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 Chrystia Freeland, 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.

Clause 1

Non-capital losses of employee life and health trusts

ITA
111(7.4)

Subsection 111(7.4) of the Income Tax Act (the “Act”) permits a three-year carry-forward and a three-year carry-back period for non-capital losses of an employee life and health trust (ELHT).

The subsection is amended to extend the allowable carry-forward period to seven years.

Clause 2

Definitions – “designated employee benefits”

ITA
144.1(1)

The definition “designated employee benefit” in subsection 144.1(1) of the Act is amended to add two more categories of employee benefits that may be offered through an ELHT.

The first category (new paragraph (d) of the definition) includes any benefit from counselling services described in subparagraph 6(1)(a)(iv). It includes counselling services in respect of the mental or physical health, or the re-employment or retirement of a taxpayer described in paragraph 144.1(2)(d). These benefits are not included in computing the income of the taxpayer.

The second category (new paragraph (e) of the definition) includes a benefit that is not a death benefit as defined in subsection 248(1) but that would be a death benefit if the amounts determined for paragraphs (a) and (b) of that definition were nil. Essentially, it means that the first $10,000 of benefit provided on the death of a taxpayer in respect of that taxpayer’s employment qualifies as a designated employee benefit. This amount is not included in computing the income of the taxpayer.

Employee Life and Health Trust

ITA
144.1(2)

Subsection 144.1(2) of the Act sets out the conditions that must govern a trust throughout a taxation year in order for the trust to qualify as an ELHT. Subsection 144.1(2) is amended in a number of respects.

Paragraph (a) requires that the trust’s purposes be limited to the provision of designated employee benefits, including related activities such as managing investments, administering payments and transferring property to another ELHT. This paragraph is amended such that the purpose of an ELHT must be to provide benefits the total cost of which is all or substantially all attributable to designated employee benefits. This means that an ELHT can offer benefits that are not designated employee benefits as long as all or substantially all of the total cost of the benefits provided are designated employee benefits. Paragraph 144.1(3)(b) restricts benefits that are not designated employee benefits to benefits that may provide a deduction (for contributions) in computing the income of the employer.

Paragraph (c) requires that a trust governing an ELHT 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 ELHT 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 ELHT 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 (e) requires that an ELHT contain at least one class of beneficiaries that represents at least 25% of all of the beneficiaries of the trust who are employees of a participating employer. In addition, at least 75% of the members of the class must not be key employees of the employer. This paragraph is amended such that the 25% and 75% tests no longer apply to each participating employer but now apply globally across all participating employers. For example, an ELHT will not be offside if one of more employers has key employees that exceed 25% of its employees provided that the total number of key employees (of all employers) under the ELHT does not exceed 25% of the total employees (of all employers) under the ELHT.

Paragraph (e) is also amended to relax the restrictions that apply to the participation of key employees. The current condition that at least 75% of the beneficiaries of a class must not be key employees does not apply (i.e., key employees may exceed 25% of the members) if key employees deal at arm's length from their employer and if the contributions made on their behalf are determined under a collective bargaining agreement. Alternatively, if an ELHT restricts the annual cost of private health services plan benefits payable to each key employee and family member – a limit of $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.

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 ELHT.

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 eliminate the reference to employer representatives and to provide that trustees who do not deal at arm's length with one or more participating employer must not constitute a majority of the trustees of the ELHT.

Breach of terms

ITA
144.1(3)

Paragraph 144.1(3)(a) of the Act stipulates that an ELHT 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 an ELHT must be operated at all times throughout a year in accordance with the requirements in subsection 144.1(2). Specifically, an ELHT 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 subparagraph 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.

Paragraph (b) is amended to remove the restriction that an ELHT cannot be operated or maintained primarily for the benefit of one or more key employees or their family members. This amendment is consequential on new conditions added to paragraph 144.1(2)(e) that limit the amount of benefits that can be offered to key employees under the private health services plan portion of an ELHT where the other conditions are not met.

Paragraph (b) is replaced by a restriction that an ELHT may not deduct any amount pursuant to subsection 104(6) for that taxation year if the trust provides any benefits in respect of which the contributions are not deductible in computing the income of an employer in respect of any taxation year. For example, fitness club memberships paid for by an employer for its employees are generally not deductible by the employer in computing its taxable income for the year. If such benefits are provided by an ELHT in a year, the trust would not be eligible to claim deductions under subsection 104(6) for the year.

Deductibility – collectively bargained or similar agreement

ITA
144.1(6)

Subsection 144.1(6) of the Act provides a special rule to accommodate the deductibility of employer contributions to an ELHT that meet certain conditions. This subsection is amended to remove the multi-employer test from the listed conditions. Whether an ELHT is a single-employer or multi-employer arrangement, deductibility is provided for contributions made pursuant to a collective bargaining agreement (or a participation agreement provided that the benefits are substantially the same as under the related collective bargaining agreement) and by reference to number of hours worked (or a similar measure).

Subsection 144.1(6) is also amended to provide for the deductibility of employer contributions to an ELHT if there is a legal requirement under the terms of the trust for each employer to participate, there are a minimum of 50 eligible employee-beneficiaries and each employee deals at arm’s length with each participating employer.

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 ELHT. Essentially, this deeming provision allows health and welfare trusts that are established under collectively bargained plans, and generally comply with most of the ELHT rules, to be deemed to be an ELHT until such time as the plans are renegotiated and the trust is able to comply with all of the conditions to be an ELHT.

A trust must notify the Minister of National Revenue in prescribed form and manner in order to be deemed to be an ELHT.

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 ELHT until the earliest of the end of 2022, the day that the trust satisfies all of the conditions in subsection 144.1(2) to be an ELHT 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 would no longer apply its administrative guidelines for health and welfare trusts after 2020. (This was extended, so that the Canada Revenue Agency would continue to apply its administrative guidelines for these trusts until the end of 2021.) 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 that apply to ELHTs.

Paragraph (b) provides that where a trust is deemed to be an ELHT 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 ELHT, 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 ELHT or to another trust that provides employee benefits substantially all of which are designated employee benefits. This is to permit the effective merger of one or more health and welfare trusts that choose to continue as an ELHT.

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 ELHT, 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.

Requirement to file

ITA
144.1(18)

New subsection 144.1(18) of the Act provides that, unless subsection 144.1(15) or (16) applies, an ELHT must notify the Minister in prescribed form, on or before its first filing-due date after 2021, that it is an ELHT if:

- prior to February 27, 2018 it provided employee benefits substantially all of which are designated employee benefits (*i.e.*, it was a health and welfare trust); and
- after February 26, 2018, it became an employee life and health trust because it satisfies the conditions in subsection 144.1(2).

The combined effect of subsections 144.1(14) to (16) and (18) is to require each health and welfare trust to report to the Canada Revenue Agency that it has converted to an ELHT and is subject to the ELHT rules in section 144.1 of the Act.

The amendments to section 144.1 of the Act apply as of February 27, 2018.

Clause 3

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 ELHTs. 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 provides designated employee benefits for its employees through a trust described in subsection 144.1(2) (*i.e.*, an ELHT).

A “prohibited investment” for an ELHT includes any of the following:

- A share of the capital stock of, an interest in, or a debt of a participating employer of the ELHT;
- 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 ELHT; and
- An interest in, or a right to acquire, property described above.

Subsection 207.9(2) provides that an ELHT 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 ELHT. 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 ELHT 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.