May 14, 2021

The Department of Finance
90 Elgin Street
Ottawa, Ontario
K1A 0G5

Attention: Lori Merrigan, Tax Policy Officer

Dear Ms. Merrigan:

Re: Bill C-30 – Submission on draft legislation governing ELHTs

Further to prior discussions and correspondence relating to the draft proposals governing Employee Life and Health Trusts (ELHTs), the Conference for Advanced Life Underwriting (CALU) is pleased to provide the following additional comments on the ELHT legislation that was released on November 27, 2020 (the "November 2020 legislation"), which is now part of Bill C-30 (Budget Implementation Bill 2021, No. 1) ("BIA 2021 No.1).[1]

In this submission CALU will comment specifically on modifications to the "25%/75%" test for key employees[2] so it will be determined at the trust (plan) level; changes that permit up to $2,500 for funding the costs of private health services plans (PHSPs) for key employees and family members[3]; and other matters relating to the provision of health and welfare benefits for employees of small businesses.

Background

CALU has been actively engaged in discussions with the Department of Finance ("Finance Canada") relating to legislative and administrative proposals governing Health and Welfare Trusts (HWTs) and ELHTs that were initially announced in Budget 2018 ("Budget 2018 proposals"). In prior submissions[4] CALU noted that incorporated small businesses have used HWTs for a number of years as a vehicle to

[1] Released on April 28, 2021 and has passed first reading in the House of Commons.
[2] Included in the November 2020 legislation.
[3] Included in the November 2020 legislation and modified in BIA 2021.
[4] Dated June 29, 2018, November 28, 2018 and August 12, 2019.

provide health and welfare benefits to their employees including “key employees”.[5] Budget 2018 originally proposed that existing HWTs would need to be wound up or converted to an ELHT by the end of 2020. Otherwise, the special administrative tax treatment provided by the Canada Revenue Agency (CRA) would no longer be available, and the trust would be treated as an ordinary *inter vivos* trust.

CALU has previously expressed concerns with the Budget 2018 proposals, noting that the rules governing ELHTs made them unsuitable for many small businesses, with the result that most small businesses would be forced to wind up their HWTs. This would make it more difficult for these businesses to provide a competitive range of health and welfare benefits to its employees on a comparable basis [6] to employees of larger employers.

A number of changes have been announced since the Budget 2018 proposals (and included as part of the final ELHT legislation in BIA 2021 No. 1) which are relevant and helpful to small business owners with existing HWTs, as follows:

- An ELHT can offer benefits that are not designated employee benefits provided all or substantially all of the total cost of benefits provided are designated employee benefits[7]
- The 25%/75% test governing ELHTS that include key employees has been modified to provide that this test takes place at the trust (plan) level rather than at the employer level[8]
- If the ELHT does not meet the revised 25%/75% test, it may still qualify as an ELHT where the ELHT limits the cost of PHSP benefits to $2,500 for each key employee and each family member (prorated if the key employee did not work the full year) determined on a family basis.[9]

In addition, the current CRA administrative position relating to HWTs has been extended to the end of 2021.

Discussion of the ELHT Legislation in BIA 2021 No. 1 and Related Tax Matters

1. Why Trusteed Insurance Plans are Important to Small Businesses

In prior CALU submissions and discussions with Finance officials, CALU has reviewed the reasons why small businesses chose to establish HWTs rather than providing employees with health-related benefits through an insurance company. We believe it is important to reinforce these various points which illustrate the potentially negative impact on small employers and their employees that could otherwise arise from losing access to HWTs, assuming similar benefit programs cannot be provided under an ELHT.

[5] As defined in subsection 144.1(1) of the Income Tax Act (Canada) (herein the “Act).
[6] In terms of the deductibility of contributions by the employer, and the types and range of benefits that can be provided to employees and the related tax treatment of such benefits.
[7] Draft paragraph 144.1(2)(a). However, draft paragraph 144.1(3)(b) restricts benefits that are not designated employee benefits to benefits that provide a deduction to the employer for contributions to the plan.
[8] Draft subparagraph 144.1(2)(e)(i) (the “25%/75% test”).
[9] Assuming the ELHT meets the PHSP funding limit test, the ELHT can also offer other designated employee benefits (as defined in subsection 144.1(1)) to key employees.

