

A decorative graphic on the left side of the page, consisting of a vertical black line intersected by a horizontal black line. To the left of the vertical line are three overlapping squares: a blue one at the top, a red one in the middle, and a yellow one at the bottom. The text 'SUBMISSION TO THE HOUSE OF COMMONS STANDING COMMITTEE ON FINANCE' is written in a large, blue, sans-serif font to the right of this graphic.

# SUBMISSION TO THE HOUSE OF COMMONS STANDING COMMITTEE ON FINANCE

## **2004 PRE-BUDGET CONSULTATIONS**

2004

## EXECUTIVE SUMMARY

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The Multi-Employer Benefit Plan Council of Canada (MEBCO) represents the interests of Canadian multi-employer pension and benefit plans (MEPs) and is representative of all persons and disciplines involved in MEPs, including union and employer trustees, third party administrators, non-profit or “in-house” plan administrators and professionals.

Among MEBCO’s many constituents are multi-employer pension plans (MEPPs), which provide pensions to their members. There are approximately 360 MEPPs in Canada, which have membership of almost 900,000 individuals. Employee contributions to MEPPs exceeded \$2 billion.

In addition, MEBCO represents the interests of multi-employer benefit plans (MEBPs), of which there are approximately 400 in Canada.

Combined, these multi-employer plans cover well over 1 million workers and their families, in industries as diverse as construction, retail, trade, entertainment, food, transportation, garment manufacturing and textiles. The majority of Canadians who participate in MEPPs and MEBPs earn middle to low incomes.

Multi-employer plans in Canada are a unique labour and management response for meeting the needs of workers and their dependents.

This role should not only be recognized by government, but should be preserved and indeed encouraged with the continuation of tax incentives to both provide necessary health and dental care benefits which are not otherwise available under Canada’s public health care system and to promote retirement savings. Multi-employer plans are the predominant form of benefit arrangements in the unionized sector of the above-mentioned industries. Often, these employees are highly mobile, working for several employers in a year. If it were not for the multi-employer plans, such employees would be forced to switch plans as often as they do employment. Benefit coverage would be haphazard, if not non-existent. Accordingly, multi-employer plans fulfill a very important social objective of providing necessary health and related benefits, which are not otherwise available under Canada’s public health care system, as well as providing supplementary pension benefits.

Any assumption that the treatment of contributions to health care plans and pensions is inequitable or constitutes a tax “loophole” is erroneous. The tax system has a multitude of incentives for a multitude of purposes. The social objectives of preserving the well-being of Canadians and the financial independence of seniors have led to the placement of certain incentives in the tax system. Those who have chosen to avail themselves of these incentives should not be penalized for doing so.

The purposes of our submission are to both assist the government in meeting its fiscal and monetary objectives; and, to represent the interests of our members with respect to retirement, health and welfare, and taxation issues.

## Highlights of our Recommendations

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### Preservation of “EET” Approach for Registered Plans

MEBCO opposes any taxation of investment earnings or contributions to registered pension plans and RRSPs. Canada’s approach should remain exempt, exempt, tax (“EET”) meaning no tax on contributions, no tax on investment earnings, and tax on receipt of the benefit or lump sum payout.

### Provide Relief for the “Solvency Crisis” facing Multi-Employer Pension Plans

MEBCO is gravely concerned that the collapse of value in Canadian and worldwide financial equity markets, the decline in long-term returns on high-quality fixed-income investments and increasing longevity has imperiled the security of pension plans in general and multi-employer pension plans in general. Single employers can address the solvency deficiency by funding supplemental contributions. Since (specified) multi-employer pension plans are limited to contributions set forth in Collective Bargaining Agreements (CBAs), the additional contribution solution is not readily available to MEPPs. MEBCO recommends a two-fold solution.

First, MEBCO suggests that MEPPs be permitted an “action plan” to address any solvency deficiency by providing for special payments over 15-years. Technically, this solution requires changes to the *Pension Benefits Standards Act*, and similar provincial Acts, but we believe the House can “strongly encourage” such a solution for federally regulated MEPPs, which should encourage similar action through the Canadian Association of Pension Supervisory Authorities (CAPSA) with the leadership of the Office of the Superintendent of Financial Institutions (OSFI).

Second, at the present time, Members of MEPPs receive a Pension Adjustment (“PA”) on all contributions made by an employer under CBAs. Employers are not permitted to remit contributions to a MEPP that are not in respect of a specific Member, and which result in a PA to individual Members. MEBCO recommends that the Income Tax Act regulations be modified to permit a CBA to negotiate special payments designed to liquidate a Solvency Deficiency, and that those special payments not generate a PA for any individual Member. In this way, MEBCO believes that there can be a solution, over time, to the current solvency crisis **that does not involve reducing benefits to active and retired Members.**

### Goods and Services Tax (GST) Rebate for MEBPs

We are seeking improvements to the tax treatment of MEBPs to address the inequity between single-employer benefit plans (“SEBPs”) and MEBPs, which negatively impacts the value of MEBP benefits to employees. MEBPs incur GST costs in respect of various administrative expenses considered to be taxable supplies under the Excise Tax Act. Unlike single-employer benefit plans (“SEBPs”), there is no possibility of offsetting these GST costs by claiming Input Tax Credits (“ITCs”). Due to the current GST legislation and the inherent nature of multi-employer plans, neither a MEBP nor a contributing employer can claim ITCs. To the extent necessary, MEBCO urges the Department of Finance to implement legislation that will permit Revenue Canada the latitude necessary to provide such rebates.

