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Client Advisory

Canada Pension Plan Contributions and Self-Insured Disability Benefits: The Rules Change Again

January 19, 2012

Summary

In December 2011, the federal government amended the Canada Pension Plan (CPP) to clarify that contributory earnings for CPP purposes include all employer-funded disability benefits provided on a self-insured basis. These new rules apply retroactively to 2006 and override case law and earlier direction from the Canada Revenue Agency (CRA) that exempted certain types of self-insured disability benefits from CPP. In a website posting dated January 13, 2012, the CRA indicated that employers must apply these new withholding requirements effective January 1, 2012.

This Advisory reviews the changes and discusses practical considerations for plan sponsors of self-insured disability programs. Note that the CPP rules do not change the existing rules for the Quebec Pension Plan (QPP).

Application of the New Rules

The new rules apply only to employer-funded disability benefits provided on a self-insured basis.

Therefore, the application of the new withholding requirements depends on the nature of the wage loss program. A plan is considered to be funded by an employer if the employer pays any portion of the costs of coverage or benefits. Self-insured benefits include those directly paid by the employer, from general revenues, as well as those paid by an administrator on behalf of an employer under an administrative services only (ASO) arrangement. Third party administrators or insurers can act as ASO providers.

It is generally understood that federal source deductions (e.g. CPP contributions and Employment Insurance (EI) premiums) do not apply to disability benefits paid:

- By a licensed insurance company under the terms of a regulated insurance contract (i.e. an insured program),

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- Under a trust that complies with the CRA's guidelines on Health and Welfare Trusts or Employee Life and Health Trusts (i.e. a trusteed program),
- Under a program in which 100% of the costs are paid for by employees (i.e. an employee-pay-all program).

The programs listed above are not considered employer-paid, self-insured programs and are therefore not subject to the new legislation.

Background

Historically, there has been considerable debate on the application of both CPP and EI to employer-paid, self-insured disability programs. In 2002 and 2003, two Federal Court of Appeal decisions confirmed that EI premiums (employer and employee) do apply to self-insured disability benefits: *Canada (Attorney General) v. National Bank of Canada* and *Université Laval v. Canada (Minister of National Revenue)*. In these cases, the Court interpreted the phrase "in respect of employment", as used to define payments subject to CPP, to include all taxable amounts paid by an employer (subject to specific statutory exclusions). Payments need not represent compensation for specific services performed as long as the amounts are a liability of the employer and paid as a result of the employment relationship.

In 2010, the Federal Court of Appeal considered the application of CPP to employer-paid, self-insured programs in *Toronto Transit Commission v. Canada (National Revenue) 2010 CRA 233* (TTC Decision). While the *Employment Insurance Act* (EI Act) refers to amounts paid "in respect of employment", the *Canada Pension Plan Act* (CPP Act) historically referred to amounts paid "for employment". The Court concluded that by using different words, Parliament must have intended a different result and found that CPP contributions could apply only to amounts paid as compensation for specific services rendered. Amounts payable under the ASO disability program were not pensionable because they were in the nature of insurance benefits rather than compensation for services rendered.

Following the TTC Decision, the CRA issued directions to plan sponsors. Rather than recognizing an exemption for all self-insured programs, CRA read the TTC Decision narrowly as allowing an exemption only where the program qualified as a "wage loss replacement plan". In very general terms, "wage loss replacement plans" include only those programs administered by a third party with benefits paid by that third party on the plan sponsor's behalf. Standard ASO arrangements would generally qualify assuming the administrator held funds on deposit from which benefits were paid. The correctness of the CRA's position, in limiting the application of the TCC Decision, was debated. For additional background, please see our August 19, 2010 Client Advisory "CRA Policy Change for Wage Loss Replacement Plans".

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Bill C-13, *An Act to implement certain provisions of the 2011 budget as updated on June 6, 2011 (Keeping Canada's Economy and Jobs Growing Act)*

A legislative amendment on this issue was included in Bill C-13 which received Royal Assent on December 15, 2011. Part 15 of the Bill amends various provisions of the CPP Act to confirm that pensionable earnings, for CPP purposes include not only salary, wages and compensation paid *"for"* pensionable services but also remuneration paid *"in respect of"* pensionable services. The use of the broader term "in respect of" is intended to ensure that any amounts paid by an employer under self-insured disability programs are considered pensionable earnings for CPP purposes. The language used in the CPP Act, for defining pensionable earnings, is now generally consistent with that used in the EI Act for defining insurable earnings (subject to express exemptions and extensions within these Acts).

