

TAX ALERT: CRA ANNOUNCES CHANGES TO TAX TREATMENT OF LUMP SUM AMOUNTS RECEIVED IN LIEU OF HEALTH AND DENTAL COVERAGE

Employers who are considering incorporating a benefits "buy out" into a departing employee's retirement or settlement package, take note: The 2011 federal Budget indicated that the CRA would be "clarifying" its administration of the rules regarding the tax treatment of lump sum amounts received in lieu of health and dental coverage. Following the Budget, the Canada Revenue Agency ("CRA") announced a reversal in its long-standing position regarding the tax treatment of lump sum payments received by employees in lieu of health and dental coverage.

Contributions made by an employer to or under a private health services plan¹ on behalf of an employee do not constitute a taxable benefit to the employee for federal tax purposes². In light of the non-taxable status of these contributions, the CRA previously held that lump sum amounts received by retirees or employees upon cancellation of their private health services plans could be considered advance reimbursements of medical expenses and, therefore, not taxable when received.

After the 2011 Budget announcement, the CRA re-examined this position and concluded that such amounts are taxable when received and medical expenses can be claimed as they are incurred. Given the complete revision in its position, the CRA decided that this position would not apply to payments of this nature made before 2012.

Prior to 2012, employers paying a lump sum amount in lieu of continuing medical or dental coverage under a private health services plan need not report the payment on an information return or withhold any amount from such a payment. This rule also applies if such an amount is paid at any time in connection with the termination of coverage provided by an insolvent employer, as long as the insolvency arose before 2012.

As of January 1, 2012, and onwards, lump sum payments of this nature should be reported on a T4A Information Return, and will be subject to withholdings in accordance with subsection 153(1) of the *Income Tax Act*.

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September 2011*

¹ Section 248(1) of the *Income Tax Act*, RSC 1985, c 1 (5th Supp), defines a "private health services plan" as meaning (a) a contract of insurance in respect of hospital expenses, medical expenses or any combination of such expenses, or (b) a medical care insurance plan or hospital care insurance plan or any combination of such plans, except any such contract or plan established by or pursuant to (c) a law of a province that establishes a health care insurance plan as defined in section 2 of the Canada Health Act, or (d) an Act of Parliament or a regulation made thereunder that authorizes the provision of a medical care insurance plan or hospital care insurance plan for employees of Canada and their dependants and for dependants of members of the Royal Canadian Mounted Police and the regular force where such employees or members were appointed in Canada and are serving outside Canada.

² Subparagraph 6(1)(a)(i), *Income Tax Act*