

NO.: **IT-502**

DATE: March 28, 1985

SUBJECT: INCOME TAX ACT
Employee Benefit Plans and Employee Trusts

REFERENCE: Paragraphs 6(1)(g) and 6(1)(h) (also sections 32.1, 104 and 107.1; subsections 6(10), 18(10), 70(2) and 212(17); paragraphs 6(1)(a), 12(1)(n), (n.1), 18(1)(k), (o), 87(2)(j.3), 88(1)(e.2), 108(1)(j) and 110.2(4)(g); and the definitions of employee benefit plan and employee trust in subsection 248(1))

At the Canada Customs and Revenue Agency (CCRA), we issue income tax interpretation bulletins (ITs) in order to provide technical interpretations and positions regarding certain provisions contained in income tax law. Due to their technical nature, ITs are used primarily by our staff, tax specialists, and other individuals who have an interest in tax matters. For those readers who prefer a less technical explanation of the law, we offer other publications, such as tax guides and pamphlets.

While the comments in a particular paragraph in an IT may relate to provisions of the law in force at the time they were made, such comments are not a substitute for the law. The reader should, therefore, consider such comments in light of the relevant provisions of the law in force for the particular taxation year being considered, taking into account the effect of any relevant amendments to those provisions or relevant court decisions occurring after the date on which the comments were made.

Subject to the above, an interpretation or position contained in an IT generally applies as of the date on which it was published, unless otherwise specified. If there is a subsequent change in that interpretation or position and the change is beneficial to taxpayers, it is usually effective for future assessments and reassessments. If, on the other hand, the change is not favourable to taxpayers, it will normally be effective for the current and subsequent taxation years or for transactions entered into after the date on which the change is published.

Most of our publications are available on our Web site at:
www.ccra.gc.ca

If you have any comments regarding matters discussed in an IT, please send them to:

*Manager, Technical Publications and Projects Section
Income Tax Rulings Directorate
Policy and Legislation Branch
Canada Customs and Revenue Agency
Ottawa ON K1A 0L5*

*or by email at the following address:
bulletins@ccra.gc.ca*

Contents

Summary

Discussion and Interpretation

Employee Benefit Plans

Definition (¶s 3-5)

Tax Result to Employee (¶s 6-15)

Tax Result to Employer (¶s 16-24)

Transition Period (¶ 25)

Tax Result to Custodian (¶s 26-31)

Employee Savings Plans (¶ 32)

Profit Sharing Plans (Other than Employees and

Deferred Profit Sharing Plans) (¶ 33)

Employee Trusts

Definition (¶s 34-37)

Tax Result to Employee (¶s 38-41)

Tax Result to Employer (¶s 42-43)

Tax Result to Employee Trust (¶s 44-46)

General Comments Applicable to Employee Benefit Plans and Employee Trusts (¶s 47-49)

Summary

¶ 1. Prior to 1980, certain plans existed in which an employee and an employer would arrange to defer payment of part or all of the employee's compensation by placing the compensation in the custody of a third party. Provided the employee had no immediate right to the compensation, the tax on the compensation would be deferred until it was eventually paid to the employee by the third party, whereas the employer would receive an income deduction in the year it was paid to the third party. These plans (commonly referred to as deferred compensation plans) were not subject to the provisions of Division G of the Act which regulates deferred and other special income arrangements.

¶ 2. This bulletin discusses the provisions which were introduced, effective for taxation years after 1979, to match the timing of the deduction from the employer's income with the inclusion of deferred compensation in the employee's income.

Discussion and Interpretation

Employee Benefit Plans

Definition

¶ 3. Subject to the exclusions in 4 below, an employee benefit plan is any arrangement under which the employer or someone not dealing at arm's length with the employer makes contributions to another person (called a custodian) and under which one or more payments will be made to or for the benefit of employees, former employees or persons with whom the employees and former employees do not deal at arm's length (hereinafter collectively referred to as "EBP beneficiary or EBP beneficiaries"). An arrangement which provides only for payment or payments to be made in respect of benefits which are expressly excluded from income by reason of subparagraph 6(1)(a)(i) of the Act is not an employee benefit plan.

