IT85R2 Health and Welfare Trusts for Employees

INCOME TAX ACT Health and Welfare Trusts for Employees IT-85R2 July 31, 1986

Paragraph 6(1)(a) and section 104 (also subsections 6(4), 12.2(3), (4), and (7), paragraphs 6(1)(f), 56(1)(d), and (d.1), 60(a), 110(8)(a) and subparagraphs 148(9)(c)(vii) and (ix); also section 19 of the Income Tax Application Rules, 1971 (ITAR)).

This bulletin replaces and cancels IT-85R, dated January 20, 1975. Proposals contained in the Notice of Ways and Means Motion of June 11, 1986 are not considered in this release.

1. The general thrust of paragraph 6(1)(a) is to include in employment income the value of all benefits received or enjoyed in respect of an employee's employment. However, there are a number of specific exceptions many of which can be described as benefits relating to the health and welfare of the employee. In some cases, the scope of the excepted benefits and applicable tax treatment are well established by other provisions of the Act, (e.g., registered pension funds or plans, deferred profit sharing plans, supplementary unemployment benefit plans, the standby charge for the use of an employer's automobile, employee benefit plans and employee trusts). The treatment to be accorded to the other exceptions can be less clear, particularly when the benefits form part of an omnibus health and welfare program administered by an employer. The purpose of this bulletin is to describe the tax treatment accorded to an employee health and welfare benefit program that is administered by an employer through a trust arrangement and that is restricted to
   (a) a group sickness or accident insurance plan (see 2 below), (b) a private health services plan, (c) a group term life insurance policy, or (d) any combination of (a) to (c).
2. Paragraph 6(1)(f) sets out the treatment of periodic receipts related to loss of income from employment under three types of insurance plans to which the employer had made a contribution. These types of plans are sickness or accident, disability and income maintenance (also known as salary continuation). In the absence of any statutory definition, the Department generally accepts that an employer's contribution to any of the three types of plans will be a contribution to a "group sickness or accident insurance plan" as described in subparagraph 6(1)(a)(i), provided that the particular plan is a "group" plan and an insured plan. This is based on the assumption that a "disability" resulting in loss of employment income would almost invariably arise from sickness or an accident and that an "income maintenance" payment would likely arise from loss of employment income due to sickness or an accident if not lay off (the latter reason justifying an exception under subparagraph 6(1)(a)(i) as a supplementary unemployment benefit plan). There may be situations where these assumptions will prove invalid but, subject to this caveat, 1(a) above may also be read as a "group disability insurance plan" or "a group income maintenance insurance plan that is not a supplementary unemployment benefit plan".

Employee Benefit Plans and Employee Trusts

3. Employee benefit plans are broadly defined in subsection 248(1) and can encompass health and welfare arrangements. However, funds or plans described in 1(a) to (d) above are specifically excluded in the definition and are thus accorded the tax treatment outlined in this bulletin. Health and welfare arrangements not described in 1(a) to (d) above (e.g., those not based on insurance) may be employee benefit plans or, less likely, employee trusts subject to the tax consequences outlined in IT-502.

4. Where part of a single plan could be regarded as a plan described in 1(a) to (d) above and another part as an employee benefit plan or an employee trust, the combined plan will be given employee benefit plan or employee trust treatment in respect of the timing and amounts of both the employer's expense deductions and the employees' receipt of benefits under the plan. However, if contributions, income and disbursements of the part of the plan that is described in 1(a) to (d) above are separately identified and accounted for, the tax treatment outlined in this bulletin will apply to that part of the plan.

