

assureflex
health spending account
the evolution of health and dental care benefits ©

Tax Act and CRA Rules

Assureflex Corporation
P.O. Box 81, Strathroy, Ontario N7G 3J1

email address: mailroom@assureflex.com
virtual office: <https://www.assureflex.com>

(866) 928-6511 Toll Free - in Ontario only
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Self-insured Private Health Services Plans

Self-insured Private Health Services Plans (Health Spending Accounts, Cost Plus Plans, and Administrative Services Only Plans for Health and/or Dental), are cost plus plans (cost of claims plus administration fee), as referred to in CRA Bulletin IT-339R2.

Plans qualifying as Private Health Services Plans facilitate the full amount of the Claim, Administration Fee and Taxes, being deductible business expenses. Benefits are tax-free to participants. These tax advantages are subject to compliance with CRA requirements.

As there must be a plan in the nature of insurance, plans for unincorporated Owners only (without participating Employees), or plans for Shareholders only (who are not also bona fide employees), are not acceptable under CRA interpretation of the Tax Act.

Owners of unincorporated Companies

- É Owners only of unincorporated businesses are not eligible.
- É Owners and Employees of unincorporated businesses are eligible.
- É Owners and Employees must be in the same Class for benefits.

Shareholders of Corporations

- É Shareholders only of incorporated businesses are not eligible.
- É Shareholders who are bona fide corporate Employees are eligible.
- É Executives and Employees can have separate Classes of benefits.

Eligibility of business Owners, with participating Employees, is inferred from CRA Tax Interpretation Letter 2001-0101935: a cost plus plan for a self-employed business person *with no employees* is not a PHSP because there is no basic insurance plan in effect.

If there are any questions regarding plans for Owners of unincorporated companies and plans for Shareholders of corporations, a Tax Accountant or Lawyer should be consulted, or an Advance Income Tax Ruling can be requested from the Canada Revenue Agency.

Questions can be directed to CRA, by email, at itrulingsdirectorate@cra-arc.gc.ca

Ontario Taxation of Health Spending Accounts

taxes Ontario 8% PST is charged on all Claims submitted and paid.
 Ontario 13% HST is charged on the Assureflex Administration Fees.
 Ontario 2% Premium Tax charged on Claims plus Administration.

example	Claims submitted and paid	\$1,000.00	plus \$80.00 PST
	Assureflex Administration Fee	<u>\$ 100.00</u>	plus \$13.00 HST
	Insurance Premium	\$1,100.00	plus \$22.00 PT
	Insurance Premium and Taxes	\$1,215.00	

Definition of Self-insured Private Health Services Plans

CRA Income Tax Interpretation Bulletin IT-339R2, paragraph 6, states:

öIn a cost plus plan, an employer contracts with a trustee plan or insurance company for the provision of indemnification of employee's claims on defined risks under the plan. The employer promises to reimburse the cost of such claims plus a administration fee to the plan or insurance company. The employee's contract of employment requires the employer to reimburse the plan or insurance company for proper claims (filed by the employee) paid, and a contract exists between the employee and the trustee plan or insurance company in which the latter agrees to indemnify the employee for claims on the defined risks so long as the employment contract is in good standing. Provided that the risks to be indemnified are those described in paragraphs (a) and (b) of the definition of private health services plan in subsection 248(1), such a plan qualifies as a private health services plan.ö

Eligible Deductible Expense for Employers

The following tests must be met for any expense to be considered a deductible expense:

- É Section 18(1)(a) of the Income Tax Act states that no outlay or expense is deductible, in computing the income of a taxpayer from a business or property, except to the extent that it was made or incurred for the purpose of gaining or producing that income.
- É Section 67 of the Income Tax Act states no deduction shall be made, except to the extent that an outlay or expense was reasonable in the circumstances.

If a cost plus payment is reimbursed under a Private Health Services Plan, IT339R2 states:

- É öThey are however, business outlays or expenses of the employer for purposes of paragraph 18(1)(a) of the Income Tax Act.ö

Eligible Non-taxable Benefit for Employees

If a cost plus plan qualifies as a Private Health Services Plan, according to IT-339R2:

- É öContributions made by an employer to or under a private health services plan, on behalf of an employee, are excluded from the employee's income from an office or employment, by virtue of subparagraph 6(1)(a)(I) of the Income Tax Act.ö

Meaning of the “Nature of Insurance”

CRA Income Tax Interpretation Bulletin IT-339R2, paragraph 3, states:

öA private health services plan qualifying under paragraphs (a) and (b) of the definition in subsection 248(1) is a plan in the nature of insurance. In this respect, the plan must contain the following elements:

