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Are you PHSP-ing?

By Tom McFeat,
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Private health services plans (PHSPs) can be a flexible and cost effective way for a small business to offer tax-free health and dental coverage to employees. Even single-person businesses can benefit.

Fiona Law looked at a raft of traditional group insurance plans while looking to provide health and dental benefits for her staff at Calgary-based CompuTouch.

Her business, which uses technology to support interactive meetings and conferences, has just three full-time employees. So she wanted something that was easy to set up and understand, a plan that would cover a wide range of medical expenses and offered the firm certainty of costs.

What she ended up choosing was not an insurance plan at all, but a private health services plan (PHSP).

"This was an alternative way of providing a benefit that was very straightforward and very transparent," she says. "It's a good compromise with a minimum of hassle."

PHSPs - sometimes called health spending accounts - have been around for more than 20 years and have grown to become popular benefit programs at thousands of small businesses in Canada.

But there are still many entrepreneurs - including sole proprietors - who mistakenly think group insurance is their only option to pay the medical bills that medicare doesn't cover.

What is a PHSP?

Private health services plans are a type of health and welfare trust governed by the Income Tax Act.

At their heart, they provide a way for a business to pay for all the medical expenses of employees and their families - and that includes the business owner - on a tax-free basis.

In the case of an unincorporated sole proprietor, a PHSP can let the entrepreneur have his or her out-of-pocket medical costs paid for by the business, with significant tax savings over paying for them with after-tax dollars.

With PHSPs, business owners can deduct all their eligible medical and dental expenses from their gross business income, instead of making them a personal expense.

"A PHSP ... transfers an out-of-pocket expense to a business deduction," says Rachel von Sturmer, who offers

independent insurance advice to small businesses through her Vancouver-based firm, True Benefits Inc.

"[PHSPs are] a great option," she says. "I have one for myself."

How do PHSPs work?

PHSPs can be set up through third-party providers - there are more than a dozen in Canada - that specialize in administering these plans. It's also possible to set up a self-administered PHSP.

General PHSP rules

Unused account balances can be carried forward for one year.

Plans for incorporated businesses must be offered to all employees. Those not wanting to participate can opt out.

Corporations can vary benefit levels by job classification, but all employees at the same level must receive the same benefit.

Maximum annual benefit can be changed at any time.

Let's assume a small business owner has agreed to fund a PHSP for his five employees for up to \$1,000 a year for each worker.

An employee or a family member visits a health practitioner and pays for an out-of-pocket medical expense (like prescription drugs, eyeglasses, or physiotherapy).

We'll assume they submit their receipts to a third-party PHSP administrator.

The administrator ensures the claim is legitimate and that the expense falls within the limit funded by the business.

Once it's approved, the administrator sends a cheque to the claimant for the entire amount (up to \$1,000 per employee per year, in this case).

The claimant gets all their medical expenses covered on a tax-free basis. And the business gets a 100 per cent tax deduction.

What does it cost?

Third-party administrators make their money by charging the business initial setup fees, as well as transaction fees that range from five to 15 per cent - 10 per cent is typical.

The tax savings

Several PHSP providers have calculators to figure out how much a PHSP can save an entrepreneur versus having no health plan at all. You can try one calculator here [<http://www.thehealthplan.ca/phspcalculator.php>]. (Note: the calculations will vary slightly from one administrator to another because of differing fee structures).

So a \$1,000 claim would cost the company \$1,000, plus the administration fee of perhaps \$100, plus GST/HST on the fee, making a total of about \$1,113 on average.

That amount can in turn be entirely deducted by the business.

Depending on the nature of the business and the income bracket of the entrepreneur, the tax savings could be as high as 39 per cent of the total amount paid.

Who and what is eligible?

Just about any medical expense that qualifies for the medical expense tax credit can be paid for through a PHSP.

Unincorporated businesses, like a partnership or sole proprietorship, qualify, as do incorporated businesses and self-employed professionals. There's no formal limitation on the number of employees, although some administrators may have their own policies.

