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UPDATE ON CANADIAN FEDERAL EXCISE TAX

The Canadian federal excise tax imposes a 10% premium tax on entities resident in Canada, including international corporations that place insurance against risk in Canada with insurers not authorized by federal or provincial insurance authorities. The tax is also applicable when coverage is placed by a non-resident broker or agent – even if the insurer is authorized in Canada.

When a placement involves more than one broker or agent, or when the payment of premium or any part of the premium is paid to more than one broker or agent, then the policy will be deemed to be placed by the broker or agent directly retained or instructed by the insured and not through any other broker or agent. Historically, auditors at the Canadian Revenue Agency (CRA) reviewing insurance placements required evidence that the Canadian broker was directly retained and received instruction from the insured. Without this evidence, the placement would be subject to the 10% federal excise tax. The tax was being applied even in instances when the broker outside of Canada was arranging the global placement and retained a Canadian broker to place the insurance for the Canadian risk, since the CRA auditors deemed the policy to be placed by the non-Canadian broker – the one directly retained or instructed by the insured.

IMPETUS FOR CHANGE

In late 2011, the auditing practices for certain global placements changed. Two factors contributed to this change:

1. Internal pressure from the CRA's own auditors. They found it challenging to sift through emails, meeting notes and telephone conversations from multiple parties to try to determine which broker was the one directly retained or instructed.

2. At the same time brokers working on behalf of frustrated clients approached the CRA with their concerns. As a result of these discussions, the CRA decided to review their administrative procedures respecting potential acceptable conditions for exemptions from the tax. Once the overall review of the administration of Part I tax is complete, the CRA will post revised publications related to this matter.

In the meantime, we want to alert you to a change in how the CRA is reviewing complex global placements.

IMPETUS FOR CHANGE

In a letter to the Insurance Brokers Association of Canada issued in January 2012, Pierre Bertrand, Director General Excise & GST/HST Rulings Directorate, stated that the Part I tax on insurance premiums other than marine would not apply when the placement meets both of the following criteria:

- More than one broker is involved in a placement
- The coverage is provided by an insurer licensed in Canada with a licensed Canadian broker shown on the policy

Discussions with the CRA have indicated, however, that the above points are only the minimum standards to be met. First, the Canadian broker owes the insured a duty of care and must meet requirements set out by provincial regulators. Second, the local Canadian broker, at minimum, should:

- Request to be named Broker of Record on the Canadian Policy
- Invoice the insured for premium related to the Canadian policies as well as collecting and remitting payment and provincial sales taxes related to the Canadian portion of the insurance premium
- Review policies received from Canadian insurer prior to issuing the policies to the insured
- Provide anything else that is required to carry out the duty of care owed to the insured

The CRA has confirmed they will not apply this change in auditing policy retroactively. *Furthermore, changes to the ETA, the regulations or the CRA's auditing practices may affect this recent interpretation.*

WHAT HAPPENS IF THE TAX IS UNPAID?

If the Canadian federal government discovers unpaid premium taxes, they will likely charge the 10% tax, plus interest and penalties, for current and prior years. They may also disallow the insurance premium (current and prior years) as a legitimate business expense for other tax purposes. Sorting out such problems can be time-consuming and costly.

CAN INSURERS OR BROKERS HANDLE THESE TAXES FOR YOU?

Foreign and Canadian insurers and brokers generally do not collect or remit federal excise taxes. Insurance buyers are responsible for filing an Excise Tax Return and remitting any applicable excise taxes.

ARE THERE EXEMPTIONS FROM FEDERAL EXCISE TAXES ON PREMIUMS?

Exemptions may be granted by the Canadian government in cases where coverage cannot be placed locally in Canada, usually because a particular class of insurance or the amount of coverage required is not available. Examples of coverages not always available in the Canadian market include Railroad Protective Liability, Manufacturers' Errors & Omissions and Punitive Wrap-Around Aviation. Exemptions may also be granted if a buyer is unable to obtain local coverage due to loss history or the nature of their risk.

Applications for exemptions must be accompanied by written letters of declination from at least five Canadian insurers. The application form, E638, is available from the Canadian government **website**.

Some classes of insurance are exempt entirely under the Federal Excise Tax Act. These include Personal Accident, Life, Sickness and Marine. For more information, refer to the Act itself, which can be found on the government website.

ARE THERE OTHER TAXES ON INSURANCE PREMIUMS IN CANADA?

In addition to the federal excise tax, there are provincial taxes on unlicensed coverage. The tax rates range from 2% to 50%. The latter is imposed by the province of Alberta.

Ontario, Quebec and Manitoba have an additional provincial sales tax on insurance premiums. Ontario charges 8% on all lines except Auto, for which there is no tax in respect of any premium. Quebec levies 9% for all lines except Auto (for which the rate is 5%). Manitoba, beginning July 15, 2012, charges 7% on all lines except for Auto, for which there is no tax. Some lines are exempt in some provinces – Automobile, Surety, Agriculture and Reinsurance Contracts, to name a few.

WHAT DOES THIS MEAN FOR MULTINATIONALS?

This change brings greater clarity and simplicity to multinationals with Canadian operations. It removes the prior tax concern for controlled master programs as long as the above criteria are met. Care must still be taken to comply with provincial taxes and non-admitted taxes.

CONTACT

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