Insurance Association Inc.

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I. Executive Summary

The Canadian Life and Health Insurance Association Inc. (CLHIA), urges the House of Commons Finance Committee to recommend that the Minister of Finance take steps in his forthcoming budget to improve retirement income security and to improve the competitiveness of Canada's income tax system. This will promote personal savings and security, and business investment and economic growth.

In particular, CLHIA recommends that:

- ***A framework for Pooled Registered Pension Plans (PRPPs) be established through the Income Tax Act that can be consistently adopted across the country, thus opening up access to workplace retirement plans for the 3.5 million Canadians who currently do not have such access. This framework should provide for an employee auto-enrolment feature to encourage participation and a contribution auto-escalation feature to encourage retirement savings growth.***

- ***Canada's tax system be made more competitive and provide additional assistance to companies suffering from tax losses and/or lack of liquidity by:***
  - ***providing a comprehensive group taxation regime that would assist companies in utilizing losses within corporate groups (Canada is the only member of the G8 without such a mechanism)***
  - ***improving access to liquidity and capital available in foreign subsidiaries by allowing loans and tax free repatriations of surplus***
  - ***facilitating the development of Canadian centres of excellence by removing tax disincentives to providing services to foreign corporations from Canada.***

In addition, this submission discusses the need to help individuals take responsibility and prepare for their own long-term care needs. One way to accomplish this would be for the Government to provide tax and financial incentives for Canadians to purchase long-term care insurance or to contribute to an RSP-style vehicle established to meet this objective. We also raise the issue of the impact of increasing regulatory burdens on financial institutions.

II. Introduction

The Canadian life and health insurance industry is pleased to contribute to the deliberations of the House of Commons Standing Committee on Finance regarding the 2012 Federal budget. The Committee's pre-budget consultations play a vital role in the budget making process and have contributed greatly to Canada's fiscal achievements and to numerous worthwhile initiatives undertaken in recent years.

Established in 1894, CLHIA is a voluntary non-profit association with member companies accounting for 99 per cent of Canada's life and health insurance business. The industry administers about two-thirds of Canada's private pension plans and protects more than 26 million Canadians, paying them over $64 billion in benefits in 2010. The life and health insurance industry is one of the largest in the Canadian economy, with 135,000 Canadians earning some or all of their income from the industry. Many highly-skilled and well-paying industry jobs are situated in Canada because the head offices of Canadian life insurers are located here. Canada's major life and health insurers are global leaders, with significant and growing operations in the United States and Asia. The three largest Canadian life and health insurers are among the top 15 in the world.

III. Implementing Pooled Registered Pension Plans and Other Pension Reforms

We urge the Committee to recommend that the Minister of Finance take steps, in his forthcoming budget, to implement Pooled Registered Pension Plans (PRPPs). Canada's Finance Ministers committed to the creation of PRPPs in December 2010. These defined-contribution plans administered by regulated financial institutions and available to all employers and the self-employed would be designed to be particularly attractive to small and mid-size employers and the self-employed, with administrative responsibilities transferred to the regulated financial institutions and economies of scale that will lead to low costs usually realized in very large traditional pension plans.

Legislation to implement PRPPs through the *Income Tax Act* should:

- ***Remove the employment relationship requirement for pension participation:*** Paragraph 8502(a) of the Regulations to the *Income Tax Act* imposes a "primary purpose" test for all pension plans, such that they are required to "provide periodic payments to individuals after retirement and until death *in respect of their service as employees"*. The reference to service "as employees" prevents self-employed and other unconnected individuals from participating in any pension plan, including PRPPs. We recommend that the *Income Tax Act* be amended to remove the requirement for an employment relationship between pension plan members and the sponsor of a pension plan, thereby facilitating expanded pension participation, especially among small employers.
- ***Establish a framework for PRPPs that can be adopted by provinces and territories to achieve a consistent, harmonized approach across the country:*** This framework would permit eligible administrators (regulated financial institutions) to offer low-cost pension plans that promote participation and growth of retirement savings. Such plans would require auto-enrolment of employees and auto-escalation of contributions (both with the right of an employee to opt out).
- ***Adopt the best administrative regime for PRPPs*:** The June 2011 consultation paper "Tax Rules for Pooled Registered Pension Plans" contemplates a two-tiered tax regime (a pension regime for those where employers are making contributions and an RRSP-style regime for those where they are not) that will increase complexity and costs. A single, hybrid regime would be more effective, allowing employers to contribute in the future if that is not immediately practical. (Otherwise they would need to change plans, creating a disincentive to employer contributions.) As pension plans, PRPPs should provide protection for spouses and common-law partners on death or marital breakdown, and be locked-in to provide retirement income. But PRPPs should use the *Income Tax Act's* simpler RRSP contribution rules, rather than traditional pension rules, to reduce the administrative burden.
- ***Exclude employer contributions from employees' earnings for purposes of determining CPP contributions and EI premiums,*** as is now the case for other registered pension plans.