Meaning of Health and Welfare Trust

5. Health and welfare benefits for employees are sometimes provided through a trust arrangement under which the trustees (usually with equal representation from the employer or employers' group and the employees or their union) receive the contributions from the employer(s), and in some cases from employees, to provide such health and welfare benefits as have been agreed to between the employer and the employees. If the benefit programs adopted are limited to those described in 1(a) to (d) above and the arrangement meets the conditions set out in 6 and 7 below, the trust arrangement is referred to in this bulletin as a health and welfare trust.
6. To qualify for treatment as a health and welfare trust the funds of the trust cannot revert to the employer or be used for any purpose other than providing health and welfare benefits for which the contributions are made. In addition, the employer's contributions to the fund must not exceed the amounts required to provide these benefits. Furthermore, the payments by the employer cannot be made on a voluntary or gratuitous basis. They must be enforceable by the trustees should the employer decide not to make the payments required. The type of trust arrangement envisaged is one where the trustee or trustees act independently of the employer as opposed to the type of arrangement initiated unilaterally by an employer who has control over the use of the funds whether or not there are employee contributions. Employer control over the use of funds of a trust (with or without an external trustee) would occur where the beneficiaries of the trust have no claim against the trustees or the fund except by or through the employer.
7. With the exception of a private health services plan, two or more employees must be covered by the plan. Where a partnership seeks to provide health and welfare benefits for both the employees and the partners by means of a trust, two distinctly separate health and welfare trusts (one for the partners and one for the employees) must be set up to ensure that the funds of each are at all times identifiable and that cross-subsidization between the plans will not occur. The exception in subparagraph 6(1)(a)(i) will of course not apply to such a trust established for the partners.

Tax Implications to Employer

8. To the extent that they are reasonable and laid out to earn income from business or property, contributions to a health and welfare trust by an employer using the accrual method of computing income are deductible in the taxation year in which the legal obligation to make the contributions arose.

Tax Implications to Employee

9. An employee does not receive or enjoy a benefit at the time the employer makes a contribution to a health and welfare trust. However, subject to 10 below, the tax consequences to an employee arising from benefits provided under such a trust are as follows:

Group Sickness or Accident Insurance Plans

(a) Where a group sickness or accident insurance plan provides that benefits are to be paid by the insurer directly to the employee, the premium paid by the trustees to the insurer for the employee's coverage will not result in a benefit to be included in the employee's income.

(b) Where this type of group sickness or accident insurance plan existed before June 19, 1971 and the requirements of section 19 of the ITAR are met (see IT-54, "Wage Loss Replacement Plans"), the benefits paid to an employee by the trustees or the insurers under such a plan in consequence of an event happening before 1974 will not result in a taxable benefit to the employee. Where these requirements are not met and in all cases of payments for events happening after 1973, the wage loss replacement benefits will be taxable under paragraph 6(1)(f) (see IT-428, "Wage Loss Replacement Plans").

Private Health Services Plans (defined in paragraph 110(8)(a))

(c) Payment by the trustees of all or part of the employee's premium to a private health services plan does not give rise to a taxable benefit to the employee. Benefits provided to an employee under a private health services plan are also not subject to tax.

Group Term Life Insurance

(d) Payment by the trustees of a premium under a group term life insurance policy will not result in a taxable benefit to the employee unless the aggregate amount of the employee's coverage under one or more group term life insurance policies exceeds $25,000. (See IT-227R, "Group Term Life Insurance Premiums"). The provisions of section 12.2 which tax accrued amounts under a life insurance policy do not apply since a group term life insurance policy will be an exempt policy for that purpose.

(e) Where a group term life insurance policy provides for a lump sum payment to the employee's estate or a named beneficiary, the receipt of the payment directly from the insurer is not included in the recipient's income.

(f) Certain group term life insurance policies provide beneficiaries thereunder with an option to take periodic payments in lieu of the lump sum payment and others provide only for periodic payments to beneficiaries. Prior to the introduction of the accrual rules in section 12.2 for 1983 and subsequent taxation years, benefits thus paid by the insurer to a beneficiary, whether as a result of exercising the option or by the terms of the policy, were annuity payments that were income of the recipient (paragraph 56(1)(d)) who deducted the capital element of the annuity payment (paragraph 60(a) of the Act and Part III of the Regulations). (g) For the 1983 and subsequent taxation years, paragraphs 56(1)(d) and 60(a) continue to apply to a beneficiary who is a holder and annuitant under an annuity contract if subsection 12.2(3) does not apply because of the exceptions in paragraphs 12.2(3)(c) to (e) or the application of subsection 12.2(7). Generally speaking, this will occur where the annuity contract (i) is a prescribed annuity contract as defined in Regulation 304, (ii) was acquired before December 2, 1982 under which annuity payments commenced before December 2, 1982, (iii) is an annuity contract that was received as proceeds of a group term life insurance policy which was itself neither an annuity contract nor acquired after December 1, 1982, or (iv) was acquired before December 2, 1982, can never be surrendered and in respect of which the terms and conditions have not been changed and is not the subject of an election under subsection 12.2(4). (h) For annuity contracts other than ones described in (g) above, the annuitant is required by subsection 12.2(3) for the 1983 and subsequent taxation years to include in income accrued amounts on every "third anniversary" of the contract. In addition, in any year that does not include a "third anniversary", paragraph 56(1)(d.1) requires the inclusion of amounts in respect of annuity payments received during the