¶ 4. Exclusions from the definition of employee benefit plan in subsection 248(1) include the following:

- (a) Registered Pension Funds or Plans as defined in subsection 248(1),
- (b) Group Sickness or Accident Insurance Plans, discussed in the current version of IT-85ⁱ,
- (c) Private Health Services Plans as defined in paragraph 110(8)(a) and discussed in the current version of IT-339ⁱⁱ,
- (d) Supplementary Unemployment Benefit Plans as defined in subsection 145(1),
- (e) Deferred Profit Sharing Plans as defined in subsection 147(1),
- (f) Group Term Life Insurance Policies as defined in subsection 248(1)ⁱⁱⁱ,
- (g) Employees Profit Sharing Plans as defined in subsection 144(1),
- (h) Wage Loss Replacement Plans of the type described in paragraph 6(1)(f) and discussed in the current version of IT-428^{iv},
- (i) Vacation-with-pay Trusts as described in paragraph 149(1)(y) and discussed in the current version of IT-389^v,
- (j) Employee Trusts as defined in subsection 248(1) (see 34 below),
- (k) Plans the sole purpose of which is to educate or to train employees to improve their work or work related skills and, abilities, and
- (l) Prescribed funds or plans under Regulation 6800.

Where an employer makes contributions to a custodian which are then used to fund several types of benefit plans, some of which are excluded from the definition of an employee benefit plan, it is necessary for the employer to identify the portion of each contribution that relates to each separate plan. If the custodian of such an omnibus arrangement does not account separately for the income and

disbursement of the component plans, it may be necessary to regard the total arrangement as an employee benefit plan and treat it accordingly in respect of the timing and amounts of both the employer's expense deductions and the EBP beneficiaries' receipt of benefits or income under the arrangement.

5. The Department considers the reference to "another person" in the definition of an employee benefit plan as a reference to an entity other than the employer but would include a trust for which the employer is trustee. However, the employee benefit plan provisions would not apply to the situation where the employer merely sets up an unfunded provision or reserve within the employer's accounts to cover future commitments to employees.

Tax Result to Employee

¶ 6. As a result of subparagraph 6(1)(a)(ii), no amount is required to be included in an employee's income in respect of any benefit received or enjoyed by the employee by reason of an employee benefit plan. Under paragraph 6(1)(g), however, all amounts received out of or under the plan or from the disposition of an interest in the plan constitute income from an office or employment to the recipient in the year received except to the extent that they represent one or more of the following amounts:

- (a) a death benefit received upon or after the death of an employee in recognition of the employee's service in an office or employment before the deduction described in the definition of death benefit in subsection 248(1) (a death benefit however, is taxable under subparagraph 56(1)(a)(iii)),
- (b) amounts which represent a return of the EBP beneficiary's own contributions, or in the case of a deceased EBP beneficiary, the refund of the deceased's contributions to an heir or a legal representative thereof (a return of contributions is discussed further in 15 below), or
- (c) a superannuation or pension benefit which is attributable to services rendered by the person while not resident in Canada (payments of this type are taxable by virtue of subparagraph 56(1)(a)(i) in the hands of a resident).

¶ 7. All amounts received by the EBP beneficiaries out of the plan, except those described in 6(a), (b) and (c) above, constitute income from an office or employment to the EBP beneficiaries regardless of the nature (e.g. capital gains, dividends) of the amounts when received by the plan and regardless of the fact that such income may have previously been taxed in the custodian's hands.

¶ 8. Where property other than cash is distributed in satisfaction of all or part of a beneficiary's interest in a trust governed by an employee benefit plan, it is the fair market value of the property which is taken into account in determining the amount to be included in income from an office or employment pursuant to paragraph 6(1)(g). The

beneficiary is deemed, by subparagraph 107.1(b)(ii), to have acquired the property at a cost equal to the greater of its fair market value at that time and the adjusted cost base to the beneficiary of the relevant interest in the trust disposed of (immediately before that time). Since the beneficiary is also deemed to have disposed of the interest in the trust for proceeds of disposition equal to the adjusted cost base of the interest (immediately before that time) by virtue of paragraph 107.1(c), no gain or loss is recognized on its disposition. Thus, where the fair market value of the property distributed is less than the adjusted cost base of the interest in the trust disposed of, the cost base of the property is increased over its fair market value by the amount of the difference.

