



Private Health Services Plan

Information Package for Accountants

For more information:

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To Whom It May Concern:

Olympia Trust Company was issued a Certificate of Registration from the Province of Alberta to operate as a Trust Company effective March 8, 1996. Olympia Trust Company is a non-deposit taking trust corporation. One of the Company's major functions is the sale and administration of a Private Health Services Plan. Olympia Trust is unique in that it is the only public trustee that we are aware of to be involved in this business.

As a public trustee our fiduciary responsibilities include scrupulous attention to relevant legislation and CCRA regulations and interpretation for the proper administration of a Private Health Services Plan.

This is a summary of the Olympia Trust Plan. Details are contained in the following pages.

1. The Olympia Trust Private Health Services is derived from Section 248(1) of the Income Tax Act and Interpretation Bulletin IT-339R2.
2. The purpose of the plan is to enable employers to provide a benefit to their employees on a tax-free basis while deducting these expenditures.
3. The Olympia Trust Plan properly sets up the Private Health Services Plan for the employer, administrates the plan for the employer as an arms length trustee through an understandable contract.
4. The Olympia Trust Contract becomes the basis of audit controls on each account on a real time basis for all transactions subsequently entered into the account.
5. Compliance regulations established by CCRA and IT Bulletins related to a Private Health Services Plan and eligible expenditures under 118.2(2) are incorporated into the Olympia Trust contracts with employers.
6. The plan works effectively for all Professional Corporations, one person incorporated companies, as well as larger employee groups.
7. The plan is in the nature of insurance.
8. Olympia Trust cautions all people interested in setting up a Private Health Services Plan or when referring people to an administrator of such plans to carefully scrutinize these plans for content and applicability.

**A PRIVATE HEALTH SERVICES PLAN ADMINISTERED
BY TRUSTEE
OLYMPIA TRUST COMPANY**

Definition of Private Health Services Plan (PHSP)

Olympia Trust's Employee Health Care Plan is a Private Health Service Plan (PHSP). It is defined by Section 248(1) of the Income Tax Act (ITA) and further explained by Interpretation Bulletin IT-339R2. The Act allows a PHSP to take a number of different forms. However, to meet the definition of a PHSP a given plan must be "a contract of insurance" in respect of hospital expenses, medical expenses or any combination of such expenses" or "a medical care insurance plan or hospital insurance plan or any combination of such plans".

This implies that CCRA would expect to see a formal contract of employment incorporating the requirement that the employer provide this medical coverage.

To minimize the likelihood of disputes with CCRA, it would be prudent to meet precisely the structure laid out in their interpretation bulletin. (For complete IT-339R2 see attachment 1).

The purpose of such plans is to enable employers to provide a benefit to their employees on a tax-free basis. Assuming these plans meet the definition of a PHSP as described in IT-339R2 elsewhere in this document any medical benefits paid on behalf of employees, including shareholder/employees, by a corporation would not be taxable as a benefit to the individual, nor would the claim benefits themselves be taxable to individual employees. Similarly, the cost of these benefits is considered a business expense. For example:

Incorporated Business

Many Alberta, British Columbia, and Manitoba CA's, doctors, lawyers, dentists operate their practices through a professional corporation ("PC"). Where the PC enters into a cost-plus plan to cover medical expenses incurred by its employees, risk of loss due to such expenses can be transferred from the employees to the PC. As such, the requisite element of insurance would need to be present, even if the only employee is also the sole shareholder of the corporation. In such a case, the corporation would be entitled to deduct its costs incurred in provision of this benefit to its employees, while the employees would bear no tax costs, as PHSP premiums paid by employers do not constitute a taxable benefit. **This rational is also true for one-person incorporated companies who are not PCs.** (see IT -339R2 attachment 1 and 2).

It is important to note that the department allows a PHSP to provide any or all coverage, which would normally qualify as a medical expense under Section 118.2 (2), that is any medical expenses for which an individual may apply for under the TI Medical Tax Credit.

By extension, corporations or employers with several employees can also make effective use of a PHSP, although for different reasons.

Canada Customs and Revenue Agency (CCRA) generally accepts that a person may be an employee despite receiving no remuneration from the employer. As such, the shareholder of a PC which distributes all of its income by way of dividends to the shareholder, rather than salaries or bonuses, would likely still be considered an employee of the PC, provided he provides services in the PC's ongoing practice.

Of interest and importance is a July 1998 IT Bulletin which clarifies CCRA's position on owner/employee medical benefits. In summary based on the facts of a particular situation, PHSP coverage provided to shareholders is considered an employment benefit rather than a shareholder benefit and therefore would be a non-taxable benefit (*For complete IT Bulletin see attachment 2*).

SUMMARY

To qualify as a TAX-FREE medical and dental benefit to employees and be FULLY DEDUCTIBLE as an operating cost to employers, a Private Health Services Plan must include a minimum set of conditions.

The Olympia Trust Plan, as a PHSP, provides for a Health Spending Account for each employee. Under the Olympia Trust Plan, each employee would be entitled to be reimbursed for eligible health expenses to a maximum fixed annual amount. As such, the following conditions must be met and maintained.

The Olympia Trust Plan provides that:

- 1) The employer is under legal obligation to fund the spending account for each employee.
- 2) In order to provide for the necessity of an element of risk, all spending account credits be claimed in the year in which they are incurred or within 12 months of the Plan year. (*Attachment 3*)
- 3) Eligible expenses within the Plan are limited to expenses which would otherwise qualify as medical expenses within the meaning of Subsection 118.2(2) of the Income Tax Act. (*Paragraph 4 IT-339R2*)
- 4) No allowance is made for cash payments in respect of unused credits.
- 5) Expenditures under the Plan must be performed or prescribed by a qualified medical practitioner. (*See IT-519R2*)
- 6) All employees in a particular classification are offered similar spending accounts.