There are also some rules that the Canada Revenue Agency has established. In the case of sole proprietorships, for example, annual PHSP funding is limited to \$1,500 for the owner, \$1,500 for a spouse and \$750 for each dependent child (there's no set funding limit for corporations, but the CRA does look for reasonable benefit amounts). One PHSP provider we found won't allow limits above \$15,000.

PHSPs for unincorporated business also have to have an insurance element in place, so some companies add travel

medical coverage.

What are the benefits of a PHSP?

Many employees like the flexibility of PHSPs. For instance, an employee with a PHSP that his small business has funded to the tune of \$2,000 can decide himself how that money will be spent - dental bills for himself and registered massage therapy for his wife, or prescription drugs for his son and eyeglasses for his daughter.

Medical costs are entirely paid for up to the funding limit. There are also none of the deductibles, co-payments or annual limits on particular kinds of services that some group health plans have.

For employers, PHSPs provide cost certainty - they know upfront how much their benefit costs will be. With some of the big providers of group insurance, some very small businesses may find that their premiums will jump if one employee has a lot of health problems because the claims aren't all pooled. Fortunately, there are some group health plans, like the Chambers of Commerce Group Insurance Plan, that pool claims and are available even to single-person businesses.

With group plans, there's always someone who doesn't like what's covered and what isn't, or doesn't like the limits that may have been imposed. Some employees will want better drug coverage, while others might want better coverage for orthodontic work. Only big employers are usually able to offer the type of group plan that allows workers to pick and choose coverage - the so-called cafeteria plans. But with PHSPs, each employee is able to choose how to spend their plan dollars.

People with pre-existing health conditions may find it difficult to qualify for some group insurance plans. With PHSPs, that's not an issue - all pre-existing conditions are covered because it's not insurance, so there are also no monthly premiums for employee or employer. In fact, if an employee doesn't have medical expenses, the employer isn't out of pocket anything.

"It's use it or lose it," points out Keith Peden, marketing manager for Brock Health, a PHSP administrator in Calgary.

Most of Peden's customers are the smallest among small business entrepreneurs - the self-employed, the sole proprietor, the family business - a group that he says most of the big group health providers typically don't focus on.

His small business clients like the flexibility PHSPs offer. "Once they figure it all out, they love [them]," he says.

Are there any drawbacks?

PHSP's are designed to deal with more of the regular, routine type of medical expense like teeth cleaning, prescription drugs and new eyeglasses - not a catastrophic medical issue. For major (ie., expensive) health events, group plans will tend to offer more coverage. That's the insurance aspect - with group plans, you can end up getting back a lot more than you paid in.

So if people only have PHSPs in place and are worried by the financial impact of a major illness or accident, the purchase of additional catastrophic medical insurance - which can include critical illness or long-term disability insurance - is a must.

There can also be an issue of privacy. A few PHSP administrators can run on a pay-as-you-go model, rather than on a pre-funded basis. With pay-as-you-go, people pay their health-care expenses and then submit receipts to their employer, who then forwards the receipts to the PHSP administrator. Many people don't want their boss to know what their medical issues are. That's why most businesses have set up pre-funded health spending accounts with the providers.

Of course, in the case of a sole proprietorship, privacy of medical bills isn't an issue because the boss is also the claimant.

Which is better?

Some businesses offer both PHSPs and group insurance plans to their employees. The PHSP can be used to cover medical deductibles or the parts of a group health insurance claim that aren't covered (some dental plans, for instance, only pay 80 per cent of the dental fee schedule and some services, like orthodontic work, may only be covered at 50

per cent).

So is a PHSP right for you?

"It depends on the number of employees and the kinds of benefits they want to provide," says Vancouver insurance consultant Rachel von Sturmer.

"Do they want to be a little bit more traditional and provide a full spectrum health, dental and life insurance plan, or are they more interested in providing a set budgetable amount per year?" she asks. "Group plans definitely have their place," and says she often recommends them, depending on the particular needs, and the budget, of the clients who consult her.

One group plan she often points clients to - the popular Chambers Plan (mentioned above) - is specifically designed for the small and medium-sized business. and is in place at more than 25,000 firms.

But for sole proprietors who've just started their own business, have no other health benefits, have taxable income but don't have a lot to spend, she's definitely in the PHSP camp.

"They're fantastic."

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