## No Taxation of Supplementary Health, Dental and Group Life Insurance Benefits

MEBCO continues to oppose any taxation of group supplementary health and dental benefits plans. Taxation would discourage participation in MEBPs, thereby placing an additional burden on the public health care system. Therefore, MEBCO supports maintaining the current tax exemptions for supplementary health and dental premiums and benefits, and re-introducing the pre-1994 exemption on group term life insurance premiums.

### Health Care

The Federal Government in cooperation with the provinces must continue the process of modernizing Medicare with meaningful reforms. The recent ten year agreement between the first ministers is a positive step towards health care reform, but falls far short, particularly in the area of drug cost containment. The release of two major parliamentary reports on the future of health care in Canada, by Senator Michael Kirby and Former Saskatchewan Premier Roy Romanow, should provide the catalyst for much needed reforms.

Canada needs a health care system that meets the needs of a modern society and can adapt to newer and more effective technologies. The pressures on our health care system must be addressed in this context and not solely in terms of dollars and cents. Further, the increasing costs associated with pharmaceuticals cannot be sustained. These rising costs are a burden on Canadians, Governments, and the benefit plans we provide for our members.

### Introduction

#### (a) Who we are

The Multi-Employer Benefit Plan Council of Canada (MEBCO) was established in 1992 to represent the interests of Canadian multi-employer pension and benefit plans (MEBPs) in relation to existing or proposed federal and provincial legislation and policies affecting MEPs. MEBCO is a federal non-share capital corporation operating on a not-for-profit basis. MEBCO's Board of Directors consists of representatives from a diverse cross-section of the employment benefits field. MEBCO represents all persons and disciplines involved in MEBPs, including union and employer trustees, professional third party administrators, non-profit or "in-house" plan administrators, and professionals including actuaries, benefit consultants, lawyers and chartered accountants. All MEBCO Executives and Directors serve in a voluntary (*i.e., unpaid*) capacity.

MEBCO currently has over 190 members in jurisdictions across Canada. MEBCO's members have responsibility for administering pension plans providing lifetime retirement income for over 1 million retired and future retired Canadians, and administering health and welfare plans providing supplemental hospital, drug, vision care, dental and / or similar benefits to a cumulative membership of workers and dependants of more than 2 million people throughout Canada. There are hundreds of MEBPs registered in Canada covering approximately **workers, and the dependants of those** workers, in industries such as building and construction, food service, retail, hotel and restaurant, graphic art, garment manufacturing, security, textile, transportation, and entertainment. A MEBP may be national, regional, provincial or local in coverage. Anywhere from two to over one thousand employers may contribute to a single MEBP pursuant to several collective agreements.

**(b) Our Submission**

MEBCO is pleased to once again participate in the pre-budget consultation process. Because MEBCO's focus is on employee pensions and benefits, the initiatives we are recommending are aimed at improving the quality of life of working Canadians and thereby productivity. Specifically, our initiatives address three broad concerns many Canadian workers have had over the past few years:

- (i) **The adequacy of health and welfare benefits**
- (ii) **The adequacy of retirement income sources, and**
- (iii) **The quality of health care**

We provide our specific input in the following sections.

**I. RETIREMENT INCOME AND MULTI-EMPLOYER PENSION PLANS**

**1. Ensuring Adequate Retirement Income for Canadians**

**MEBCO RECOMMENDATION**

**MEBCO opposes any taxation of investment earnings or contributions to registered pension plans and RRSPs. Canada's approach should remain exempt, exempt, tax (EET) meaning:**

- **No tax on contributions**
- **No tax on investment earnings**
- **Tax on receipt of the benefit or lump sum payout**
- **No disguised taxes or limitation on pension funds such as the suspended proposal to limit pension fund investment in income trusts.**

MEBCO understands that there is no imminent threat to introduce any such unwarranted new taxation of registered pension plans; however, MEBCO feels so strongly that this status quo must be maintained that we find it appropriate to reiterate our views at each year's pre-budget consultations.

Much has been said and written in recent years about the impending retirement for aging Canadians, especially "baby boomers". Most Canadians expect to retire on income from both public sources (i.e. CPP/QPP and OAS) and private sources (e.g. "registered plans, including: employer-sponsored pension plans, RRSPs, and RRIFs). As a matter of public policy, it is desirable to minimize the reliance of Canadians on public sources and to encourage and promote private funding of retirement income.

Among MEBCO's many constituents are pension plans, which cover workers many with middle to low incomes. The current retirement saving system in Canada is failing this group by not providing the kind of tax-assisted incentives needed to encourage greater retirement savings.

As the responsibility to ensure adequate retirement income shifts to private sources, additional incentives will be necessary to encourage individuals and their employers to save for retirement.

MEBCO would strongly oppose any action to either treat as taxable income any employer contribution to a registered pension plan or to tax any investment returns received by a registered plan within the current limits of the Income Tax Act. Canada's approach should remain exempt, exempt, tax ("EET") meaning no tax on contributions, no tax on investment earnings, and tax on receipt of the benefit or lump sum payout.

As we have stressed in our past submissions to the Standing Committee on Finance during pre-budget consultations, we continue to strongly oppose any taxation of pension fund assets or RRSP investment income. Such actions would have a further negative impact on a system that has already demonstrated that it is not producing sufficient retirement income.

MEBCO reiterates that any characterization of retirement savings tax assistance as expenditure or tax revenue loss is incorrect. Such assistance involves only tax deferral. All assets in pension plans will ultimately be subject to tax upon the payout of pension benefits. By allowing tax-assisted retirement savings, the aggregate income of Canada's seniors increases, which when spent greatly aids the Canadian economy. Moreover, income security created by a strong private pension system reduces reliance on government sponsored plans and public resources. This is critical given the ageing demographics of the country and the strain it will put on the public retirement system.

