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Health and Welfare Plans – Canada

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Health and Welfare Plans
The Benefits

Health and Welfare Plans

What are they?

- group sickness or accident insurance plan (GSAIP):
  - not legislatively defined
- private health services plan (PHSP):
  - defined in s. 248(1)
  - a contract of insurance in respect of hospital expenses or medical expenses
  - a medical care insurance plan or a hospital care insurance plan
- group term life insurance policy (GTLIP):
  - defined in s. 248(1)
- wage loss replacement plan (WLRP):
  - not legislatively defined
  - if a group plan, a subset of a GSAIP

Health and Welfare Plans
What are they?

- a flexible benefit plan (flex plan) is a *meta* plan:
  - also, not legislatively defined
- a flex plan grants credits that can be allocated to HWPs and other plans or benefits
- a properly designed flex plan has no tax consequences in and of itself:
  - the tax consequences are pushed down to the benefits or plans to which the credits are allocated
- we will deal no further with flex plans

Health and Welfare Plans

Tax consequences to employees

- excluded from employment income under s. 6(1)(a), if a GSAIP, PHSP or GTLIP
- income inclusion for GTLIP: s. 6(4)
- income inclusion for WLRP: s. 6(1)(f):
  - different rules for lump sum settlements
- coverage itself is not taxable, except for GTLIP
- benefits payable as a result of coverage are not taxable, except for WLRP

Health and Welfare Plans

Tax consequences to employers

- deductible, if paid on a pay-as-you-go basis
- if benefits are pre-funded, deductibility is restricted:
  - common law: *Atherton*
  - s. 18(9)(a)(iii)

Health and Welfare Plans
Regulation by the CRA

- there is a near legislative vacuum with respect to HWPs
- the rules are formulated and administered by the CRA
- the basic framework for HWPs:

I. HWP must be in the nature of insurance

II. must provide benefits with respect to employees and not with respect to shareholders

III. WLRPs must be funded

IV. PHSPs and GSAIPs must “normally” cover only those expenses that qualify for the medical expense tax credit (METC)

Health and Welfare Plans Funding

Health and Welfare Plans
Funding

- health and welfare trust (HWT):
  - not legislatively defined
- employee life and health trust (ELHT):
  - draft legislation of February 26, 2010
- it is believed that the ELHT will replace the HWT:
  - no transition rules provided

Health and Welfare Plans

Health and Welfare Trust

- may be used to fund only HWPs: GSAIPs, PHSPs and GTLIPs
- may fund what is actuarially required
- can deduct what is contributed in a year, if actuarially required, but only to extent of benefits paid in that year:
  - CRA draws no distinction between coverage and payment on the occurrence of a risk assured
  - all payments under a HWT are considered insurance by CRA
- trust may deduct, in computing its income:
  - expenses in earning income
  - normal operating expenses
  - <u>taxable</u> benefits paid to beneficiaries
- no reversion of surplus to employer or related entity

Health and Welfare Plans

Health and Welfare Trust

- no anti-discrimination rules:
  - benefits must be provided *qua* employee and not *qua* shareholder
- no residence requirement
- if trust fails to qualify as a HWT, all benefits paid thereunder are likely taxable

Health and Welfare Plans
Employee Life and Health Trust

- only designated employee benefits (DEBs) may be provided under an ELHT, except on wind-up:
  - DEBs are benefits under GSAIPs, PHSPs and GTLIPs
  - same rule as for HWT
- on wind-up, pro-rata distribution may be made to beneficiaries, other than *key employees**:
  - not clear what could be distributed to beneficiaries on wind-up of HWT
- trust must be resident in Canada:
  - no residence requirement for HWT

** defined later*

ELHTs

What is a key employee?

- determined in respect of a taxation year
- at any time, in the year or before, did not deal at arm’s length with employer
- at any time, in the year or before, was a *specified shareholder** of the employer
- in any 2 of 5 years preceding the year, earned employment income from employer > 5 times the YMPE

** s. 248(1)*

Health and Welfare Plans
Employee Life and Health Trust

- only beneficiaries are employees, related persons or another ELHT:
  – not clear who beneficiaries could be under a HWT
- trust cannot be maintained primarily for the benefit of key employees:
  – no such rule for HWTs
- rights of each key employee cannot be more advantageous than a given “reference class”* of employees:
  – no such rule for HWTs
- no rights, except for DEBs, may be provided to employer or non-arm’s length persons:
  – probably the same rule as for HWTs

** explained below*

ELHTs

What is a reference class?

- RC contains at least 25% of all employees who are beneficiaries
- no more than 25% of the members of the RC are key employees
- the rights of each member of the RC are identical

Health and Welfare Plans

Employee Life and Health Trust

- trust must be administered in accordance with its terms and objects:
  - same rule as for HWTs
- trust must have legal right to enforce payment of contributions to trust:
  - same rule as for HWTs
- employer representatives must not constitute a majority of trustees:
  - no such rule for HWTs

Health and Welfare Plans
Employee Life and Health Trust

- employees are taxed based on the nature of the coverage or payment, not based on the fact that the coverage or payment is provided out of or under the ELHT:
  - same rule for HWT
- payment from a “tainted” ELHT is not necessary taxable:
  - if payment is a DEB, not taxable unless a s. 6(1)(f) payment
  - all distributions from “tainted” HWTs are taxable
- act of funding is not a taxable event:
  - same rule for HWT
- employee contributions retain same tax treatment as if made directly:
  - same rule for HWT

Health and Welfare Plans
Employee Life and Health Trust

- a contribution, in a year, is only deductible to the extent of DEBs payable in the year
- undeducted balance of contribution is deductible, in a subsequent year, to the extent of DEBs payable in that subsequent year
- CRA’s reading of s. 18(9)(a)(iii), with respect to HWTs, has been upheld, although by addition of specific provision
- asymmetry between insured WLRPs and those funded (by HWT or ELHT) has been maintained

Health and Welfare Plans

Employee Life and Health Trust

- ELHT is allowed, in computing income for a year, to deduct DEBs that became payable in the year
- main policy change for funded HWPs
- for HWT, only taxable distributions of DEBs are deductible
- 3-year non-capital loss carry-forward, or carry-back, is allowed
- if DEBs are greater than or equal to income of ELHT otherwise determined, ELHT earnings are essentially free of tax

Health and Welfare Plans Outstanding issues

Health and Welfare Plans
Outstanding issues

I. No legislated rules for benefits:
   i. what is a medical expense?
   ii. what is a qualifying drug?
   iii. what is a plan in the nature of insurance?

II. Is there sufficient incentive to fund HWPs?

III. Asymmetry between funded and insured disability plans

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