- (a) an undertaking by one person
- (b) to indemnify another person
- (c) for an agreed consideration
- (d) from a loss or liability in respect of an event
- (e) the happening of which is uncertain.ö

An undertaking by one person to indemnify another person, described in CRA Tax Interpretation Letter 2001-0101935 as:

öA PHSP exists if the employer is obligated under the employment contract to reimburse such expenses incurred by the employees or their dependents.ö

For an agreed consideration - between the employer and an insurer, described in CRA Technical Interpretation Bulletin IT-339R2, paragraph 5 as:

öIf the agreed consideration is in the form of cash premiums, they usually relate closely to the coverage provided by the plan and are based on computations involving actuarial or similar studies. Plans involving contracts of insurance in an arm's length situation normally contain the elements outlined in 3 above.ö

For an agreed consideration - between the employer and the employee, described in CRA Technical Interpretation Bulletin IT-339R2, paragraph 7 as:

öAn arrangement where an employer reimburses its employees for the cost of medical or hospital care may come within the definition of a private health services plan. This occurs where the employer is obligated under the employment contract to reimburse such expenses incurred by the employees or their dependents. The consideration given by the employee is considered to be the employee's covenants as found in the collective agreement or in the contract of service.ö

Cost Plus Claims on a “One-time” Basis

To be considered a PHSP in accordance with section 248(1) of the Income Tax Act, there must be a contract or insurance plan in place. Because öuniqueö or öad hocö cost plus plans are paid outside of any contract or plan, they do not meet the definition of a PHSP.

In addition to IT-339R2 paragraphs 5 and 6, the 1991 Corporate Management Tax Conference article by CRA, entitled öFlexible Employee Benefit Arrangementsö states:

öThere should be some formal structure to the arrangement.

If a bona fide plan exists, its terms and conditions and benefits available under it, should be made known to the qualifying employees, and such employees should have legal access to coverage and benefits under the plan.ö

CRA Tax Interpretation Letter 2001-0101935 states:

öA PHSP normally has a ceiling in respect of the amounts that may be reimbursed. In our view, a plan that has no limits may be subject to section 67 of the Act. Section 67 of the Act provides that, in order to qualify as a deduction from income, an outlay or expense must be reasonable in the circumstances.ö

Tax Issues Relating to Self-employed Business Owners

According to CRA, a öcost plusö plan can't be a deductible business expense for the plan sponsor or a non-taxable benefit for the plan member when the plan is used for self-employed business owners only. However, an öinsuredö plan would qualify.

CRA Tax Interpretation Letter 2001-0101935 states:

öA PHSP requires an undertaking by one person to indemnify another person. A cost plus plan for a self-employed business person *with no employees* is not a PHSP because there is no basic insurance plan in effect.ö

CRA Tax Interpretation Letter 2002-0127485 states:

öAs stated in Technical Interpretation Letter 9904155, dated April 28th., 1999, it continues to be our view that a plan which consists of a contract between a proprietor and an administrator, under which the administrator agrees to reimburse the proprietor, his or her spouse and members of his or her household for actual medical and hospital expenses and receives, as consideration, an amount equal to the amount reimbursed plus an administrative fee, does not qualify as a PHSP since it does not contain the necessary elements of insurance.ö

öIn this situation, no person has undertaken to indemnify another person. Rather, the proprietor has assumed all of the risk for the personal hospital and medical bills. In our view, even though a proprietor enters into a contract with an administrator to pay medical and hospital expenses, this is not sufficient to conclude that the plan is a PHSP.ö

Tax Issues Relating to Shareholders

CRA Tax Interpretation Letter 2001-0106815 states:

öIf coverage under a PHSP is received by an individual by virtue of his or her employment, the related benefits are not taxable and payments made by the employer pursuant to the PHSP would be deductible. It is a question of fact whether benefits are received by an individual by virtue of being a shareholder or employee.ö

CRA Tax Interpretation Letter 2003-0050541 states:

öUnless a shareholder is actively engaged as an employee of a company, any benefit derived by the shareholder as a result of PHSP coverage is not exempt under subparagraph 6(1)(a)(i) of the Income Tax Act (the Act), but rather is taxable under subsection 15(1) of the Act. However, if a shareholder is actively engaged as an employee of the company, and the benefits received by the shareholder under the PHSP (including the applicable limits) are reasonable having regard to all of the circumstances, it is our general view that the benefits would be derived by virtue of the individual's employment and exempt under subparagraph (6)(1)(I).ö

CRA Tax Interpretation Letter 2006-0174121C6 states:

That in its view, the fact that an individual is the only employee and shareholder of the corporation does not mean a benefit is received in the capacity as a shareholder.