To add clarity, MEBCO's position includes no new "disguised taxes", such as "registration fees" or other disbursements to government that may not be called a "tax", but have the impact of being a "tax". This also includes new limits and restrictions on pension funds, such as the now suspended federal budget proposal to limit pension fund investments in Income Trusts. The proposed restrictions unfairly excluded these plans from benefiting from the growth and stable cash flow that the investment trust vehicle is expected to deliver. Investment restrictions of this kind generally undermine the ability of pension funds to diversify their risk, imposing a greater cost and impediment to the delivery of retirement security benefits to beneficiaries. These measures are unnecessary from a tax policy perspective given that members are ultimately taxed on the benefits paid from these plans.

## 2. Relief for MEPPs facing a "Solvency Crisis"

### MEBCO RECOMMENDATIONS

**Through the *Pension Benefits Standards Act*, amend funding provisions to allow Trustees of (specified) MEPPs to establish an action plan designed to liquidate any unfunded "solvency deficiency" through a series of "special payments" that would amortize the unfunded liability over a period of up to 15-years.**

**Amend the ITA to permit Employers to make negotiated "special payments" to a (specified) MEPP to fund solvency deficiencies without such contributions being allocated to any particular Member, and without conferring a Pension Adjustment on any Member.**

Pension legislation with respect to minimum funding is primarily a provincial responsibility, with the noted exception that federal regulation applies in designated industries (e.g. inter-provincial transportation) and in the territories. Nevertheless, OSFI is well staffed, and provides leadership in establishing rules and guidelines that are often adopted by the provinces. OSFI participates in the Canadian Association of Pension Supervisory Authorities (CAPSA), comprised of representatives of the regulators from each of the jurisdictions in Canada, which has recently released a consultation paper entitled “Proposed Regulatory Principles for a Model Pension Law”<sup>1</sup>. OSFI and some provincial counterparts are promoting the necessity of Trustees of (specified) MEPPs cutting benefits of retirees, surviving spouses and active members where the Plan has a solvency deficiency, and that solvency deficiency cannot be liquidated within 5-years. In fact, OSFI is promoting an even shorter period over which it would permit any solvency deficiency to be liquidated.

MEBCO acknowledges that a Board of Trustees must be required to take an appropriate “action” or “actions” where an actuarial valuation, performed by a qualified actuary in accordance with accepted actuarial practice, reveals unfunded liabilities.

MEBCO believes that (specified) MEPPs will persist, and should be given ample opportunity to develop an action plan to address any solvency deficiency without having regulators require Trustees to reduce benefits. Generally, (specified) MEPPs have a long life expectancy, and distinct from corporations, do not generally go bankrupt. (Specified) MEPPs persist even if one or a number of participating employers go bankrupt.

The Union and the participating employers have the ability to negotiate additional funding for a Plan with a solvency deficiency, if the Trustees believe that this is a preferred action over reducing the pensions of retirees. Trustees have a fiduciary responsibility to act solely in the best interests of plan beneficiaries. The Trustees recognize that they must act responsibly, and in accordance with their fiduciary obligations at law. They need to be given the tools and opportunity to fulfill this responsibility, since retired Canadians have little ability to save for their retirement after their working career ends.

MEBCO acknowledges that a (specified) MEPP Board of Trustees needs to work with regulators in order to address any solvency deficiency. Reasonable measures could be implemented that would ensure that any solvency deficiency is indeed being adequately addressed (including annual reporting, assurance that the Current Service Contributions are not exacerbating the problem, elimination of any benefit increases in an amount or value that are not fully paid from Current Service Contributions, excluding any benefit enhancements in amount or in value that are not mandated by legislation).

The proposed policy of allowing plan sponsors and contributors an extended time frame to fund solvency deficiencies in extraordinary circumstances has already been embraced by the Federal Government and OSFI, as is evident in the amendments to the *Pension Benefits Standards Act* Regulations permitting Air Canada to fund its solvency deficiencies for the next 10 years, as opposed to the statutorily imposed 5 year period. It seems highly inequitable that MEPPs should not be extended the same accommodation when faced with the solvency deficiency where there is little, if any, risk that a MEPP become “bankrupt”. Similar measures have now been adopted or proposed in several other jurisdictions in Canada.

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<sup>1</sup> CAPSA Report, *Proposed Regulatory Principles For a Model Pension Law*, January 2004.

New Brunswick has recently amended its pension benefits regulations to grant the Superintendent discretion to approve requests to extend the amortization period for solvency deficiencies to 15 years.<sup>2</sup>

Alberta is another province that has demonstrated a willingness to consider alternative funding solutions. The Alberta Ministry of Finance in its discussion paper, containing proposals for pension law amendments, entitled “Strengthening Risk Management, Disclosure and Accountability”<sup>3</sup>, proposed to amend the Alberta *Employment Pension Plans Act* to introduce some flexibility around requiring MEPPs to fund on the basis of solvency. The proposal includes a requirement to adopt a 10 year amortization schedule for unfunded liabilities. In discussing the need to reform the existing legislative regime that requires solvency tests to be performed and all plans to fund on the basis of those tests over not more than 5 years, the Finance Ministry stated.

“Solvency funding was put in place to lessen the chances the plan members would not receive full benefits if the plan were to terminate. Due to current market conditions – low interest rates that result in high solvency liabilities, plus recent declines in asset values – some plans are having more difficulty funding for solvency deficiencies than for going concerned unfunded liabilities. This is a particular problem for multi-employer collectively bargained plans because it is difficult for them to respond to the variability of solvency payments. Termination of these plans is unlikely (although not unheard of), but is important to ensure that the plans have long term stable funding on a going concern basis.”<sup>4</sup>

Solvency funding of any form is, in MEBCO’s view, inappropriate for MEPPS.

