Taxation of Employee Benefits

(Group Insurance)

in Canada

By Marthe Cloutier, FCIA, FSA
Bruno Gagnon, FCIA, FSA

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In Canada, group insurance benefits are subject to several forms of taxation under a number of tax measures. Taxes are collected both by the Federal government and by the provinces. The purpose of this study note is to review and explain the various forms of taxation that apply to group insurance.

1.0 Income Tax

In Canada, both the provinces and the federal government tax the income of individuals and corporations. Except for the Province of Québec, which has its own income tax, the provincial income tax is calculated as a percentage of the federal income tax and, as a result, is applied in the same manner and to the same income as the federal income tax.

From the point of view of employee benefits, income tax is important in various ways:

- it allows employers to deduct from their taxable income the amount contributed toward specific employee benefits, as a cost of doing business, under specific rules;
- it allows employees to benefit from tax credits on their contribution toward group health and dental insurance, under certain circumstances;
- it allows employees to benefit from tax credits on the portion of eligible health and dental expenses that is not reimbursed by a group health and dental insurance program;
- it allows employees who receive taxable disability benefits to deduct from their taxable income their contributions to these disability benefits, under certain circumstances;
- it forces employees to pay income tax on certain benefits provided or paid for by the employer and for which the employer was allowed a tax deduction, on the principle that what is deducted by one party should be taxable to the other;
- as an exception to the preceding rule, it allows employees not to pay tax on certain benefits provided or paid for by the employer, even though the employer was allowed a tax deduction.

By specifying the conditions under which employee benefits plans qualify for a favourable tax treatment, the federal Income Tax Act, together with its information circulars, interpretation bulletins and income tax folios (gradually replacing interpretation bulletins), has done a great deal in shaping employee benefits programs in Canada. For example, group health insurance plans typically cover only expenses that qualify for a medical expenses income tax credit under the Income Tax Act. To a certain extent, the Québec Income Tax Act, which has become somewhat different from the federal Income Tax Act over time, from a group insurance point of view, has also contributed in shaping programs covering groups that include employees located in the Province of Québec.

1.1 Basic Concepts

1.1.1 Deductions and Credits

A deduction is an amount that can be subtracted from gross income in calculating taxable income. In simple words, a deduction gives the taxpayer tax relief based on his/her marginal tax

rate since it reduces the taxable income. For example, if a taxpayer can deduct $1,000 from his/her gross income and the marginal tax rate is 45%, then the taxpayer get tax relief for 45% x $1,000 = $450. Deductions are scarce as most former deductions were transformed into non-refundable tax credits in the late 1980s. The most widely used remaining deductions are contributions to a registered retirement savings plan (RRSP), contributions to a pension plan and union and professional dues.

An income tax credit is an amount that can be deducted from the income tax that the taxpayer has to pay. Typically, tax credits are calculated by multiplying the amount eligible to the credit by the tax rate of the lowest income bracket. Federal income tax credits are 15% of the eligible amount. Provincial tax credits are typically based on the provincial income tax rate in the lowest income bracket. A tax credit can be either refundable or non-refundable. A refundable tax credit can lead to negative income tax while a non-refundable credit cannot reduce the income tax payable below 0. Nearly all income tax credits are of the non-refundable type. All tax credits related to social programs and employee benefits are non-refundable, such as:

- Canada Pension Plan (CPP)/Québec Pension Plan (QPP) contributions;
- Employment insurance premiums;
- Medical expenses.

For Québec provincial income tax, CPP/QPP contributions, employment insurance premiums, parental insurance premiums and contributions to the “Fonds des services de santé” are bundled with the basic personal amount used to calculate a flat basic personal income tax credit.

1.1.2 Private Health Services Plan

Favorable tax treatment is granted to a health and/or dental plan that qualifies as a “Private Health Services Plan” (PHSP), as defined in the Income Tax Act and in Interpretation Bulletin IT-339R2. (At the time of this writing, “IT-339-R” has not yet been replaced with an income tax folio). To qualify as a PHSP, a plan must be in the nature of insurance. In this respect the plan must contain the following basic elements:

(a) an undertaking by one person,

(b) to indemnify another person,

(c) for an agreed consideration,

(d) from a loss or liability in respect of an event,

(e) the happening of which is uncertain.

The plan must also essentially cover expenses that qualify as medical expenses for the non-refundable tax credit for medical expenses under income tax folio S1-F1-C1 (formerly known as Interpretation Bulletin IT-519R2 consolidated) and substantially all of the premiums or other consideration payable for the coverage provided relate to such expenses. (This is the position of the Canada Revenue Agency since 2015; prior to Jan 1, 2015, all medical expenses covered under a plan had to be eligible to the medical expense tax credit.) These expenses are summarized later in this study note, under “Group Health and Dental Plans”.

