June 29, 2018

The Honourable Bill Morneau P.C., M.P.
Minister of Finance
Finance Canada
90 Elgin Street
Ottawa, ON K1A 0G5

Via Email: HWT-consultationFSBE@canada.ca

Dear Minister Morneau:

Re: Budget 2018 – Conversion of Health and Welfare Trusts to Employee Life and Health Trusts

We are writing on behalf of the Conference for Advanced Life Underwriting ("CALU"). CALU is a national professional membership association of established financial advisors (life insurance, wealth management and employee benefits), and accounting, legal, tax and actuarial professionals. For over 25 years CALU has engaged in public policy advocacy on behalf of its members, and its sister organization, Advocis. Through these efforts, CALU represents the interests of more than 13,000 insurance and financial advisors. The members of our two organizations provide financial, tax and estate planning advice to millions of Canadians from all walks of life and across a broad economic spectrum, including shareholders of private corporations.

In the 2018 federal budget (Budget 2018), the federal government indicated that the Canada Revenue Agency (CRA) would no longer extend their administrative position to Health and Welfare Trusts ("HWTs") created after February 27, 2018 (the budget day). If a trust purporting to be a HWT Trust is created after the budget day it will be subject to the normal rules applicable to inter vivos trusts.

Budget 2018 further indicated that HWTs in existence on the budget day would, by the end of 2020, need to be converted to Employee Life and Health Trusts ("ELHT") or wound-up. Otherwise, starting in 2021, an HWT would be treated as a regular inter vivos trust for tax purposes.

CALU is writing to provide our comments on the implications of the loss of HWTs in terms of providing health and welfare benefits to owners of private corporations and their employees.

Background

The ELHT rules were introduced in the 2010 federal budget, effective for 2009 and future years. In April 2010 CALU made a submission to the Department of Finance ("Finance Canada") on the proposed rules governing ELHTs, a copy of which is attached (the "original submission"). In the original submission we outlined our understanding of the rationale for the introduction of ELHTs, the main differences in the tax rules governing ELHTs and the CRA's administrative guidance for HWTs, and our concerns should the CRA withdraw its guidance on HWTs due to the introduction and enactment of the ELHT rules.[1]

[1] Many of our comments in the original submission relating to the use of ELHTs by small businesses continue to be relevant in today's environment and will be highlighted in this submission.

In follow-up discussions between CALU and Finance Canada on the draft ELHT rules and their impact on small employers, Finance Canada indicated that the ELHT legislation was designed primarily to deal with the potential financial insolvency of several large public companies. The goal of the ELHT legislation was to create a workable set of rules that would allow these large employers to establish funded and trusteed employee benefit programs to protect current and retired employees. While Finance Canada contemplated that smaller employers may also want to establish ELHTs, this was not the intended focus of the legislation. In fact, the ELHT rules ensured that such plans could not be established primarily for the benefit of shareholder-employees, family members and highly paid employees.

As a result, since 2010 employers have had the choice of setting up a trusteed employee health and welfare benefit plan as either a HWT or ELHT, assuming the applicable criteria and conditions could be met.[2] Many of the HWTs established for employees of small businesses, which we estimate to number in the thousands, will not qualify as ELHTs and therefore will need to be wound-up. This may have an adverse impact on the level and types of benefits available to their employees. For other small business owners, while their HWT may qualify for conversion to an ELHT, the employer will need to assume the costs associated with the conversion of the trust as well as the additional administration and compliance requirements under the ELHT rules.

Overview – Trusteed Health and Welfare Benefit Programs

Both HWTs and ELHTs are trusteed programs designed to deliver the following types of benefits:

- Group sickness and accident insurance benefits offered under group sickness and accident insurance plans (GSAIPs)[3]
- Benefits offered under a Private Health Services Plan (PHSP)[4]
- Group term life insurance plan benefits (GTLI plans)[5]

Employers, large and small, use HWTs and ELHTs for the following reasons:

- To obtain independent and often professional support for the administration of employee benefits;
- To ensure compliance with all regulatory and tax reporting obligations;
- To self-insure certain benefits (for example, disability or medical care expenses) where insurance coverage is not available[6], or costs are prohibitive, while managing the risks associated with self-insurance;

---

[2] Interpretation Bulletin IT-85R2 was updated by Income Tax Folio S2-F1-C1, Health and Welfare Trusts, effective November 28, 2015 (the “Folio”).

