Information for Employers

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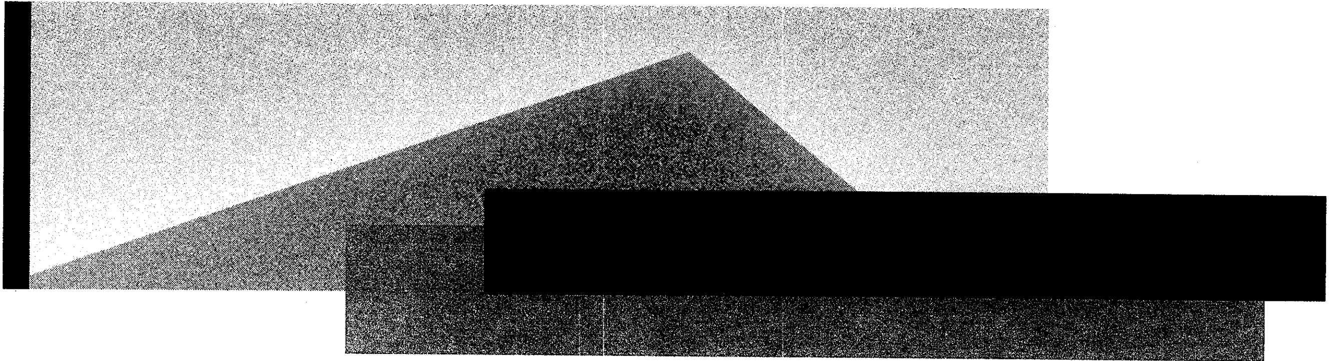

Employer - Provided Group Term Life Insurance

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Canada

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Summary

The following update provides information about the amendments to the income tax legislation regarding employer-provided group term life insurance released by the Minister of Finance on June 16, 1994. This update also confirms Revenue Canada's position on deducting at source and reporting for this benefit. The following is not a complete description of the legislation, and is provided on the basis that the draft legislation is passed into law in essentially the same form as proposed.

Changes to the legislation

In summary, effective July 1, 1994, the draft amendments eliminate the income tax exemption for the first $25,000 of coverage under a group term life insurance policy. This change applies to both current and retired employees who receive group term life insurance benefits from their present or former employer. As a result, any reference in this update to "employee" will, depending on the context, apply equally to "former employee." Any reference to "employer" will apply equally to "former employer."

Essentially, the draft amendments provide that the benefit to an employee is the total of the following three items, as they apply:

- the employee's term insurance benefit;
- the employee's prepaid insurance benefit; and
- sales tax applicable to the employee's insurance coverage, less any sales tax the employee paid either directly or by way of reimbursement to the employer.

Term insurance is any life insurance under a group term life insurance policy other than insurance for which a lump-sum premium has become payable or has been paid. Life insurance for active employees would usually be term insurance, although term insurance is sometimes provided for retired employees as well.

Prepaid insurance is insurance for which a lump-sum premium is payable or has been paid.

A **lump-sum premium** is a premium for insurance on an individual's life where all or part of the premium is for insurance for a period that extends more than 13 months after the payment of the premium (or more than 13 months after the time the premium became payable, if it is paid after it became payable). Lump-sum premiums are usually paid to acquire paid-up insurance. This is insurance for the remainder of an individual's lifetime, and for which no further premiums will be payable for that insurance. Lump-sum premiums paid to purchase paid-up insurance are paid-up premiums. Paid-up insurance is most commonly acquired for employees when they retire.

Calculating a benefit

In calculating an employee's term insurance benefit from coverage provided for the employee after June 1994, it doesn't matter when the employer paid the premiums to provide that coverage. Therefore, even if the premiums to provide term insurance coverage after June were paid in January 1994, for example, the new rules will apply to that coverage. However, in calculating the employee's prepaid insurance benefit, it does matter when the employer paid the premiums. The rules for determining an employee's prepaid insurance benefit apply only to premiums paid after February 1994. This is more fully described later in this update.

For 1994, an employee's total benefit from employer-provided group term life insurance will consist of the total of the benefit calculated for the first six months of the year under the existing rules, **plus** the benefit calculated for the last six months of the year by using the rules provided in the draft amendments.