Group health and dental plans, whether traditional, flexible or in the form of Health Spending Accounts, are typically intended to qualify as PHSPs.

1.1.3 Spouse

Living in a conjugal relationship can have a significant impact on the calculation of a taxpayer's taxable income or income tax credits. It must be noted that the notion of "spouse" for income tax purposes is not necessarily the same as for other purposes.

For income tax purposes, a "spouse" includes a married spouse, a civil union partner (civil union being a contract that can be dissolved by common agreement, without requiring a judgment of divorce), and a common-law partner. In Canada, spouses are not required to be of different genders. The civil union partner is treated as a common-law partner for Federal income tax purposes and as a married spouse for Québec income tax purposes. This situation is due to the fact that civil union falls exclusively under provincial jurisdiction.

To be considered as a "spouse", a common-law partner must either *[Income Tax Act - Section 248.1]*:

- have been living in a conjugal relationship with the taxpayer for a continuous period of at least one year, without being separated from the taxpayer for more than the past 90 days; or
- have been living in a conjugal relationship with the taxpayer and be the parent of a child of whom the taxpayer is a parent, without being separated from the taxpayer for more than the past 90 days.

1.2 Employer's Point of View

1.2.1 General Principle

The employer is allowed to deduct from its taxable income, as a cost of doing business, expenses incurred for the purpose of gaining or producing income from its business *[Income Tax Act Section 18 (1)].* This includes the amount contributed toward the following employee group insurance benefits:

- life insurance, along with accidental death and dismemberment insurance (for the employee, his/her spouse and dependent children), provided that the employer is not the beneficiary;
- disability income insurance (including salary continuance plans, short term and long term disability coverage);
- health and dental insurance (for the employee, his/her spouse and dependent children).

The amount deductible is the premium paid to an insurance company, if the benefit is provided under an insured arrangement, or the benefit itself, if it is provided through a self-insured arrangement. The expenses charged by an insurer or third party administrator to administer a self-insured plan are also deductible.

1.3 Employee's Point of View

The basic principle underlying the deductibility of employer contributions in any group insurance plan (including a self-insured plan) is that the amount deducted by the employer should be taxable in the employee's hands, unless a tax break is granted to the employee. Such tax breaks are, indeed, granted as will be shown in this document.

The taxation of employer contributions in the employee's hands can be done either:

i) at the time when the employer makes its contribution (in this situation, the taxable amount will be the employer's contribution); or

ii) at the time when the benefit is received (in this situation, the taxable amount will be the portion of the benefit paid for by the employer); or

iii) never, if the employee benefits from a tax break.

As a general rule, employees cannot deduct their contributions to a group insurance plan, whether insured or not, in calculating their income tax. The sole exception applies to employees who received disability income benefits during the year, who may deduct their contributions toward the disability income insurance plan, as described under "Group Disability Income Insurance" in this study note. This being said, any amount considered to be paid by the employee toward eligible health & dental expenses (insurance premiums or eligible expenses not covered by an insurance program) give rise to an income tax credit, as will be shown later in this document.

1.3.1 Group Life Insurance

Group life insurance premiums paid by the employer for the employee and his/her dependents are a taxable income for the employee under Section 6(4) of the Income Tax Act.

In reading the Act and related documents, one must be extremely careful not to be mislead by Section 6(1)a)(i), that seems to exempt group term life insurance from taxation. In the past (before July 1994), Section 6(1)a)(i) actually exempted group term life insurance from taxation and Section 6(4) brought back the cost of group term life insurance for the portion in excess of $25,000 in taxable income. With the abolition of the $25,000 exemption, the whole cost of group insurance paid by the employer is now taxable to the employee per Section 6(4). However, Section 6(1)a)(i) was not modified to reflect this not so new situation, thus creating potential confusion.

1.3.1.1 Employee Group Life Insurance

When the premium rate does not vary according to age and sex, the taxable premium is calculated as the premiums paid by the employer, for the employee's coverage, after adding the provincial sales tax (where applicable) minus contributions from the employee. In calculating the premiums paid by the employer for the employee's coverage, it is usual for the employer to deduct the portion of an experience-rating refund that corresponds to the coverage of the employee.