MEBCO questions the assumption underlying the OSFI proposal that the solvency ratio is the appropriate measure of adequate funding. MEBCO acknowledges that if the employer in a single-employer pension plan goes bankrupt, it is important to have a solvency ratio of at least 1.00. However, in the MEPP situation, it is theoretically possible that many employers (let alone only one employer) could go bankrupt where the MEPP has a solvency ratio below 1.00, and no members’ benefits will necessarily be jeopardized.

MEBCO opposes the application of solvency rules to defined benefit MEPPs due their unique nature. Technically, the only benefit that has been promised is a target benefit. Therefore, technically MEPPs are always solvent. Moreover, solvency rules should not apply to MEPPs as they seldom wind up.

In the alternative, if OSFI takes the position that solvency rules must apply to defined benefit MEPPs then MEBCO opposes the recommendation to reduce the amortization period for funding a solvency deficiency from the current five years to a new three-year rule. In fact, for benefit enhancements, MEBCO reiterates its view that there should be no constraints to funding such enhancements over up to 15-years. In MEBCO's view, this is certainly preferable to reducing pensions of retirees and surviving spouses, and accrued benefits of active Members.

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<sup>2</sup> Regulation 91-195 to the New Brunswick *Pension Benefits Act* S.N.B. 1987, c.P-5.1.

<sup>3</sup> Alberta Finance, *Strengthening Risk Management, Disclosure and Accountability*, November 24, 2003.

<sup>4</sup> IBID, at p. 16.

Further, in order for there not to be constraints on a MEPP's ability to offer its current level of benefits, any solvency deficiency should be allowed to be funded using a modified solvency basis. The modified solvency basis should reflect the funding realities of MEPPs. The basis should include the following factors: (a) an amortization period appropriate to MEPPs for funding a solvency deficiency; (b) no requirement to apply such solvency tests as the "maximum cost" rule (particularly, not mandating that liabilities be valued under an assumption that all members will elect to retire at the single "early retirement date" that generates maximum liabilities, when it is statistically evident that many members actually retire BEFORE such date, and many members actually retire AFTER that date); (c) the ability to use expected experience and (d) the ability to use averaging for interest rates, assets and liabilities.

There are different funding realities between MEPPs and single employer pension plans. It is very difficult, if not impossible, to obtain additional contributions from employers when there is no current collective bargaining, and a three-year period could needlessly force a board of trustees to reduce benefits.

MEBCO strongly reiterates our position that suggests that employers in a Negotiated-Contribution, Defined Benefit MEPP must never have any obligation to fund benefits beyond the provisions of the Collective Agreement. Even in the unfortunate position of a plan failure, pension legislation and regulation should never obligate an employer to make supplementary contributions to a MEPP beyond the contributions set forth in a Collective Bargaining Agreement.

If MEPPs will be required to fund all or most of the up-front cost of all benefit improvements, increases in benefit levels will most likely cease and the retirement income security of Canadians covered by MEPPs will deteriorate.

Finally, such a rule would be inconsistent with all other jurisdictions. MEBCO supports a harmonization of regulatory provisions, rather than additional diversity.

In addition to changes needed in the (federal) *Pension Benefits Standards Act* and the various provincial equivalents, MEBCO urges changes in the ITA to provide for appropriate treatment of any series of "special payments" designed to liquidate any unfunded solvency deficiency. As an example, the Collective Bargaining Agreement ("CBA") could specify that \$1.00 per hour worked would be such a "special payment". Such payments must be as set forth in a CBA, used solely to liquidate any unfunded solvency deficiency, not attributable to any member, and not generate a PA<sup>5</sup> for any member.

The PA is the tax measure of the pension credits earned by a member in a year. The PA for most defined benefit plans is generally defined as 9-times the amount of lifetime retirement benefit earned in a year<sup>6</sup>. If a single-employer pension plan incurs a solvency deficit, the employer must make "special payments" and no additional PA is imposed on a member. For a (specified) MEPP, the PA is based on the amount of employer contribution, much like a pure

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<sup>5</sup> The ITA limits the ability of members to earn pension credits in registered pension plans as a result of the global limit of 18% of compensation, or the money purchase limit for the year. In addition, the PA determines the amount of RRSP contribution room that is available to a member of a registered pension plan. Generally, an individual can contribute up to 18% of income from employment to an RRSP to a maximum (\$13,500 in 2003), less the PA.

<sup>6</sup> A \$600 deductible applied. Thus, for example, if a plan provided an annual lifetime pension of \$480 for each full year of credited participation, the PA would be \$3,720, i.e., \$480 times 9, less \$600.

defined contribution pension plan<sup>7</sup>. However, any “special payments” as currently provided for in the ITA would add to a member’s PA. MEBCO would like the same treatment for “special payments” under (specified) MEPPs as exists under single-employer pension plans.

Attributing a PA to a member in connection with a solvency deficiency payment is in effect a double tax. The member is not receiving pension credit for these contributions, and has already received a PA for the benefits promised on an annual basis. As the PA determines the amount of RRSP contributions that is available, the MEPP member would be deprived of the contribution room to an individual RRSP, notwithstanding that they have not received the corresponding pension credit as a result of the solvency deficiency payment.

MEBCO believes that such a modification would encourage unions and employers to include sufficient levels of “special payments” to liquidate any solvency deficiency over a reasonable future time horizon, and minimize the likelihood that pension reductions would be made to pensions of retired Canadians.

