



# Special Notice

21 June 2019

## Department of Finance Releases Draft Legislative Proposals Supporting the Conversion of Health and Welfare Trusts

**O**n [May 27, 2019](#), the Department of Finance (Finance) released draft legislative proposals to support the conversion of Health and Welfare Trusts (HWTs) established by Canadian plan sponsors into Employee Life and Health Trusts (ELHTs). The measures are intended to simplify the tax rules surrounding employee trusts to provide “greater certainty and consistency to taxpayers.”

This *Special Notice* analyzes the proposed draft legislation, and its impact for plan sponsors and their employees or members.



## Background

HWTs and ELHTs are trusts established by benefits plan sponsors for the purpose of providing specific health and welfare benefits to their employees or members. The tax treatment for HWTs is not explicitly set out in the Federal *Income Tax Act*. However, in 2010 the *Income Tax Act* was amended to explicitly set out the tax treatment of certain elements of ELHTs, including the treatment of surplus and the pre-funding of benefits. The Canada Revenue Agency has published several administrative positions, including the *Income Tax Folio S2-F1-C1* regarding the requirements for qualifying as an HWT that often mirror the specific tax treatments for ELHTs, but these requirements have never been codified in the *Income Tax Act*, which has caused confusion for plan sponsors and other stakeholders.

In the 2018 Federal Budget, to provide greater certainty and consistency in the tax treatment of HWTs and ELHTs, the government proposed changes to the *Income Tax Act* to ensure that a single set of rules applies to both. The changes included proposed transitional administrative guidance for winding up existing HWTs, as well as additional rules to facilitate the conversion of HWTs to ELHTs.

Stakeholders were invited to submit comments on:

- Whether an HWT can continue as an ELHT without the creation of a new trust;
- Whether, and under what conditions, a rollover of assets to a new trust will be permitted; and
- The tax implications for an HWT that does not satisfy the conditions to become an ELHT, or where the trustees of an HWT choose not to convert.

A number of stakeholders proposed a simple conversion process, and recommended additional clarification on multiple issues relating to existing ELHTs rules, such as permissible benefits and eligible employees/members. Given this stakeholder input, the government has now proposed changes to the *Income Tax Act* under two distinct categories:

- Amendments to facilitate the conversion of existing HWTs into ELHTs; and
- Amendments to improve the operation of ELHT rules.

## Amendments to Facilitate the Conversion of HWTs to ELHTs

Proposed measures to facilitate the conversion include:

- Extending the rules governing ELHTs to apply to trusts created prior to 2010;
- Allowing existing HWTs to elect to continue as ELHTs without adverse tax implications, or having to create a new trust;
- Introducing transitional rules to permit HWTs to be deemed ELHTs until December 31, 2022, if certain conditions are met, to allow current HWTs to amend the terms of their trust agreement; and
- Introducing transitional rules to provide for a tax-free rollover of assets where a new trust is created, or where two or more existing trusts merge so assets accumulated in existing HWTs continue to be available to provide benefits to plan beneficiaries.



## Amendments to Improve the Existing ELHT Rules

Proposed changes to improve the operation of existing ELHT rules include:

- Allowing trusts to deduct certain amounts for benefits provided to individuals other than eligible beneficiaries, including self-employed contractors, when determining the trust's taxable income for the year. The proposed amendment will allow the deductions if it is reasonable to conclude that the trustees "neither knew nor ought to have known" that designated employee benefits were provided to non-eligible beneficiaries, or contributions were made in respect of the same;
- Introducing a rule that would impose a tax on a portion of investments or loans made that constitute prohibited investments or loans to a participating employer, or a person with whom the participating employer does not deal at arm's length, rather than declaring the ELHT invalid;
- Requiring that a majority of the ELHT trustees deal at arm's length with participating employers, rather than requiring that employer representatives not constitute a majority of the trustees or otherwise control the trust;
- Removing the existing multi-employer test respecting the deductibility of employers' contributions to an ELHT, where contributions are required by a collective bargaining agreement;
- Allowing certain non-resident trusts that meet the relevant conditions to qualify as an ELHT.

## Health and Welfare Trusts after 2020

The definition of an "employee benefit plan" pursuant to section 248(1) of the *Income Tax Act* will be amended to clarify that a trust that does not convert to an ELHT or wind up by the end of 2020, but still provides designated employee benefits, will be considered an "employee benefit plan." Designated employee benefits provided to an employee under an employee benefit plan will be taxed in the manner as if the benefits were provided through an ELHT, but may be subject to different requirements with respect to the timing of employer deductions for contributions made in respect of the plan.

## Other Issues Under Consideration

Finance has acknowledged that there are other issues identified in submissions from stakeholders in 2018 that remain under consideration, including items not addressed in the draft legislative proposals. They include:

- What types of benefits are currently considered as "designated employee benefits" under an ELHT, and whether other benefits should be considered;
- Expanding the scope of the Private Health Services Plan component of designated employee benefits;
- Determining the use of ELHT rules to provide benefits to "key employees," as defined by subsection 144.1(1) of the *Income Tax Act*, including the use of self-insured arrangements; and
- Determining the rules related to the carry back and carry forward of non-capital losses under ELHTs.



## Impact

The proposed amendments are a welcome change that confirms a straightforward conversion process with no adverse tax implications. In addition, the transitional measures provide an extension for plan sponsors to make necessary changes to their trust agreements and benefit offerings, to ensure that their plans meet the full ELHT requirements.

The implementation of these amendments will provide a degree of continuity regarding the tax treatment of HWTs and ELHTs, and lessen the uncertainty that plan sponsors often experience when determining what taxation rules need to be followed for existing plans. This uncertainty has led to numerous Canada Revenue Agency interpretation bulletins attempting to codify any number of scenarios presented by interested parties about HWTs versus ELHTs.

Interested stakeholders are invited to submit comments to the Department of Finance by July 31, 2019. Based on the comments received, it is anticipated the government would introduce amendments to the *Income Tax Act* as soon as is practicable.

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