Practical Considerations

1. *Retroactive Effect and Reconciliation with CRA Guidelines*

The Bill 13 changes to the CPP were made retroactive to 2006 to eliminate potential governmental costs associated with taxpayers seeking CPP refunds on self-insured benefits paid out before 2012. Were the law made effective from January 2012, taxpayers who had paid the CPP contribution on those benefits could have sought refunds based on the TTC Decision.

It appears that the CRA will not be seeking to reassess plan sponsors or plan members for unpaid CPP contributions in relation to benefits paid before 2012. On January 13, 2012, the CRA issued the following statement confirming that regardless of the historic filing position or nature of the disability program, taxpayers should start paying CPP on self-insured benefit payments made on or after January 1, 2012:

> "The treatment of wage loss replacement plans (WLRP) payments for Canada Pension Plan (CPP) purposes changed over the years. For a period, payments made from certain types of uninsured WLRP plans were not considered pensionable. In December 2011, new CPP legislation clarified that **all** payments made from uninsured WLRPs are considered to be remuneration from pensionable employment. This legislation is retroactive to January 1, 2006.
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> Employers who have not deducted CPP on uninsured WLRP payments in the past, whether those plans follow insurance principles or not, should start doing so effective January 1, 2012. Employers who deducted CPP on these WLRP will not be refunded those deductions. However, the Canada Revenue Agency will consider any request it receives from employees to review their particular situation on a case-by-case basis."

2. *Mitigating the Impact: CPP Annual Maximums and CPP Disability Benefit Claimants*

The impact of the new CPP rules is mitigated by the CPP contribution limit (currently 9.9% of contributory earnings, to an annual maximum contribution of $2,306.70). Individuals on short-term disability often have significant periods of active service in the year during which they will have paid

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into the CPP. In many cases, individuals reach or approach their maximum CPP contribution during these periods of active service.

For those plan members who go on to claim long-term disability (LTD) benefits, there are strong arguments that pensionable earnings, for CPP purposes, should not include amounts received under an employer's LTD program by an individual who qualifies for the CPP disability benefit. Under most LTD programs, the benefit is offset by regular CPP disability benefits paid or payable to the individual and these plans require the individual to make appropriate application for CPP disability benefits on a timely basis. Eligibility for CPP disability benefits is generally assessed after approximately four months of continuous disability.

3. *Impact on Plan Administration*

Administrative providers historically have not offered a means of administering CPP contributions or EI premiums in relation to self-insured disability programs. In light of changes in the CPP, some service providers are developing a manual approach to allow for collection and remittance of employee CPP contributions. Plan sponsors should carefully review their administrator's current and future capabilities in relation to both CPP and EI collection, reporting and remittance. Employers should ensure that the administrator provides sufficient reporting to ensure that appropriate employer CPP contributions and EI premiums can also be paid. In order to become fully compliant with the new CPP rules (and existing rules for EI), plan sponsors may need to consider other funding options including moving to an advise-to-pay arrangement (i.e. where the provider adjudicates initial and ongoing eligibility but benefits are paid through an employer's payroll systems) or moving to an insured or independently trusteed arrangement.

4. *Plan Member Communications*

Plan sponsors should consider the need to communicate to plan members any change in payroll taxes or other pay-based levies resulting from Bill C-13 or any change in funding strategy.

5. *Funding Strategy*

CPP contributions are only one consideration in developing an appropriate funding strategy for a particular program. Federal source deductions should be considered together with the application of provincial pay-based taxes and levies (e.g. QPP, Ontario Employer Health Tax) as well as federal and provincial transaction taxes (e.g. retail sales tax, premium tax, goods and services tax, harmonized sales tax).

In developing an appropriate strategy, source deductions may be less important than other issues, including the implications to cashflow, accounting reporting, litigation/arbitration risk, administrative complexity and cost as well as employee and labour relations, and especially security of benefits. Towers Watson has tools to assist plan sponsors in reviewing the pros and cons of insured, trusteed and self-insured programs as well as hybrid funding structures.

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For more information

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