In any other situation the taxable premium for a particular employee is calculated as the sum, over the year, of the product of the average daily premium rate in force (adjusted for refunds) during the year for the class of employees who have a common premium rate and to which this employee belongs ("premium category"), and the daily amount of insurance in force for this employee; the employee's contribution toward group life insurance is then subtracted from this result. Where applicable, sales tax is added to this result to produce the amount subject to the taxable premium. *[Income Tax Act Regulation - Section 2702].*

Contributions to the C/QPP are collected on the taxable amount but not employment insurance premiums *[CRA, Employer's Guide to taxable Benefits and Allowances, 2013]*.

Death benefits under a group life insurance plan are not taxable to the recipient.

1.3.1.2 Death benefits Paid by the Employer *[IT-508R; not yet superseded by an Income Tax Folio]*

Any amount paid by the employer because of the death of an employee is taxable to the recipient. However, the recipients can collectively deduct the lesser of the actual amount or $10,000. In this situation, the following rules apply:

- When the recipient (or one of the recipients) of the death benefit is the spouse of the deceased employee, the spouse may deduct the first $10,000 from his/her taxable income.
- If there are two or more recipients, one of which is the spouse of the deceased employee, the total deduction cannot exceed:
  - (a) $10,000 for the spouse; and
  - (b) for the other beneficiaries, their proportionate share of the excess of $10,000 (if any) over the amount received by the spouse.
- If none of the recipients is the spouse of the deceased employee, the total deduction is apportioned among the recipients.

In other words, the spouse has precedence over all other beneficiaries in claiming the tax deduction.

If death benefits are received from more than one employer, the total deduction is limited to $10,000 for all death benefits combined.

1.3.1.3 Dependents' Group Life Insurance

When the premium rate does not vary according to age and gender, the taxable premium is calculated as the premiums paid by the employer, for the coverage of the employee's dependents, after adding the provincial sales tax (where applicable) minus contributions from the employee. Experience-rating refunds are apportioned among the employees and subtracted from the employer's contribution.

The death benefit payable under dependents' group life insurance is not taxable.

1.3.1.4 Survivors’ Income Benefit

The income tax paid by the employee is calculated on the premium paid by the employer, in the same manner as for employee group life insurance, with the commuted value of the survivor income benefit being used as the insurance amount.

Upon the death of the employee, the commuted value of the survivor income benefit will not be taxable. However, based on this commuted value, each periodic payment will be split into non taxable capital and taxable interest.

1.3.2 Group Accidental Death & Dismemberment Insurance (AD&D)

The amount of an employer’s contributions to a group sickness or accident insurance plan is included in an employee’s income for the year in which the contributions are made to the extent that the contributions are not in respect of a wage-loss replacement benefit payable on a periodic basis. As a result, group AD&D premiums paid by the employer for the employee and his/her dependents are a taxable income for the employee. Both the premiums and the applicable sales tax are taxable. Prior to January 1, 2013, group AD&D premiums were only taxed at the provincial level, in the Province of Québec.

Benefits are not taxable to the recipient.

1.3.3 Group Critical Illness Insurance

As group critical illness insurance is not a wage-loss replacement benefit payable on a periodic basis, group critical illness premiums paid by the employer for the employee and his/her dependents are a taxable income for the employee since January 1, 2013. Both the premiums and the applicable sales tax are taxable. Prior to January 1, 2013, group critical illness premiums were only taxed at the provincial level, in the Province of Québec.

Benefits are not taxable to the recipient.

1.3.4 Group Disability Income Insurance

Employer contributions to group disability income insurance are not taxable to the employees. However, benefits arising from these contributions are taxable

All income replacement benefits paid for by the employer under a group plan and received by an employee on a periodic basis as a result of a sickness, maternity or accident, whether under a salary continuance plan, a disability income plan or an accident & sickness insurance plan are taxable to the employee at the time that the payment is made to the employee.

Interpretation Bulletin IT-428 (not yet superseded by an Income Tax Folio) defines an “insurance plan” as a plan based on insurance principles, that may be either insured or self-insured, and for which premiums are paid or sufficient funds are accumulated. If the plan is an “insurance plan”, the total amount contributed to such plan by the employee since the later of:

(a) the date when the employee joined the plan, or

(b) the last year for which the employee received benefits under the plan, if the employee was then able to deduct all prior contributions, or

(c) the year 1967

may be deducted from the employee's benefits. The continuity of the plan is not affected by internal alterations in the plan such as an improvement in benefits or a change of insurer. However, when an employee moves from one plan to another, whether because of a change in job classification or a change of employment, the employee cannot deduct contributions made to the former plan.

A deduction cannot be claimed against benefits paid under a salary continuance plan, a plan based on sick leave debits or a supplementary unemployment benefit plan as these plans are supposed to be fully funded by the employer.

