IT-428 Wage Loss Replacement Plans

DATE: April 30, 1979

1. Paragraph 6(1)(f) provides that, for 1972 and subsequent taxation years, amounts received on a periodic basis by an employee or an ex-employee as compensation for loss of income from an office or employment, that were payable under a sickness, accident, disability or income maintenance insurance plan (in this bulletin referred to as a "wage loss replacement plan") to which the employer made a contribution, are to be included in income, but subject to a reduction as specified in that paragraph for contributions made by the employee to the plan after 1967. Before 1972, such amounts received by a taxpayer were not included in income.

2. Paragraph 6(1)(f) does not apply to a self-employed person inasmuch as any amount received by such person in the way of an income maintenance payment would not be compensation for loss of income from an office or employment. With regard to "overhead expense insurance" and "income insurance" of a self-employed person, see Interpretation Bulletin IT-223.

Exemption for Plans Established before June 19, 1971

3. Transitional provisions in section 19 of the Income Tax Application Rules, 1971 stipulate that amounts that would otherwise be included in income under paragraph 6(1)(f) are to be excluded if they were received pursuant to a plan that existed on June 18, 1971 and were in consequence of an event that occurred prior to 1974. Comments on these transitional provisions, particularly with regard to admissible and non-admissible changes in pre-June 19, 1971 plans, appear in IT-54. It is to be noted that, for 1974 and subsequent taxation years, the exemption in section 19 of the ITAR is applicable only if amounts received by a taxpayer are attributable to an event occurring before 1974. In this context, the word "event" has reference to the thing that caused the disability. In the case of an accident, for example, although the effect on the taxpayer's health may not have become noticeable or serious until 1974 or a later year, the "event" would have occurred before 1974 if the accident took place before 1974 and the later disability was directly attributable to the accident. Similarly, in the case of a degenerative disease such as muscular dystrophy, the "event" is the onset of the disease however much later the incapacity occurs. On the other hand, a recurring disease, such as a seasonal allergy or chronic tonsillitis, would qualify as an "event" only for the particular period of one attack.

Meaning of a "Wage Loss Replacement Plan"

5. In the Department's view, a plan to which paragraph 6(1)(f) applies is any arrangement, however it is styled, between an employer and employees, or between an employer and a group or association of employees, under which provision is made for indemnification of an employee, by means of benefits payable on a periodic basis, if an employee suffers a loss of employment income as a consequence of sickness, maternity or accident. This arrangement may be formal in nature, as evidenced by a contract negotiated between an employer and employees, or it may be informal, arising from an understanding on the part of the employees, that wage loss replacement benefits would be made available to them by the employer. Where the arrangement involves a contract of insurance with an insurance company, the insurance contract becomes part of the plan but does not constitute the plan itself.

6. Where it is apparent that a plan was instituted with the intention or for the purpose of providing wage loss replacement benefits, the assumption will be that it is a plan to which paragraph 6(1)(f) applies unless the contrary can be established. Such a plan will be considered to exist where, for example, payments under the plan are to commence only when sick leave credits are exhausted or where benefits are subject to reduction by the amount of any wages or wage loss replacement benefits payable under other plans. A supplementary unemployment benefit plan, as defined in subsection 145(1), is not considered to be a plan to which paragraph 6(1)(f) applies.

7. A plan for purposes of paragraph 6(1)(f) of the Act and section 19 of the ITAR must be an "insurance" plan. Those provisions are not applicable, therefore, to uninsured employee benefits such as continuing wage or salary payments based on sick leave debits, which payments are included in income under paragraph 6(1)(a). It is to be noted that, while a plan must involve insurance, it is not necessary that there be a contract of insurance with an insurance company. If, however, insurance is not provided by an insurance company, the plan must be one that is based on insurance principles, i.e., funds must be accumulated, normally in the hands of trustees or in a trust account, that are calculated to be sufficient to meet anticipated claims. If the arrangement merely consists of an unfunded contingency reserve on the part of the employer, it would not be an insurance plan.

8. An employer may contribute to separate plans for different classes or groups of employees. For example, there may be one plan for clerical staff and another plan for administrative staff. Each plan will be recognized as a separate plan. In other circumstances, an employer may have one plan that provides for short-term sickness benefits and another plan that provides for long-term disability benefits. Each such plan normally would be considered a separate plan for all purposes but, if desired, they may be treated as one plan provided they comply with the following conditions:

(a) the same classes of employees are entitled to participate in both plans, and

(b) the premiums or other cost of each plan is shared in the same ratio by the employer and the employees.

