

Cost Plus



Cost Plus is a cost efficient and tax effective means of covering health and dental expenses or supplementing existing group insurance benefits.

Working with your Chambers Plan group benefit coverage, Cost Plus can:

- cover items not covered or paid for by your group plan,
- reimburse these costs on a tax-free basis to individuals,
- be paid with pre-tax dollars through your company, creating a business deduction like group insurance premiums.

What Is Cost Plus?

Cost Plus is a proven, tax-effective means of covering Health, Dental or Vision Care expenses not eligible under your regular Chambers Group plan. Used correctly it can be considered a Private Health Services Plan (PHSP), recognized by Canada Revenue Agency (CRA) as a vehicle which allows businesses to deduct health-related expenses eligible under the Income Tax Act. Eligible Cost Plus charges are treated the same as group insurance premiums and can be a deductible business expense. Cost Plus benefits paid to individuals are generally not taxable in the hands of the employee who receives them (except in Quebec where provincial taxes apply).

Cost Plus covers all supplies and services considered eligible medical expenses under the Canadian Income Tax Act. This would include amounts over any limits in your benefit plan, the co-insurance amounts you are responsible for, or expenses such as orthodontic treatments that may not be part of your current benefit program.

Who Can Use Cost Plus?

Cost Plus can be used by most businesses, but there may be limits as to the total amounts deductible to the business under this arrangement.

Business Structure	Can Be Used By	Limits
Incorporated Business	All employees are eligible	No limits, however the Income Tax Act requires an amount be reasonable and incurred for the purpose of earning income from the business in order to be deductible.
Unincorporated business with arm's length (unrelated) employees covered under the Chambers Plan	All employees are eligible, including the owner	The total deduction (<i>including health and dental premium and cost plus expenses</i>) allowed in respect of the owner is limited to the "cost of equivalent coverage" provided to employees. In other words, the maximum amount that owners can deduct is equal to the amount of coverage they provide to their employees.
Unincorporated business where the only employees covered under the Chambers Plan are related to the owner	All employees are eligible	The total deduction (<i>including health and dental premium and cost plus expenses</i>) allowed in respect of the owner is \$1,500 for each of the owner and the spouse, plus \$750 for each dependant child. For a typical family of 4, the maximum deduction would accordingly be \$4,500.
Unincorporated business with no employees, or no employees covered under the Chambers Plan	Not eligible	N/A

Getting Started

To use Cost Plus, an employer must have an obligation under the employee's contract of employment to reimburse eligible expenses under the program. Though many employers do not use formal, written employment contracts, if you wish to offer Cost Plus benefits to your employees, you can include a written addendum to their group insurance employee booklet outlining its availability.

There is no claim limit for the amount of medical expenses that can be reimbursed, but any expenses must be reasonable in order to be deductible. Different claim limits can be set for different groups or classes within the organization.

Can Shareholders Use Cost Plus?

A shareholder can use Cost Plus if they are actively employed by the company, and the benefit is paid in their capacity as an employee. As an employee, the amount would be deductible to the corporation and the benefits paid would be non-taxable to the individual. If Canada Revenue Agency deems the benefit is received in their capacity as a shareholder however, then the amount is not deductible to the corporation, and the benefits paid become a taxable benefit to the individual.

How Do We Make A Claim?

Expenses not covered under your Chambers Plan Health or Dental benefits may be submitted as long as they qualify as a medical expense as defined under section 118.2(2) of the Income Tax Act. Simply forward a Cost Plus claim form and original receipts, along with a cheque for the amount of the claim plus a small administration fee and applicable taxes. We will process the claim and reimburse the employee or service provider accordingly. Based on the criteria discussed above, your firm may deduct the entire amount as a business expense.

If your firm has an Extended Health benefit with the Chambers Plan, the administration fee is 5% of the claimed health expense, up to a maximum of \$125 per claim. If your firm does not have an Extended Health benefit, the administration fee is 12% of the claimed health expense (no maximum).

If your firm has a Dental benefit with the Chambers Plan, the administration fee is 5% of the claimed dental expense, up to a maximum of \$125 per claim. If your firm does not have a Dental benefit, the administration fee is 12% of the claimed dental expense (no maximum).

... a "tax effective" means of enhancing your group benefit program.

Say an employee in a 50% marginal tax bracket has \$3,000 in orthodontic expenses. He or she would have to be paid an additional \$6,000 from the employer to cover the cost of the \$3,000 bill.

Cost to the company: \$6,000, plus any applicable payroll taxes.

With Cost Plus, the company would instead issue a cheque for \$3,000 (plus fees and taxes) to the Plan, and the Plan would reimburse the \$3,000 claim to the employee.

Cost to the company: \$3,000, plus applicable fees and taxes.

Quick Reference for Financial Advisors

Reference Income Tax Folio S1-F1-C1 / IT529 / IT339R2 / IT85R2

What is Cost Plus?