A short-term and a long-term disability income plan may be combined for the purpose of calculating the income tax deduction to which the employee is entitled, if the following conditions are met:

(a) the same classes of employees are entitled to participate in both plans, and

(b) the premium or cost of each plan is shared in the same ratio by the employer and the employees.

When a disability income insurance plan is fully paid for by the employees, benefits paid under such a plan are not taxable because they are deemed to arise from contributions made by the employee and that were not deductible when they were made. It must be noted, however, that when a plan is paid for both by the employer and the employees, in whatever proportions, benefits are taxable as described in the previous paragraphs, for all disabled employees, even those for whom the employer may not have contributed to the plan. The only way to provide these employees with a non-taxable benefit is to put them in a separate plan, in which the employer does not contribute at all.

The tax status of group disability benefits depends on the tax situation of the plan at the time an employee becomes disabled. For example, an employee-pay-all plan, which is non-taxable, will become a taxable plan when the employer starts contributing to it. However, benefits paid to an employee who became disabled prior to the change will remain non-taxable even after the employer starts contributing to the plan.

An employer may provide coverage to its employees under individual policies or any other type of non-group plan. In such a situation, the premium paid by the employer is a taxable benefit to the employee, regardless of the fact that the employee may or may not have received any disability benefit during the year.

A plan sponsor must be very careful not to combine taxable and non-taxable disability under the same financial arrangement (e.g., by cross-experience-rating a taxable plan with a non-taxable plan). If plans are combined, benefits provided under the non-taxable plan would be at risk of losing their non-taxable status if any employer money was deemed to be transferred from the taxable plan to the non-taxable plan. A similar problem may arise when an employee-pay-all plan is on a refund accounting or hold harmless basis if the employer is responsible to make up a shortfall. In such a situation, any shortfall made up by the employer would make the whole plan taxable.

1.3.5 Group Health & Dental Plans

Employer contributions to group health and dental plans, whether insured or not, are not taxable to employees, except in the Province of Québec, where these contributions, along with the 9% tax applied on them, are taxable under provincial income tax only.

At the federal level and in all provinces except Québec, contributions by an employee to a medical or dental plan (that constitutes a "Private Health Services Plan") qualify for a non-refundable income tax credit but only for the portion of these contributions which, together with any eligible medical or dental expenses not reimbursed by an insurance plan, exceeds the lesser of 3% of the employee's net income or $2,237 (for taxation year 2016; this amount is indexed annually). In Québec, the employee is entitled to a provincial income tax credit for the portion of his/her contributions which, together with the taxable employer's contributions and any eligible medical or dental expenses not reimbursed by an insurance plan, exceeds 3% of the combined net income of the employee and his / her spouse (the $2,237 limit on the 3% threshold does not apply in Québec for provincial income tax).

To qualify for the income tax exemption on employer contributions or the tax credit on employee contributions, the plan must be a "Private Health Services Plan" and all or substantially all of the premiums paid under the plan must relate to medical expenses that are eligible for the medical expense tax credit if they were not covered by the plan. Such expenses are described in income tax folio S1-F1-C1. Eligible medical expenses must have been paid on behalf of the taxpayer, the taxpayer's spouse or a dependent of the taxpayer.

For medical practitioners, eligible expenses vary by province or territory and are detailed in Appendix 1. The following are eligible in all provinces:

- a chiropractor;
- a dental hygienist;
- a dentist;
- a denturist, dental mechanic or denturologist;
- a dietician;
- a licensed or registered practical nurse;
- a registered nurse (including a nurse practitioner);
- an occupational therapist;
- an optician;
- an optometrist;
- a pharmacist;
- a physician;
- a physiotherapist or physical therapist;
- a psychologist;
- a social worker; and
- a surgeon.

The following are eligible in Ontario, Quepébec, British Columbia, and Alberta, that together represent 86% of the Canadian population:

- an acupuncturist;
- an audiologist;
- a dental technician or technologist;
- a midwife;
- a podiatrist; and
- a speech language pathologist.

Considering that since Jan 1, 2015, the plan must essentially cover expenses that qualify as medical expenses for the non-refundable tax credit for medical expenses (while prior to Jan 1, 2015, all medical expenses covered under a plan had to be eligible to the medical expense tax credit), there is no problem covering practitioners who are not eligible in a particular province, as long as these professionals are widely recognized (simply said, your plan can cover a kinesiologist or even a sexologist, but not a guru, a houngan or a marabout.)