## **II. HEALTH & WELFARE AND MULTI-EMPLOYER BENEFIT PLANS ("MEBPS")**

### **Background of MEBPs**

Collective agreements negotiated by one or more unions establish these plans and the contributions necessary to finance and provide benefits. Contributions are usually based on a dollar amount per hour worked by an employee. These plans are "trust funds" and are generally administered by a joint board of trustees, comprised of an equal number of trustees appointed by the participating union(s) and the employer groups. These trustees are responsible for receiving contributions from employers, determining and paying certain benefits to members and their dependants and/or entering into insurance contracts for the provision of other benefits. In the event that an employer is delinquent in making contributions, the trustees pursue collection proceedings.

Some of the more common forms of coverage provided by MEBPs include:

- Extended Health and Hospital Care;
- Drug Care;
- Dental Care;
- Vision Care;
- Sickness and Disability;
- Life Insurance; and
- Retiree Health, Dental and Life Insurance.

MEBPs provide continuous benefits coverage to workers as they change employment from one contributing employer to another. This portability or seamless coverage is essential for workers in mobile, seasonal industries like construction and entertainment. Additionally, most MEBPs allow for the accumulation of revenues and "pay-direct" schemes to protect workers and their

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<sup>7</sup> Thus, if an employer contributed \$2.10 per hour worked, and 1,800 hours are needed to get a full year of credited participation, the PA would be \$3,780.

dependents during periods of unemployment not uncommon in many of the industries represented.

MEBPs play an integral part in achieving the goal of the *Canada Health Act* ("CHA") of meeting the health care needs of Canadians and their families. The delivery of health care benefits through MEBPs substantially alleviates the fiscal pressures on Canada's public health system.

MEBCO believes that the federal government (and its provincial partners) need to enhance their recognition of the importance of MEBPs in providing Canadians with health care coverage. Employer sponsored benefit plans play an integral role in Canada's health care system, through the provision of health coverage to individuals and families for those services not covered under the Canada Health Act (e.g. dental care, prescription drugs, preferred hospital accommodations, out of country services). The exclusion of certain services from the *CHA*, such as dental care and prescription drugs, leaves millions of Canadians vulnerable to illness and disease. Lack of preventive care, particularly in oral health in its early stages, results in more complicated and costlier care, which is insured by government programs. This is counterproductive to prudent fiscal management of health care dollars.

MEBPs fill these health care "gaps" and help alleviate fiscal pressures on Canada's public health system. MEBPs need to be embraced by federal and provincial governments as active partners in the provision of health care coverage, and encouraged by tax policy.

**Apart from direct financing, the government plays an important role in financing through the tax system by allowing employers to deduct the cost of health benefit plans for employees for tax purposes.** This is recognition that encouraging benefit plan coverage in non-CHA insured services is an important **health care financing mechanisms**. However, that encouragement is not strong enough. Beyond the limitations of government sponsored health care under the *CHA*, many employees still do not have access to employer sponsored plans due to employment status and the fact that the administrative costs of managing such benefits is too onerous for small employers. Existing tax policy continues to discourage the growth of MEBPs

MEBPs, like all supplemental insurance plan premiums, are subject to retail sales tax of eight percent in Ontario and nine percent in Quebec. They are the only jurisdictions in North America to levy such taxes. The combined tax burden equaled \$776 million in 2000. As part of its initiative to require accountability from provinces with respect to health care funding transfers, the federal government should play a more active role in encouraging Ontario and Quebec to remove application of retail sales tax on employer sponsored health and welfare plans. In addition to the specific tax measures discussed below, MEBCO suggests that the federal government consider making future health transfer increases to these provinces conditional on the elimination of these tax barriers to the growth of employer sponsored health and welfare plans.

The levying of federal and provincial taxes on MEBPs and other supplemental benefit plans is a deterrent and is counter to good public policy. Each dollar of tax levied is an additional administrative cost the results in decreased benefits or increased premiums to employers. In the next two sections, we address specific tax measures that should be addressed in the Budget to remove barriers and disincentives for the development and growth of MEBPs.

Of equal importance to the sustainability of MEBPs is addressing the increasing cost of health care and prescription drugs, discussed in the last section on reform and funding of the health care system.

### 3. GST Relief for MEBPs

#### MEBCO RECOMMENDATION

**Extend to MEBPs the current rebate concept found in section 261.01 of the Excise Tax Act. The rate of the rebate should be 100% of the GST paid on taxable supplies. Given that employers contributing to single-employer benefit plans (SEBPs) currently claim Input Tax Credits (ITCs) on all GST paid on Taxable Supplies, a 100% rebate rate would put MEBPs and their contributing employers on a level playing field with their SEBP counterparts.**

Neither MEBPs nor their contributing employers are able to claim ITCs or rebates for GST paid by MEBPs for Taxable Supplies. In contrast, an employer who sponsors a SEBP claims ITCs in respect of GST paid on plan administration expenses paid by the employer. The single employer engaged in commercial activities typically regards this expenditure as an overhead cost which directly relates to its business activities. This comparative inequity increases the cost of providing benefits to participants of MEBPs and their families. This inequity is exacerbated in provinces participating in the Harmonized Sales Tax (“HST”), where in effect, the HST increases GST paid by MEBPs, from 7% to 15% on services for which they do not currently pay provincial sales tax. While the HST is currently limited to the participating Atlantic Provinces, we are aware that other provinces, such as Ontario, have actively considered HST participation. Obviously, this further erodes the ability of multi-employer plans to deliver important social security benefits.