The Canada Revenue Agency has several published positions and rulings regarding Cost Plus. The main reference is Interpretation Bulletin IT-339R2, which discusses health and dental insurance plans in general, and has a specific reference to Cost Plus plans in paragraph 6.

In a "cost plus" plan an employer contracts with a trustee plan or insurance company for the provision of indemnification of employees' claims on defined risks under the plan. The employer promises to reimburse the cost of such claims plus an administration fee to the plan or insurance company. The employee's contract of employment requires the employer to reimburse the plan or insurance company for proper claims (filed by the employee) paid, and a contract exists between the employer and the trustee plan or insurance company in which the latter agrees to indemnify the employee for claims on the defined risks so long as the employment contract is in good standing. Provided that the risks to be indemnified are those described in paragraphs (a) and (b) of the definition of "private health services plan" in subsection 248(1), such a plan qualifies as a private health services plan.

What are the taxation rules governing Cost Plus?

If the plan and the claim fall under the guidelines of a "private health services plan", then the payment by the employer is a deductible business expense, and the payment to the employee is a non-taxable benefit.

What criteria must be met when setting up Cost Plus?

In order to use Cost Plus, a few criteria need to be satisfied:

- The benefits must be part of a Private Health Services Plan.
- The expenses submitted under the plan must meet the definition of medical expenses in the Income Tax Act. This is a large list, and is available in Income Tax Folio S1-F1-C1.
- The availability of Cost Plus must be part of the employee's contract of employment.

Can owners of unincorporated businesses use Cost Plus?

The definition of a Private Health Services Plan requires "an undertaking by one person to indemnify another person". With a Cost Plus arrangement, the business is agreeing to indemnify a person.

In a true employer-employee relationship, one person (the employer) is paying or indemnifying another person (the employee), and a business can be a corporation or it can be a sole-proprietor or partnership. However, in an unincorporated business with no employees, the business owner and the claimant are the same person. Canada Revenue Agency has clearly stated that they would not consider Cost Plus claims to be part of a Private Health Services Plan in this case.

In an unincorporated business with employees, the owner may be able to use Cost Plus, but the amount deductible as a business expense will be restricted to the levels stated earlier.

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Quick Reference for Financial Advisors (continued)

Are shareholders eligible?

It is important to distinguish between benefits received as a shareholder and benefits received as an employee. Canada Revenue Agency has stated that where a particular benefit is made available only to shareholders, there is a presumption that the benefit is made in his/her capacity as a shareholder.

In order to argue that the benefit is received as an employee, it may need to be demonstrated that Cost Plus is available to all employees, or a class of employees, for example, senior executives. If the only person entitled to use Cost Plus is a shareholder who is also the company President, you could argue that it is reasonable to provide a certain amount of Cost Plus benefits based on an overall remuneration package that you would need to offer an unrelated person to perform the same job.

With income tax legislation, a corporation is considered a separate person. Accordingly, the test noted above (“an undertaking by person to indemnify another person”) can be met even in a one-person business. The dollar limits mentioned above in respect of unincorporated businesses do not apply in the case of a corporation.

In all cases, there are general rules in Income Tax that require an expense be reasonable and be paid in the course of earning income from a business. This test may become more onerous in cases of Cost Plus claims by a corporation whose only employee is also a shareholder, or in cases where Cost Plus is made available only to a class of senior executives.

What are the employer’s responsibilities?

There are several things an employer can do to ensure their Cost Plus program flows smoothly and minimizes taxation risk.

- Though we can review the Cost Plus claim for reasonableness, we are not making an assertion that the medical expense is allowable under the Income Tax Act. Employers must ensure any items submitted under a Cost Plus claim are eligible expenses under the Act.

- Document the availability of Cost Plus to employees, including dollar limits if applicable.
- Since we don’t necessarily know the legal structure of each business, employers must ensure any Cost Plus claims submitted are for eligible individuals and within any dollar limits imposed by Canada Revenue Agency

Are there any risks?

Though Cost Plus has been used for many years and is widely recognized by insurers, brokers, tax professionals and Canada Revenue Agency, as with any transaction involving a tax deduction or benefit, there are risks. In general, the risk factors associated with a Cost Plus claim include:

- The size of a claim – a large claim is more likely to be reviewed and challenged as being unreasonable and not incurred in the course of earning income from business.
- The relationship of the claimant to the business – a Cost Plus claim for a shareholder is more likely to be challenged than for an arm’s-length employee.
- Documentation – is the entitlement to use Cost Plus documented in a contract of employment or some other form?
- Availability of Cost Plus to others – is Cost Plus available to all employees, certain classes only, or shareholders only?

Risks can be minimized through proper documentation and implementation of reasonable claim limits.

The information in this document is not intended as tax advice for employers or employees. Employers should consult their tax advisor(s) before submitting claims through Cost Plus. The Chambers Plan does not know the specific details of an individual or firm’s tax or legal situation, and as such, the information provided in this document is generic in nature.