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**Origins and Prospects for Employee Life and Health Trusts in Canada**  
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**Abstract:**

A discussion of the events and factors behind the establishment of pre-funded health benefit plans in Canada with reference to the experience of voluntary employee benefit associations in the United States and the auto sector restructuring in North America during 2008-2009. It is argued that "employee life and health trusts" are used in effect to defease legacy cost liabilities of employers and only likely to be used in the context of restructuring of a workplace or industry. Their structure is compared to other target benefit programs currently being proposed in Canada and elsewhere. The key issues in their negotiation and administration are summarized.

**Keywords:**

Employee benefits, labour relations, trusts, restructuring, tax

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## **ORIGINS AND PROSPECTS FOR EMPLOYEE LIFE AND HEALTH TRUSTS IN CANADA**

Simon Archer\*

### **I. INTRODUCTION**

About five years ago, the federal government passed legislation enabling pre-funding of health and welfare benefit plans in Canada.<sup>1</sup> In a familiar pattern, the impulse behind this legislative change came from the United States, where pre-funded health benefit vehicles have been available for decades and had recently featured in the workout to a large cross-border restructuring. The result was the development of a new form of pre-funded health and welfare trust vehicle in Canada, known by its statutory designation of “employee life and health trust” or ELHT, which amended some provisions in the *Income Tax Act*<sup>2</sup> and codified some long-standing administrative practices of existing health and welfare trusts (“HWTs”). Five years later there appears to be very limited use of this vehicle, an experience predicted by and consistent with long-term trends in the provision of pre-funded employer-centric benefits generally. ELHTs are likely to be limited to restructuring contexts in which an employer’s liability is defeased by transfer to an ELHT and may be accompanied by negotiated reductions to benefits.

### **II. ADMINISTRATIVE CATEGORY FOR HWTS**

Prior to the introduction of the ELHT proposals in February, 2010 and legislative reform of December 15, 2010, the primary regulatory framework that applied to HWTs was established by administrative practice of the Canada Revenue Agency (“CRA”) through Interpretation Bulletin IT-85R2.<sup>3</sup> A summary of HWT

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1. *Income Tax Act*, R.S.C. 1985 (5th Supp.), c. 1, s. 144.1.

2. R.S.C. 1985, c. 1 (5th Supp.), as amended (“ITA”).

3. Canada Revenue Agency, IT-85R2, July 31, 1986 as amended. Available online at: <<http://www.cra-arc.gc.ca/E/pub/tp/it85r2/it85r2-e.html>>.

treatment is useful in contrasting the 2010 amendments creating ELHTs.

HWTs are *inter vivos* trusts the contributions to which are deductible to an employer in the year the contribution is payable. They are essentially conduits. The key limitation contained in IT-85R2 was that where contributions exceeded the amount necessary to provide current benefits to employees, the deduction would be denied. Trusts established for the purpose of providing health and welfare benefits were taxable on income in excess expenses and benefits paid. Reserves were also taxable, and so efforts were made to ensure HWTs were ran without accumulating surpluses to avoid unintended taxable income. Prior to the auto sector restructuring in 2008, however, this was not widely perceived to be a limitation to providing health and welfare benefits to employees.

It should be noted for completeness that benefits provided through an HWT were are taxable to the employee in the same manner as those provided directly by employers: group term life insurance is taxable in the year a premium is paid, death benefits are not taxable, premiums or contributions on disability benefits are not taxable benefits but receipt of the benefit is taxable, and premiums and benefits paid in respect of private health services plan are not taxable.

Although the 2010 legislation codified some of the administrative policy governing HWTs, the CRA confirmed in a technical letter that there was no immediate plan to withdraw the administrative regime for HWTs set out in their IT-85R2.<sup>4</sup> The CRA's positions continue to apply to trusts established after 2009 where the conditions are satisfied.<sup>5</sup>

### III. VEBAS AND THE AUTO SECTOR RESTRUCTURING

The introduction of ELHTs in Canada was in the context of a major industrial restructuring and these events bear recalling. Even before the onset of the financial crisis of 2008, each of the "Big Three" North American auto manufacturers were in a weakened financial state. Years of declining market share resulted in excess

4. CRA documents 2011-0398371C6, June 10, 2011 and 2011-36252112 dated June 10, 2011.

5. The CRA has identified a number of tax issues involving the use of HWTs and had attempted to revise its administrative rules in 2005. However, due to public consultation feedback at the time, revisions were not made to IT-85R2.

capacity, higher unit costs (since fixed costs for engineering, fixed capital, marketing, and other inputs had to be shared among a shrunken volume of total output), and a period of financial difficulty.

This situation was then subject to the general financial crisis of 2008-2009 which made financing even more difficult to obtain. In the United States, General Motors Limited (“GM”) and Chrysler LLC (“Chrysler”) filed for bankruptcy protection. Ford Motor Company (“Ford”) did not, but had borrowed heavily against its assets, at one point even (reportedly) employing its corporate logo as collateral.

In Canada, GM and Chrysler subsidiaries were poised to file an application under the *Companies’ Creditors Arrangement Act*.<sup>6</sup> In the event, no private financing was available for the restructuring. The governments of the United States, Canada and Ontario became prepared to provide financial support to GM and Chrysler only on the basis of certain conditions, which included reduced “legacy cost” liabilities and a transfer of those liabilities to independent entities, essentially operating as defeasance trusts.

Legacy costs associated with unfunded pension and health care expenses for retirees have been and are much-discussed in traditional manufacturing sector and industrial sectors in North America. Very briefly, so-called legacy costs result from several factors, including:

- The design of the employer-centric benefits system in North America, in which private employers (rather than governments) provide a significant share of pension and health care benefits. By way of contrast, in Canada certain health care benefits are publicly funded, and in competitor markets of Europe and Asia, these costs are often borne either by government programs or individual contributions.
- The unexpectedly fast increase in the cost of these benefits, reflecting changes such as longer life expectancy, high rates of health care inflation, low interest rates and changes in methods for accounting for these benefits (which, together, increased the accounting and actuarial costs of liabilities); and
- The increase of the proportional burden of these legacy costs amongst active employees, particularly where downsizing shrinks the active workforce. This is particularly important

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6. R.S.C. 1985, c. C-36 as amended (“CCAA”).