

# Long and whining road – Harmonized Sales Tax points insurers need to consider

We have another seven months of political posturing to endure before July 1, 2010, when the Harmonized Sales Tax (HST) arrives in Ontario, British Columbia (B.C.), and possibly one or more of the other remaining PST provinces (Manitoba, Saskatchewan and P.E.I.).

For all insurers, HST has many touch points requiring systems, documentation, costing and pricing changes. Both the Life and Property and Casualty (P&C) sectors have conducted high level impact studies, and there have been a variety of information sessions on the differing HST effects for Life and P&C insurance.<sup>1</sup> With only seven months remaining to the start date, this brief article illuminates some of the less obvious practical issues now facing internal HST implementation teams. It highlights areas where upgrading internal knowledge of HST will improve decision making, lower delivered cost to clients, and reduce claims costs. While some concerns are shared by all insurers, there are a number of features peculiar to either the Life or P&C sectors

## A problem shared...

We now have the transitional rules for Ontario and B.C., enabling procurement departments of insurers to consider whether to accelerate or delay capital acquisitions to incur non-recoverable PST or HST. This analysis will be very specific to the particular asset, because while PST is generally not recoverable, some, none, or all of the HST *may* be recoverable as a function of which insurance product of the insurer it supports. For example, acquisition of a new computer system

or software that supports the service of administering employers' self-insured group health plans would be a cost on which the insurer can recover *all* of the GST/HST, because HST will be charged on the fee paid by the employer. Consequently, in this case delayed acquisition lowers net cost. This decision requires marrying knowledge of planned acquisitions with an understanding of how the insurers GST/HST recovery method works, and which specific area of the business the asset will support. Without connected thinking here, the tax outcome is a lottery.

Existing outsourcing contracts will have to be subjected to the same 'HST smart' analysis to raise costing knowledge from "How much more tax will we pay?" to the smarter "How much more *net* tax will we pay?", which is the *real* information needed to evaluate whether the outsourcing should be reconfigured or unwound. Some outsourcing arrangements may no longer be viable at 13% HST, where the service procured supports a product line that is entirely exempt from GST/HST, meaning that the entire increase in tax from 5% to 13% is a cost to the insurer. Any prospective outsourcing arrangements under consideration will need to have the cost/benefit analysis urgently extended

to include a range of sales tax regimes, including the very real possibility of HST in all provinces but Alberta, at 15% or 16% (a very feasible outcome within three years). The extreme of the range should include a fully harmonized Quebec which takes the HST cost to a higher level than that of the current QST 'zero-rating with compensatory taxes' model. If you thought the HST impact for insurers was dismal, spare a thought for outsourcers focused on the financial sector.

Again for all insurers, a detailed picture of the exempt (such as medical) and taxable (such as legal) composition of claims costs is needed to update reserves, so the actuaries are not left out of the HST fun.

## Life: at the sharp end

Much of the published financial sector commentary on HST has focused on the cost side of the house, but product design and pricing is a fruitful area to be revisited by the group life and benefits sector under the HST. The key here is the distinction between pure administration of an employer's self-insured plan (which is a taxable service subject to GST/HST) and contracts where the employer does purchase risk coverage (which is a supply entirely exempt from GST/HST).

So, if the purchase of risk coverage under the contract is effectively a GST/HST on/off switch, wouldn't all employers automatically select the "HST off" switch by purchasing a contract with some risk coverage? No. Why? The vast majority of employers are completely indifferent

<sup>1</sup> To listen to a recent PwC Insurance EyeOpener audiocast on *Sales Tax Harmonization and its Impact on Insurers*, please visit [www.pwc.com/ca/insurance](http://www.pwc.com/ca/insurance).

to the HST charged because they can recover all GST/HST borne on their costs related to the making of supplies of HST taxable goods and services. As a function of the same HST recovery rule, the cost to the insurer of making an HST taxable supply is lower than that of making an exempt supply. An HST-informed dialogue between insurer and employer/customer will identify whether a contract subject to HST enables delivery of the service at a lower cost to the employer and at a higher margin for the insurer. Knowing enough to design the right contract for each customer can lower both customer/delivered and insurer/delivery cost. The exception is those employers who cannot recover HST, for whom an exempt contract is a real 13% saving, at the cost to the insurer of some non-recoverable HST. This is one aspect of the group business that did receive attention at the inception of the GST, but the knowledge has likely decayed over time. Upgrading or reinstalling this connection between knowledge of the tax treatment of the product, and the tax impact on the client, into the client-facing personnel of a group life insurer is a must.

### HST for loss adjusters

When the GST was introduced both in-house and independent loss adjusters in the P&C sector learned that there were three types of claimants from a GST perspective. The first can not recover any of the GST on claims costs (repair, replacement, legal etc.) because they incurred the cost as a consumer, and so the GST became cost to the insurer of



settling the claim. The second type of claimant is registered for GST and can recover all the GST on the constituent claims cost because the costs related to the carrying on of an activity involving the supply of goods and or services subject to GST. The third type is a trickier claim to deal with, and involves claimants registered for GST, but able to claim only some of the GST on constituent claims costs as a function of a mystery known as GST recovery methods. Some education of loss adjusters on GST recovery methods can quickly demystify the subject, enabling the adjuster to engage the claimant in a discussion on how much of the GST is recoverable from the CRA, and how much forms part of the claims cost. A fourth rogue variant that might exist is the claimant that is paid the GST by the insurer under the indemnity contract, and then also recovers the taxes from the CRA, either through blissful ignorance, or a fortuitous economy with the facts when dealing with their friendly loss adjuster.

At 7% when the GST was introduced, loss adjusters were keen to upgrade their knowledge of this significant aspect of claims cost, where the right knowledge and questions could lower claims cost. Here again, knowledge levels have likely decayed over time. Consequently, given the rate of 13% in Ontario, a review of internal procedures on establishing GST registration status of claimants (refreshed at claim time, even if established at policy

issuance) and an education session for adjusters on the GST/HST characteristics of claimants is a modest investment that will yield real reductions in claim cost.

### Little time, missing pieces

The significant rules yet to be released for the HST are the revised place-of-supply rules that will effectively remove incentives for entities such as insurers that can not recover all the HST they pay from either sourcing or relocating outside of the HST provinces. These rules are of real interest and needed soon to enable implementation teams to finalize any system changes having a long lead time. One new feature that has been predicted is a rule that will oblige any segregated fund of an insurer situated outside of the HST zone to self-assess HST to the extent it holds funds supporting policies for policy holders within the HST zone

The place-of-supply rules may be released quite late, and piecemeal, so the best approach is to map all systems impacted, and then rough-in changes on a predictive basis as far as possible, slotting the detailed final rules into place once we have them. One's planning should accommodate the possibility of more provinces joining at different rates, and also of Quebec adopting a fully harmonized model. Foresight, agility and springtime insomnia will all be attractive traits in HST implementation team members.

Please visit [www.pwc.com/ca/insurance](http://www.pwc.com/ca/insurance) to view our recent Insurance Club EyeOpener audiocast and numerous resources on Sales Tax Harmonization and its impact on insurers.

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