<u>Recommendation</u>: A PRPP framework should be established through the Income Tax Act that can be consistently adopted across the country, thus opening up access to workplace retirement plans for the 3.5 million Canadians who currently do not have such access. This framework should provide for an employee auto-enrolment feature to encourage participation and a contribution auto-escalation feature to encourage retirement savings growth.

IV. Enhancing Canada's Tax Competitiveness

Canada's tax competitiveness has improved substantially over the last few years. We are particularly encouraged by the Government's decision to stay the course with respect to the reduction of the federal corporate income tax rate to 15%. As corporate income tax rates are reduced, similar and consistent reductions should be made to other taxes such as the Part VI capital tax on financial institutions and the Part VI.I tax on corporations paying dividends on taxable preferred shares. In addition Canada's tax competitiveness could be further improved by the following measures.

Providing a Comprehensive Group Taxation Regime:

The CLHIA and its members support the Government's initiative to explore the range of possible approaches for a new system of corporate group taxation. The system for the taxation of corporate groups is of particular significance for our industry due to the highly regulated nature of the financial services sector, which results in business activities being conducted in separate corporations. To attract more head offices and investment to Canada, Canada's system for the taxation of corporate groups must be competitive with major developed countries around the world. As discussed in our April 15, 2011 submission to the Department of Finance, the CLHIA believes that, in developing an improved system for the taxation of corporate groups, the Department should be guided by three main principles:

i) The new system should be simple and flexible. It should be elective and available to all corporate members of a related group who are subject to taxation in Canada.
ii) The new system should include the provinces, ideally, with Canada and the provinces participating in a common (or substantially similar) system to minimize complexity and compliance and administrative costs.
iii) The range of attributes that may be "transferred" under the new system should include, at a minimum, capital and non-capital losses but may be extended to other attributes if that can be done without undue complexity and delay.

We look forward to working with the federal and provincial governments and other interested participants from the business community in developing a new system for the taxation of corporate groups.

***Recommendation*: We recommend that the Government proceed with the introduction of a comprehensive group taxation regime without delay. This would improve the country's international tax competitiveness as Canada is the only country within the G8 without a statutory group tax relief mechanism.**

Liquidity and Accessing Capital in Foreign Subsidiaries:

Liquidity and access to capital are critical for businesses to fund future growth and investment. Uncertain global economics can make accessing liquidity difficult. Many Canadian companies with successful foreign operations have significant liquidity available in jurisdictions outside Canada, but they are hampered in repatriating this cash by tax rules that are outdated and out of step with other developed nations, including the US. This was acknowledged in the Final Report of the Advisory Panel on Canada's System of International Taxation which strongly recommended the adoption of a full exemption regime for all foreign active business income. Implementation of the Advisory Panel's recommendations will take some time; in the meantime, immediate action is needed to permit Canadian businesses to access capital available in jurisdictions outside Canada. We therefore recommend interim measures be adopted for the next three years (or until an exemption system is implemented) to allow immediate access to such capital and resources by:

(i) allowing loans from foreign subsidiaries to Canadian parent companies without adverse tax consequences by a) eliminating Canadian withholding tax on the interest payable to the foreign affiliate, b) ensuring that any interest or foreign exchange gains earned by the foreign affiliate are not subject to accrual taxation in the hands of the Canadian parent (i.e., are not "foreign accrual property income" or "FAPI"), and c) characterizing the loan as an active business asset of the foreign affiliate.

(ii) allowing tax free repatriations of surplus by permitting distributions to Canada out of the taxable surplus account of a foreign affiliate to be treated as if they were distributions received by the Canadian taxpayer out of exempt surplus of a foreign affiliate (except to the extent that such amounts are deductible under section 113 of the *Income Tax Act*).