Other eligible expenses include:

- a full-time attendant (other than the patient’s spouse) or for full-time care in a nursing home if the patient is disabled, such cost being subject to limitations;
- transportation in ambulance;
- transportation to the nearest facility capable of providing medical services, if such facility is located at least 40 kilometers from the patient’s place of residence; reasonable travel expenses (other than the cost of transportation) such as meals, accommodation and parking are eligible for the patient only if the facility is located at least 80 kilometers from the patient’s place of residence). In this latter situation, the same kind of expenses for transporting one individual who accompanies the patient may also be claimed as an eligible medical expense provided that a medical practitioner has certified in writing that the patient is incapable of travelling without the assistance of an attendant.
- an artificial limb, iron lung (including a portable chest respirator and a machine for supplying air or oxygen and/or medication to the lungs under pressure), rocking bed, for poliomyelitis victims, wheel chair, crutches, spinal brace, spinal support, brace for a limb (including elasticized stockings and boots and shoes where the brace is built in, ileostomy or colostomy pad, truss for hernia, artificial eye, laryngeal speaking aid, aid to hearing (including special devices and “cochlear” implants), artificial kidney machine (along with the installation expenses), phototherapy equipment and oxygen concentrator;
- diapers, disposable briefs, catheters, catheter trays, tubing or other products required by reason of incontinence;
- eye glasses and contact lenses (a prescription is required);
- laser eye surgery;

- oxygen tent or other equipment necessary to administer oxygen, insulin, vitamin B12 for pernicious anemia;
- cost of a device designed to enable a diabetic patient to measure the patient's blood sugar level, including the cost of test tapes or test tablets;
- expenses for acquiring and maintaining an animal specially trained to assist a patient who is blind or profoundly deaf or has severe autism, severe diabetes, severe epilepsy or a severe and prolonged impairment that markedly restricts the use of arms or legs;
- expenses incurred for a bone marrow transplant, including expenses to locate a donor and reasonable travel expenses of both the patient and the donor, and of one person accompanying each of them;
- reasonable expenses relating to rehabilitation expenses (including training in lip reading and sign language);
- Note-taking services, voice recognition software, reading services or deaf-blind intervening services when required because of a physical or mental impairment;
- reasonable expenses for alterations to the dwelling of a patient who has a severe and prolonged mobility impairment;
- reasonable moving expenses (not to exceed $2,000) for a patient who has a severe and prolonged mobility impairment and needs to move to a more accessible dwelling;
- alterations of the driveway of the residence of a patient who has a severe and prolonged mobility impairment, to facilitate the patient's access to a bus;
- a van that has been adapted for the transportation of a patient who has a severe and prolonged mobility impairment, up to certain limits;
- any other device or equipment which is prescribed by regulation; the most common items currently included under Regulation 5700 are
    - wigs for patients who suffered abnormal hair loss owing to disease or medical treatment;
    - needles and syringes used for injections;
    - pacemakers;
    - orthopedic shoes;
    - hospital bed;
    - device or equipment, including a replacement part, designed exclusively for use by a patient suffering from a severe chronic respiratory ailment or a severe chronic immune system disregulation;
    - A power-operated guided chair installation, for a patient that is designed solely to be used in a stairway;
    - A mechanical device or equipment designed to assist a patient to enter or leave a bathtub or shower, or to get on or off a toilet;

- A walking aid exclusively designed to provide support in the action of walking, where the patient has a mobility impairment. Common examples of walking aids are canes and walkers;
- external breast prosthesis required because of a mastectomy;
- device, including a telephone ringing indicator, that enables a deaf or mute person to make and receive phone calls;
- a visual or vibratory signalling device, such as a fire detector, for a person with a hearing impairment;
- an electronic speech synthetizer;
- device to decode special television signals to permit the script of a program to be visually displayed;
- devices enabling a blind individual to read or to operate a computer;
- devices designed to enable an individual with a mobility impairment to operate a vehicle;
- device designed to be attached to infants diagnosed as being prone to sudden infant death syndrome in order to sound an alarm if the infant ceases to breathe;
- a glucometer or an infusion pump used in the treatment of diabetes;

- drugs that can only be lawfully acquired if it is prescribed by a medical practitioner or dentist;
- drugs and medical devices that are not yet approved for sale and are obtained under Health Canada's Special Access programme;
- laboratory, radiological or other similar diagnostic procedures;
- medical marihuana (other than seeds) provided by Health Canada or by an individual who possesses, on behalf of the patient, a designated-person production license to produce marihuana under the *Marihuana Medical Access Regulations* or an exemption for cultivation or production under section 56 of the *Controlled Drugs and Substances Act*;
- artificial insemination procedures;
- cost of making or repairing a denture, including amounts paid to a denturologist or dental mechanic;

While many of the expenses listed above are typically not covered under a group plan, they can be claimed under a health care spending account. Any of these expenses that is not totally reimbursed by a group health insurance plan can be used in calculating the non-refundable tax credit for medical expenses.