9. An association of employers, or a health and welfare trust that is organized and managed by or on behalf of both employers and employees in a certain industry, may establish a plan with an insurer that is available to all employer-members. In these circumstances, if there is one insurance contract between the insurer and the association of employers or the health and welfare trust and the contract was entered into after June 19, 1971, there is considered to be one plan. Where employees contribute to the cost of benefits provided by a health and welfare trust, see paragraph 6 of IT-85R regarding the amount that may qualify as an employee's contribution for purposes of subparagraph 6(1)(f)(v). For plans that existed prior to June 19, 1971 see paragraph 7 of IT-54.

10. Where the nature of employment in a particular industry is such that it is usual for employees to change employers frequently (e.g. the construction industry) and the continuity of wage loss replacement benefits can be assured only if such benefits are provided under a plan administered by a union or a similar association of employees rather than directly by the various employers, the arrangement between the participating employers and the organization representing the employees is viewed as a single wage loss replacement plan.

Lump-sum Payments

11. If a lump-sum payment is made in lieu of periodic payments, that amount will be considered to be income under paragraph 6(1)(f).

12. Some contracts of employment may provide for payment of periodic benefits to employees in respect of loss of income due to disability and may also provide that employees will receive a lump-sum payment on retirement, resignation or death based on the value of unused sick leave credits accumulated under that plan. Even though these separate arrangements may be jointly funded by employer-employee contributions, it is the position of the Department that such lump-sum payments are not a periodic payment under a wage loss replacement plan to which paragraph 6(1)(f) applies but are taxable in the employee's hands by subsections 5(1) and 6(3) as remuneration received by them pursuant to their contract of employment. To the extent that a part of the lump sum payment has been funded by employee contributions not deducted by the employee under subparagraph 6(1)(f)(v) in computing the portion of amounts taxable under paragraph 6(1)(f), the accumulated employee contributions in respect thereof (but not any interest credited thereon) would represent a return of capital to employees and need not be included as part of the taxable lump sum payment.

Employee's Contribution

13. Employee contributions that are deductible under subparagraph 6(1)(f)(v), are restricted to those that were made to the particular plan from which the benefits were received. Thus, if an employee changes employment and becomes a beneficiary under the plans of the new employer, the employee may not deduct the contributions made during the previous employment from benefits received from the new employer's plan. For this purpose, a change in employment is not considered to take place where an unincorporated business is incorporated or where there has been a merger or amalgamation. Also, the continuity of an existing plan is generally not affected by internal alterations in the plan, such as a change in the insurer or an improvement in benefits. However, for purposes of section 19 of ITAR, an increase in benefits after June 18, 1971, in a pre-June 19, 1971 plan may be viewed as the creation of a new plan as indicated in paragraph 4 of IT-54. On the other hand, where an employee, because of a promotion or job reclassification, is moved from one of his employer's plans to another, such as a move from the "general" plan to the "executive" plan, contributions to the former plan would not be deductible in respect of benefits received from the latter plan.

Employer's Contributions

14. For benefits received by an employee under a wage loss replacement plan to be subject to tax in his hands under paragraph 6(1)(f), the plan must be one to which the employer has made a contribution out of his own funds. An employer does not make such a contribution to a plan if he merely deducts an amount from an employee's gross salary or wages and remits the amount on the employee's behalf to an insurer. In these circumstances, the employee's remuneration for tax purposes is not reduced by the amount withheld and remitted by the employer to the insurer. Where the employer has made an actual contribution to a plan, paragraph 6(1)(a) provides that it is not to be included in the income of the employees if the plan is a "group sickness or accident insurance plan". It is considered that this exemption in paragraph 6(1)(a) applies to any of the three types of plans mentioned in paragraph 6(1)(f), provided that they are group plans.

15. If an employer should have a plan that is in part a wage loss replacement plan and in part a plan that provides for other types of benefits, the employer must be prepared to identify that part of any premiums paid by him, or other contribution by him to the plan, that relates to the other types of benefits included in the plan and, similarly, the part of the employees' contributions, if any, that relate to the wage loss replacement part of the plan. This information is required to determine whether the wage loss replacement plan is one to which the employer has contributed and the relevant amount of an employee's contribution for purposes of subparagraph 6(1)(f)(v).