¶ 9. If property distributed is depreciable property of a prescribed class and the capital cost to the trust exceeds the deemed cost to the beneficiary, the capital cost to the beneficiary is deemed by paragraph 107.1(d) to be the amount which was the capital cost to the trust. The difference is deemed to have been allowed to the beneficiary as capital cost allowance. In a subsequent disposition of the property by the beneficiary there is a potential for recapture of capital cost allowance deducted by the trust.

¶ 10. The Department considers an amount to have been received by an EBP beneficiary out of the plan upon the earlier of the date upon which payment is made and the date upon which the EBP beneficiary has constructively received a payment. Constructive receipt is considered to apply in situations where an amount is credited to an EBP beneficiary's debt or account, set apart for the EBP beneficiary or otherwise made available to the EBP beneficiary without being subject to any restriction concerning its use. Consideration will be given to the application of subsection 56(2) (indirect payments) where payments are made to persons other than the employee or former employee while living.

¶ 11. Where the terms of an employee benefit plan provide that an employee entitled to benefits thereunder may elect to defer the receipt of a lump-sum amount payable on death, retirement or other termination of employment, it is the Department's view that the amount so deferred would normally be taxed in the year of actual receipt provided the election to defer is made prior to the termination of employment. Where, for instance, the plan specifies that an amount becomes payable 30 days after a particular event, the election must be made prior to the 30th day after such event. If, however, the plan specifies that the amount becomes payable on the happening of a particular event and the amount is to be paid within 30 days thereafter, the election must be made prior to the particular event.

¶ 12. Subsection 70(2) may be applicable on the death of an EBP beneficiary in respect of an entitlement by reason of membership in an employee benefit plan. However, such a determination depends upon the nature of the deceased's interest in the plan and is unaffected by the plan's qualification as an employee benefit plan. Factors taken into

account in determining whether or not an amount is a "right or thing" are discussed in the current version of IT-212^{vi}, but subsection 70(2) will generally be applicable to a funded deferred compensation arrangement whereas it will not generally be applicable to a lump-sum payment out of an unregistered pension plan.

¶ 13. Paragraph 110.2(4)(g) denies the pension income deduction for employee benefit plan payments whether reported under paragraphs 6(1)(g) or 56(1)(a).

¶ 14. Since payments out of an employee benefit plan represent income from an office or employment, subsection 212(17) specifically excludes these payments from Part XIII tax when paid to a non-resident of Canada. Such payments attributable to services rendered in Canada will be taxed under Part I as income from employment as provided by subsection 2(3), paragraph 6(1)(g) and subparagraph 115(1)(a)(i) unless exempted by a tax convention.

¶ 15. EBP beneficiary contributions to the plan are not deductible for tax purposes in any circumstances. As discussed in 6 above, a return of EBP beneficiary contributions by the plan is not included in income. Furthermore, the following amounts are not taxable in the year received from the plan because subsection 6(10) deems them to be a return of amounts contributed to the plan by the individual:

- (a) an amount included in the income of an individual in a year previous to the year in which it was received from the plan, and
- (b) where an employee trust subsequently becomes an employee benefit plan, a defined portion of amounts previously allocated and taxed when the plan was an employee trust.

The defined portion in (b) above is calculated as the lesser of

- (c) the unpaid amounts which were allocated to the individual or a deceased person of whom the individual is an heir or legal representative when the plan was an employee trust, and
- (d) the individual's share of the cost amount of the employee trust's assets less its liabilities immediately before ceasing to be an employee trust

minus

- (e) amounts previously received out of a plan by the individual or a deceased person of whom the individual is an heir or legal representative when the plan was an employee benefit plan and which were deemed to be a return of contributions under (b) above.

Tax Result to Employer

¶ 16. After the 1979 taxation year, paragraph 18(1)(o) denies a deduction for employer contributions to an employee benefit plan. However, by virtue of subsection 18(10), the denial of a deduction does not apply

- (a) to the portion of contributions with respect to non-residents, who are regularly employed abroad, for services rendered while non-residents, or
- (b) where the plan custodian is a non-resident, to the portion of contributions with respect to employees who were not resident in Canada, or who were resident for a period (excluded period) of not more than 36 of the 72 months prior to the contributions and were beneficiaries under the plan before becoming resident, for services performed or to be performed while they are non-residents or during the excluded period.

¶ 17. Commencing with the 1980 taxation year, an employer's deduction is conditional upon contributions to the plan being included in the income of employees. Section 32.1 provides specific rules to achieve this result and to ensure that the deduction available to an employer is limited to contributions in respect of the employer's own employees or former employees.

