City of Burnaby

Meeting 2017 April 03

COUNCIL REPORT

FINANCIAL MANAGEMENT COMMITTEE

HIS WORSHIP, THE MAYOR
AND COUNCILLORS

SUBJECT: TAXATION OF EMPLOYER-PROVIDED HEALTH BENEFIT PLANS

RECOMMENDATIONS:

1. THAT Council advise the Union of BC Municipalities that it is opposed to any decision in the future by the Federal Government to include employer-provided group health benefit plans as a taxable benefit under the Federal Income Tax Act.

2. THAT this report be forwarded to Burnaby Members of Parliament and Burnaby Board of Trade.

REPORT

The Financial Management Committee, at its meeting held on 2017 March 22, received and adopted the *attached* report providing information on the Federal Government's review of the tax-exempt status of employer-provided group health benefit plans.

Respectfully submitted,

Councillor D. Johnston
Chair

Councillor C. Jordan
Vice Chair

Copied to:	City Manager Director Finance Director Human Resources

City of Burnaby

Meeting 2017 Mar 22

COMMITTEE REPORT

TO:	CHAIR AND MEMBERS FINANCIAL MANAGEMENT COMMITTEE	**DATE:**	2017 March 10
FROM:	ACTING DIRECTOR FINANCE	**FILE:**	8150-01

SUBJECT: **TAXATION OF EMPLOYER-PROVIDED HEALTH BENEFIT PLANS**

PURPOSE: To provide information on the Federal Government's review of the tax-exempt status of employer-provided group health benefit plans.

RECOMMENDATIONS:

1. **THAT** the Financial Management Committee recommends Council advise the Union of BC Municipalities that it is opposed to any decision in the future by the Federal Government to include employer-provided group health benefit plans as a taxable benefit under the Federal Income Tax Act.

2. **THAT** this report be forwarded to Burnaby Members of Parliament and Burnaby Board of Trade.

REPORT

1.0 BACKGROUND

At the 2017 January 26 meeting of the Executive Committee of Council, staff were requested to provide information on the possible change to the Federal Income Tax Act that would end the tax-free status of employer-provided group health and dental benefit plans reportedly under consideration by the federal government.

One week following Council's meeting, the Federal Government announced that it has no plans in the upcoming 2017 Budget to tax Canadians on employer-provided health benefit plans. This declaration likely came after mounting opposition to the move from a diverse group of interests, including, medical associations, insurance companies, unions and small businesses.

While this is welcome news, there is no guarantee that this measure will not be revisited in the future. The federal government have recently indicated that the current tax exemption status of employer-provided group health benefit plans was being scrutinized as part of a sweeping review of tax credits worth over $100 billion dollars a year in foregone federal tax revenue. The government has insisted that the goal in undertaking this was to ensure tax fairness and to simplify the tax code, not to generate additional tax revenue. The 2016 Report on Federal Tax Expenditures forecasts the federal government will forego as much as $2.9 billion in 2017 from the non-taxation of employer-provided group health and dental benefit contributions.

It should be noted that this measure stemmed from the recommendations contained in a report of the *Advisory Panel on Healthcare Innovation* dated 2015 July. In this report, two of several recommendations put forward by the Panel are as follows:

1. Create a new Refundable Health Tax Credit (RHTC) to provide tax relief of 25 percent on eligible out-of-pocket healthcare expenditures up to $3,000 per year, replacing the Refundable Medical Expense Supplement.

   The RHTC would apply to the first-dollar spent on eligible expenses, and would be income-tested, with the full value of the credit made available to lower-income Canadians who bear a significant cost relative to their means. It would be administratively simple for tax filers, with tax slips issued by insurers and providers of health services. Payments to individuals with recurring expenses could be made on a quarterly basis."

2. *"Make employer-provided premiums for employer-sponsored health and dental benefits a taxable benefit to the employee, while permitting employees to claim this expense as a qualifying medical expense a under the new Refundable Health Tax Credit."*

In their report, the Panel argued that that current non-taxation of employer-provided group health benefit plans creates unfairness as well as distorts the choice of compensation paid by public and group employers. The Panel also argued that individuals who are not able to participate in employer-provided health benefit plans received on average less tax relief for premiums under the current Medical Expense Tax Credit.

2.0 EMPLOYER-PROVIDED GROUP HEALTH BENEFIT PLANS

In Canada, employer-provided group health and dental benefit plans are currently not included as a taxable benefit, outside of Quebec. In particular, group health benefits are generally provided for under Extended Health which typically covers chiropractic care, acupuncture, vision and eye care and prescription drugs, among other benefits. Both group health and dental benefits provide employees with tax-efficient compensation.

Employer-provided group health benefit plans help fill crucial gaps in the public health system. It is estimated that group health benefit plans covers nearly 30 billion annually in health care costs for up to 22 million Canadians and their families, accounting for nearly 30% of the health-related spending nationally. Group coverage offers significant cost savings and access advantages over individual insurance, where high costs, medical underwriting, pre-existing condition limitations and benefit maximums are significant barriers to coverage, particularly for those in greatest need.

3.0 IMPACT OF TAXING HEALTH BENEFIT PLANS ON CITY EMPLOYEES

If the federal government decides in the future to end the tax-free status of employers-provided health benefit plans, those benefits would be reported on an employee's T4 slip as a taxable income. This would be in addition to any employer-provided contributions for Medical Services Plan (MSP), Basic Life which are already considered a taxable income.

The following table illustrates the taxable benefit impact on City employees using one employee group for simplicity. The table is based on 2016 data for part-time and full-time City employees who were enrolled in the City's extended health and dental plans throughout the year to outline the tax implications based on different income levels and taxable benefits for individual or family coverage. Taxation of 2016 health benefit plans would have resulted in the amounts indicated being included on an employee's T4 as a taxable benefit. Part-time employees who earn considerably less than their full-time counterparts would feel the impact of this measure more as the same taxable benefit would be applied to a much lower salary base. Both groups would also experience a reduction in their bi-weekly take-home pay which could cause unnecessary hardship for those already trying to make ends meet.