Employee Pay-All Plans

16. An employee-pay-all plan is a plan the entire premium cost of which is paid by one or more employees. Except as indicated under 21 below, benefits out of such a plan are not taxable even if they are paid in consequence of an event occurring after 1973, because an employee-pay-all plan is not a plan within the meaning of paragraph 6(1)(f).

17. It is a question of fact whether or not an employee-pay-all plan exists and the onus is generally on the employer to prove the existence of such a plan. It should be emphasized that the Department will not accept a retroactive change to the tax status of a plan. For example, an employer cannot change the tax status of a plan by adding at year end to employees' income the employer contributions to a wage loss replacement plan that would normally be considered to be non-taxable benefits. On the other hand, where an employee-pay-all plan does, in fact, exist and it provides for the employer to pay the employee' s premiums to the plan and to account for them in the manner of wages or salary, the result is as though the premiums had been withheld from the employee's wages or salary. That is, the plan maintains its status as an employee-pay-all plan if the plan provided for such an arrangement at the time the payment was made.

18. If, under a wage loss replacement plan, the employer makes contributions for some employees, but not all, the plan will not be considered to be an employee-pay-all plan even for those employees who must make all contributions themselves. It is the Department's view that all payments out of a wage loss replacement plan to which the employer has contributed are subject to the provisions of paragraph 6(1)(f) regardless of the fact that the employer's contributions may be on account of specific employees only.

19. Where the terms of a plan clearly establish that it is intended to be an employee-pay-all plan, the plan will be recognized as such even though the employer makes a contribution to it on behalf of an employee during an elimination period (i.e. the period after the disability but before the first payment from the plan becomes due). During this period normally there would be no salary or wages from which the contribution could be deducted. Any amount so contributed by an employer should be reported as remuneration of the employee on whose behalf it was contributed in order to maintain the employee-pay-all character of the plan.

20. Where an employer pays, on behalf of an employee, the premium under a non-group plan that is

(a) a sickness or accident insurance plan,

(b) a disability insurance plan, or

(c) an income maintenance insurance plan,

the payment of the premium is regarded as a taxable benefit to the employee. The payment by the employer is not viewed as a "contribution" by the employer under the plan, and paragraph 6(1)(f) does not apply to subject to tax in the employee's hands any benefits received by him pursuant to the plan.

21. Whether or not the benefits an employee receives under a plan are required to be included in his income is governed both by the type of plan in effect at the time of the event that gave rise to them and any changes in the plan subsequent to that time. When a pre-June 19, 1971 plan, or an employee-pay-all plan, is changed and becomes a new taxable plan, an employee who was receiving benefits at the time of the change may continue to receive them tax-free thereafter but only in the amount and for the period specified in the plan as it was before the change. Where the new taxable plan provides any increase in benefits, whether by increases in amounts or through extension of the benefit period, the additional benefits must be included in income since they flow from the new taxable plan. Where an employee is receiving benefits under a taxable plan at a time when it is converted to a new employee-pay-all plan, the benefits he continues to receive subsequent to the date of conversion, to the extent that they were provided for in the old plan, will remain of an income nature because they continue to flow from the old taxable plan.

Claimant's Survivors

22. If the payment of wage loss replacement benefits should continue after the death of an employee who was receiving such benefits, paragraph 6(1)(f) is not applicable to such benefits paid to the widow or other dependent for the reason that the amounts received do not relate to a loss of income from an office or employment of the recipient. Such payments, however, may be viewed as being received in recognition of the deceased employee's service in an office or employment and be included in income as a death benefit if they exceed the exemption provided in subsection 248(1).

Information Returns

23. Paragraph 200(2)(f) of the Income Tax Regulations stipulates that every person who makes payments pursuant to a wage loss replacement plan is required to file Form T4A information return. The law does not require that income tax be deducted from such payments.

U.I.C. Employee Premium Rebate

24. A wage loss replacement plan may qualify the employer for a reduction in unemployment insurance premiums under subsection 64(4) of the Unemployment Insurance Act, 1971. This subsection also provides that five-twelfths of any such reduction must be used by the employer for the benefit of his employees. The benefit may be conferred directly by the employer, indirectly through an employees health and welfare trust or in any other manner, but it will only be tax-free in an employee's hands if it is conferred in the form of a benefit specifically exempt from taxation by paragraph 6(1)(a).