In terms of purpose and structure, both MEBPs and SEBPs are identical. Both are typically structured as trusts considered to be “health and welfare trusts” by the Canada Revenue Agency. The purpose of both is to provide much needed and valued health and related benefits to employees.

Consequently, the income tax treatment of both is identical. However, the GST treatment favours SEBPs over MEBPs. While both types of plans pay GST on administrative expenses, the claiming of input tax credits (“ITCs”) to offset GST expenses is only available to SEBPs. An employer who contributes to a SEBP usually claims ITCs in respect of GST it has paid on such administrative expenses. In contrast, in the context of MEBPs, there is no practical or cost-efficient mechanism for contributing employers to pay or, to be invoiced for their pro rata shares of administrative expenses incurred by a MEBP. Therefore, the financial relief from GST, which may be available under SEBPs arrangements, is clearly unavailable to MEBPs and their contributing employers. Consequently, GST paid by MEBPs reduces the amount of monies otherwise available for benefits to plan members and their families.

The provinces continuing to cut back on health care benefits further exacerbate the vulnerable position of employees incurring medical expenses. These cut backs are made up by either the private sector (through MEBPs or SEBPs) or, unfortunately, individuals. Yet SEBPs and their

employer sponsors have a distinct advantage over MEBPs and their sponsors in respect of claiming ITCs.

This problem for MEBPs is the same problem that multi-employer pension plans formerly faced. That problem was alleviated by the introduction of a GST rebate under section 261.01 of the *Excise Tax Act*.<sup>8</sup>

Extending a full GST rebate to MEBPs, as the government has recently extended to municipalities, would have no direct cost to the government, while providing substantial benefits to the health care system as a whole. MEBCO has estimated<sup>9</sup> that the cost to the government in foregone tax revenues of a full rebate to Health and Welfare Trusts to be between \$7 and \$12 million dollars annually, which is insignificant when measured against annual increases in government health care spending.

### Technical Analysis

Under the existing provisions of the *Excise Tax Act*, it is not possible to obtain any relief for GST paid by MEBPs for administrative expenses. In contrast, many employers contributing to SEBPs claim ITCs for GST paid on expenses incurred by them in the delivery of benefits to their employees. A single employer engaged in “commercial activities” typically may regard such expenses as overhead costs, which directly relates to its business activities.

Generally, a GST registrant may claim ITCs to the extent that it makes “taxable supplies” in the course of its “commercial activities”. The corollary is that a GST registrant cannot claim ITCs to the extent that it makes GST “exempt supplies” and/or it is not engaged in “*commercial activities*”.<sup>10</sup>

A “commercial activity” can be:

- A business (other than a business carried on without a reasonable expectation of profit by an individual, a personal trust or a partnership, all of the members of which are individuals)
- An adventure or concern in the nature of trade (other than an adventure or concern engaged in without a reasonable expectation of profit by an individual, a personal trust or a partnership, all of the members of which are individuals), or
- The making of a supply of real property<sup>11</sup>.

The making of exempt supplies is specifically excluded from being “commercial activities”<sup>12</sup>.

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<sup>8</sup> Bill C-24 received Royal Assent on 20 October 2000. Rebate applicable to GST paid or payable after 1998.

<sup>9</sup> MEBCO estimates are based on statistical analysis of Statistics Canada data and member surveys. The details of the calculations including assumptions used have been provided to senior policy advisors in the Ministry of finance and the Canada customs and Revenue Agency.

<sup>10</sup> *Excise Tax Act* (ETA), s. 169(1).

<sup>11</sup> ETA, s. 123(1) “commercial activity”

<sup>12</sup> *Ibid.*

Benefit plans, whether single-employer or multi-employer, are usually unable to claim ITCs because they are not considered to be engaged in “commercial activities”<sup>13</sup>. A single employer who contributes to an SEBP usually claims ITCs on the basis that it paid GST on expenses incurred in the course of its commercial activities. Typically, in an SEBP, administrative expenses are paid as incurred and often after the invoice for such expenses is forwarded directly to the employer for payment. Since the SEBP cannot generally claim ITCs, the employer claims them in the same way as any other overhead expense. The benefit levels are defined in advance and the employer’s contribution obligation is determined based on the funded status of the plan given the established benefit level.

In contrast, in the MEBP environment, there is no mechanism to have contributing employers pay for administrative expenses directly or to invoice employers for such expenses on a transaction-by-transaction basis, collect the GST and remit it to the Canadian Customs and Revenue Agency (CCRA). The contribution obligation of employers under a MEBP is established through collective bargaining. Based on the funded status of the MEBP, the trustees establish the benefit level so that both benefits and administrative expenses can be paid out of the contributions received from the participating employers and earned income.

A MEBP, unlike a SEBP, may have hundreds of participating employers most of who would be small companies and who would remit contributions in varying amounts depending on the applicable collective agreement. Also, in a MEBP, the employer group is constantly changing with certain employers exiting due to bankruptcy, etc. and new employers becoming contributors.

In the similar context of pension plans, the CCRA has indicated that, in the absence of actual transactions for consideration flowing from a multi-employer pension plan to the employers, the multi-employer pension plan cannot be viewed as engaging in commercial activities and therefore cannot claim an ITC. The recent amendment to the *Excise Tax Act* provided for a GST rebate.

**The bottom line for MEBPs is that GST in respect of the delivery of health and welfare benefits is a net cost and, therefore, is reflected in either decreased benefits to employees and their families or increased contributions by employers.**

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<sup>13</sup> Benefit plans are not typically engaged in commercial activities because they are:

- Not engaged in a business;
- Not engaged in an adventure or concern in the nature of trade; and/or
- Making exempt supplies by paying benefits to employees.