Even though this list is impressive, the Canada Revenue Agency lists a number of medical expenses that are not eligible and that are commonly claimed in error, such as:

- athletic or fitness club fees;
- birth control devices (non-prescription);

- blood pressure monitors;
- purely cosmetic procedures such as liposuction, hair replacement procedures, augmentations (such as chin, cheek & lips), filler injections and teeth whitening;
- over-the-counter medications, vitamins and supplements, even if prescribed by a medical practitioner;
- personal response systems;
- the part of medical expenses for which the patient can get reimbursed (such as reimbursements from a private insurance);
- contributions to provincial health insurance programs.

While these expenses are not eligible per se to the income tax credit, including things such as over-the-counter medications in a group plan, as ancillary benefits, will not disqualify the group plan from being considered a “private health services plan”.

Benefits are not taxable to the recipient.

1.3.6 Ancillary Benefits

Health insurance plans may include benefits such as legal assistance, travel assistance, travel cancellation insurance, etc. as long as these benefits remain ancillary to the health insurance plan. In such a situation, ancillary benefits do not attract an adverse tax treatment.

1.3.7 Employee Assistance Programs

Employee assistance programs are paid for entirely by the employer. Employer contributions to such plans are not taxable to employees if they are for an employee’s retirement or re-employment or for mental or physical health. Services provided under these plans are also non-taxable. *[Income Tax Folio S2-F3-C2, Section 2.46]*

1.4 Flexible benefits Programs

The Canada Revenue Agency (CRA), in its interpretation bulletin IT-529 (not replaced yet with an income tax folio), considers flexible benefits programs as programs providing credits to employees. The granting of credits that have no redemptive value does not necessarily confer a taxable benefit to the employee; it is the selected options that are subject to income tax in the same manner as under a traditional group program.

Income tax considerations are an integral part of the design of flexible benefits programs and an important aspect of the selection of the benefits by the employees. To allow each type of benefit in a Flex plan to be treated according to the tax rules that normally apply to the particular type of benefits, CRA requires that the Flex plan be segregated into multiple parts. This is done by requiring employees to make their choices prior to the beginning of the plan year. If choices were made after the beginning of the plan year, the entire Flex plan will be considered as a single plan for which all parts would be simultaneously subject to all tax requirements that are normally applicable only to certain benefits. As a result, some amounts that are not meant to be taxable would be taxed in the hands of the employees. Hence, employees’ choices must be irrevocable except in the following situations:

- when there is a “life event”; or
- when there is a change in the employment status of the employee.

A “life event” must be defined in the plan documentation and typically includes events such as the birth, adoption or death of a dependent, a change in marital status or the loss of insurance coverage under a spouse’s employer’s plan. A change in an employee’s place of residence (typically moving to or from Québec) is considered a “life event” if it results in a change to the amount of flex credits allocated to the employee.

If a change in coverage is allowed as a result of a “life event” or of a change in the employment status of the employee, it must apply prospectively only.

If, after the beginning of the plan year, a Flex plan permits an exchange of Flex credits for cash or a transfer of credits between benefit options or a new selection of benefits (except for a “life event” or change in employment status), then the employees will be considered as having constructively received employment income equal to the value of all the allocated credits, not just those exchanged for cash or transferred between benefit options. Such income will be taxed.

The conversion of any portion of an employee’s salary to flex credits results in an income inclusion of the amount of salary so converted. Thus, if an employee forgoes an amount to which he/she is entitled, such as a negotiated salary increase, vacation or bonus, the amount of remuneration forgone is included in income in the year in which the amount is converted to flex credits. On the other hand, when a contract of employment is renegotiated upon the expiry of a former employment contract to incorporate a decrease in the level of salary or wages to be paid to an employee over the term of the new contract and the new contract also provides for additional flex credits, the additional credits will not be required to be included in the employee’s income as part of salary and wages.

1.4.1 Life Insurance

The method prescribed by the Income Tax Regulations for calculating the taxable benefit arising from the employer’s contribution to a group term life insurance plan requires the use of an average premium rate (either the daily average or a rate that does not vary with age and sex). When the employee can select a life insurance amount, paid by the employer, with a premium rate that varies with age or sex, the taxable benefit must be calculated not on the actual rate charged to the employee but rather on an average rate that is obviously different from the actual rate.

