

Health & Welfare Trusts

a) *Executive Summary*

Designed for

- Principals and employees of Canadian Controlled Private Corporations.
- Where the corporation is bonusing down to small business income tax level.
- Bonuses are taxed at top personal marginal rates.
- After tax bonus amounts are available for investment.

A properly structured Health and Welfare Trust (HWT) provides the client an immediate corporate deduction without any income inclusion in the hands of the employee in certain situations.

HWTs are not defined or otherwise expressly provided for in the Income Tax Act. Instead, the trust arises by implication in the Income Tax Act. Firstly, subparagraph 6(1)(a)(i) of the Income Tax Act excludes from taxable income from an office or employment certain contributions made by the employer to, among other things, a group sickness or accident insurance plan. Secondly, paragraph 6(1)(f) includes in taxable income periodic payments received from a sickness or accident plan, disability insurance plan or an income maintenance plan. This combination of non-taxable contributions and taxable benefits required the establishment of a formal vehicle to accomplish the intentions and affect of these provisions. This is expressed in CRA's guidelines as laid out in IT-85R2.

The purpose of the HWT is to allow employers to provide certain health and welfare benefits to employees, and former employees as well as their immediate families. The types of benefits a HWT can provide include:

- **A Group Life Insurance Plan**
 - The receipt of a death benefit is not taxable to the employee, but
 - Benefit for costs for insurance in excess of \$25,000 is included in income.
- **A Group Sickness or Accident Insurance Plan**
 - Current interpretations include Critical Illness insurance as an accident or sickness plan.
 - Benefits paid as a single payment as the result of a critical illness appear not to be taxable.
- **Private Health Services Plan**
 - Coverage not a taxable benefit.
 - Benefit not included in employee's income.



➤ **Disability Benefits—Long and Short Term**

- Employer contributions to the trust are tax deductible.
- If employer contributions not taxed to the employee the benefits are taxable.
- If the employee has included the costs of the plan in his/her income the benefits are non-taxable to the extent paid for by the employee.

There is no formal registration, or requirement to submit the trust deed to CRA prior to implementing a HWT. Administratively, CRA requires the trust meet the following conditions to be considered a HWT:

- The funds must be used exclusively to provide permissible benefits and cannot revert to the employer nor can the trust invest in or otherwise provide funds to the employer or another non-arm's length party.
- On wind-up of the plan, surplus funds must be distributed to a registered charity.
- The employer must be legally bound to make the contributions to the trust.
- The trustees must be independent of the employer and have a legally enforceable right against the employer to demand funding. Paragraph 6 of IT85R2 indicates that where the employer controls the funds the arrangement would not be considered a HWT.
- Where a HWT is established to provide group benefits, such as group sickness and accident insurance plans the plan must include at least 2 employees.
- The plan must be established to provide employment related benefits.
- A shareholder that is not employed in the business would not be eligible to participate.
- CRA may attack the trust if the only beneficiaries are the owners and members of their family.
- The exclusive purpose of the trust must be to provide health benefits, wage loss replacement and/or life insurance.
- Paragraph 6 of IT85R2 states that an employer's contributions to the trust must not exceed the amount required to fund the benefits.

c) Tax Consequences

Employer

- Contributions to a HWT are deductible on an accrual basis.
- There is no specific provision in the Act to address the deduction therefore rely on section 9 of the Act.

Employee

- There are no immediate tax consequences to the employees as a result of the employer funding the trust.
- Benefits provided under a private health services plan such as hospitalization, dental, eyeglasses, et cetera are considered tax-free.
- Short term and long term disability benefits on the other hand remain taxable on receipt under paragraph 6(1)(f) of the Act as they are periodic payments.



Trust

- Employer contributions to the trust are not income of the trust.
- Investment income, net of related expenses and the payment of benefits, which are taxable to employees, is taxed at the highest tax rate applicable to intervivos trusts.

Planning Point - Consider Alberta Residency for the Trust.

- A T-3 Return is filed for the HWT where trust income exceeds \$500 in the year.
- A T4A is required to be filed to report taxable benefits paid out of the trust to an employee and income tax must be withheld from taxable payments.

Consequences of Being Disqualified as a Health & Welfare Trust

- If the arrangement established as HWT does not meet CRA's approval; it will likely be reassessed as an Employee Benefit Plan.
- Contributions would not be deductible by the employer until such time there is an income inclusion in the hands of the employee. All payments made out of the plan to the employee would be taxable.
- It is possible to obtain an advance tax ruling to ensure plan does comply.

d) Planning for the Owner/Manager

HWTs can be used to fund a tax-deductible health and wage loss insurance plan. The benefits would be actuarially calculated to meet CRA's guidelines on deductibility of contributions. Depending upon the age of the employees covered, and the level of wage loss benefits to be insured, the annual contributions required to fund the plan could accumulate to be quite significant. Critical illness benefits, long-term disability benefits can be reinsured by the Trust. Policies with refund of premium options offer planning advantages over the long-term.