HWTs have been an important vehicle to source and administer group benefits for certain small employer groups, particularly those which include family members. For instance, some insurance companies will not insure smaller groups of employees or offer coverage to a particular industry or certain occupations. Some small employers may also be precluded from obtaining insurance benefits because they do not qualify based on minimum employee requirements. The employees would therefore need to purchase individual health plans which may disqualify them because of pre-existing medical conditions of its members. One solution is to pool a number of employer groups together to access group benefits in an aggregate format. Thus, by participating in a multi-employer HWT, an employer can access group insurance products that it may otherwise be unable to obtain on its own. A multi-employer HWT to pool such employers offers a valuable and cost-effective solution.

For smaller employers, the fees and expenses that insurance companies build into their traditional group insurance costs can also be quite significant. In order to be more cost-effective, a trust may be created in order to provide health and dental benefits. Third party administrators (TPAs) or “cost-plus” providers are often engaged to administer and pay claims on behalf of the trust, resulting in lower fees to the employer than what an insurance company is likely to charge.

Trusts administered by TPAs also permit the mixing and matching of different products from multiple insurance companies, creating a customized design of benefits using the most appropriate products at the best possible price from all of the market options.

There are also a number of other important points to consider:

1. Third party arrangements (often through a trust) protect the privacy and confidentiality of an employee’s health information from the employer and other parties.
2. The employer is removed from the adjudication and administration process – reducing potential conflicts between the employer and employees on whether specific health care expenditures should be covered under the plan.
3. As noted, while individual private health insurance plans are available in the market, they often require medical evidence to provide affordable coverage. These plans may also exclude certain coverages and/or offer coverages that are not meaningful to the plan member but increase the cost to the policyholder. Such plans also put arbitrary caps or limits on different plan coverages which often do not correspond with the needs of plan members. The premiums under such plans also increase with the age of the insured, even though actual claims may not justify such increases.

For these reasons, the inability to use a trusteed plan which can source and offer different insurance coverages and health care spending account features, on similar terms and conditions as those offered by larger employers, may put small employers at a competitive disadvantage. In addition, the various tax rules and conditions applicable to ELHTs may result in unfairly discriminating against owner/managers and more highly paid employees relative to health and welfare plans offered by larger employers to employees holding similar positions and income levels.

2. 25%/75% Rule – Multi-Employer Plans

As previously noted, the 25%/75 test will now apply at the trust level rather than for each participating employer in the trust. While recognizing this may assist certain multi-employer HWTs to qualify as an ELHT, we believe this change will not be helpful for the majority of HWTs established for small employers, due to the large percentage of key employees who currently participate in multi-employer HWTs designed for small businesses. While it is possible that these plans might attract new employers with a larger percentage on non-key employees, it could take a number of years before such plans could qualify as an ELHT under the 25%/75% rule.

As well, HWT plan administrators have expressed concerns with their ability to monitor the status of employees in multi-employer plans, which consist primarily of small employers, to determine compliance with the 25%/75% rules. This results from the fact that employees may become shareholders or receive bonuses in a year which would result in them becoming key employees in the following year, without this information being disclosed by the employer or otherwise becoming available to the trustees. This would create an additional compliance burden for HWT plan administrators, with a high level of tax risk should the ELHT be found to be in breach of the 25%/75% requirement.[10]

Rights of Key Employees Are Not More Advantageous

In addition to meeting the 25%/75% rules, for a plan to qualify as an ELHT the rights under the trust of each key employee of a participating employer cannot be more "advantageous" than the rights of a class of beneficiaries described in paragraph (e).[11] There is significant concern that this provision will disqualify an existing HWT as an ELHT even where the 25%/75% rule is satisfied.

Consider the following example involving a multi-employer HWT established for a specific service sector.

