

Department of Finance Releases Draft Legislative Proposals Relating to the Conversion of Health and Welfare Trusts

On May 27, 2019, the Department of Finance released draft legislative proposals that aim to facilitate the conversion of existing Health and Welfare Trusts into Employee Life and Health Trusts and would amend the existing Employee Life and Health Trust tax rules to allow Health and Welfare Trusts to continue to operate similarly after the conversion.

Background

The 2018 Federal Budget proposed that legislative provisions be introduced to convert the Health and Welfare Trusts (HWTs) into Employee Life and Health Trusts (ELHTs). This would mean only one set of tax rules would apply to these arrangements after 2020. The government invited stakeholders to provide input on this transition and consultations concluded on June 29, 2018. PBI along with other industry stakeholders and clients submitted recommendations and comments.

Provisions for the Conversion of Trusts

The legislation proposes a streamlined approach to the conversion of existing Health and Welfare Trusts (HWTs) to Employee Life and Health Trusts (ELHT). This is accomplished by first extending the provisions of ITA 144.1(1) to all HWTs.

Existing HWTs can then elect to continue as an ELHT by notifying CRA in a prescribed form and manner without any adverse tax implications and without having to create a new trust. This must be done by December 31, 2020. The requirement to "file in prescribed form" or "file in prescribed form and manner" means that CRA should be notified in a letter included with the plan's T3 Trust Income Tax and Information Return.

The legislation includes transitional rules which:

1. Provide until December 31, 2022, for HWTs to amend the terms of their plans to be compliant with ELHT regulations, and
2. Provide for a tax-free rollover of assets where a new trust is created, or where two or more existing trusts merge.

The legislation also requires that trusts that do not convert to an ELHT by the end of 2020 will be treated as "employee benefit plans" for income tax purposes.

Amendments to Existing Employee Life and Health Trust Rules

The transition rules also include the following changes to the existing legislation based on feedback gathered during the initial consultation process in 2018:

Subject	Previous Legislation	Draft Legislative Proposals
Requirements to be a MEP	<p>At no time in the year should more than 95% of the employee beneficiaries be employed by a single employer or related group of employers;</p> <p>There must be 15 unrelated contributing employers or 10% of the employee beneficiaries should be employed by more than one unrelated employer.</p>	These provisions have been removed.
Composition of trustees	Employer representatives cannot constitute a majority of ELHT trustees.	Replaced with the requirement that a majority of trustees deal at arm's length with each participating employer.
Benefits paid to other than Eligible Beneficiaries	Trust is precluded from deducting certain amounts when determining the trust's taxable income in respect of the taxation year.	Prohibition on deductions does not apply if it is reasonable to conclude that the trustees neither knew nor ought to have known that designated employee benefits have been provided to, or contributions have been made in respect of, non-eligible beneficiaries.
Investments in Participating Employers	ELHTs cannot make a loan to, or any investment in, a participating employer or a person with whom a participating employer does not deal at arm's length.	Acquisition of a prohibited property would not cause the entire trust to become offside, but would instead impose a tax on the portion of the investments (or loans) that are prohibited investments
Residency Requirements	ELHTs must be resident in Canada.	Allows certain non-resident trusts, that otherwise meet the relevant conditions, to qualify as an Employee Life and Health Trust if certain conditions are met.

Other Items under Consideration

The following items are under consideration by the Department of Finance:

- the types of benefits that currently qualify as "designated employee benefits" under an ELHT and whether other benefits should be considered;
- the expansion of the scope of the Private Health Services Plan component of designated employee benefits;

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- the use of ELHT rules to provide benefits to "key employees", and
 - the rules related to carry back and carry forward of non-capital losses under ELHTs.

Conclusion

The proposed amendments accomplish the wishes of stakeholders for an administratively streamlined transition process that minimizes adverse tax consequences. Going forward, how legislation is adapted to deal with the items still under consideration will be critical to plan sponsors as these issues are fundamental to the operation of trustee benefit programs.