The two following approaches can help with this issue:

- Design the flex plan in such a way that there may be a common basic amount of life insurance provided by the employer’s contribution and that any additional amount is paid for by contributions from the employee.
- Consider each age/sex/smoking status bracket as being a different “premium category” within the meaning of the Income Tax Regulations.

1.4.2 Disability Income (Short- or Long-Term)

Extra care must be taken not to mix a taxable plan with a non-taxable plan. Otherwise, the non-taxable plan would lose its non-taxable status. It is possible, though, to offer an employer-paid basic plan and a non-taxable supplementary plan paid for entirely by employees. In this situation, the plans should preferably not be under the same insurance policy and certainly not be cross-experience-rated.

1.4.3 Medical and Dental Plans

A medical and/or dental plan will provide tax-free benefits if the plan qualifies as a private health services plan (PHSP) as described in the Income Tax Act and on page 2 of this note. As a result, the fact that the employee may be given a choice between various medical or dental plans does not prevent benefits to be provided tax-free, as long as these plans have the nature of an insurance plan.

One option in a flexible benefits program can be a Health Care Spending Account (HCSA). To be considered a PHSP, the plan must carry an element of risk for each employee. In other words, the employee must not be sure to be able to use all the money allocated to him/her in the HCSA. This can be achieved with either of the two following approaches:

1) Year-end balance in the HCSA is carried forward up to a maximum of 12 months after which any remaining amount is forfeited. In this situation, prior year expenses may not be claimed against the current year account.
2) Unused amounts are forfeited at year-end. In this case, expenses incurred in the prior year can be claimed against the current year account. Under this approach, an employee can minimize the risk of losing the HCSA money by allocating each year to the HCSA a proportion (no greater than 100%) of the credits allocated to him/her under the flex plan equal to the portion of the medical expenses incurred in the prior year that have not yet been reimbursed at the beginning of the new year, plus any amount that he/she is reasonably sure to incur for medical (and dental) expenses in the new year.

The allocation of credits to the HCSA must be done at the beginning of the year.

As described above, employer contributions to group health and dental plans are not taxable to employees, except for provincial income tax in the Province of Québec. In Québec, employees are taxed only on the average value of benefits received from the account.

1.5 The Situation in Québec

Québec is the only Canadian province that has its own income tax system and collects its income tax on a separate income tax return. As a result, this province is able to have its own tax policy, which can be and happens to be somewhat different from the federal tax policy.

As can be seen from the previous paragraphs, Québec income tax differs from the federal income tax as it does not give a tax break to health and dental plans. The fact that health and dental plans may not be insured does not change this situation, as employer contributions to self-insured plans, covering both the benefits and administration charges (including provincial tax) are subject to income tax in the employees' hands.

For uninsured plans, Québec *[Section 5.1.2 of the Guide on Taxable Benefits IN-253-V (2014-10)]* requires the employer to calculate the equivalent of a premium for each combination of coverage (such as individual, family or single-parent coverage) and benefits (such as medical, hospital or dental expenses) by averaging the benefits and expenses paid among all employees who have the same combination. If the plan does not distinguish between the types of coverage and benefits it provides, the equivalent of a premium cannot be broken down by type of coverage or benefits. This equivalent, reduced by employee contributions and increased by the sales tax, is the taxable benefit.

The calculation is done in the following manner:

$$\text{Value of Employee's coverage} = \frac{(A \times B)}{C} + \frac{(D \times E)}{F} - \text{Employee's contribution to the plan during the year}$$

Where:

A = the total amount of benefits (including the related tax) paid in the year to all employees who have the same types of coverage and benefits as the employee (see section 5.1.3 if this is a private health services plan)

B = the number of days (during the year) that the employee has the coverage and benefits concerned

C = the number of employee-days of coverage (that is, the total number of employees who have the types of coverage and benefits concerned, for each day in the year)

D = expenses, except those associated with establishing or modifying the plan (including any related tax) incurred with respect to a third party, for the administration or management of the plan for the year

E = the number of days (during the year) that the employee is covered under the plan

F = the number of employee-days of coverage under the plan (that is, the total number of employees covered by the plan, for each day in the year)

If different types of coverage (such as individual, family or single-parent coverage) or optional benefits (such as medical, hospital or dental expenses) are provided under a plan, and the employees covered by the plan do not all have the same types of coverage or benefits, the formula (A x B) / C must be applied to each type of benefit the employee has.