[3] The term GSAIP is not defined in the Income Tax Act (Canada) (the “Act”). In paragraph 1.4 of the Folio a GSAIP is described as an “arrangement between an employer and employees which provides for the payment of benefits (periodic or lump sum) to an employee who suffers a loss as a result of sickness, maternity or accident”. This would typically include short and long-term disability; long term care and critical illness plans (whether group or individual policies included in a “common plan”). The Folio also indicates that a GSAIP must have at least two employee plan members.

[4] Defined in subsection 248(1) of the Act to include (a) a contract of insurance in respect of hospital expenses, medical expenses or any combination of such expenses, or (b) a medical care insurance plan or hospital care insurance plan or any combination of such plans.

[5] Defined in subsection 248(1) of the Act as a group life insurance policy under which the only amounts payable by the insurer are (a) amounts payable on death or disability of individuals whose lives are insured in respect of, in the course of, or because of their office or employment or former office or employment, and (b) policy dividends or experience rating refunds. Paragraph 1.7 of the Folio indicates that a group term life insurance policy cannot be self-funded and must provide coverage to two or more employees.

[6] For example, because the employee group is not large enough to qualify for group coverage or an employee is not insurable under an individual policy.

- To keep assets that are funding benefits separate from the employer's assets, thereby protecting them from the employer's creditors, and preserving those funds for the benefit of employees;
- To support multi-employer industry benefit plans (often administered by unions); and
- To centralize service for separate benefit coverages which may be offered by different providers, individual vs. group policies or through self-insurance.

Employers may generally deduct their contributions to each of these plans. The tax treatment of employer contributions for employees varies, depending on the plan:

- Employer contributions to a GTLI plan are taxable to employees.
- Employer contributions to a GSAIP are taxable to employees if the insurance benefits paid from the plan are tax-free. This generally makes employer contributions to critical illness insurance (CII) and income style long term care insurance (LTCI) plans taxable, while exempting from tax employer contributions to disability income insurance (DII) plans (except in Quebec for provincial income tax purposes).
- Employer contributions to a PHSP are tax-free to employees (except in Quebec for provincial income tax purposes).

Insurance benefits paid from such plans to the employee or their dependents are usually tax-free, except DII plan benefits paid on a periodic basis, where the employer has contributed to the plan.[7] Often, employees will pay their own premiums to a DII plan so that they can receive the insurance benefits tax-free.

Impact on the Termination of HWTs on Small Business Owners

CALU believes small business owner-employees and their key employees should have access to health and welfare benefits comparable to those available to similarly remunerated employees in larger private and public companies, with comparable tax treatment for the employer and employees. In other words, the provisions of the Act as well as CRA administrative policies should not prevent the delivery of tax-effective GSAIP and/or PHSP benefits to employees of small businesses simply because they are highly paid and/or have an ownership interest in the business.

On the other hand, we also recognize there must be rules in place to ensure that owner-employees and highly paid employees are not entitled to tax supported health and welfare benefits that are not available to other employees in comparable circumstances.

With this perspective in mind, the ELHT vehicle would not be suitable for many small businesses for the following reasons:

1. The "key employee" restrictions in section 144.1 of the Act would prevent the use of an ELHT in most family businesses or in those businesses where a significant percentage of employees are earning in excess of five times the Year's Maximum Pensionable Earnings in any two of the preceding five tax years.[8]
2. Even if the key employee restrictions can be satisfied, there are a number of provisions in subsection 144.1(2) of the Act which are designed to ensure that an ELHT is not used to provide rights that are "more advantageous" for key employees. As noted in our original submission,[9] we believe this provision could impact the ability of smaller employers to attract and retain employees with special

[7] Paragraph 6(1)(f) of the Act.

[8] As defined in section 18 of the Canada Pension Plan. Please also refer to page 7-10 of the original submission for a more detailed discussion of these concerns.

[9] See page 8.

management or technical skills or could lead to increased costs if the employer has to design an alternative benefit program for these employees. As well, owner-employees may be subject to "reverse discrimination" as their level of benefits will be lower than what a comparably skilled and paid executive might be entitled to with a larger private or public company.

