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Please note that the following document, although believed to be correct at the time of issue, may not represent the current position of the CRA.

Prenez note que ce document, bien qu'exact au moment émis, peut ne pas représenter la position actuelle de l'ARC.

PRINCIPAL ISSUES: Does a cost-plus health plan for a sole employee-shareholder qualify as a PHSP?

POSITION: No.

REASONS: See response

XXXXXXXXXX

2014-052130

P. Waugh

June 25, 2014

Dear XXXXXXXXXXXX:

Re: Private health services plan

We are writing in response to your email dated February 19, 2014, in which you asked about the tax implications of amounts paid under a cost-plus health plan (Plan).

In the situation described, a Plan is offered by a corporation to its sole shareholder who is also the sole employee. The Plan is administered by a third party (e.g., insurance company or trustee plan). The employee-shareholder submits health expenses (e.g., prescription drug receipts, dental receipts) to the Plan administrator who invoices the corporation for the same amount plus an administration fee. Once the amount is paid, the Plan administrator reimburses the employee-shareholder. This coverage may continue for periods when the corporation does not earn business income.

Our Comments

This technical interpretation provides general comments about the provisions of the Income Tax Act (Act) and related legislation (where referenced). It does not confirm the income tax treatment of a particular situation involving a specific taxpayer but is intended to assist you in making that determination. The income tax treatment of particular transactions proposed by a specific taxpayer will only be confirmed by this Directorate in the context of an advance income tax ruling request submitted in the manner set out in Information Circular IC 70-6R5, Advance Income Tax Rulings.

Employment benefits, whether provided in cash or in-kind, are generally included in an employee's income under paragraph 6(1)(a) of the Act. However, there are a number of exceptions in the Act, such as where the employer provides health benefits to its employees through a private health services plan (PHSP).

A PHSP is defined under subsection 248(1) of the Act as a contract of insurance in respect of hospital expenses, medical expenses, or any combination of such expenses or a medical care insurance plan, a hospital care insurance plan, or any combination of such plans. The position of the Canada Revenue Agency (CRA) on what constitutes a PHSP is outlined in Interpretation Bulletin IT-339R2, Meaning of private health services plan [1988 and subsequent taxation years]. Paragraph 3 of IT-339R2 specifies that a PHSP must be a plan in the nature of insurance. Therefore, it must represent an undertaking by one person to indemnify another person, for an agreed consideration, from a loss or liability in respect of an event, the happening of which is uncertain. In other words, a particular plan or arrangement would not qualify as a PHSP unless it involves a reasonable element of risk that is assumed by the insurer, whether that insurer is the employer or a third party.

Paragraph 6 of IT-339R2 provides general information regarding a cost-plus plan where an employer contracts with a trustee plan or insurance company for the provision of indemnification of employees' claims on defined risks under the plan, and promises to reimburse the cost of such claims plus an administration fee to the plan or insurance company. Therefore, an employer may have a cost-plus plan that qualifies as a PHSP.

However, a cost-plus plan under which the administrator agrees to reimburse the sole employee-shareholder, 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. Effectively, the sole employee-shareholder is paying for the personal hospital and medical expenses for himself or herself and his or her household members through his or her solely-owned corporation without any risks being assumed by the Plan administrator. Therefore, it is our view that a cost-plus plan for a sole employee-shareholder would not likely constitute a plan in the nature of insurance.

The tax implications will depend on whether the individual is receiving benefits in his or her capacity as an employee or shareholder. The determination of whether the sole employee-shareholder is receiving benefits in his or her capacity as an employee or shareholder is a question of fact. Generally, where a sole shareholder is also the sole employee, CRA would consider the sole shareholder-employee to receive the benefits in his or her capacity as a shareholder unless he or she can demonstrate that employees, who are not shareholders, with similar duties and responsibilities to another corporation of a similar size receive similar benefits under a similar Plan.

Where it is determined that the individual received the benefit in his or her capacity as a shareholder, subsection 15(1) of the Act would apply to include in the shareholder's income for the year the amount of the reimbursement. Where subsection 15(1) applies, the payments made to the Plan administrator would not be deductible by the corporation under paragraph 18(1)(a) of the Act since the payment was not incurred by the corporation for the purpose of gaining or producing income from a business or property.

Please see IT-339R2 for further information on the requirements that must be met in order for a health care plan to be considered a PHSP.

We trust these comments will be of assistance to you.

Yours truly,

Nerill Thomas-Wilkinson, CPA, CA
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