> Class A - All senior management including key employees (6 members of which 3 are key employees) - Funding benefit of $10,000 per year
> Class B - All remaining management staff (12 members) – Funding benefit of $6,000 per year
> Class C - All other staff (60 members) – Funding benefit of $2,500 per year

As can be seen from this example, it would appear that the 25%/75% rule has been satisfied by the employee composition of both Class B and Class C. However, the CRA could take the view that the "rights" of the key employees in Class A are more "advantageous" than those for employees in Classes B/C and therefore the plan could not qualify for an ELHT. To qualify, the benefits for key employees (which in this example are competitive with benefits offered to senior management at larger employers) would need to be significantly reduced, or alternatively, they would need to be excluded from the plan.

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[10] Proposed subparagraph 144.1(3) does not create an exception to the requirement that the trust be operated at all times throughout a year in accordance with the requirement of subsection 144.1(2) where there is a breach under paragraph 144.1(2)(e). As a result, where a breach occurs the ELHT would be denied a deduction under subsection 104(6) of the Act for that particular taxation year, indirectly affecting all employers under the plan.
[11] Paragraph 144.1(2)(f).

It is highly unlikely that the employers participating in this HWT would want to convert the HWT into an ELHT under these conditions.

Key Employees - $2,500 Limit on PHSP Costs

BIA 2021 No.1 includes another provision that will permit a plan to qualify as an ELHT even though the trust does not satisfy the 25%/75% rule. Under this provision the plan may qualify as an ELHT where the total cost of PHSP benefits for each key employee or a family member in respect of the year does not exceed $2,500.[12]

The Explanatory Notes released with BIA 2021 No. 1 describe the change as follows:

> Alternatively, if an ELHT restricts the annual cost of private health services plan benefits payable to each key employee and to each family member to no more than $2,500 (prorated if the key employee did not work full-time throughout the year), then *there are no limits on the number of key employees (including non-arm's length employees) that may participate under the ELHT*. *The $2,500 is a limit for each family member but it is applied on a group basis*. As such, any unused portion of the maximum $2,500 limit provided in respect of the key employee or any particular member of their family may be used to provide additional benefits to any other eligible member of the family in respect of which the $2,500 limit is exceeded.

This is a welcome change from the November 2020 legislation, which appeared to prevent the sharing of the $2,500 funding amount per plan beneficiaries between members of a family. As well, we understand from discussions with Finance Canada officials that where an ELHT satisfies the $2,500 funding limit, the ELHT can also provide other designated employee benefits to key employees and family members.

However, it is unclear whether the provisions of paragraph 144.1(2)(f), which requires that the rights of each key employee are not more advantageous than the rights of a class of beneficiaries described in paragraph (e), have any application to an ELHT that qualifies under new subparagraph 144.1(2)(e)(ii) and we would appreciate your views on this.

It also needs to be recognized that costs associated with medical and dental care typically increase each year, often at a rate which exceeds the rate of inflation. We therefore recommend that the $2,500 limit be annually indexed to changes in the Consumer Price Index (similar to other indexed tax credits) to ensure this limit keeps pace with inflationary increases in medical costs.[13]

Extension of CRA Administrative Rules for HWTs

Finally, we would like to acknowledge and thank Finance Canada and the CRA for extending the administrative rules governing existing HWTs to the end of 2021. This has been very helpful to both

[12] Proposed subparagraph 144.1(2)(e)(ii).

[13] We would also note that the PHSP deduction limits specified in section 20.01 have not been updated since this provision was enacted in 1998.

employers participating in HWTs and plan administrators, particularly during these difficult times for business owners.

However, given the continuing financial stress and demands that the pandemic is placing on all business owners, as well as the potentially negative tax impact if an employer fails to modify an existing HWT before the end of the 2021, we hope that Finance Canada would be supportive of a further extension in the CRA's administrative position relating to existing HWTs to the end of 2022.

Thank you for considering our submission and we look forward to having further dialogue with Finance Canada on the issues of and questions raised in this submission.

Yours truly,

Barry Pascal
Chair, Board of Directors

Guy Legault
President & CEO

cc. Andrew Donelle, Department of Finance