year under the contract. As an alternative to the application of subsection 12.2(3) and paragraph 56(1)(d.1), the annuitant may elect under subsection 12.2(4) (before annuity payments commence) to include accrued amounts on an annual basis. In each instance, the issuer will provide the annuitant with a T-5 information slip indicating the amount of income to be reported in respect of the annuity contract.

Shared Contributions

10. In 9 above the trustees are assumed to be receiving contributions only from the employer to pay for the cost of benefits under the trust plan. However, the trustees may also receive employee contributions to pay a part of the cost of the benefits being provided under the plan. If the plan does not clearly establish that the trustee must use the employee contributions to pay all or some part of the cost of a specific benefit, then it will be assumed that each benefit under the plan is being paid out of both the employer and the employee contributions. If the benefit in question is otherwise taxable to the employee, then in these circumstances a part of it is non-taxable. The non-taxable part is that proportion of the benefit received by the employee for the year that the total of employee contributions received by the trustees in the year is of the aggregate of the employer and employee contributions received by the trustees in the year. The above treatment will not apply if the benefit must be reported as income according to paragraph 6(1)(f) (see 9(b) above). However, the employee's contributions to plans referred to in 9(b) may be deductible for tax purposes from benefits received from the plan. See IT-428 for details.

Taxation of Trust

11. A trust which invests some of the contributions received and earns investment income, or has incidental income (other than contributions from employers and employees which are not included in computing income of the trust), is subject to tax under section 104 on the amount of such "trust income" remaining after the deductions discussed in 12 below. Where gross income (i.e., the aggregate of its income from all sources) exceeds $500 in the taxation year (and in certain other circumstances indicated on the form), the trustee is required to file form T3 (Trust Information Return and Income Tax Return).
12. In computing trust income subject to tax, the trust is allowed to deduct, to the extent of the gross trust income, the following expenses, premiums and benefits it paid, and in the following order: (a) expenses incurred in earning the investment or other income of the trust, (b) expenses related to the normal operation of the trust including those incurred in the collection of and accounting for contributions to the trust, in reviewing and acquiring insurance plans and other benefits and for fees paid to a management company to administer the trust, except to the extent that such expenses are expressly not allowed under the Act, (c) premiums and benefits payable out of trust income of the current year pursuant to paragraph 104(6)(b). Benefits that are paid out of proceeds of an insurance policy do not qualify. Other benefits paid are normally regarded as having been paid first out of trust income of the year. However, premiums and benefits that would not otherwise be taxable in the hands of the employee by virtue of paragraph 6(1)(a) may be treated at the trustee's discretion as having been paid out of prior year's funds or current year's employer's contributions, to the extent that they are available, to avoid the application of subsection 104(13). The remainder of the income of the trust is subject to income tax under section 122 of the Act. As an inter vivos trust, the taxation year of the trust coincides with the calendar year.

13. For administrative simplicity, payments of taxable benefits by the trustee to or on behalf of employees are to be reported on Form T4A by the trustee and not on the T3 Supplementary. Information on the completion of Form T4A is contained in the "Employer's and Trustee's Guide". Although the trustee is required to withhold income tax from taxable benefits paid to employees, these amounts will not be subject to either Canada Pension Plan contributions or unemployment insurance premiums when paid by the trustee.
14. Although actuarial studies of the trust may recommend the establishment of "contingency reserves" to meet its future obligations, transfers to such reserves are not deductible for tax purposes by the trust.

Setting up a Plan

15. There is no formal registration procedure for a health and welfare trust and no requirement that the trust agreement be submitted to the Department for approval prior to the implementation of the plan. However, the advice of the District Taxation Office may be requested where there is any doubt as to the acceptability of the trust agreement as a health and welfare trust. Full particulars of the arrangement including a copy of all pertinent documents should accompany the request.