



Healthcare Spending Account (HCSA)

Like employer-sponsored health care plans in Canada (with the exception of Quebec), an HCSA must be structured like a Private Health Services Plan (PHSP) in order to receive a favorable tax status as summarized in Table below.

	When Flexible Credits are Deposited (Employer Contributions)	When Benefits are Paid Out.
All provinces except Quebec	Not taxable to employee	Not taxable to employee ¹
Quebec	Taxable to employee ²	Taxable to employee for provincial income tax purposes, based on the average amount of claims paid from the HCSA plus applicable Quebec sales tax

A PHSP, as defined by Section 248(1) of the Income Tax Act, is any vehicle created to provide to or reimburse a group of employees for health care and dental care expenses, where the provider of the benefits earns a tax deduction for amounts spent on the plan and the employees bear no tax burden for benefits received. Revenue Canada’s Interpretation Bulletin 339R lists the five basic elements that a health care benefits plan must contain to qualify as a private health services plan:

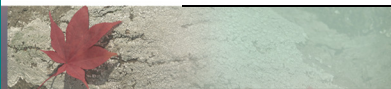
- It must be an undertaking of one person
- To indemnify (reimburse) another person
- For an agreed consideration
- From a loss or liability in respect of an event
- *The happening of which is uncertain*

Therefore, for an HCSA to resemble a true form of insurance and qualify as a PHSP to provide reimbursement on a tax-effective basis, some element of insurance risk or uncertainty that the risk covered will actually occur must be incorporated in the account design. Simply put, there must be some chance that the employee will lose the funds allocated to the account. Funds are lost in very much the same way that an employee would not be able to recoup premiums paid for insurance coverage if the insured risk never occurs. Revenue Canada has since relaxed the rules; however, it has since outlined three different design features that must be included in a health care spending account to introduce the required element of risk. They are:

- Employees must make elections for the account only once annually. This means that at the start of each plan year, employees determine how many flexible credits (whether new money or freed-up flexible credits) will be contributed to their accounts for the coming year. However, once made, this allocation decision is irrevocable, unless the employee’s family status has changed due to reasons such as a marriage or the birth of a child.

¹ In Ontario, the benefit amount paid out is considered the premium and is subject to premium tax and retail sales tax.

² In Quebec, employer contributions subject to premium tax and Quebec sales tax.





- Funds allocated to an HCSA must be used to reimburse expenses incurred during that year. Revenue Canada states that plans can deal with unused HCSA flex credits at plan year-end in one of two ways, by incorporating either:
 - A use it-or-lose-it feature, under which any remaining amount in the account at plan year-end is forfeited and returned to the employer; or
 - A carry-over or roll-over feature, under which the unused flex credits will be rolled over for the following 12 months (without any tax consequences to the employee), or the unclaimed expenses for a given year can be carried forward to the following 12 months, but not both.

Roll-over of unused flex credits is the most prevalent feature. When this feature is chosen, the first-in/first-out rule is normally applied: this means that the flex credits rolled-over from the prior plan year are used up first before the flex credits deposited for the current plan year, which serves to minimize the chances of forfeiting the rolled-over flex credits at year-end. Which feature is adopted is a matter of employer discretion, but paying out the unused flex credits in cash is not an alternative.

- The HCSAs must incorporate a us-it-or-lose-it feature for unused flex credits when an employee:
 - Terminates
 - Retires
 - Dies
 - Goes on general leave of absence greater than 30 days.

If these requirements are met, then payments of eligible expenses through health care spending accounts are deductible by the employer and not taxable to the employee. Health Care Spending Accounts (HCSA) are an effective way to extend an employee's health and/ or dental coverage.