- 7) Employees not forego any amount to which he/she would otherwise be entitled in order to obtain the increased benefit.
- 8) The Plan is not a Health and Welfare Trust. The Plan may be contained within a Health & Welfare Trust but in general terms, stands on its own merit.
- 9). **The Plan is in the nature of insurance Paragraph 3, IT-339R2, attachment 3&4**
The department goes on to imply that it is essential that payment by the employer not be made on a gratuitous basis. Therefore it is important that a trustee independent of the employer have the authority to enforce payment. Further where the independence of the trustee is uncertain the department may question the validity of the PHSP with the attendant potential of disallowing the benefits.

Conclusion

Olympia Trust offers a simple, effective, professionally administered plan. The Company has been very instrumental in bringing the cost plus PHSP to the market place.

Since the inception of our plan in 1996, a number of "similar plans" have appeared in the market place. These plans may or may not represent true competition. Olympia Trust has reviewed most of the other plans and with few exceptions they either simply do not comply with CCRA regulations or are set-up with such disregard for the regulations that CCRA may question the validity of their plan. This of course will impact clients negatively abolishing the benefit they would otherwise correctly deserve.

The mention of "A Health and Welfare Trust" often arises. A Health and Welfare Trust is not a PHSP. It is a complicated mechanism that has been bandied about and in most cases, unless great care and expense is taken, its implementation is inappropriate. Also the "trustee" may in fact be spurious and ultimately this inattention to regulations set down by CCRA is harmful.

It is incumbent upon a trust company to properly represent what it offers to the public. One of the concerns that arises is that "similar" offerings that are not compliant and in fact do not have a proper "trust" relationship, may tarnish legitimate plans.

TAX TOPICS

**Private Health Services Plan
Coverage for Shareholders**

With respect to the shareholder-manager of a corporation, there is a general presumption that a benefit with respect to a private health services plan would be conferred on the individual in his or her capacity as a shareholder and included in income pursuant to subsection 15(1) (see Technical Interpretation No. 9505265). Revenue Canada appears to have reversed this position.

In a recent interpretation, Revenue Canada indicated that “when equivalent coverage under a private health services plan is extended to all employees, including the employees who are shareholders, the benefit provided to the employee-shareholders from such coverage is normally considered to be an employment benefit rather than a shareholder benefit”. Where all employees of the corporation are shareholders, Revenue Canada states:

Similarly, when all employees of a corporation are shareholders and it is reasonable to conclude, based on the particular facts of the situation, that the private health services plan coverage has been provided as part of a reasonable remuneration package, the benefit from such coverage is also considered to be an employment benefit rather than a shareholder benefit. In such a case, the benefit is not included in the employee-shareholders' income by reason of the exclusion in subparagraph 6(1)(a)(i) of the Act, and the corporate employer is entitled to a deduction in respect of the contributions made for such coverage, subject to any limitations imposed under the Act.

■ *Technical Interpretation, Business and Publications Division,
July 27, 1998,
Document No. 9815645*

Private Health Services Plans Must Provide for a Degree of Risk

It is Revenue Canada's belief that a health insurance plan must involve a reasonable degree of risk in order to meet the definition of "private health services plan" in subsection 248(1). Plans that provide an indefinite carry forward of unclaimed medical expenses would not involve a reasonable degree of risk. However, a plan would have a reasonable degree of risk if it provided that any unused balances be forfeited.

Technical Interpretation, Business and General Division

June 2, 1992

Revenue Canada File Number 9210485

Rollover of Unused Credits in a PHSP

Is it permissible for unused credits in a health care plan established under a cafeteria plan to be rolled over to future years?

Department's Position

Yes. However, for the health care plan to qualify as a PHSP, the plan must involve a reasonable element of risk that is assumed by the employer. Plans that permit the choice of a rollover or a cash-out of unused credits will not qualify as PHSPs. A plan that permits the rollover of unused expenses as well as credits also is not likely to qualify. Plans that permit the rollover of unused credits to be applied to other plans under a cafeteria plan are not considered PHSPs.

On the assumption that your current plan qualifies as a Private Health Services Plan expenses and co-insurance amounts eligible for reimbursement under the health spending account option will be limited to amounts which would otherwise qualify as medical expenses of the individual within the meaning of subsection 118.2 (*see enclosed 118.2 Medical Expense Credit*) of the Income Tax Act (The Act). Eligible amounts may be claimed in the plan year in which they are incurred or within 12 months of the end of the plan year. The individual subscriber forfeits any credit remaining at the end of a plan year.

Technical Interpretation, Business and General Division

Revenue Canada File Number 9428595.

Plan of Insurance

BULLETIN IT-339R2 (Meaning of private health services plan) paragraph 6 – a PHSP must be in the nature of insurance in order to properly qualify. The following comparison shows how the Olympia Trust Plan qualifies.

Points of Insurance

- a) One entity indemnifies another.
- b) For an agreed consideration.
- c) From a loss or liability in respect of an event the happening of which is uncertain (ie: risk)

Olympia Trust PHSP

- a) Employer (corporation) indemnifies employees.
- b) Employer establishes benefit level for each classification of employee.
- c) Employer accepts a reasonable degree of risk by establishing a set benefit level for employees and does not know if employee will claim the amount available. Likewise, the employee is uncertain if the allowable level offered will be used. The employee will forfeit any unused credits after the prescribed period of time.

References

1. Technical Interpretation, Business and General Division; June 1992. Revenue Canada File Number 9210485.
2. Technical Interpretation, Business and General Division; November 1994. Revenue Canada File Number 9428595.