CANADA REVENUE AGENCY UPDATES HEALTH AND WELFARE TRUSTS CHAPTER OF INCOME TAX FOLIO

The Canada Revenue Agency (CRA) updated Chapter 1: Health and Welfare Trusts of Income Tax Folio 1: Specific Plans Offered by Employers. Effective July 27, 2015 Income Tax Folio S2-F1-C1, Health and Welfare Trusts, replaces and cancels Interpretation Bulletin IT-85R2, Health and Welfare Trusts for Employees dated July 31, 1986. The Chapter was created to clarify the conditions that must be satisfied for a trust arrangement to qualify as a health and welfare trust. It also outlines the tax implications to an employer for contributions made to a health and welfare trust, the tax implications to an employee receiving benefits from the trust, and the taxation of the trust itself. The Chapter also serves to explain the CRA's position regarding the taxation of employee health and welfare benefit programs administered through a health and welfare trust.

This bulletin highlights and explains key aspects of this new regulation that might affect trustees, unions and employers.

What is a Health and Welfare Trust?

Health and welfare trusts are not defined in the Income Tax Act ("the Act"). However, the Chapter outlines the general meaning of a health and welfare trust as:

> "a trust arrangement established by an employer for the purpose of providing health and welfare benefits to its employees. Under this type of trust arrangement, trustees (usually with equal representation from the employer and the employees or their union) receive contributions from the employer and in some cases from employees, to provide certain health and welfare benefits agreed to between the employer and the employees. **Multiple employers can participate in the same health and welfare trust.**"

Requirements to Be Considered a Health and Welfare Trust by the CRA

Benefits to be Provided

The Chapter sets forth the benefits that can be administered through a health and welfare trust as follows:

A health and welfare trust may only administer the following:

1. a group sickness or accident insurance plan;
2. a private health services plan;
3. a group term life insurance policy; or
4. any combination of the above plans.

Registration and Reporting Requirements

The CRA does not require any formal registration and there is no requirement that the trust agreement be submitted to the CRA for approval prior to the implementation of the trust.

A trust may qualify as both a health and welfare trust and an employee life and health trust in certain circumstances. In these cases, it is up to the trust to maintain evidence which supports the intended arrangement.

Plan Design

With the exception of group term life insurance benefits, health and welfare trusts can provide these benefits through third-party insurance contracts, directly from the property of the health and welfare trust (a self-insured plan), or a combination of both. Group term life insurance benefits must be provided through insured arrangements with an insurance provider.

Governance

The trustee(s) of a health and welfare trust control any matters related to the administration of, funding of, investments by, or payments of any benefits under a health and welfare trust. These trustees must act independently of the employer(s). If the employer controls the trust fund, the CRA states that the trust cannot be considered a health and welfare trust (HWT). The agreements relating to the setting up of a HWT should therefore include a provision that specifies that the funds of the trust can never revert back to the employer and a provision that offers the trustees the power to enforce the contributions required by an employer to the trust.

A paragraph was added to provide general guidance concerning the establishment of a health and welfare trust.

Contributions

An employer must make contributions to fund employee health and welfare benefits in order for a trust to qualify as a health and welfare trust. This means that an entirely employee funded or union funded health and welfare trust would not be considered a health and welfare trust arrangement by the CRA.

Contributions should be calculated to not exceed the amount required to provide health and welfare benefits to the plan members and a trust should not permit surplus accumulations under the terms of a trust agreement or through its method of funding if it wants to qualify as a health and welfare trust. However, the existence of a temporary or permanent surplus in any given year will not automatically affect the status of a trust as a health and welfare trust.

Coverage Limitations

If a benefit plan provides coverage for non-employees, regardless of whether these beneficiaries pay for their own coverage, it cannot be considered a health and welfare trust by the CRA. Similarly, a trust established by a partnership to provide health and welfare benefits to its partners is not a health and welfare trust.