When to start adjusting deductions

When possible, source deductions should have been adjusted starting July 1, 1994, to take into account the additional benefit. However, given the timing of the release of the draft amendments, Revenue Canada recognizes that some employers may not have had enough time to meet the implementation date due to such things as reprogramming requirements or calculation problems. Therefore, as long as an employer has made a reasonable effort to implement the new provisions as quickly as possible, penalties and interest will not be assessed for late remittance for this benefit in 1994. Nevertheless, employers should note that, once implementation is complete, any deductions they missed during the implementation period should be caught up in subsequent pay periods in 1994. This will minimize the possibility of employees having a tax balance outstanding at the year end.

Legislative changes in detail

Group term life insurance policy

The draft legislation defines a "group term life insurance policy" as a group life insurance policy where the only amounts payable by the insurer are policy dividends, experience rating refunds, and amounts payable upon the death or disability of an employee or former employee.

Benefit calculation for term insurance

For each day in the year:

- multiply the amount of term insurance in force for the employee on that day by the average daily cost of insurance;
- total the above amounts for each day in the year;
- add the sales tax applicable to the premium paid in respect of the coverage for the year;
- subtract any amount the employee paid in respect of the term insurance and sales tax for the year.

The average daily cost of insurance referred to above is determined by:

- adding the total of the premiums payable for the calendar year under the policy for term insurance and any premiums paid in the year in respect of prior years (e.g., premium deficiencies) which have not as yet been included in the calculation of the cost of insurance for any year;
- subtracting from the above total any policy dividends or experience rating refunds the employer received in the year; and
- dividing the remainder by the amount determined by:
  a) calculating the total amount of term insurance in force for all employees for each day in the year; and
  b) adding together the total amount of term insurance for all employees for each day in the year, to give a total for the year as a whole.

The proposed rules provide flexibility in determining the average daily cost of insurance by also permitting the use of any other reasonable method, as long as it is substantially similar to the method specified above. In some cases, an example of a reasonable method would be the use of the policy year instead of the calendar year.

It should be noted that, when an employer enjoys a premium holiday instead of receiving an experience rating refund, the effect will be a reduction in the average daily cost of insurance for the year.

In calculating the average daily cost of insurance, the new rules refer to the term "premium category," which refers to the grouping of employees for premium purposes (e.g., union vs. non-union). For 1994, the rules specify that there is only one premium category for all individuals who are covered under a group term life insurance policy. This is also the case under the existing rules. However, for 1995 and subsequent years, the cost of insurance will be calculated for each premium category for which different premium rates have been established, except when the premium categories are based on age, sex, or both. For example, if two premium categories have been established based on age, they will be considered to be one category for the purpose of calculating the average daily cost of insurance.

The benefit calculation is based on factors which may be known only at the end of the year. Therefore, for purposes of **deducting** at source during the year, the employer may calculate the benefit using a reasonable estimate of these factors. However, for purposes of **reporting** the benefit at year-end on the employee's T4 or T4A, the employer should recalculate to determine the actual benefit using the correct figures.

Example for purposes of deducting at source

Assumptions

For example, let us assume that:

- three employees earning salaries of $38,000, $41,000, and $42,500 respectively are covered under the policy;
- the employees are expected to work all year and their salaries are not expected to change;
- the benefit payable in the event of death is 2 × the salary;
- employees are paid biweekly;
- the annual premium charged by the insurer is $1,200 (estimated);
- the policy is not experience-rated;
- the coverage is fully employer-paid; and
- sales tax applies at the rate of 8% and, in this example, is determined as a percentage of the term insurance benefit.

Using the above assumptions, the taxable benefit for purposes of deducting at source for the employee earning $41,000 is calculated as follows:

a) Average daily cost of insurance (per dollar of coverage)

$$\frac{\textbf{(Premiums - refunds)}}{\textbf{Sum for the year of total coverage for each day}} = \frac{(\$1,200 - 0)}{[(\$38,000 \times 2) + (\$41,000 \times 2) + (\$42,500 \times 2)] \times 365} = \frac{\$1,200}{88,695,000} = \$.000013529$$

b) Term insurance benefit for the pay period

Employee coverage × average daily cost of insurance per dollar of coverage × **Number of days in pay period** = **($82,000 × $.000013529) × 14 = $15.53**

c) Sales tax

$15.53 × 8% = $1.24/pay period

d) Estimated benefit for the pay period

Term insurance benefit + sales tax benefit = $15.53 + $1.24 = $16.77

Accidental death and dismemberment

Policy premiums for accidental death and dismemberment coverage are not included in determining the taxable benefit from group term life insurance coverage.

