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Health and Welfare Trusts

Health benefits for employees are normally provided through an insurance company. However, a viable option may be a trust arrangement called a health and welfare trust. Under this arrangement, the trustees of the trust receive contributions from the employer, and in some cases from employees, to provide the health benefits for employees. The types of benefits managed through a health and welfare trust are restricted to group sickness or accident insurance plans, private health services plans, group term life insurance policies, or any combination of these. Advantages of this type of arrangement include reduced administration fees and additional coverage for a select group of employees such as top executives. For example, group plans usually cover neither all medical services nor do they pay 100% of the costs incurred by the employee. Using a health and welfare trust can cover say 100% of an expanded list of medical services for a select group of employees.

Health and welfare trusts are an administrative concession by the CRA. While they have set out certain conditions that have to be met, the CRA does not have a formal registration procedure. To prevent abuse, they have a number of requirements to establish one of these trusts. The funds contributed to the trust cannot revert back to the employer or be used for any purpose other than providing the health benefits agreed to. To prevent excess tax deductions, the employer's contributions to the fund must not exceed the amounts required to provide current benefits. The payments by the employer to the trust must be legally required under the trust document and cannot be made on a voluntary basis. The trustees should act independently of the employer to avoid having the employer retain control over the funds.

Employer contributions to a health and welfare trust are deductible to the extent that they are reasonable and incurred to earn income. For employers using the accrual method of accounting, the payments are deductible in the year in which the legal obligation to make the contributions arose. For the employees, their taxable benefit will be determined in the same way they would if this trust arrangement were not used.

The trust itself does not pay tax on the payments received from the employer and none of the payments made by the trust to the employees are deductible. However, any investment income earned in the trust will be taxed at the top marginal rate for individuals so there are no tax rate advantages to this arrangement.

An interesting issue is whether the employer can deduct payments that are not needed to fund current expenses but are needed to pay for future liabilities. For example, if an employer makes a payment to the trust for 100% of the estimated cost of all current and future claims for long-term disability, would this lump-sum payment be deductible to the company? The CRA's position is that the portion of the payment required for the current expenses is deductible now and the portion required for the future expenses is classified as a prepaid expense and will be deductible in the future year to which the expense relates.

While there may be some interesting benefits from using a health and welfare trust, there are also some costs. Along with the costs related to its ongoing maintenance, there will be professional fees incurred for establishing the trust, maintaining financial records, filing tax returns, reporting to employees and ongoing management of the trust. In addition, depending on the type of benefits covered by the plan, actuarial valuations may be required to establish the liability that is to be funded by the company.

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