July 6, 2023

The Honourable Chrystia Freeland, P.C., M.P.
Deputy Prime Minister of Canada and Minister of Finance
90 Elgin Street Ottawa, ON
Ottawa, ON K1A 0G5
Via email: Chrystia.Freeland@fin.gc.ca

Dear Deputy Prime Minister :

Re: Budget 2023 – Dividends Received by Financial Institutions

On behalf of the Conference for Advanced Life Underwriting (CALU), we are writing to communicate our concerns with proposals contained in the 2023 federal budget (Budget 2023) that would deny the dividend received deduction (DRD) for dividends received by life insurance companies on shares that are mark-to-market property.[1]

CALU is a national professional membership association of leaders in the life insurance and financial advisory industry. Along with our partner organization, Advocis, we speak for more than 17,000 insurance and financial advisors in every part of Canada and, in turn, the interests of millions of Canadians.

We understand that discussions have already taken place between life insurance company representatives and officials from Finance Canada regarding the rationale for eliminating the DRD as well as the consequential impact this proposed change could have on life insurance policyholders. CALU has also engaged in high level discussions with Finance Canada officials on this issue. While we don't plan to review in detail the tax policy arguments against making this change, we do share the life insurance industry's concern that eliminating the DRD will result in double tax on the payment of inter-corporate dividends received by financial institutions. We have attached a C.D. Howe Intelligence Memo that was addressed to your office, which provides an excellent discussion of this particular issue.

CALU's main concern, however, relates to the potential impact of this tax change on the future cost of individual life insurance coverage, and/or the benefits payable under such policies. We have been advised that the disallowance of the DRD for life insurance companies will result in additional taxes payable in the range of $250 million per year. In turn, approximately 80 per cent of this tax ($200 million per year) will ultimately be passed on to existing and new life insurance policyholders in the form of lower benefits and/or higher premiums. This is because a significant percentage of the assets backing life insurance policy reserves consist of common and preference shares issued by public companies.

This increased tax burden will have a negative impact on both existing individual permanent life insurance policies which permit the adjustment of policy benefits or expenses, as well as premiums that are payable on

[1] Proposed subsections 112(2.01) and (2.02) of the Income Tax Act (Canada) (the Act). Herein all statutory references are to the Act.

newly issued life insurance policies. In particular, this could have a negative impact on participating life insurance policies, whose insurance values and death benefit protection depend on the annual payment of policy dividends by the issuing life insurance company. The values of many in-force policies have already suffered over the past few years due to declining dividend scales, reflecting lower returns on insurance companies' par funds which support these policies. The impact of the disallowance of the DRD could result in further dividend reductions and require policyholders to make additional deposits or accept lower death benefit protection at a time when their own cash flow could be at risk due to retirement and/or inflationary pressures.

It is also important to note that many existing policyholders are effectively "locked-in" to their insurance coverage for a variety of reasons. They will therefore not be able to take steps to compensate for this increased tax by adopting an alternative strategy that will provide the required financial liquidity on death. For example, policyholders often suffer an economic loss on the disposition of their life insurance policy as the value of the policy is significantly less than cumulative premiums paid to date.[2]

Alternatively, the receipt of the policy's cash value could result in a taxable policy gain which reduces what would otherwise be available for reinvestment.[3] This is to be contrasted with other types of financial products such as GICs or equity investments where is it relatively easy for an individual to move existing funds to a new investment product without necessarily incurring non-deductible losses or triggering taxes.

For prospective life insurance policyholders, the increased cost of acquiring life insurance protection due to the elimination of the DRD could result in the purchasing a sub-optimal amount of life insurance and/or seeking out less costly but more risky approaches for providing financial liquidity to their estate. For example, rather than buying permanent life insurance an individual may decide that it is more cost effective to buy term insurance and invest the remainder in equity fund, exposing both themselves and their estate beneficiaries to equity market volatility.

We are therefore requesting that the government reconsider its proposal to eliminate the DRD for life insurance companies in order to protect the insurance benefits of existing life insurance policyholder as well as eliminate a disincentive for Canadians to acquire new life insurance policies.

We hope this input is helpful in your decision-making process and we would be pleased to discuss this issue in greater detail with your officials. Please contact Guy Legault, CALU President and CEO, for any questions you may have. He can be reached via email at glegault@calu.com or by phone at 613-505-9632 ext. 101.

[2] Note that life insurance premiums are funded with after-tax dollars. However, any loss arising from the disposition of a life insurance policy cannot be claimed as a deduction against taxable income.
[3] On the disposition of a life insurance policy the difference between the policy's CSV and its adjusted cost basis is fully included in income and subject to taxation (subsection 148(1)).

Sincerely yours,

Robert McCullagh

Guy Legault

Robert McCullagh
Chair, Board of Directors

Guy Legault
President & CEO

Att.

cc. Trevor McGowan, Associate Assistant Deputy Minister, Tax Policy Branch, Finance Canada (Trevor.McGowan@fin.gc.ca)
Robert Demeter, Director General, Tax Legislation Division, Finance Canada (Robert.Demeter@fin.gc.ca)
Christophe Cinqmars-Viau, Senior Policy Advisor, Office of the Deputy Prime Minister and Minister of Finance (Christophe.cinqmars-viau@fin.gc.ca)