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TaxNewsFlash

Canada

Insurers — Have Your Say on New Accounting Standards

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Insurers in Canada may want to provide feedback on potential tax changes to address a new accounting standard for the insurance industry. Finance recently announced that it is seeking input from industry stakeholders, including life and property and casualty (P&C) insurers on how best to enact tax legislative changes to address the international accounting rules for insurance contracts that are scheduled to become effective in 2023. Specifically, Finance is asking for comments on how it can maintain the current alignment between the taxation of profits and the timing of income earning activities, as well as any other potential taxation issues that could arise as the new accounting standard, known as IFRS 17, is implemented.

Finance states that this consultation, which ends on July 30, 2021, is intended to help inform potential legislative changes to the *Income Tax Act* and other administrative tools to accommodate this upcoming change.

Background

Life and P&C insurers will have to change their financial reporting for insurance contracts when IFRS 17 comes into effect on January 1, 2023. Currently, insurers in Canada follow the reporting standards set out in IFRS 4, as developed by the International Accounting Standards Board (IASB), which specify how transactions are recognized, measured, presented and disclosed in financial statements. IFRS 4 was intended to be an interim standard for insurance contracts until IFRS 17 was completed.

Income, measured under generally accepted accounting principles, typically serves as the basis for computing a corporation's taxable income. For insurers, the current calculation of taxable income generally matches the measurement of accounting income under IFRS 4 as a result of specific tax rules for insurance contracts, which allow them to set aside tax-deductible reserves in recognition of future claims to be paid from premiums received.

Calculating profits for tax purposes and IFRS 17

Because IFRS 17 alters the calculation of corporate income from insurance contracts, it's not yet clear how insurance businesses will have to calculate profits for tax purposes. Specifically, IFRS 17 defers recognition of a portion of insurance revenues into profits, which is currently included in income when insurance contracts are sold. Finance notes that it intends to address key tax policy questions related to this issue.

Finance advises that, under the new IFRS 17 standard, reserves will continue to be determined actuarially when insurance contracts are sold. IFRS 17 introduces a new reserve, the Contractual Service Margins, that includes a portion of the profits earned on underwritten insurance contracts to be deferred and gradually released into income over the estimated life of the insurance contracts. If adopted for tax purposes, this mechanism would lead to a deferred recognition of profits into taxable income. IFRS 17 also introduces an asymmetrical treatment of profit and losses, as only profits will be deferred through the Contractual Service Margins. Where a group of contracts is expected to generate a loss over its lifetime at the moment of underwriting, then the insurer must immediately deduct the loss against income.

IFRS 17 consultation

Finance is asking for public feedback on legislative adjustments to maintain the current alignment between the taxation of profits and the timing of income earning activities. Specifically, Finance notes that it would not consider the Contractual Service Margins reserve a deductible reserve for tax purposes.

Finance states that its public consultation on IFRS 17 is intended to help achieve its desired tax policy outcome in a way that can be implemented by insurance companies and audited by the CRA. Finance also notes that it will accept comments on other potential taxation issues that could arise from implementing or transitioning to IFRS 17 until July 30, 2021.

We can help

Your KPMG adviser can help you assess the effect of any potential changes to the calculation of corporate income from insurance contracts or other issues that arise from the adoption of IFRS 17. For details on the implications for your insurance business, contact your KPMG adviser.