Preface

These explanatory notes describe proposed amendments to the *Income Tax Act*. These explanatory notes describe the proposed amendments, clause by clause, for the assistance of Members of Parliament, taxpayers and their professional advisors.

The Honourable William Francis Morneau, P.C., M.P.
Minister of Finance

These notes are intended for information purposes only and should not be construed as an official interpretation of the provisions they describe.

Department of Finance Canada   Ministère des Finances Canada

Clause 1

Employee Life and Health Trust

ITA
144.1(2)

Subsection 144.1(2) of the *Income Tax Act* (the "Act") sets out the conditions that must govern a trust throughout a taxation year in order for the trust to qualify as an employee life and health trust. Subsection 144.1(2) is amended in a number of respects.

Paragraph (c) requires that a trust governing an employee life and health trust must be resident in Canada. It is amended to permit the trust to be resident outside of Canada if it meets the conditions set out as clauses (A) to (C) in new subparagraph (ii). Specifically, if an employee life and health trust provides designated employee benefits to both residents and non-residents of Canada and if at least one participating employer is resident outside of Canada, then the trust may be resident in a country in which a participating employer resides.

Paragraph (d) requires that the trust have no beneficiaries other than persons each of whom is an employee of a participating employer, an employee's spouse or common law partner, a member of the employee's household who is related to the employee, another employee life and health trust or Her Majesty in right of Canada or a province. This paragraph is amended to include a reference to former employers, which is intended to ensure that where an employer no longer contributes to the trust and the employer previously participated in the plan, retirees and former employees of that employer can still receive designated employee benefits.

Paragraph (h) requires that the trust not make a loan to, or an investment in, a participating employer (or a person not dealing at arm's length with a participating employer). Where this occurs, the trust will be precluded from any deductions provided for under subsection 104(6) for any taxation year in which the condition is not met. If a trustee inadvertently acquires an investment in an entity that did not deal at arm's length with a participating employer, the tax consequences could be inequitable where the value of the prohibited investment represents a small fraction of the total trust capital.

Accordingly, paragraph (h) is repealed and new Part XI.5 is added to the Act to impose a tax on the value of a prohibited investment acquired by an employee life and health trust.

For more information, see the commentary on new Part XI.5 of the Act.

Paragraph (i) requires that employer representatives do not constitute a majority of the trustees of the trust (or otherwise control it). It is amended to replace this condition with the requirement that a majority of trustees must deal at arm's length with each participating employer.

Breach of terms

ITA
144.1(3)

Paragraph 144.1(3)(a) of the Act stipulates that an employee life and health trust that, in a taxation year, breaches the terms required to govern the trust under subsection 144.1(2) may not deduct any amount pursuant to subsection 104(6) for that taxation year.

Paragraph 144.1(3)(a) is amended to provide an exception to the condition that the trust must be operated at all times throughout a year in accordance with the requirements in subsection 144.1(2). Specifically, an employee life and health trust will not be considered to have breached its terms where the trustees could not reasonably have known about the participation of beneficiaries other than those described in subparagraphs 144.1(2)(d)(i) or (ii) (*i.e.*, beneficiaries other than employees or their family members).

For example, in the case of a plan with many participating employers where benefits are provided under a negotiated collective agreement, if it reasonable to conclude that the trustees could not reasonably have known about the participation of certain non-employee contractors who are members of the union, the participation of the contractors may not necessarily result in a breach of the terms that govern the plan.

Deductibility – collective agreement

ITA
144.1(6)

Subsection 144.1(6) of the Act provides a special rule to accommodate the deductibility of employer contributions to employee life and health trusts that meet certain conditions. This subsection is amended to remove the multi-employer test from the listed conditions. Whether an employee life and health trust is a single-employer or multi-employer arrangement, deductibility is provided for contributions made pursuant to a collective bargaining agreement (or a participation agreement in respect of a collective bargaining agreement) and by reference to number of hours worked (or a similar measure).

Conditions – deemed employee life and health trust

ITA
144.1(14)

New subsection 144.1(14) of the Act provides that a trust that meets certain conditions may be deemed to be an employee life and health trust. Essentially, this deeming provision allows health and welfare trusts that are established under collectively bargained plans, and generally comply with most of the employee life and health trust rules, to be deemed to be an employee life and health trust until such time as the plans are renegotiated and the trust is able to comply with all of the conditions to be an employee life and health trust.

The trust must notify the Minister in prescribed form and manner in order to be a deemed employee life and health trust.

Deemed employee life and health trust

ITA
144.1(15)

New subsection 144.1(15) of the Act provides the consequences of a trust meeting the conditions under new subsection (14). In particular, paragraph (a) provides that a trust meeting those conditions will qualify as a deemed employee life and health trust until the earliest of the effective date of the next collective bargaining agreement enacted after the Announcement Date, the end of 2022, the day that the trust satisfies all of the conditions to be an employee life and health trust and the day that the trust no longer meets the condition that all or substantially all of the employee benefits provided by the trust are designated employee benefits.

