

## Private Health Services Plans

If you are self-employed or own your own business, you may want to consider establishing a “private health services plan” (PHSP), as a way of having your business deduct the costs of health and dental benefits to your employees. Although the rules are slightly different in each case, establishing a PHSP can result in a tax-deductible expense to the business, and a tax-free benefit to the self-employed person or corporate employee. In either case the plan must be formal and there must be an element of risk for the employer.



### Corporations

A properly documented and structured PHSP is fully sanctioned by the Canada Revenue Agency, and can best be described as a “pay-as-you-go” benefit plan. Employees pay for costs as incurred, but then submit their bills to the company. The employer then reimburses the employee for the costs. In another variation, a third-party insurance company acts as an intermediary between the employer and employee (for a fee of course). Thus the corporation would write a cheque to the insurer for the reimbursement plus the administration fee, and the insurer in turn reimburses the employee. The end result in each case is that the employer deducts the costs from taxable income, and the employee receives a *tax-free* benefit.

PHSPs can be used in conjunction with traditional group insurance plans (e.g. to provide vision care where the group plan excludes, or to provide additional coverage to key employees, and can be designed to be quite flexible (e.g. benefits can be restricted to an annual maximum, or to certain types of expenditures).

Benefits paid for shareholders will be allowable under a PHSP, provided they are not deemed by CRA to be paid to the individuals in their capacity as shareholder. This test is fairly easy to meet provided the same benefits are available to arm’s length employees. Where there are no other employees in the company, however, this test is somewhat more difficult to meet.

As is invariably stated in the interpretations relied upon by the insurers, and indeed by some of the insurers in their own literature, it is what the CRA call “a question of fact” as to whether, in a situation where the only employees of a corporation are shareholders, shareholders and their families will be viewed as receiving the PHSP benefits (or any benefit, for that matter) in their capacity as employee or shareholder. For example, in a Technical Interpretation (Document 2003-0012665) dated October 2, 2003 the Business and Partnerships Division of the Rulings Directorate of CRA stated that it is possible to have a PHSP for a sole shareholder/employee, and his family, whereby the benefits are excluded from the employee’s income by virtue of



subparagraph 6 (1) (a) (i) of the Income Tax Act, while at the same time being tax deductible to the corporation. In the Interpretation, however, the CRA cautions, again, that if the benefits are deemed to be received “qua shareholder”, the benefits would be taxable to the shareholder/employee, and non-deductible to the corporation. Thus this would result in double taxation – clearly a punitive, and undesirable result.

The CRA generally states that how they decide these matters is “based on the particular facts of the situation”. This will include whether they think the benefits are provided as a part of a reasonable remuneration package.

## Private Health Services Plans (con't)

### Unincorporated Businesses

If you are a sole proprietor or a partner in a partnership, there are specific rules in the Income Tax Act that allow a deduction for health and dental insurance premiums in calculating net income. You can deduct insurance premiums for yourself, your spouse or common-law partner, and other members of your household.



In order for insurance premiums to be deductible, your income from business in the current or preceding year must be more than 50% of your total income for that year. The deduction will also be allowed if your income other than from business is \$10,000 or less.

Limits to deductions are:

- \$1,500 per year for yourself plus:
- \$1,500 per year for your spouse or common-law partner
- \$1,500 per year for each other member of your household 18 years of age or over, and
- \$750 per year for each member of your household under 18.

These limits do not apply if you have one or more arm's length, full-time employees. In such a case, the benefits for the self-employed person is limited to the lowest of "cost of equivalent coverage" made available to any such employee. For example if the coverage for the self-employed person is the same as for non-family members, the full amount will be deductible. This can include insurance premiums or PHSP benefits, as described above.

If there are no arms length employees, it is doubtful PHSP premiums would be deductible, as CRA would likely rule there is no "element of insurance" involved.

## Types of Payments Allowed

Examples of eligible costs include:

- extended medical insurance, such as prescription drugs and semi-private hospital rooms.
- dental benefits
- vision or eye care benefits
- medical or hospital expenses such as:
  - payments to a medical practitioner, nurse, dentist, public or private hospital for medical or dental services
  - remuneration for attendant care or the cost of full-time care in a nursing home or other institution
  - transportation of patients to or from hospitals, by ambulance
  - medical aids such as artificial limbs or eyes, wheel chairs, crutches, braces, trusses, speaking or hearing aids, iron lungs or oxygen tents or artificial kidney machines
  - reasonable renovation costs related to access to or mobility within the home of a patient who lacks normal physical development or who has a severe or prolonged mobility impairment
  - a wide variety of medicines, equipment, aids, devices prescribed by a medical practitioner and related to physical impairments, conditions or syndromes (see Federal Income Tax Regulation Section 5700 for a full list)
  - laboratory tests, radiography or other diagnostic procedures as prescribed by a medical practitioner
  - payments to a dental mechanic
  - seeing eye dogs for blind, deaf or impaired persons, including maintenance and training

Payments deducted under any of the above rules may not be deducted as medical expenses on your personal tax return. Conversely, if you do claim premiums or other medical expenses on your tax return, you may not deduct them under a PHSP arrangement

Note that if your income is higher than the lowest tax bracket, a deduction under a PHSP is more beneficial.