It should be noted that the average 2016 full-time salary of $66,382 for this employee group would also include many employees who make considerably less than the average and would too be adversely impacted by the taxation of health and dental benefits.

Table 1: Estimated Impact of Taxing City Health Benefit Plans on City Employees

Status	No. Employees	Beneficiary Categorization	Average 2016 Salary ($)	2016 Dental Taxable Benefit ($)	2016 Ex. Health Taxable Benefit ($)	2016 Taxable Benefit for Ex. Health and Dental ($)	Percent of Total Taxable Benefit on 2016 Average Salary
Part-time	26 12 34	Single Employee & Dep. Family	32,449.09 41,720.91 33,015.61	545.52 1,036.32 1,745.76	1,690.80 1,690.80 1,690.80	2,236.32 2,727.12 3,436.56	
	72		**35,728.54**			**2,800.00**	**7.84%**
Full-time	220 283 393	Single Employee & Dep. Family	64,347.98 66,018.24 68,780.55	545.52 1,036.32 1,745.76	1,690.80 1,690.80 1,690.80	2,236.32 2,727.12 3,436.56	
	896		**66,382.26**			**2,800.00**	**4.22%**

In support of this argument, Mercer Canada estimates that half of Canadian employees covered by an existing employer-provided health benefit plans earn $40,000 per year or less. As such, ending the tax-exempt status would have the biggest impact on the middle class and the working poor. Mercer argues that seniors on fixed incomes that have vested-post retirement contributions could also be adversely affected by the measure as their taxable income could rise thereby adversely affecting their eligibility for the federal government's Guaranteed Income Supplement Program which is income-tested.

4.0 IMPACT OF TAXING HEALTH BENEFIT PLANS ON CANADIANS

4.1 Impact on Employers

An estimated 22 million Canadians or 13.5 million workers and their dependents would be adversely affected by any future change in tax policy for employer-provided health benefits, outside of Quebec. According to Mercer Canada some of the adverse consequences from eliminating the tax-free status of these programs could potentially include:

1. Mercer Canada argues that the cost of group benefit plans particularly for prescription drugs has greatly outpaced payroll growth, putting these contributions under substantial financial pressure. The tax exemption of employer-provided benefit plans has enabled employers to mandate plan participation which keeps costs affordable to the group by retaining young, healthy plan members. The taxation of these benefits could potentially destabilize employer contributions as individuals could potentially drop coverage. For instance, as published in the *Journal of Public Economic* dated 25 September 2000, it was found that that when Quebec introduced provincial taxation of employer-provided health benefits in 1993, approximately one in five (20%) employees reportedly lost their employer-provided health and dental plan. With the costs and risks of such programs much higher now, a far larger proportion of employers could abandon these programs if they are fully taxed at the federal level.

2. Mercer Canada also argues that ending the tax exemption of employer-provided health benefit plans would also effectively reduce employee after-tax compensation which could potentially cause significant disruptions in labour relations and collective bargaining resulting in substantial additional costs to employers. Employers could also be subject to added legal risks, especially with respect to the devaluation of vest-post-retirement benefits accrued over the working career of retired members.

3. Lastly, Mercer Canada argues that such a measure could also negatively impact employers who rely on health benefit contributions to maintain a healthy work place, enhance productivity and wellbeing of employees, and attract and retain the people needed for innovation and growth. Taxation of employer-provided health benefits plans could also diminish the value of the programs employers offer to their employees if they are suddenly required to include employer contributions as a taxable benefit.

4.2 Impact on Middle-Class and Lower Income Canadians

As previously noted, the potential elimination of the tax-free status could potentially harm millions of working, middle-class and lower-income Canadians and their families who rely on these employer-provided benefits to sustain their health. As noted, such a measure would be felt more by middle-class and lower-income groups who would see a reduction in their take-home pay.

It has been suggested that replacing the tax exemption with refundable tax credits for individuals would open up coverage opportunities for the uninsured, including workers who lose their employer-provided plan. However, the Quebec experience suggests that most individuals will not obtain replacement coverage and that the number of uninsured Canadians will rise, putting greater pressure on public health programs.

4.3 Potential Impact on the Health Care System

Lastly, if the tax-free status of employer-provided health benefits were to be eliminated and employers decide to reduce or eliminate them and/or employees decide to opt out of these benefit plans, there could potentially be a substantial shift in healthcare costs to the public health system. Without these health benefits, more Canadians could potentially enter the public system and drive up costs which would place a greater burden on the federal government's finances.

5.0 RECOMMENDATION

The federal government has recently indicated that the current tax exemption status of employer-provided group health benefit plans is being scrutinized as part of a sweeping review of tax credits worth over $100 billion dollars a year in foregone federal tax revenue. While the government has no plans in the upcoming 2017 Budget to tax Canadians on employer-provided health benefit plans, there is no guarantee this measure will not be revisited in the future.

Any future decision by the federal government to amend the Federal Income Tax Act to end the tax exemption for employer-provided health benefits could potentially have direct and significant consequences for middle-class and lower income Canadians who are already trying to make ends meet.

It is recommended that the Financial Management Committee recommends Council advise the Union of BC Municipalities that it is opposed to any decision in the future by the Federal Government to include employer-provided group health benefit plans as a taxable benefit under the Federal Income Tax Act. It is further recommended that this report be forwarded to Burnaby Members of Parliament.

Bob Klimek
ACTING DIRECTOR FINANCE

BK/mm

Copied to: City Manager
Director Human Resources