



Federal income tax and disability benefits

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Disability benefits can be provided by an employer under a salary continuance plan or a disability income benefit plan. This GroupLine deals with disability income benefit plans, which are also referred to as wage loss replacement plans by the Canada Revenue Agency.

Employers often have questions about the income tax status of disability benefits that are provided under a disability income benefit plan, such as a short-term disability plan (STD) or long-term disability plan (LTD).

The taxability of disability benefits paid to employees depends on who pays the premiums for the plan. If employees pay 100 per cent of the premium cost, the plan is considered an employee-pay-all plan, and benefits are not taxable. If the employer makes any contribution towards the premium cost, any payments received by an employee under the disability income benefit plan are subject to income tax.

Non-taxable status requirements

In order for disability benefits to be non-taxable, a legal obligation for employees to pay the full premium must be in place. The Canada Revenue Agency may ask an employer for a plan document or other material that confirms employees are required to pay 100 per cent of disability premiums. An insurance company contract is a supporting document only and forms part of the plan, but it is not necessarily evidence of the complete plan itself.

The employer must also show that, in actual practice, the plan is employee-pay-all. If the employer remits premiums on behalf of employees, the premium amounts should be reflected as additional salary on employees' regular pay stubs and on their T4s.

For example, an employer with a 100 per cent employee-pay-all plan might, after discussion with an accountant, make arrangements to increase employees' gross salary to account for their monthly premium costs. The employer would then reflect the employees' premium contributions as payroll deductions and forward the premium amounts to Great-West Life.

If an employer remits premiums on behalf of employees in this way, the additional gross salary paid and corresponding payroll deductions should be reflected on employees' payroll stubs and T4s. The employer may also be paying the retail sales tax for employees in those jurisdictions that assess retail sales tax on premiums to benefit plans. To maintain a plan's employee-pay-all status, the retail sales tax should be assessed to employees as a taxable benefit.

Separation of plans

It is important to keep the operation of an employee-pay-all plan totally separate from other disability income plans to which the employer may be contributing. The Canada Revenue Agency recognizes that separate plans for different classes or groups of employees may exist under the same insurance policy and that the employer may be contributing for some employees and not for others. The agency has stated that when two or more plans are covered by the same insurance policy, separate plans are considered to exist if the administration of the plans demonstrates that they are separate for claims, premiums and administrative charges.

There must not be cross-subsidization between the two plans; also, the level of benefits, the premium rates, the qualifications for membership and other terms and conditions of each of the plans must not depend on the existence of the other plan. If these criteria are not met, then only one plan is considered to exist and all amounts paid out of the plan would be taxable for all employees.

Retroactive changes

An employer cannot retroactively change the tax status of a plan. For example, at the end of the year, an employer cannot retroactively make a plan non-taxable by increasing all T4s by the amount of premiums the employer contributed during the year. An obligation for employees to pay 100 per cent of premiums must be in place when the premiums are paid in order for a plan to be non-taxable. As indicated above, the employees' contributions must be accounted for throughout the year on pay records.

For more information

Please contact your benefit advisor or Great-West group representative if further information is required.

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