



Consumer Taxes

TVQ. 516-1 **Financial Expenses and Administration Costs**

Date of publication: **November 29, 1996**

Reference(s): *An Act respecting the Québec sales tax* (R.S.Q., c. T-0.1), sections 512 and 516

This bulletin states how the tax on insurance premiums provided for in Title III of the *Act respecting the Québec sales tax* (the “Act”) applies to the charges demanded by an insurer who grants terms of payment to his clients.

INTRODUCTION

1. An insurer who practices damage insurance can offer his clients a service that allows them to spread the payment of their insurance premiums over several instalments according to certain terms and conditions and in consideration for additional charges.

THE ACT

2. According to section 516 of the Act, administration costs connected with a damage insurance policy, except those payable to a person other than the insurer and separately indicated on the invoice, are deemed to be insurance premiums. Consequently, pursuant to that section and section 512 of the Act, the tax on insurance premiums applies to these charges when they are payable to an insurer.

APPLICATION OF THE ACT

3. It is difficult at times to determine if the charges demanded by an insurer who grants terms of payment to his clients constitute financial expenses or administration costs.

Financial Expenses

4. When an insurer grants terms of payment to a client who wishes to spread out the payment of his insurance premium, he then performs a service for his client. In fact, the insurer allows his client to use or to withhold an amount of money owing to him. This service can be remunerated. This remuneration consists in financial charges or interest charges if they are determined according to the amount of the premium and if they are directly proportional to the period over which the payment is spread, i.e. if they accrue from day to day.

Example

An insurer issues an insurance policy to a client. The premium for the period from January 1, 1996, to December 31, 1996, amounts to \$1 200. The client wishes to spread the payment of his premium over a 12-month period. The insurer agrees and bills his client charges that represent 3% of the total premium spread equally over the number of instalments the client must make. Therefore, the client must pay the insurer a monthly charge of \$3, i.e.:

$$\$1\ 200 \times 3\% = \$36 \quad 12 \text{ months} = \$3 \text{ per month.}$$

It is agreed that if the insurance contract is cancelled, the insurer will retain the portion of the charges calculated by taking into account the number of days between the commencement of the policy and its cancellation, and will refund the excess amount collected from his client, where applicable. If the policy is cancelled on March 15, 1996, the insurer will already have collected the charges for the months of January, February and March, i.e. \$9. He will therefore have to refund his client for the excess charges he collected, i.e.:

$$\$9 - (75/366 \text{ days} \times \$36) = \$1.62.$$

When calculated in this fashion, the charges billed by the insurer constitute financial expenses since they were determined according to the amount of the premium (3% × \$1 200) and are directly proportional to the period over which it is spread (i.e. they accrued from day to day). These financial expenses, therefore, are not subject to the tax on insurance premiums.

5. The fact that financial expenses can accessorially comprise a portion of administration costs or that they are designated as administration costs or other expenses does not change the nature of these expenses. The same applies where these expenses are determined by the use of a single, nominal or flat rate, as in the preceding example, i.e. applied to the total premium, for the entire term of the insurance policy, regardless of the periodic payments made by the client.

Administration Costs

6. Moreover, when an insurer grants terms of payment to a client who wishes to spread out the payment of his insurance premium, he cannot claim any remuneration for the service he performs other than the reimbursement of certain expenses he incurs to perform this service, i.e. administration costs, service charges or management charges. This will be the case if these expenses are fixed.

Example 1

An insurer issues an insurance policy to a client. The premium for the period from January 1, 1996, to December 31, 1996, is \$1 200. The client wishes to spread the payment of his premium over a 12-month period. The insurer agrees and bills his client a fixed charge of \$3 per instalment. It is agreed that if the insurance policy is cancelled, the insurer will retain the charges already collected.

In this example, the charges billed by the insurer constitute administration costs since they were not determined according to the amount of the premium and did not accrue from day to day. In fact, these charges are fixed, i.e. they were not calculated according to the number of days during which

the client benefitted from the money due to the insurer. Consequently, these administration costs are subject to the tax on insurance premiums under section 512 of the Act.

7. Charges billed by an insurer and calculated by means of a percentage which applies to the total amount of the premium due by his client also constitute administration costs if they are not reimbursable if the insurance policy is cancelled.

Example 2

In the same situation as that considered in the preceding example, the insurer, rather, bills charges that represent 3% of the total premium due by his client, payable at the time of the initial instalment of the insurance premium. It is agreed that if the insurance policy is cancelled, the insurer will not reimburse any charges to his client, regardless of the policy's cancellation date.

In this example, the charges billed by the insurer constitute administration costs since, although they were determined according to the amount of the premium ($3\% \times \$1\,200$), they did not accrue from day to day. These administration costs, therefore, are subject to the tax on insurance premiums under section 512 of the Act.

8. It should be pointed out that the administration costs connected with damage insurance are not deemed to be an insurance premium if they are payable to a person other than the insurer, an insurance broker for example, and if they are separately indicated on the invoice (section 516 of the Act).

9. This bulletin has effect from July 1, 1992.