Budget 2018 announced that the Canada Revenue Agency will no longer apply its administrative guidelines for health and welfare trusts after 2020. Paragraph 144.1(15)(a) effectively provides an extended period (as late as the end of 2022) for collectively-bargained health and welfare trusts described in subsection 144.1(14) to transition to the rules in section 144.1 of the Act that apply to employee life and health trusts.

Paragraph (b) provides that where a trust is deemed to be an employee life and health trust because it meets the conditions in subsection 144.1(14), then paragraph 144.1(3)(a) does not apply. Accordingly, a trust that is deemed to be an employee life and health trust, but does not satisfy (for a limited period of time) conditions set out in subsection 144.1(2), is not prevented from deducting certain amounts under subsection 104(6) including the deduction of non-capital losses.

Trust-to-trust transfer

ITA
144.1(16)

New subsection 144.1(16) of the Act permits the transfer of property on a tax-deferred basis, where the Minister has been notified in prescribed form, from a trust that provides employee benefits substantially all of which are designated employee benefits to an employee life and health trust or to another trust that provides employee benefits substantially all of which are designated employee benefits. This is to permit the merger of one or more “health and welfare trusts” that choose to continue as an employee life and health trust.

Where this provision applies, each property transferred is deemed to be transferred to the receiving trust for an amount equal to the cost amount of the property to the transferor trust immediately before the time of the transfer.

Deductibility of transferred property

ITA
144.1(17)

New subsection 144.1(17) of the Act provides that for the purpose of the transition from a health and welfare trust to an employee life and health trust, any transfers of property are considered to not be a contribution to the receiving trust in respect of subsections 144.1(4) to (6) and are not deductible by any participating employer.

These amendments apply as of February 27, 2018.

Clause 2

Tax in Respect of Employee Life and Health Trusts

ITA
207.9(1)

New Part XI.5 (new section 207.9) of the Act introduces a special tax in respect of the acquisition of prohibited investments (and related income and capital gains) for employee life and health trusts. This special tax is consequential on the repeal of paragraph 144.1(2)(h).

Subsection 207.9(1) contains two definitions that apply for the purposes of Part XI.5. A "participating employer" for the purposes of Part XI.5 means an employer who is required to make contributions to an employee life and health trust in respect of its employees.

A "prohibited investment" for an employee life and health trust includes any of the following:

- A share of the capital stock of, an interest in, or a debt of a participating employer of the employee life and health trust;
- A share of the capital stock of, an interest in, or a debt of a person or partnership that does not deal at arm's length with a participating employer of the employee life and health trust; and
- An interest in, or a right to acquire, property described above.

Subsection 207.9(2) provides that an employee life and health trust is liable to pay tax if the trust acquires property that is a prohibited investment, if income is received or becomes receivable by the trust from a prohibited investment or if the trust has a taxable capital gain from the disposition of a prohibited investment.

New subsection 207.9(3) provides the amount of tax payable under this Part by an employee life and health trust. Where the trust acquires property that is a prohibited investment for the trust, paragraph (a) provides for a tax equal to 50 % of the fair market value of the property at the time it is acquired. Paragraph (b) provides for a tax equal to 50 % of any income from prohibited investments or any taxable capital gains from the disposition of prohibited investments.

Subsection 207.9(4) provides that the trust is entitled to a refund of any tax imposed under subsection (2) if the trust disposes of the property before the end of the calendar year following the calendar year in which the tax arose (or such later time as is permitted by the Minister of National Revenue). However, no refund is available if it is reasonable to expect that the trust knew or ought to have known at the time the property was acquired by the trust that the property was, or would become, a prohibited investment.

Subsection 207.9(5) provides a deemed disposition rule for property that becomes, or ceases to be, a prohibited investment. Subsection 207.9(5) provides that a property held by an employee life and health trust is deemed to have been disposed of immediately before the time that it became, or ceased to be, a prohibited investment for proceeds of disposition equal to the property's fair market value. The trust is also deemed to have reacquired the property for the same amount at the time of its change in status.

These amendments apply to the 2014 and subsequent taxation years.

Clause 3

Definitions - "employee benefit plan"

ITA
248(1)

The definition "employee benefit plan" in subsection 248(1) of the Act is amended consequential on the winding down of the Canada Revenue Agency's administrative guidelines with respect to health and welfare trusts and related amendments made to the employee life and health trust rules in section 144.1. The definition is amended to clarify that a trust that provides designated employee benefits (*e.g.*, private health services plan) but does not meet the conditions to be an employee life and health trust may be considered to be an employee benefit plan.

This amendment will apply as of January 1, 2021, at which time the health and welfare trust guidelines will no longer be applicable.