¶ 18. By virtue of paragraph 32.1(1)(a), the employer's deduction for a taxation year is the amount allocated under subsection 32.1(2) to the employer for that year by the plan custodian to the extent it does not exceed the aggregate of the employer's contributions for the year or a preceding year to the plan that were neither previously claimed as a deduction nor refunded. Paragraph 32.1(1)(b) provides a final deduction to the employer once the plan's obligations to EBP beneficiaries have been satisfied and none of the property of the plan will thereafter be available to the employer. This final deduction is also limited to the portion of amounts previously contributed to the plan that has neither been deducted by nor refunded to the employer.

¶ 19. Pursuant to subsection 32.1(2), the plan custodian determines the amounts to be allocated to the employer. This allocation represents the payments out of the plan during the year (other than a return of contributions - see 6(b) above) to the employer's employees or former employees or their

estates or heirs that exceed the income of the plan for the year. Consequently, payments from the plan are considered to be first a return of EBP beneficiary contributions, secondly a distribution of the plan's income for the year, thirdly a distribution of employer contributions and finally a distribution of the plan's prior years' income, if any.

¶ 20. Pursuant to subsection 32.1(3), the income of the plan for a year excluded from the allocation to the employer as noted above is determined as follows:

- (a) where the plan is a trust, its income for the year determined without reference to subsections 104(4) to (26), and
- (b) in any other case, the aggregate of the non-capital portion of all payments made under the plan in the year by the custodian.

¶ 21. Paragraph 12(1)(n.1) requires an employer to include in income for a taxation year the amounts received in that year from an employee benefit plan (other than amounts required by paragraph 104(13)(a) to be included in income under paragraph 12(1)(m)) to the extent they exceed the amount by which the aggregate of

- (a) contributions to the plan for the year or a preceding year, and
- (b) prior inclusions in income under paragraph 12(1)(n.1) exceeds the aggregate of
- (c) deductions with respect to contributions to the plan in computing income for that year and any preceding year, and
- (d) amounts received from the plan in prior years (other than amounts included in income by virtue of paragraph 12(1)(m)).

¶ 22. In general, the amount required to be included by an employer in income under paragraph 12(1)(n.1) is the excess of amounts received to date over the undeducted portion of the employer's contributions made.

Example

<u>Year</u>	<u>Employer Contributions</u>	<u>Plan Earnings</u>	<u>Payments to Employee</u>	<u>Return of Contributions to Employer</u>	<u>Deduction to Employer (Section 32.1)</u>
1	\$3,000	\$300	\$2,000	\$ 300	\$1,700
2	<u>1,000</u>	<u>200</u>	<u>100</u>	<u>2,100</u>	<u>NIL</u>
Total	<u>\$4,000</u>	<u>\$500</u>	<u>\$2,100</u>	<u>\$2,400</u>	<u>\$1,700</u>

Computation of 12(1)(n.1) inclusion

	<u>Year 1</u>	<u>Year 2</u>
Amounts received to date	\$ 300	\$2,400
Less: Amounts contributed to date	\$3,000	\$4,000
Less: Amounts deducted to date	<u>1,700</u>	<u>1,700</u>
Undeducted portion of contributions	<u>1,300</u>	<u>2,300</u>
Paragraph 12(1)(n.1) inclusion	<u>\$ NIL</u>	<u>\$ 100</u>

¶ 23. For the purposes of section 32.1, the Department considers that if an amount has been constructively received by an employee (see 10 above), the plan has made a constructive payment to the employee.

¶ 24. In multi-employer plans, if one of the corporate members were to be liquidated before the termination of the employee benefit plan, the benefit of the deduction discussed in 17 above would be lost unless the liquidation is one to which subsection 88(1) applies, in which case the parent corporation would be deemed to be a continuation of the liquidated subsidiary company by virtue of paragraphs 87(2)(j.3) and 88(1)(e.2). Paragraph 87(2)(j.3) also provides a similar “rollover” upon amalgamation of a predecessor corporation’s entitlement to the deduction under section 32.1.