CRA agreed öthat a pragmatic approach to the determination is warranted and, generally, if it is reasonable to conclude that the benefit has been provided as part of a reasonable employee remuneration package we will consider it to be received qua employee.ö

Communicating the Benefits to Employees

In the 1991 Corporate Management Tax Conference article by CRA, entitled öFlexible Employee Benefit Arrangementsö it states:

öThere should be some formal structure to the arrangement. If a bona fide plan exists, its terms and conditions and benefits ... should be made known to qualifying employees and such employees should have legal access to coverage and benefits under the plan.ö

Carry Forward Provisions

There are some administrators who indicate that the unused deposits or eligible medical expenses can be carried forward indefinitely until all funds are used or expenses are paid. There are only two carry forward options available, and both are limited to 12 months.

1. Carry forward of the unused deposits into the Health Spending Account, or
2. Carry forward of the eligible (Health and/or Dental) medical expenses.

CRA Income Tax Interpretation Bulletin IT-529, paragraph 16, states:

öWhile a plan which includes a carry forward provision undoubtedly reduces the risk of loss to the employee, a plan which permits the carry forward of either the unused allocation or eligible medical expenses (but not both) up to a maximum of 12 months will not be disqualified as a private health services plan solely by reason of the carry forward provision in the plan.ö

Withdrawal or Transfer of PHSP Funds

Allocations to a Health Spending Account, can not be withdrawn by the Employee. Allocations (deposits or notional maximums) can only be used for eligible expenses under a Private Health Services Plan, including Health Spending Accounts or insured plans.

Unused allocations (made as deposits) are returned to the Employer at the end of the benefit period, or at the end of the 12 month carry forward (if a carry forward is included in the plan). Unused allocations can not be specified/designated for transfer to an RRSP.

CRA Income Tax Interpretation Bulletin IT-529, paragraph 17, states:

öIf an employee is able to withdraw or transfer an amount from a health care spending account (other than as a premium payable in respect of another private health services plan), the health care spending account will not be a private health services plan and all amounts received out of the account, including reimbursements of eligible medical expenses, will be included in the employee's income under paragraph 6(1)(a).ö

öFor example, if an employee is able to reallocate an amount which was previously applied to a health care spending account to another benefit option such as a group RRSP, the health care spending account will not qualify as a private health services plan because a contribution to an RRSP is not a qualified medical expense. However, the ability to reallocate credits to another private health services plan, such as a vision or dental plan will not affect the status of the health care spending account as a private health services plan.ö

Added Contributions on behalf of Employees

Stated in Technical Interpretation Letter 9916035, dated August 3rd., 1999:

Contributions Allowable

If a contract of employment is renegotiated, and the new contract results in a reduced salary in return for a corresponding increase in the amount of premiums paid by the employer to a private health services plan, the additional premiums paid by the employer will not be treated as part the employee's salary, nor will it result in a taxable benefit to the employee (because of the specific exemption in subparagraph 6(1)(a)(i) of the Act). If a previous contract of employment is only verbal, the onus will be on the employer to satisfy CRA that a valid renegotiated employment agreement is in place and that the increased benefits are funded by the employer.

note: Cannot be selectively applied to certain Employees, but must be applied to all of the Employees in a Class, to prevent discrimination under Employment Standards Act.

Contributions Not Allowable

Paragraph 18 of Interpretation Bulletin IT-529, "Flexible Employee Benefit Programs," states there will generally be no advantage to an employee in using payroll deductions to contribute to a Health Spending Account. If an employee forgoes part of their salary or other amount to which that employee is otherwise entitled, amounts thus forgone is included in the employee's income. In other words, the employee is taxed on the gross amount of salary received and not the net amount of his or her pay cheque. This is explained in paragraphs 3 and 22 of IT-529

Benefits Allowable

All benefits allowed by CRA Income Tax Folio S1F1C1 the "Medical Expense Tax Credit" see CRA document: <http://www.cra-arc.gc.ca/tx/tchncl/ncmtx/fls/s1/f1/s1-f1-c1-eng.html>

Other Medical Expenses

Over-the-counter medications, vitamins and supplements, even if prescribed by a medical practitioner, are not eligible. However, a non-prescription medication, that is legally available only with intervention of a Pharmacist, would qualify if prescribed by a medical practitioner.

Medical supplies and equipment that can be purchased "over-the-counter or off-the-shelf" without a prescription from a Medical Practitioner; or services not provided by a member of an Ontario Regulated Health Profession, or registered in their jurisdiction, are not eligible.

note: eligible if dollar amount is less than 10% of the total specific Claim submitted.
see CRA website: <http://www.cra-arc.gc.ca/whtsnw/tms/phsp-rpam-eng.html>