#### 4. Taxation of MEBPs Health, Dental and Life Insurance Benefits

##### MEBCO RECOMMENDATION

**No new taxation of group supplementary health and dental benefits plans. Any new taxation will discourage participation in multi-employer benefit plans (MEBPs), thereby placing an additional burden on the public health care system. The current tax treatment of health and dental benefits should be maintained.**

**Re-instate the pre-1994 exemption from tax on premiums for the first \$25,000 of employer provided Group Term Life Insurance benefits or as a minimum, provide an exemption where Group Term Life Insurance coverage does not exceed \$25,000 for all Plan members.**

MEBCO understands that there is no imminent threat to introduce any such unwarranted new taxation of group supplementary health and dental benefits plans federally; however, MEBCO feels so strongly that this status quo must be maintained that we find it appropriate to reiterate our views at each year's pre-budget consultations. There has been a history of "creeping taxation" for "group insurance" programs, particularly at the provincial level. Over the past 10-years, such changes have included:

- Application of "premium taxes" to non-insured Plans
- In Ontario, inequitable application of the premium tax for non-insured plans
- In some provinces, expansion of the level of premium tax
- In some provinces, expansion of the Provincial Sales Tax to premiums
- In Quebec, taxation as income of employer contribution to the cost of a private health services plan
- Taxation of all of the employer contribution to Group Term Life Insurance (formerly, the first \$25,000 of coverage was tax exempt)

When in 1994 the issue of equity was raised as a rationale for eliminating the federal tax preference for private health services plans, MEBCO argued that it was inequitable to penalize the majority of the population to attain comparable treatment for both employed and self-employed workers. The government accepted this argument and opted to provide tax relief to the self-employed to re-establish equity respecting the tax treatment of these benefits.

The prevalence of group supplementary health and dental benefits plans, in conjunction with government programs, has aided in ensuring that Canadians enjoy one of the best and affordable standards of healthcare in the world. In fact, the existence and nature of taxation of group supplementary health and dental benefits plans, in conjunction with the existence of universal government programs, has contributed to the overall economy by having many employers choose to locate manufacturing operations employing many Canadians in meaningful jobs, in Canada.

MEBCO would strongly oppose any action to either treat as taxable income any employer contribution to any group supplementary health and dental benefits plans (referred to as “private health services plans”, in the ITA), or to treat as taxable income any reimbursement of expenses provided by such Plans. MEBCO contends that if either of these tax changes occurred universally, such as that which occurred in Quebec but only with respect to the provincial component, a probable consequence is that many employers and MEBPs would reduce or eliminate many of the Plans that have contributed to the high degree of health in the population, and ultimately adversely impact the long-term “Medicare” costs.

In the MEBP context, the majority of plans established to deliver supplementary health and dental plans are established as trusts that qualify as Health and Welfare Trusts for ITA purposes, which allows employers to immediately deduct its contributions in the year the contribution is made, and taxes the employee on the benefits when received, and not on the value of the contribution when its made. Relatively speaking, this is efficient from a tax and administrative perspective, and encourages the establishment of these plans and thus the delivery of health and dental benefits to Canadians.

Historically, these plans have also provided life insurance benefits to employees on a group term basis. However, in 1994 the federal government eliminated the previous tax exemption on the first \$25,000 of coverage. This measure creates a dual disincentive to MEBPs from providing these benefits. The benefit obviously becomes less desirable to the employee when he is taxed on premium payments. As well, imposing a different tax treatment on these benefits delivered through Health and Welfare Trusts, adds substantially to the cost of administration and the sustainability of these benefit plans generally. Administrators of these MEBPs are required to track group life insurance payments separately and issue T4As for the tax value of the premium payment for each employee.

The fiscal or social objectives served by this tax policy are not readily apparent. Employer provided life insurance coverage provides privately funded income security to the families of deceased employees. Without this security, the family beneficiaries are more likely to rely on government social assistance and other public resources, negatively impacting government revenues. The amount of foregone tax if the exemption were reinstated is minimal. MEBCO roughly estimates the tax loss at less than \$7M, which is insignificant if compared only to the added administrative cost on MEBPs, in the aggregate estimated at \$10M. This is simply inefficient and shortsighted.

MEBCO recommends that the previous exemption on the first \$25,000 of coverage be reinstated, or in the very least, a tax exemption introduced for all group term life insurance policies providing coverage not in excess of \$25,000. This alternative measure would at least alleviate the administrative burden imposed on MEBPs who continue to provide life insurance benefits as part of a health and welfare plan, and eliminate the disincentive from continuing these benefits. Moreover, such an exemption would not reduce government tax revenues materially.

## 5. Adequate Funding and Reform for Canada's Health Care System

### MEBCO RECOMMENDATIONS

**MEBCO recommends that all governments recognize that there is only one taxpayer, and that the issue is not WHO provides medical care to Canadians, but HOW to provide the best medical care possible in the most cost-effective fashion. MEBCO would support virtually any initiative designed to achieve this objective**

**MEBCO in particular objects to actions which merely "download" to private plans and individuals programs that have historically been provided by government**

MEBCO has watched and participated with interest in the debate over the future of health care, especially with respect to recommendations resulting from the Senate Committee headed by Michael Kirby and the Commission headed by Roy Romanow, and most recently "the Ten Year Agreement" reached at the First Ministers meeting in Ottawa. MEBCO is encouraged by the terms of the Ten Year Agreement and in particular the Federal Government's commitment to increase funding to eliminate the so-called "Romanow Gap".