Transition Period

¶ 25. For plans in existence prior to 1980 which meet the definition of an employee benefit plan, the Department accepted for the 1980 taxation year a claim for an expense deduction in respect of the employer’s contributions provided the EBP beneficiaries reported such amounts as income so that the matching concept was present. When such amounts (as well as amounts which were taxed in years prior to 1980 and allowed as a deduction to the employer) are subsequently paid out of the plan in 1980 and subsequent years, clause 32.1(1)(a)(ii) will preclude a further deduction by the employer and paragraph 6(10)(a) will provide the EBP beneficiaries with treatment of the amounts as returns of EBP beneficiary contributions.

Tax Result to Custodian

¶ 26. Where the plan is not a trust, the custodian is taxable on the plan’s income which has not been paid out in the year at the custodian’s applicable tax rate. Contributions are not included in gross income nor are payments out of those contributions or prior years’ accumulated income deductible by the custodian.

¶ 27. Where the plan is a trust, the trust is taxable on its income determined under Part I. Contributions are not included in gross income and payments out of those contributions or prior years’ accumulated income are not deductible by the trust.

¶ 28. The trust includes in its gross income the amount of its income from the investment of trust property and other income incidental to the operation of the trust. Where gross income (i.e., the aggregate of its income from all sources) exceeds \$500 in the taxation year (and in certain other circumstances indicated on the form) the trustee must file form T3, *Trust Information Return and Income Tax Return*.

¶ 29. In determining the income of the trust for a taxation year there may be deducted, in the following order:

(a) expenses incurred in earning the investment or other income of the trust,

(b) expenses related to the normal operation of the trust (including those incurred in the collection of and accounting for contributions to the trust) except to the extent that such expenses are expressly not allowed under the Act, and

(c) pursuant to paragraph 104(6)(a.1) amounts paid to beneficiaries (including an employer where the trust so provides) out of current year’s trust income including amounts to which they have an unrestricted right (see 10 above).

The remainder of the income of the trust is subject to income tax under section 122 of the Act. As an inter vivos trust, the taxation year of the trust coincides with the calendar year. Amounts which have been taxed in the trust will also be included in beneficiaries’ income when received in a later year. That is, additional tax becomes exigible if the income of the trust is not paid annually to beneficiaries.

¶ 30. Where the trust distributes property other than cash to beneficiaries in satisfaction of all or part of their interest in the trust, the trust is deemed by paragraph 107.1(b) to have disposed of the property for proceeds equal to its cost amount to the trust immediately before that time. Cost amount is defined in subsection 248(1). That is, if the trust held property and distributed it to beneficiaries after its value had appreciated, there would be no tax consequences to the trust. On the other hand, if the trust sells the property at a gain and fails to distribute the gain to the beneficiaries within the taxation year, the trust will be taxed upon the gain and the beneficiaries will be taxed upon the amount distributed to them in a subsequent year.

¶ 31. If the trust is a non-resident its income from trust property would not be subject to Part I tax except possibly under section 94. (See the current version of IT-447.^{vii}) However, such income from Canadian sources may be subject to withholding tax under Part XIII.

Employee Savings Plans

¶ 32. Typically the terms of an employee savings or thrift plan provide that the employer’s contributions will be a percentage of employee contributions. There may be a vesting period and withdrawal restrictions. Where such a plan is administered by a custodian, it will normally fall within the definition of an employee benefit plan and be subject to the employee benefit plan rules outlined above. However, an employee savings or thrift plan will not be an employee benefit plan provided that the plan is structured in such a way that the employer’s contribution is a payment of salary and paid to the plan custodian at the direction of the employee. Consequently, there are four tax treatments possible with regard to the employer contributions:

<u>Situation</u>	<u>Status of Plan</u>	<u>Employee</u>	<u>Employer</u>
1. Employer makes payments to plan at employee direction	Not an EBP	Taxed under 5(1)	Immediate deduction from income
2. Employer's contribution to plan constructively received by employee at time of contributions	EBP	Taxed under 6(1)(g) at time of contribution	Deduction under 32.1 at time of contribution
3. Vesting of employer's contributions to the plan is delayed and constructive receipt is present on vesting	EBP	Taxaed under 6(1)(g) at time of constructive receipt	Deduction under 32.1 at time of constructive payment
4. Constructive receipt of employer contributions not present	EBP	Taxed under 6(1)(g) at time of actual receipt	Deduction under 32.1 at time of actual payment

Profit Sharing Plans (Other than Employees and Deferred Profit Sharing Plans)