Prepaid insurance

In general terms, an employee's prepaid insurance benefit for a year is equal to the amount of lump-sum premiums the employer paid in the year for that employee. However, as a transition measure, lump-sum premiums paid before 1997 to purchase paid-up insurance (e.g., "paid-up premiums") are spread out over three years. For example, when an employer buys paid-up insurance in 1994 for an employee, the employee would have a benefit in each of the years 1994, 1995, and 1996, which is equal to one-third of the premiums the employer paid. Similarly, when an employer buys paid-up insurance in 1996 for an employee, the employee would have a benefit in each of the years 1996, 1997, and 1998, which is equal to one-third of the premiums the employer paid.

More specifically, an employee's prepaid insurance benefit for a year is the total of:

- each lump-sum premium paid in the year for insurance on the life of the employee (except a premium paid before March 1994, or a paid-up premium paid before 1997); and
- one-third of each paid-up premium for insurance on the life of the employee, when the premium was paid:
  a) after February 1994, and before 1997; and
  b) in the year, or one of the two preceding years.

Any amounts the employee paid for prepaid insurance either directly, or by way of reimbursement, are not included for the purpose of calculating the employee's benefit from prepaid insurance.

It should be noted that the sales tax applicable to paid-up premiums cannot be prorated in the same way that premiums are. The **full amount** of the sales tax applicable to paid-up insurance is a taxable benefit in the year the employer pays it.

An employee will not have a prepaid insurance benefit if the employee died before July 1994. If an employee died before July 1994, the taxable benefit, if any, would be determined under the rules as they apply to insurance for periods before July 1994. If an employee dies after July 1994, and before the full amount of the premiums for paid-up insurance has been included in the employee's income, any amounts remaining to be included in income will be included in the employee's income in the year of death.

Deducting at source and reporting

Employers

When an employer contracts directly with an insurance company to provide life insurance coverage for its employees, the employer will be required to deduct at source based on the total of salary or wages and employment benefits (including life insurance). The employer will have to report these amounts on each employee's T4 slip (T4A slip for retirees) at the end of the year. The employer will report the benefit from employer-provided group term life insurance in box 40 of the T4 slip, "Other taxable allowances and benefits" (box 28, "Other income," on the T4A slip for retirees).

Multi-employer benefit plans

A multi-employer benefit plan is a plan under which two or more unrelated employers provide benefits to their employees. The employers pay amounts (usually determined by union contract) to the plan administrators or trustees who administer the plan.

When, instead of contracting directly with an insurance company, an employer makes payments to a multi-employer benefit plan administrator or trustee to provide group term life insurance benefits for its employees, the requirement for employers to deduct for the amounts paid to plan administrators or trustees is waived.

Employers are responsible under the *Income Tax Act* for reporting all benefits from employment, regardless of whether these benefits are provided through multi-employer plans. However, given the special circumstances that multi-employer plans create, multi-employer benefit plan administrators or trustees can report the benefit from group term life insurance on behalf of employers in box 28, "Other income," on the T4A slip. Nevertheless, they will not be required to make deductions at source from the benefits they report on behalf of employers. However, when administrators report the benefit from employer-provided group term life insurance on T4A slips of employers as outlined above, the $500 reporting threshold for T4A slips described in the *Employers' Guide to Payroll Deductions* will not apply.

Health and welfare trusts

The draft legislation regarding employer-provided group term life insurance will not change the status of a health and welfare trust which administers an employer's group term life coverage for its employees. However, employers should still ensure that they provide trustees of such a plan with the information in this update so the trustees are aware of the legislative changes.

Additional information

For more information on this topic, contact your Revenue Canada income tax office.

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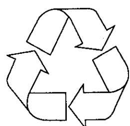

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