



JOHNSTONE'S JOURNAL is published monthly, and designed to provide topical information of interest not only to plan administrators, but to all employees who enjoy coverage under the benefit plan. Feel free to make copies, and use as a payroll staffer.

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A Key to the Tax Status of Group Insurance Tax Effective Allocation of Premiums

The Tax Rules

Canada Revenue Agency (CRA) has a number of rules that apply to the taxation of group insurance benefits. Understanding these rules and applying them appropriately is sometimes confusing. Considering this, the following provides an overview of the rules that apply across Canada except Quebec. If you require details of taxation of benefits in Quebec, please contact our office.

Basic & Dependent Life Insurance

All premiums paid for by the employer **must** be shown as a taxable benefit. Regardless of how premiums are paid, all benefit payments are made tax-free to the beneficiary.

AD&D and Critical Illness (CI)

Premiums can be 100% employer paid without creating a taxable benefit to the employee. Regardless of how premiums are paid, all benefit payments are made tax-free to the beneficiary.

Disability Benefits

If the **employee** pays 100% of the premium for disability benefits (weekly indemnity and long term disability) or is deemed to have paid the premiums, then the benefit, if ever received, is received tax-free. If the **employer** pays \$0.01 (or more) towards the cost of these benefits, it taints the tax status, and benefit payments are considered taxable. The test will be whether or not the premium for these benefits is paid in the employee's after tax dollars.

Extended Health (EHC) & Dental (includes Vision and Employee Assistance Plans-EAPs)

Premiums can be 100% employer paid without creating a taxable benefit to the employee. Regardless of how premiums are paid, any benefit payment made to a health care

provider, a dentist, or any claims reimbursed to the employee are without tax consequences to the employee.

Health Spending Accounts—H.S.A.

All premiums and contributions must be made by the employer as employee contributions are not allowed. Benefit payments made to a health care provider, a dentist, or any claims reimbursed to the employee are without tax consequences to the employee.

Provincial Medical Premiums

In B.C., coverage for the provincial medical plan (MSP) requires premium payment. All premiums paid for by the employer **must** be shown as a taxable benefit.

How to Apply the Rules

Who is shown to pay the premium costs for each benefit determines whether a taxable benefit is created or not. Essentially, the premiums paid by an **employer** towards life benefits (basic & dependent), and provincial health benefits **must** be added to the employees income in the form of a taxable benefit. Who pays the premium for disability benefits, (weekly indemnity & long term disability) will determine whether the benefit payments can be made tax-free or taxable. As a general rule, most disability plans are established to pay benefits tax-free to a disabled employee. As such, the employee should pay, or be seen to have paid, the premium for these benefits.

Premiums paid by the employer towards accidental death and disablement (A.D.&D.), C.I., EHC, vision care, employee assistance plans (EAP), dental and H.S.A. do not create a taxable benefit.

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The Simple Strategy

Apply the employer share of premiums to A.D.&D., C.I., EHC, vision care, EAP, dental and H.S.A.. Apply the employee share of premiums to disability benefits, life benefits, and, if necessary, to provincial medical benefits (for employees in B.C). Any employee shortfall in covering off the cost of these benefits should be shown as a taxable benefit.

Two-stage Accounting

This simple strategy can be applied to any arrangement where benefit costs are shared between the employer and employee.

Where the costs arise and where they are applied may differ. For example, many employers today share the costs of benefits on a 50/50 basis. While the employees' share of costs is calculated by taking 50% of the total, this does not mean they are paying 50% of each benefit. This is simply the first stage of accounting, and **determines how much the employee has available** to apply to benefits. It does not determine where the employee's share is applied. Where the employee's share is applied is the second stage of accounting. Assuming that the disability benefits are to be paid tax-free, the employee's share is now applied in the following order; first against disability benefits, second against life benefits, and finally, if necessary, to provincial medical coverage (in B.C.). Any shortfall in the employee's share is then added to the employee's income as a taxable benefit.

Taxable Benefit Same as Premiums

Increasing the employee's income, and showing payment as a taxable benefit is an acceptable way of showing that the employee has paid the premiums. Essentially, as long as tax has been paid on the premium, CRA is satisfied.

Calculate and Remit Monthly

However, CRA is adamant that they will only accept this arrangement if the taxable benefit is included in the employee's income at the time the payment is made. This means that the taxable benefit, and the appropriate tax withholdings, need to be done monthly, and **cannot be done at year end.**

In fact, CRA says: "...the Department will not accept a retroactive change to the tax status of a plan. For example, an employer cannot change the tax status of a plan by adding at year end to employees' income the employer contributions to a wage loss replacement plan..." (IT428 paragraph 17).

Pretty clear wording from CRA. So make sure any taxable benefits attributed to your benefit plan are calculated and shown monthly. Also, make sure that your monthly tax remittances reflect payments attributed to these taxable benefits.

Help with the Calculations



Johnstone's Benefits' proprietary software, JEMS has been designed to calculate the most tax effective allocation of benefits for you, and show any taxable benefit

that might arise. In order for us to do this, we must know the correct sharing arrangements. We can accumulate the taxable benefit amounts and assist you in the completion of your T4's.

If you have any other questions about taxation and your benefit plan, or would like to discuss any of these points further, please call Johnstone's Benefits.