¶ 33. A profit sharing plan that is neither an employees profit sharing plan as defined in subsection 144(1) nor a deferred profit sharing plan as defined in subsection 147(1) generally falls within the definition of an employee benefit plan and therefore is subject to employee benefit plan rules outlined above. Paragraphs 18(1)(k) and 18(1)(o) prohibit a deduction for an employer's contribution to a profit sharing plan or an employee benefit plan respectively. If a profit sharing plan that falls within the definition of an employee benefit plan could receive the exemption in some given circumstances under subsection 18(10) (see 16 above), paragraph 18(1)(k) would still prohibit a deduction to the employer at the time of contribution. However, section 32.1 allows the employer a deduction for employer contributions when they are paid out to the employees regardless of the fact that the plan is a profit sharing plan.

Employee Trusts

Definition

¶ 34. Subject to the exclusions in 36 below, an employee trust is an arrangement established after 1979 which meets all of the following conditions:

- (a) payments are made by an employer to a trustee in trust for the sole benefit of employees or former employees of the employer or employees or former employees of a person who does not deal at arm's length with the employer (the term "employee(s)" in the following paragraphs on employee trusts includes "former employee(s)");
- (b) the right to the benefits vests in the beneficiaries at the time of each payment;
- (c) the amount of a benefit does not depend on the beneficiary's position, performance or compensation as an employee;
- (d) the trustee allocates annually to beneficiaries the amount as set out in 37 below; and

- (e) the trustee elects in the return of income filed within 90 days from the end of the first taxation year of the trust to be an employee trust.

¶ 35. A qualifying arrangement that subsequently fails to meet any of the above conditions ceases to be an employee trust and thereby becomes an employee benefit plan trust subject to the employee benefit plan provisions. However, as discussed in 15 above, subsection 6(10) provides relief from double taxation in respect of previously taxed allocations.

¶ 36. By virtue of the definition in subsection 248(1) of the Act, an employee trust does not include

- (a) an employees profit sharing plan defined by subsection 144(1),
- (b) a deferred profit sharing plan defined by subsection 147(1),
- (c) a deferred profit sharing plan which has been revoked, or
- (d) any trust established before 1980.

¶ 37. Pursuant to paragraph (b) of the definition of employee trust in subsection 248(1), the amount to be allocated annually to beneficiaries by the trustee, in a reasonable manner, consists of the aggregate of

- (a) employer contributions for the year including contributions from a person who does not deal at arm's length with the employer,
 - (b) income of the trust for the year computed without reference to subsection 104(6) (other than a taxable capital gain) from a property or other source other than a business, and
 - (c) a capital gain of the trust for the year from the disposition of property,
- less the aggregate of
- (d) the loss of the trust for the year (other than an allowable capital loss) from a property or other source other than a business, and

- (e) a capital loss of the trust for the year from the disposition of property.

This annual allocation does not provide for the allocation of negative amounts to beneficiaries, and such amounts may not be applied against the trust's income of other years. For example, if capital losses exceed capital gains, non-business income and employer contributions in a year, the capital losses are not deductible by beneficiaries because no amount can be allocated to beneficiaries. While a capital loss in a year reduces the amount to be allocated to beneficiaries in that year, it may not be applied to reduce future capital gains or allocations.

Tax Result to Employee

¶ 38. No amount is required to be included in employees' incomes under paragraph 6(1)(a) in respect of any benefit actually received or enjoyed by reason of participation in an employee trust. However, under paragraph 6(1)(h) beneficiaries must include in their income from an office of employment amounts allocated to them by the trustee (see 37 above) for the year regardless of the nature (e.g. capital gains, dividends) of the amounts when received by the trustee. Consequently, the beneficiaries are taxed only on amounts allocated each year which may differ from amounts paid into or distributed by the employee trust during that year.

¶ 39. Where a beneficiary is in receipt of a distribution in kind from an employee trust in settlement of all or part of the beneficiary's interest in the trust, the beneficiary is deemed, pursuant to paragraph 107.1(a), to have acquired the property at a cost equal to its fair market value at that time. If the property is depreciable property of a prescribed class and the deemed cost is less than the capital cost to the trust, paragraph 107.1(d) provides that the capital cost to the beneficiary is deemed to be the amount that was the capital cost to the trust. The difference is deemed to have been allowed to the beneficiary as capital cost allowances. Thus, in a subsequent disposition of the property by the beneficiary, there is a potential for recapture of capital cost allowance deducted by the trust. Paragraph 107.1(c) provides that the beneficiary is deemed to have disposed of the interest or part interest in the trust at its adjusted cost base.