MEBCO applauds the Government's initiative to tie health transfer dollars to accountability and performance measures included in the terms of the health accord. As MEBCO has stated in past submissions, real solutions towards a sustainable health care system is not simply a matter of funding alone, but rather requires real reform, including accountability measures. In this regard, the First Ministers Ten Year Agreement is a good first step.

In previous submissions to this committee, MEBCO has voiced its concern over the increase in the private sector share of health care spending. As the private sector share continues to increase at a faster rate than public sector spending, costs are shifted to private health services plans, including MEBPs. As of 2003, approximately 30% of total health costs were paid for privately, matching an all time high since Medicare was introduced.<sup>14</sup> In Ontario, the private sector's share of drug spending is 34%.<sup>15</sup> The total of private sector spending from private health insurance increased from 29% in 1988 to 40% in 2001.<sup>16</sup> The added importance of this is demonstrated by the fact that while private insurance benefits are enjoyed by an average 60% of employees, the percentage varies from 40% for low-income employees to over 70% for higher-income employees.

The same challenges facing governments also face private health services plans, (e.g. rising prescription costs, a fixed level of dollars, etc.) Many MEBPs have experienced consistent double-digit "inflation" cost increments over the past decade and more. By turning greater attention to preventive health care services, and particularly by addressing the significant and

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<sup>14</sup> Ibid, "Health Care in Canada 2004", page 7.

<sup>15</sup> Ibid, page 94.

<sup>16</sup> Ibid, page 96.

continued prescription costs (which are higher than any other Country except the USA), Canada can affect real reforms and improvements to health care.

While health care is a provincial jurisdiction, the federal Government has a responsibility to ensure a stable level of funding to the health care system.

There is a familiar refrain that is no stranger to the debate over health care ~ **there is only one taxpayer**. This fact has been seemingly lost on many engaging in the debate over the future of health care in Canada. The debate has been sidetracked by arguments over federal cash contributions, tax points, and jurisdictional squabbles. Let's be clear, at the end of the day, within the publicly funded system, **Canadians, not Governments** pay for health care through the tax system. And Canadians want a health care system that will be properly managed, accountable and that ensure service for themselves, their family and friends.

The real solution to a sustainable health care system has never really been one of funding, although changes in the structure of the Canada and Social Transfer helped to mask the lack of real reform by undermining accountability in the system.

The problems exist in two areas. One, as we have just discussed, is the rise in health cost and the lack of real reform in the delivery of health care. The second is the downloading of costs instead of working with partners to ensure a more efficient and effective delivery of coverage and services.

As we have described above, employee benefit plans are an integral part of the health care coverage equation. In spite of an overall increase in health care spending, the administration of health care continues to face problems because costs are simply shifted around and downloaded onto private health services plans, such as MEBPs, without addressing the underlying reform issues.

### **The downloaded cost of Pharmaceuticals**

According to Statistics Canada, the portion of health care expenditures that is due to pharmaceuticals now outstrips all other areas of health care spending, except hospitals. It is projected that Canadians spent (expected to reach \$19.6 billion in 2003) represents a 142% increase since 1993.<sup>17</sup>

But the public / private split is less the issue than the increasing total expenditure. The debate about the increasing cost of drugs is of great concern to MEBCO because as government plans begin delisting pharmaceuticals to contain costs, these costs will inevitably be pushed down to private health services plans, including MEBPs. The cost of pharmaceuticals is not only a problem for governments; managing drug costs is also a priority for MEBP Trustees.

Drug coverage under private health services plans had grown at a rate of in excess of 10% per annum over the past 12 years, to become the largest category of MEBP expenditure. As should be self-evident, MEBPs are dealing with their own cost containment issues and cannot absorb any further downloading of drug costs from government plans. To do so either jeopardizes level of benefits available or drives up the plan costs to prohibitive levels.

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<sup>17</sup> "Drug Expenditure in Canada, 1985-2003", Canadian Institute for Health Information (2004); "Health Care in Canada, 2004" Annual Report by the Canadian Institute for Health Information.

## Conclusion

MEBPs and MEPPs in Canada are a unique labour and management response for meeting the needs of workers and their dependents. This role should not only be recognized by government, but should be preserved and indeed encouraged with the continuation of tax incentives to both provide necessary health and dental care benefits which are not otherwise available under Canada's public health care system and to promote retirement savings.

Canada needs a health care system that meets the needs of a modern society and can adapt to newer and more effective technologies. The pressures on our health care system must be addressed in this context and not solely in terms of dollars and cents. Further, the increasing costs associated with pharmaceuticals cannot be sustained. These rising costs are a burden on Canadians, Governments, and the benefit plans we provide for our members. In terms of accountability for health care, the political gamesmanship must end and Canadians want co-operation among jurisdictions, as do we.

The assumption that the treatment of contributions to health care plans and pensions is inequitable or constitutes a tax "loophole" is erroneous. The tax system has a multitude of incentives for a multitude of purposes. The social objectives of preserving the well-being of Canadians and the financial independence of seniors has led to the placement of certain incentives in the tax system. Those who have chosen to avail themselves of these incentives should not now be penalized for doing so.

Any taxation of contributions to pension plans and on the plan's investment earnings would reduce plan coverage and benefit levels. Individuals not financially equipped for retirement rely on social services. The government will not save money by taxing pension plans. In addition, changes to public pension coverage will affect private pension plan design and, therefore, cannot be considered in isolation.

Accordingly, we respectfully submit that health benefits retain the current tax status, that the current retirement savings and pension system be preserved, that MEBPs be permitted to recover GST paid in respect of administration supplies and services and that Canada's health care programs be designed to deliver needed benefits in the most effective manner possible, without simply relying on a cost-shift away from government programs.