Income Tax

I pointed out that in most cases these would be long-term policies such as whole life policies.

● (1622)

In the interest of the minister and his officials I have two specimen life insurance policies here from a reputable Canadian company, the National Life Assurance Company of Canada, a company with which I have had some dealings down through the years as an agent.

The first specimen policy is a whole life policy in the amount of $10,000 paying an annual dividend. The individual is 29 years of age and pays a premium of $182.30. If that policy continued for a considerable time, to age 60, he would have paid in $5,651.30. He might then want to borrow on the policy, in which case the loan or cash surrender value, these incidentally in most cases are pretty much the same, would be $4,810. In other words he would have paid in more than that amount.

In the other example I have the insured person is aged 35. This also is a policy for $10,000 with a premium of $193.90. If he paid for a 25 year period he would have paid in $4,847.55. The loan or cash surrender value would be $3,920. Again after that long period of payment the insured would not get back as much as he had paid in.

I have pointed out to the minister and his officials, and they have agreed, that in respect of probably 999 of every 1,000 policies the holders would not have any loan investment in them. Because of that I asked the minister why in the name of heaven he did not scrap the whole thing and forget about it. I can see the former minister clenching his fists. When I questioned him during the summer he took strong exception to the situations I have been presenting at this time to the government and the minister.

I have a letter here from the Life Insurance Underwriters of Canada, a part of which I should like to quote. They wrote the letter after hearing my comments in the House regarding the government's arguments. The letter states:

> You mention the government's argument that taking out a policy loan is an unfair tax shelter. We suggest this argument is wrong. There might have been an argument that a policy loan could be used as a tax avoidance scheme when we were looking at the prospect of a tax being levied at death. A policyowner in later years might conceivably take out a maximum loan in anticipation of death and thereby reduce or eliminate tax. But this argument disappeared with the dropping of the death tax.
>
> If a policy lapses as a result of failure to pay either premiums or policy loan interest or both, the present section 148 tax on a surrender comes into effect and the policyowner will be taxed as if there had been no loan and the entire cash value was received at that time. So there is no possibility of tax avoidance there.

In a later letter from the same association, again commending me for bringing this to the attention of the government, the following is stated:

> We sincerely hope that the efforts being made by you and some other members in the House will be rewarded by the withdrawal of the Bill C-11 provisions which discriminate against policy loans.

I give full marks to the minister for going the second, the third and the fourth miles, but the clause which is left is insignificant, not worth while and should be scrapped. I would ask the minister how he intends to police this. Will he set up another bureaucracy, a lot of officials with adding machines checking policies to determine cash value? I suggest it will cost more than it is worth. If you collect $50,000, which is probably the maximum under this provision, I am sure it will cost $200,000 to do so. Would you let me have your comments on that, Mr. Minister?

Mr. Chrétien: I have looked into the problem referred to by the hon. member. We believe we must maintain the clause in the bill because of its importance. It is important that we retain the provisions included in a policy holder's income relating to the excess of policy loan he receives over his cost of the policy, otherwise this would lead to serious abuse.

The abuse is that a taxpayer would be permitted to withdraw his income on a policy without paying any tax at all. This would constitute a massive loophole. This probably does not apply to small policies, but let me give you an example of a man purchasing an insurance policy for the single payment of $100,000. It is reasonable to assume that, after a 12 year period, the cash surrender value of that policy would probably be about double the original investment, that is, $200,000. Treating the policy loan as a real loan would permit that person to withdraw the $200,000 entirely free of tax. He could then, by paying the policy loan interest, maintain the policy in force until his death. Since there is no tax at death, he would have received his earnings entirely free of tax.

I would like also to emphasize that our proposal will not mean a tax on all policy loans. In fact it will mean a tax on very few, as I said earlier. This is because of the example I have given the hon. member. A policy holder will be entitled to recover his costs before any income arises. Thus, if a policy holder has paid $3,000 in premiums he will be allowed to recover $3,000 in policy loans before any income arises.

Let me also remind the hon. member that we have made other provisions relating to policy holders exceedingly reasonable. Certainly in relation to policy loan interest, the rules are now far more generous than under the present act. For the first time we have given the majority of policy holders recognition for the interest they pay on policy loans. In addition, we continue to make it possible for Canadians who borrow through policy loans, for the purpose of earning income, to deduct policy loan interest currently.

As I indicated, if policy loans were to continue to be treated as loans, a major tax avoidance vehicle for the wealthy would result. It would also make the tax on surrenders during lifetime totally ineffective. We have to treat policy loans on the basis of what they are, and we need to keep the proposed rules relating to policy loans to prevent a major loophole for the wealthy.

Mr. Darling: Mr. Chairman, I listened to the minister with interest. He was talking about the wealthy policy holder who will be the expert in getting around government regulations, beating the government out of the tax. The minister mentioned a $100,000 policy. Let me tell him that anyone putting money into a $100,000 policy as an investment certainly ought to see