3. Costs of administration - Leaving aside the costs of converting a HWT to an ELHT, there will be additional costs of running an ELHT in relation to a HWT for small business owners. For example, it may be necessary to appoint an outside trustee to comply with paragraph 144.1(2)(i) of the Act (due to the prohibition on representatives of the employer constituting a majority of the trustees or otherwise controlling the trust). The trustees must also review the constitution of the plan on a regular basis as employees are hired or depart to ensure the requirements of paragraph 144.1(2)(e) continue to be satisfied (limitations on the proportion of key employees who can be beneficiaries of the trust).
4. Small businesses also bear a heavy compliance burden under the ELHT rules. If at any time during the year an ELHT fails to satisfy the requirements in subsection 144.1(2), then paragraph 144.1(3)(a) denies the employer's right to deductions under subsection 104(6). Even a temporary, quickly remedied failure results in the loss of deductions for the entire year. Small businesses can be especially vulnerable to this risk because small changes in the composition of their workforces can easily push them offside.
5. There is also the ongoing risk that the ELHT may lose its status for violations of subsection 144.1(2), resulting in adverse tax consequences for both the employer and employees.

For these reasons, small business owners will either not be able to convert their HWT to an ELHT or will not find the ELHT rules accommodating in terms of ensuring the delivery of health and welfare benefits to their employees on a cost and/or tax-effective basis. This in turn will hamper the ability of owner-managed businesses and certain other small businesses from providing GSAIP and PHSP benefits to their employees.

Other Concerns for Small Business Owners – CRA Interpretations re PHSPs

The CRA has provided its views on PHSPs in archived Interpretation Bulletin IT-339R2[10] ("IT-339R2) as well as a number of more recent technical interpretations. In particular, the CRA has stated that a PSHP must be a plan in the nature of insurance. The insurance requirement is clearly met if a contract of insurance is purchased from an insurance company to provide the required benefits.[11]

IT-339R2 also indicates that a PHSP may be "self-insured" provided certain requirements are met:

> An arrangement where an employer reimburses its employees for the cost of medical or hospital care may come within the definition of private health services plan. This occurs where the employer is obligated under the employment contract to reimburse such expenses incurred by the employees or their dependants. The consideration given by the employee is considered to be the employee's covenants as found in the collective agreement or in the contract of service.[12]

The CRA also indicated in IT-339R2 that a "cost-plus" plan[13] can qualify as a PHSP where the reimbursed expenses fall within the types of benefit that can be provided by a PHSP.

---

[10] "Meaning of Private Health Services Plans" dated August 8, 1989.
[11] Paragraph 8 of IT-339R2 specifically references health and dental plans offered by insurance companies as qualifying as PHSPs.
[12] Supra note 9, paragraph 7.
[13] Under such plans an employer contracts with a third party (including an insurance company) to indemnify an employee's claims for specified risks under the plan. In turn, the employer reimburses the plan provider for the cost of employee claims plus an administrative fee.

On the other hand, the CRA has stated that a cost-plus plan designed to reimburse the only employee-shareholder and his or her family members for health benefits that would normally fall within the definition of a PHSP wouldn't qualify, as such a plan did not contain the necessary elements of insurance. In particular the CRA noted:

> Effectively, the sole employee-shareholder is paying for the personal hospital and medical expenses for himself or herself and his or her household members through his or her sole-owned corporation without any risks being assumed by the Plan administrator.[14]

We are concerned that this interpretation would also extend to family owned businesses, where all the employees are family members. This further perpetuates "reverse discrimination" in terms of the delivery of health and welfare benefits within the small business environment in relation to employees of larger private and public corporations.

In Summary

CALU is of the view that HWTs are important in the delivery of GSAIP and PHSP benefits to employees of small businesses on a tax and cost-effective basis. For the reasons discussed above, many small businesses won't be able to convert their HWTs to ELHTs to gain the same benefits. As well, CRA interpretations relating to PHSPs make it difficult for certain small businesses to use "cost-plus" arrangements or self-fund benefits in lieu of purchasing more expensive individual health insurance plans.

We therefore recommend that as part of the process of establishing a workable framework for transitioning HWTs to ELHTs, that a review of the tax rules and CRA administrative practices relating to small business owners be undertaken to ensure that family operated businesses, as well as those who rely on highly paid employees, are not adversely affected.

CALU is committed to ongoing dialogue with Department of Finance and the Minister's office to ensure that the tax system is fair and equitable for all taxpayers, including the shareholders of private corporations.

Yours truly,

Marty McConnell
Chair

Guy Legault
President

cc. Ben Chin, Chief of Staff, Office of the Minister of Finance (ben.chin@canada.ca)
Dev Saxena, Senior Policy Advisor, Office of the Minister of Finance (dev.saxena@canada.ca)
Andrew Donelle, Director, Deferred Income Plans, Finance Canada (andrew.donelle@canada.ca)

[14] CRA Technical Interpretation #2014-0521301E5.