¶ 40. The provisions of paragraph 110.2(4)(g) (denial of pension income deduction) and subsection 212(17) (exclusion from Part XIII tax) discussed in 13 and 14 above also apply to payments out of an employee trust.

¶ 41. Contributions to an employee trust by employees are neither deductible for income tax purposes nor taxed on distribution. See also 15(b) above concerning an employee trust which subsequently becomes an employee benefit plan.

Tax Result to Employer

¶ 42. In the absence of a specific provision in the Act to deny employers a deduction for their contributions to an employee trust, the provisions of subsection 9(1) and

paragraph 18(1)(a), subject to the general limitation of reasonableness under section 67, apply to permit a deduction to employers. However, if an employee trust is also a profit sharing plan, other than an employee's profit sharing plan as defined in subsection 144(1) or a deferred profit sharing plan as defined in subsection 147(1), paragraph 18(1)(k) denies a deduction to the employer for contributions to such a trust. This is in contrast to an employee benefit plan that is also a profit sharing plan where, as outlined in 33 above, a deduction would be available to the employer.

¶ 43. All amounts received by an employer or by a person with whom the employer does not deal at arm's length, out of or under an employee trust, are income to the recipient in the year received pursuant to paragraph 12(1)(n).

Tax Result to Employee Trust

¶ 44. Qualification as an employee trust requires the annual allocation of all non-business income of the trust to its beneficiaries. The allocation of business income if any, is precluded by subsection 104(6). Net business income is taxed in the trust at the rates specified in section 122. The trustee must file form T3, *Trust Information Return and Income Tax Return* where gross business income exceeds \$500 in the taxation year and in certain other circumstances indicated on the form.

¶ 45. Where an employee trust distributes property other than cash to beneficiaries, the trust is deemed by paragraph 107.1(a) to have disposed of the property for proceeds equal to its fair market value at that time, creating the possibility of recapture of capital cost allowances and capital gains or losses in the trust.

¶ 46. The comments in 31 above also apply to an employee trust which is a non-resident trust.

General Comments Applicable to Employee Benefit Plans and Employee Trusts

¶ 47. By virtue of the definition of "trust" in paragraph 108(1)(j), the following provisions of subdivision k (sections 104 to 108) do not apply to a trust governed by an employee benefit plan or an employee trust:

- (a) subsections 104(4) and (5) dealing with deemed periodic realizations,
- (b) subsections 104(12), (14) and (15) dealing with preferred beneficiary elections, and
- (c) sections 105 to 107 dealing with benefits under trusts and transactions involving interest in trusts.

¶ 48. Amounts to be included in income of recipients or beneficiaries as outlined in 6 and 38 above, which for taxation purposes will be regarded as salary or wages derived from an office or employment, whether derived from an employee benefit plan or an employee trust, will not be subject to either Canada Pension Plan contributions or unemployment insurance premiums. In the case of payments

out of or under an employee benefit plan, a requirement to withhold income tax will arise at the earlier of the date payment is made to the recipients or the date on which they acquire an unrestricted right to receive payment. No liability for withholding is incurred by a trustee in respect of allocations or payments made to beneficiaries out of or under an employee trust. The trustee or custodian, as the case may be, is required to make an information return to report both

the amounts allocated under an employee trust and payments out of or under an employee benefit plan. Form T4A is the prescribed form.

¶ 49. The Act does not restrict the investments which an employee benefit plan or an employee trust may acquire. However, refer to 10 above concerning use of plan funds by an EBP beneficiary.

ⁱ Modified by Correction Sheet CS 24 dated April 20, 2001

ⁱⁱ Modified by Correction Sheet CS 24 dated April 20, 2001

ⁱⁱⁱ Reference to IT-227R has been deleted since IT-227R and its Special Release were cancelled by the *Index to Interpretation Bulletins and Technical News* dated December 31, 2001.

^{iv} Modified by Correction Sheet CS 24 dated April 20, 2001

^v Modified by Correction Sheet CS 24 dated April 20, 2001

^{vi} Modified by Correction Sheet CS 24 dated April 20, 2001

^{vii} Modified by Correction Sheet CS 24 dated April 20, 2001