Investment Limitations

Funds of a health and welfare trust cannot be invested in or used by the employer or a person or group that is determined not to deal at arm's length with the employer.

Use of Trust Funds

The funds of the trust and any income earned in the trust cannot revert to the employer or be used for a purpose other than providing health and welfare benefits.

Additionally, the distribution of surplus funds to employees is not an acceptable use of trust funds in most cases and may disqualify the trust as a health and welfare trust. A rare exception to this rule is where a health and welfare trust is wound up.

Tax Benefits and Implications for Employers

Contribution Deductibility

Contributions to a health and welfare trust are deductible as a business expense starting from the year in which the legal obligation to make the contribution arose.

For insured plans, the employer may only deduct in the year, contributions equal to the premiums paid or payable by the trust to acquire insurance coverage for that year.

For self-insured plans, the employer may only deduct in the year, contributions that were required to fund health and welfare benefits that could reasonably be expected to be paid or become payable by the trust in that year (as determined actuarially).

Employer contributions that are not deducted in a year can generally be deducted the following year when the HWT uses the contributions to provide health and welfare benefits.

Administrative Costs Deductibility

Reasonable administrative costs for health and welfare benefits provided through an insured or a self-insured plan are deductible.

Tax Implications for Plan Members

Treatment and Recognition of Benefits

Benefits Plan	HWT Trust Contributions to Plan Included in Members' Income	Benefits Received Taxable to Member
Group sickness or accident insurance plan that provides lump sum payments or pays benefits that are not compensation for the loss of employment income	Yes	No
Group sickness or accident insurance plan that provides periodic payments as compensation for the loss of employment income	No	Yes
Private health services plan	No	No
Group term life insurance policy	Yes	Yes*

* Employee contributions to the group term life insurance policy reduce the annual benefit that is included in income.

An employee's income may also be reduced by the amount of contributions made by the employee to the plan before the end of the year provided that these contributions have not already reduced the amount of benefits previously received by the employee.

Medical Expense Claims

Private health services plan premiums, contributions or other consideration paid for by the employer cannot be claimed as eligible medical expenses by an employee.

CPP Contributions and EI Premiums

Taxable benefits provided through a health and welfare trust may be subject to Canada Pension Plan contributions and Employment Insurance premiums in certain circumstances.

Tax Implication for the Health and Welfare Trust

Tax Treatment

A HWT is considered an inter vivos trust for tax purposes and as such is taxed on its income at the highest marginal rate for individuals on a calendar year basis.

Income	Taxable Income
Income derived from investing contributions in taxable investments	Yes
Incidental income (i.e. penalties for late contributions)	Yes
Contributions from the employer(s) and employees	No

Expenses	Deductible from Gross Income
Transfers to contingency reserves	No
Expenses related to the HWT's operation	Yes
Expenses incurred in earning the income of the trust	Yes
Benefits and premiums paid or payable for the current year	Yes
Benefits paid out of proceeds of an insurance policy	No
Net capital losses	Yes
Provincial Sales Taxes and Premium Taxes	No
Premiums and benefits that would not otherwise be taxable in the hands of the employee by virtue of section 6 treated at the trustees' discretion as having been paid out of prior year's funds or current year's employer's contributions	No

Trust Deemed Realization Rule

A health and welfare trust is not subject to the 21-year deemed realization rule in subsection 104(4). The rule prevents the use of a trust to indefinitely defer the recognition of gains accruing on capital property for tax purposes and treats capital property of a trust as having been disposed of and reacquired by the trust every 21 years at the property's fair market value.

Comment Period

To allow for feedback, this newly published Chapter has a three-month comment period ending October 27, 2015. During this period the folio chapter can be relied upon as an accurate summary of the Canada Revenue Agency's (CRA's) interpretation of the law. PBI will submit suggestions about the structure or content of this Chapter.

The information provided in this article is not comprehensive and is not intended or offered as professional or legal advice. Please refer to the information provided directly by the Canada Revenue Agency for more details and contact your professional consultants for advice.

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