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LEGISLATIVE UPDATE

March 9, 2018

2018 Federal Budget Proposes to Discontinue the Health and Welfare Trust Regime

The 2018 Federal Budget announced that Health and Welfare Trusts ("HWTs") will need convert to Employee Life and Health Trusts ("ELHTs") or windup by the end of 2020. This change was proposed so that only one set of tax rules, those in the Income Tax Act for ELHTs, will apply to all trusts established for the provision of group benefits. Transitional rules will be added to the Income Tax Act to facilitate the conversion. Starting in 2021, trusts that have not converted will be subject to the normal tax rules for trusts.

Given these changes, the CRA will not apply its administrative positions with respect to Health and Welfare Trusts to trusts established after Budget Day. It will also announce transitional administrative guidance relating to winding up existing Health and Welfare Trusts.

Stakeholders are invited to submit comments on transitional issues, both administrative and legislative, to HWT-consultation-FSBE@canada.ca until June 29, 2018. After the consultation period, the Government will release draft legislative proposals and transitional administrative guidance.

The Budget lists the following issues as being under consideration:

- Whether a Health and Welfare Trust can continue as an Employee Life and Health Trust without the creation of a new trust.
- Whether, and under what conditions, a rollover of assets to a new trust will be permitted.
- The tax implications for a Health and Welfare Trust that does not satisfy the conditions to become an Employee Life and Health Trust, or where the trustees of a Health and Welfare Trust choose not to convert.

HWT vs. ELHT

HWT and ELHT are very similar with identical definitions in terms of plan sponsors, the kind of benefits they can provide, and funding rules. However, there are a few things that are different:

HEALTH & WELFARE TRUST (HWT)	EMPLOYEE LIFE & HEALTH TRUST (ELHT)
A HWT must meet guidelines in Folio S2-F1-C1.	ELHTs must meet the requirements of ITA s. 144.1 throughout the taxation year.
Trustee(s) One or more acting independently of the employer in their administration of the trust.	**Trustee(s)** One or more – employer representatives must not constitute a majority or otherwise control the trust.

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Beneficiaries All employees can be beneficiaries with no rules on the level of benefits that can be received by "key employees".	**Beneficiaries** "Key employees" who are highly compensated may not receive preferential benefits.
Use of Trust Funds on Wind-Up Funds remaining in the trust after wind-up may be used to provide additional benefits to employees, or may be distributed to the employees or to a registered charity.	**Use of Trust Funds on Wind-Up** Trust Funds can only be distributed to: • The beneficiaries of the trust, other than key employees, according to their interest in the trust. • Another ELHT. • The Government (as a last resort).
Surplus Restrictions Employer contributions must not exceed the amount required to provide benefits to employees. 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. Where a permanent surplus exists and not steps are taken within a reasonable time to eliminate it, employer contributions to the trust may not be deductible.	**No surplus Restrictions**

Taxation Rules

Some of the biggest differences between HWTs and ELHTs are in the taxation rules. Both are Inter Vivo Trusts with the taxation year at December 31. For both types of trusts, no funds can revert to the employer and the tax treatment of employer contributions are similar. Nearly everything else is different:

HWTs must calculate their taxable income and pay taxable benefits out of the trust.

Health & Welfare Trust (HWT)	Employee Life & Health Trust (ELHT)
Trust residency No trust residency requirement.	**Trust residency** Trust must be resident in Canada for tax purposes.
Employer contributions Deduction of reasonable contributions to earn income from business or property paid in the year the legal obligation to make the contribution arose. Cannot deduct contributions that relate to benefits payable in a subsequent taxation year.	**Employer contributions** Deductible when: • Reasonable expense to earn income from business or property deductible in the year or prior year the legal obligation to pay the benefits arose. • Used to pay premiums to licensed insurance company to provide benefits in the year and prior year. • Contribution for benefits paid during the year is based on an independent actuarial report. • No loans to or investments in an employer or related person.

	• Contributions made in one year that are not deductible may be deducted in future years to which benefit payments relate.
Employees (beneficiaries) No restrictions on the participation of key employees.	**Employees (beneficiaries)** Trust must contain restrictions on the extent to which key employees may be trust beneficiaries.
Taxation of trust Only taxable employer-funded benefits paid, premiums paid, normal operation costs, and expenses incurred in earning investment income can be deducted from its income for tax purposes.	**Taxation of trust** All benefits paid, premiums paid, normal operation costs, and expenses incurred in earning investment income can be deducted from its income for tax purposes. ELHTs can have special non-capital loss accounts that will allow a portion of the income to be carried forward or back three years if the trust has excess income: this allows some sheltering of income for years when the trust had actual taxable income.
Subject to 21-year deemed disposition. Alternative Minimum Tax.	**Not subject to** 21-year deemed disposition. Alternative Minimum Tax.

Things to Consider for Plan Sponsors

In anticipation of these changes, sponsors of Health and Welfare Trusts will need to plan for the conversion and work with their advisors to ensure that they are compliant with the ELHT provisions by the end of 2020. The issues to consider include a review of Trust Agreements, group benefit underwriting arrangements, investment portfolios, and any surpluses held within the trust. Having the proper frameworks in place today will smooth the transition and lessen the impact of the conversion when the rules come into effect.