



August 12, 2019

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

*By email: [hwt-consultation-fsbe@canada.ca](mailto:hwt-consultation-fsbe@canada.ca)*

Dear Sirs:

**Re: Draft Legislation — Conversion of Health and Welfare Trusts — Released May 27, 2019**

The Conference for Advanced Life Underwriting (“CALU”) is pleased to have this opportunity to provide its feedback to the Department of Finance (“Finance Canada”) on the draft legislative proposals released on May 27, 2019, that are designed to facilitate the conversion of Health and Welfare Trusts (“HWTs”) to Employee Life and Health Trusts (“ELHTs”) (the “legislative proposals”). CALU is the only national professional organization dedicated to advanced planning issues related to life underwriting, tax planning and wealth management. CALU’s 665 industry leading members include insurance and financial advisors as well as accounting, tax, legal and actuarial experts. Through a strategic partnership with Advocis, we advocate on behalf of more than 13,000 advisors in support of fair and competitive public policies to grow and preserve the financial well-being of Canadian family businesses.

In this submission CALU will specifically comment on the legislative proposals that will treat an HWT as an employee benefit plan (EBP) where an HWT is not wound up or converted to an ELHT by the end of 2020, other issues to be considered as noted in the Backgrounder released with the draft legislation and the proposed timing for HWTs to be wound up or converted to ELHTs.

**Background**

Small business owners have used HWTs for many years as a vehicle for corporate employers to provide certain health and welfare benefits to employees (including shareholder/employees). Budget 2018 originally proposed that, by the end of 2020, existing HWTs would need to be wound-up or converted to an Employee Life and Health Trust (ELHT). Otherwise, any HWT that continued to exist after 2020 would no longer benefit from the special administrative tax treatment provided by the Canada Revenue Agency (“CRA”) and instead would be treated as an ordinary *inter vivos* trust.



CALU noted in a prior submission to the Minister of Finance<sup>1</sup> that the rules governing ELHTs made them unsuitable for many small businesses, with the result that most small business owners would be forced to wind up their HWTs. We further expressed concerns that this change, combined with CRA technical interpretations relating the HWTs, would make it difficult for small business owners to offer certain health and welfare benefits to its employees on a similar tax basis as those applicable to employees of larger employers. We recommended that the existing ELHT rules be modified prior to the end of 2020 to accommodate benefit plans offered to employees of small businesses. In turn, this would assist small businesses in attracting and retaining qualified employees who are required for their profitable growth and expansion.

The legislative proposals have identified a new approach which small business owners might consider in place of winding-up an existing HWT. That is, an existing HWT which remains in effect after 2020 would be treated as an employee benefit plan (EBP). This tax treatment might be acceptable to a number of small businesses, provided that certain questions and issues are addressed in a favourable manner by Finance Canada and/or the CRA.

### **Conversion of an HWT to an EBP**

Legislation relating to EBPs has been in place since the early 1980s. While drafted broadly, the original intent of the legislation was to deal with the growth in the number of unregistered pension plans under which the employer was permitted to claim a current deduction for contributions to the plan, while taxation of such contributions on behalf of plan members were deferred until pension benefits were received by those members.

The existing rules in the Income Tax Act (Canada)<sup>2</sup> relating to EBPs are designed to match the employer's deduction of contributions with the inclusion of plan benefits in the employee's income.<sup>3</sup> As well, special rules govern the tax treatment of income and capital distributions by a trust to plan beneficiaries (including the employer). However, the existing definition of an EBP and other provisions of the Act specifically carve out any portion of the arrangement that is a plan which provides group sickness or accident benefits, including any such plan provided through an HWT.

The draft legislation will modify the definition of EBP to eliminate the exemption for any trusted plan that offers a group sickness and accident insurance plan, group term insurance plan or private health services plan, effective for 2021. Thus, an existing HWT that is not wound-up or converted by the end of 2020 will become an EBP. However, the tax treatment of designated employee

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<sup>1</sup> Dated June 29, 2018.

<sup>2</sup> Herein referred to as the "Act". Unless otherwise specified, all statutory references are to the Act.

<sup>3</sup> An EBP is defined in section 248(1). Section 32.1 governs the deduction of employer contributions to an EBP. Employee benefits are taxable under paragraph 6(1)(g). Various other provisions govern the taxation of EBP income. The CRA's interpretation of the tax rules governing EBPs is set out in Interpretation Bulletin IT-502 dated March 28, 1985.

benefits<sup>4</sup> received by EBP members will continue to be similar to having received those benefits under an HWT.<sup>5</sup>

While it appears that the overall tax treatment of an EBP is preferable to an HWT being treated as an ordinary *inter vivos* trust, a number of questions arise for those employers who may contemplate this as an alternative to winding-up an existing HWT. We have set out some of our preliminary questions in Schedule A, and we look forward to your response to those questions.