Facilitating Development of Canadian Centres of Excellence:

The current Canadian tax regime inhibits the development of centres of excellence in Canada and thus encourages the development of such expertise and service providers outside Canada. This is because having a Canadian company or head office providing services to non-residents could cause those recipients to be considered to be carrying on business in Canada and be subject to the Canadian tax regime. This places Canadian multi-nationals at a disadvantage to their main competitors, US multinationals, which are generally not limited in this way. This disincentive should be removed by broadening the scope of section 115.2 of the *Income Tax Act* (that sets out the circumstances in which a foreign recipient of services provided by a Canadian will not be considered to be carrying on business in Canada solely because of the receipt of those services). Currently, section 115.2 applies only in respect of certain limited investment services provided to third parties. We recommend that section 115.2 be broadened such that the mere provision of services by a Canadian business will not cause a foreign recipient of such services to be considered to be carrying on business in Canada. We also recommend that section 115.2 be made applicable to all non-residents, including related parties. Canada's transfer pricing regime offers sufficient protection to ensure this change to section 115.2 would not result in an erosion of Canada's tax base. The importance for the financial sector of these legislative changes has been heightened in the last few years with the many positive developments in the Toronto Financial Services Alliance's efforts to create leading financial services hubs in Toronto for global risk management, mining and energy financing, retirement financing solutions, and skilled financial services support. The current tax regime interferes with these important growth opportunities.

Recommendation: We recommend that the Government improve the competitiveness of our tax system and provide additional assistance to companies suffering from tax losses and/or lack of liquidity by:

- ***improving access to liquidity and capital available in foreign subsidiaries by allowing loans and tax free repatriations of surplus***
- ***facilitating the development of Canadian centres of excellence by removing tax disincentives to providing services to foreign corporations.***

V. Improving Support for Long-Term Care Needs

The dynamics of health care in Canada are changing. Shorter hospital stays, more outpatient treatment and an aging population with longer life expectancy are increasing the need for continuing care for many Canadians. Continuing or long-term care can encompass a wide range of health services delivered either in-home or in the community. This specialized care is provided to individuals who may be aging, recovering from a disability or who are chronically or terminally ill. These needs could include medical, nursing, social or therapeutic treatment or assistance with

activities of daily living. For example, there are roughly 250,000 people residing in long-term care facilities in Canada at present and this number will rise dramatically over the coming decades as baby boomers continue to age.

Most Canadians are under the expectation and misperception that their long-term care needs will be provided for by government as they age. Canada needs to do more to educate Canadians on the reality that this is not the case. We also need to help individuals take responsibility and prepare for their own long-term care needs. To assist Canadians' planning and saving for long-term care, we believe that the Government should provide tax and financial incentives for Canadians to purchase long-term care insurance, or to contribute to an RSP-style vehicle which could be established to meet these objectives.

VI. Regulatory Burden

Unintended Consequences from Accounting and Regulatory Change: Accounting and regulatory changes currently being contemplated in Canada and internationally will precipitate negative impacts, potentially very dramatic, to life insurance companies. These impacts are described in a July 2011 report entitled "Fixed income strategies of insurance companies and pension funds" of the Bank for International Settlement's Committee on the Global Financial System (the Committee chaired by Governor Carney). Life insurers are major providers of long-term funding to banks, the corporate sector in general, and the public sector, and also provide consumers with long-term guaranteed products. Hence life insurers contribute substantially to a well functioning economy and ease the burden on governments to provide security to its citizens. The accounting and capital changes currently being considered have the potential to shift life insurers' investments more towards high quality long-term bonds such as government bonds and away from long-term corporate bonds and equities and to withdraw products offering long-term guarantees. We encourage the Government to take into account the conclusions of this study as it contemplates any capital, accounting or other regulatory changes.

FATCA: The US Foreign Account Tax Compliance Act (FATCA) as currently contemplated will result in significant costs and increased compliance burdens for Canadian financial institutions and their foreign subsidiaries. We understand the objective of FATCA to reduce tax evasion by US citizens. However, the legislation currently does not distinguish between low-risk nations such as Canada and tax havens. Nor does the legislation provide sufficient exemptions for life insurance products purchased to provide financial security, not to evade taxes. We appreciate the efforts of the Minister of Finance and his Department to raise the industry's concerns with the US government and encourage them to work to develop a bilateral (or multilateral) solution, utilizing the tax information sharing provisions under the Canada-US Income Tax Treaty.

VII. Conclusion

We encourage the Committee to recommend that, in his forthcoming budget, the Minister of Finance take steps to implement Pooled Registered Pension Plans and to enhance the competitiveness of Canada's tax system.

The industry greatly appreciates this opportunity to contribute to the Committee's pre-budget consultations and stands ready to make available any further information which the Committee may require.