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A judge of the Tax Court of Canada recently shot down an Ottawa surgeon's attempt to protect an employee from the risk of a disabling illness or injury.

You will not be surprised once you learn why.

You might, however, wonder why tax policy-makers are being so unaccommodating toward employers wishing to honour long-term promises for medical and disability benefits.

After all, those employers may recognize that, like Nortel Networks Corp., they might not be around to keep promises that are no richer than tax policy-makers enjoy.

But first to plastic surgeon Stanley Labow. Officials who reassessed several of his tax returns he filed in the 1990s were justifiably suspicious he was trying to circumvent tax laws.

Justice Eric Bowie of the tax court has now heard Labow's appeal of their assessment, and ruled it was an obvious tax dodge.

The part-time employee Labow sought to protect was his wife, who already had disability coverage elsewhere. The judge reports Labow declared a business expense when he contributed a total $397,696 over two years to a trust fund, conveniently located in a Caribbean tax haven.

The tactic was recommended by his accountant. The trust fund scheme he and others used was designed by a creative Ottawa lawyer. An actuary calculated how much to contribute.

Labow contributed enough pay his wife medical and disability benefits to age 70. But Bowie writes in his ruling that the actuary assumed her earnings were nearly twice what she was actually paid, and assumed she would become totally disabled two years after the plan was established.

"It is difficult to see how there could be any commercial purpose to Dr. Labow entering into such an arrangement," Bowie ruled on Aug. 6. It wasn't necessary, disability insurance might have been cheaper, and he would not be so generous to anyone but his wife.

We should spare some sympathy for Labow. Rules for retirement savings plans are too restrictive for him to match what civil servants earning less money will enjoy in retirement.

A similar difference of treatment is evident in the design of a proposed new vehicle for companies with a legitimate wish to provide medical, disability and other benefits to employees and retirees.

Ottawa proposed to change income tax rules to permit something called an Employee Life and Medical Trust to enable an element of the survival plan for General Motors Corp., Chrysler Group LLC and their Canadian subsidiaries.

The automakers wanted to provide a set amount of money to pay for medical and assorted other benefits for employees and retirees in order to get those future liabilities off their books.

If Canada had agreed to something similar to what in the United States are called a Voluntary Employee Beneficiary Association, contributions to the new trusts would have been tax deductible and the tax on earnings would have been deferred.

They would have been similar to a pension plan. And they could allow an employer to prefund medical benefits for retirees, and backstop a promise of disability income in case the company did not purchase insurance and, like Nortel, later disappeared.

Benefits consultants at Eckler Inc. got excited when they read new wording to tax provisions the Department of Finance published last week for public comment.

But finance officials have confirmed to the Star there has been no change of plan. Employers would only get to claim deductions year by year in proportion to benefits paid that same year. Tax on earnings could not be deferred.

So there will be much less incentive to prefund retiree benefits, even though accounting rules force employers to recognize those future costs on their balance sheet.

And there will be much less incentive to set aside money to pay disability benefits, even though tax rules permit employers to write off the cost of insurance that includes a reserve of money to pay future disability benefits.

“It is disappointing to say the least,” says Eckler principal Charlene Milton.

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