We also believe there may continue to be issues with the application of the EBP rules to trustee plans that are established primarily for the benefit of employees who are also shareholders of the employer, which as noted below, will need to be addressed as part of the transitional process.

### **Other Issues to be Addressed**

In the Backgrounder to the draft legislation Finance Canada indicates it is also considering a range of other issues identified in submissions by taxpayers. CALU is very supportive of Finance Canada's ongoing review and consultation, particularly for the following issues:

- Clarifying what types of benefits qualify under the definition of designated employee benefits and possibly modifying this definition to include other “wellness” types of benefits;
- Expanding the scope of the private health services plan component of designated employee benefits to accommodate owner managers; and
- Reviewing the use of ELHTs to provide benefits to “key employees”<sup>6</sup> including the use of self-insured arrangements. For example, there may be merit to having the key employee definition determined at a plan level rather than at the employer level, which might facilitate the development of multi-employer plans for certain sectors of the small business community.

We would be pleased to continue our discussions with Finance Canada on these important issues.

### **Extension of the Transitional Period**

The draft legislation recognizes that unionized employers who offer HWTs may require additional time to negotiate and amend the terms of their plans to comply with the ELHT rules. Thus, new provisions will deem an existing HWT to be an ELHT until December 31, 2022, provided certain conditions are met.<sup>7</sup>

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<sup>4</sup> Defined in subsection 144.1(1) to include a group sickness or accident insurance plan, a group term insurance plan or a private health services plan.

<sup>5</sup> Subparagraph 6(1)(g)(iv).

<sup>6</sup> Defined in subsection 144.1(1).

<sup>7</sup> Draft subsections 144.1(14) and (15).

We are of the view that similar considerations apply to small business owners, given the number of complex decisions that must be made relating to existing HWTs. For example, employers will need to determine if their current HWT can be modified to comply with the ELHT rules, and if it can, whether this would be the most cost-effective approach to replace the existing plan. This will require going “out to market” to determine if the current benefit plan can be effectively replaced by one or more plans offered by insurance carriers, or if an EBP model might be preferred.

These decisions are further complicated by the number of outstanding questions and issues relating ELHTs, EBPs and private health services plans, and the fact that final legislation may be delayed by the fall election and related post-election government activity. We would therefore recommend that the effective date of all tax changes relating to existing HWTs be deferred until the end of 2021.

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

Yours truly,

Roger Sinclair  
Chair

Guy Legault  
President & CEO

cc. Andrew Donelle, Department of Finance  
Lori Merrigan, Department of Finance  
Robert McCullagh, Chair, CALU HWT Task Force  
Kevin Wark, Tax Advisor, CALU

**Schedule A to CALU's Submission to Finance Canada on HWTs**  
**Questions Relating to Transitioning and HWT to an EBB**

1. Please confirm that where an HWT remains in effect after 2020 and becomes an EBP, this does not result in a deemed disposition of the assets in the trust or any immediate taxation to the employer or plan members.
2. The terms of an HWT do not permit distributions to an employer. However, an EBP is permitted to make distributions to an employer. Can you confirm that if an HWT remains in effect after 2020, its terms can be modified to permit distributions to an employer, and such distributions will be subject to the current tax rules in paragraph 12(1)(n.1)?
3. Please confirm the difference between a plan with a custodian and a plan with a trustee for purposes of the EBP rules. We note there is a reference in paragraph 26 of IT-502 which indicates that a custodian is taxable on the plan income. Can you clarify the basis for imposing tax on the custodian if it is not acting as trustee?
4. Please confirm the following general tax consequences of having a trustee EBP (based on the revised definition of EBP)?
  - a. *Employees* – benefits received in relation to a GSAIP, group term plan or a PHSP will be taxed in a similar manner as benefits received under a HWT. However, any benefits that don't fall under these categories (or other exclusions) will be taxed as received. Employees may make contributions to an EBP but such contributions are not deductible. Conversely, distributions to an employee from employee contributions are not taxable.
  - b. *Employer* – the employer will be able to deduct contributions when benefits are received by the employee (such benefits do not need to be taxable to the employee). However, deductions are deferred where benefits are funded by trust income or employee contributions. Payments from an EBP to the employer may be taxable under paragraph 12(1)(n.1).
  - c. *The Trust* – it will be subject to tax at the top marginal rate. It is not taxed on contributions. It can deduct the current year's income that is distributed to the employer or employee. Income that is retained (and taxed to the trust) may be taxed again to the employer or employee when it is distributed in a future tax year.
5. Can CRA's comment on the tax treatment of "cost plus" arrangements for owner/managers and key employees which are funded through an EBP?