Self Funding Your Health Care Cost

A business can sometimes find the cost of health insurance premiums overwhelming. Yet not providing some form of health insurance to your employees is not an option. For some businesses, self funding employees' health care may be an option. Canada Revenue Agency recognizes this fact and has set up rules around a private health service plan (PHSP).

How does it work?

This type of plan can provide benefits to corporations with employees for medical expenses that are eligible medical expenses under the Income Tax Act. The employer sets certain levels of eligible medical expenses they are willing to pay. The levels of medical expenses can be based on certain factors such as job description or seniority. For example the corporation may be willing to reimburse employees with 1 to 3 years of seniority for $1,000, employees with 4 to 6 years of seniority $1,500, and employees with over 6 years of seniority $2,000. It is also possible to include the shareholder in this group of employees as long as the shareholder does work for the corporation. There are strict rules a shareholder must be adhered to and if broken will result in double tax.

When an employee incurs a medical expense that is not covered by the provincial government, they submit the receipt to the employer for reimbursement. The employer gets a full tax deduction for the expense and the employee does not have a taxable benefit for the reimbursement. The only cost in addition to the true medical expense may be 10% or 15% paid to the third party administrator.

Options

A PHSP can be used to supplement an existing group benefit plan. Effectively, it can be used to top up their existing group benefit coverage, or reimburse for health-related expenses that aren't covered by their plan. The PHSP can be administered by the company administering the group benefit plan whereby plan members submit their expense claims to the group benefit provider. A PHSP can also be self-administered by the employer.

Few requirements to qualify as a PHSP

1. The PHSP must be a contract of insurance. Where it represents self-insurance by a company who promises to pay into the employee's account an agreed upon amount for a year. The employment agreement must discuss this insurance plan.
2. Only expenses eligible under the Income Tax Act for the Medical Expense Tax Credit are covered
3. Only eligible recipients as outlined in the Income Tax Act are covered. This is defined as employees, employee spouse or common-law partner, and other children and dependents.

Some advantages

1. Lower costs. If this is the only plan used for a corporation and it is not used as a secondary medical plan.
2. More employee benefits. This can be used as a secondary medical plan in addition to a lower cost insurance plan. Therefore, more employee benefits can be offered.
3. Flexibility on expenses covered. As long as the medical expenses are eligible under the Income Tax Act, they can be covered under this plan. Therefore, an employee with glass may spend his credits on eye glasses, as for an employee with small children may spend his credits on prescription drugs.

Some disadvantages

1. If it is the only health plan offered to employees, it could fall short of covering any extreme unforeseen medical expenses.
2. Less employee privacy. If the plan is administered internally then someone in the organization is aware if the employee medical expenses. This may make the employees feel uneasy.
3. More administration.

Illustration #1:

An employee makes $150,000 a year and has worked at his place of employment for 5 years. He has $2,500 of medical expenses in a year for his family. He has a choice, either pay for them personally and claim a medical expense credit or participate in the company's PHSP. The company has offered all employees with more than 5 years of experience up to $2,500 of PHSP reimbursement. What should he chose?

If the employee claims the medical expenses on his personal tax return he would only get a tax credit for $330 of the expenses and save $73 in taxes. That is because the first $2,171 of medical expenses for an employee making $150,000 a year are not eligible for the medical expense tax credit.

If the employee uses his employer's PHSP, the employee would be able to get reimbursed for $2,500. This is not a taxable benefit and therefore he won't pay any taxes on this reimbursement. The corporation gets a full tax deduction worth $387 in tax saving.

Illustration #2:

A shareholder in the company discussed in illustration #1 also has $2,500 in medical expenses. He also makes $150,000 a year. He can either take the money to pay for the medical expenses as additional salary or participate in his company's PHSP. What should he chose?

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The additional salary will save the corporation $387 in taxes but the shareholder will personally have to pay $1,200 in taxes. By deducting the medical expenses he save $73 in personal taxes. Therefore, overall, there is an increase in taxes by $740.

If the shareholder participates in the PHSP he could take the $2,500 out of the corporation tax free and the corporation gets a tax deduction of $387. Therefore, there is an overall decrease in taxes of $387.

This is to provide general tax advice. Please consult your accountant before implementing a private health service plan.

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