For Health Care Spending Accounts, Québec does not provide specific guidance on how to calculate the taxable amount. Many employers seem to simply use the amount of benefits and expenses paid by the HCSA to an employee as his/her taxable income.

The situation in Québec (different tax treatment of health and dental plans under provincial income tax compared with federal income tax) illustrates the fact that, starting from the same general principles (that is, whatever is deductible by the employer regarding employee benefits should be taxable to the employee at some point in time and the government may decide to grant tax breaks to foster public health), different governments may tax employee benefits differently.

2.0 Premium Taxes

All provinces impose premium tax on group life and accident and sickness insurance premiums. The tax is applied to the gross premiums paid, less any dividends that are declared. The original thought behind the implementation of a premium tax was to finance the regulatory bodies (e.g., the provincial superintendents of insurance).

The tax rate is 5% in Newfoundland, 3.75% in Prince Edward Island, 3% in Québec (since December 3, 2014), Alberta, Nova Scotia, Saskatchewan, Northwest Territories and Nunavut, and 2% in the other provinces, as well as in Yukon Territory.

In Québec, the 3% premium tax is called "Tax on Capital of Insurance Corporations". In addition to this tax, Québec also collects a compensatory tax on financial institutions. According to the government of Quebec, this tax was implemented to remove the tax advantage that insurance companies would otherwise have because insurance products were then zero-rated under the Québec sales tax (a GST-type tax), which allowed insurance companies to claim input tax credits. By comparison, under the federal goods and services tax, insurance products are tax-exempt and insurance companies cannot claim input tax credits. As a result of the harmonization of the Quebec sales tax to the GST, insurance products became tax-exempt under Québec sales tax and the compensatory tax was to be abolished on January 1, 2013. However, due to the need for the province to get more tax revenues, the compensatory tax was kept and was set to 0.30% as of January 1, 2013. In its March 2017 budget, the Québec government extended the time frame for abolishing this tax. As a result, the tax is now scheduled to be abolished as of March 31, 2024. On December 3, 2014, a "temporary" surtax of 0.18% was added and is now scheduled to be discontinued as of March 31, 2022. As a result, life & health insurance premiums are currently taxed at a combined rate of 3.48% in Québec.

Québec, Ontario, and Newfoundland apply their premium taxes not only on group insurance premiums but also on self-insured plans (usually referred to as "Administration Services Only" or "ASO" plans). In this case, the taxes apply to the benefits paid under the ASO and to the administration expenses of the ASO.

3.0 Sales Taxes

Québec, Ontario, and Manitoba are currently charging a sales tax on group insurance. The tax is collected by the insurer or by the plan administrator (for ASO plans) and remitted to the provincial government.

3.1 Federal Goods and Services Tax

The goods and services tax (GST) was introduced January 1, 1991. It is more complex and comprehensive than the federal sales tax it replaced. Group insurance premiums are exempt from the tax and most services provided for under a group policy do not attract GST. The GST is currently collected at a rate of 5%.

Administrative fees paid under a self-insured plan to which no stop-loss (whether specific such as a large amount pooling arrangement or aggregate such as traditional stop-loss arrangements) is attached are subject to GST. Where a self-insured plan has an insurance element (stop loss or large amount pooling), the fees paid under the self-insured plan are exempt from GST.

3.2 Québec

The application of a provincial sales tax to group insurance began in 1985, when Québec imposed its then 9% retail sales tax on all insurance premiums. After intensive lobbying from the insurance industry, Québec decided not to apply this tax on individual life and health insurance premiums. The tax remained on group life and health insurance, along with property and casualty insurance and automobile insurance. At that time, self-insured plans that were not funded more than 30 days in advance were exempt from the tax. As a result, self-insured plans became very popular in Québec since they allowed a tax savings of 11.2% (the combination of the 9% retail sales tax and the 2% premium tax, which was not charged on self-insured plans at that time). In 1991, the Québec government decided to charge the retail sales tax on self-insured plans.

When Québec replaced its retail sales tax by a GST-type sales tax in 1992, it was decided that insurance would be zero-rated under the new sales and that a special sales tax, at the rate of 5% on automobile insurance and 9% on property & casualty insurance and group life & health insurance (including self-insured plans) would be charged instead of the new sales tax. As a result, the tax rate on group insurance premiums (9%) became different from the regular sales tax rate. In 2013, when Québec harmonized its sales tax with the federal GST, insurance became tax-exempt under the Québec sales tax (as it was already under the GST) instead of being zero-rated, a minor change that brought no additional tax money. To continue collecting tax money on group insurance programs and property& casualty insurance products, the Québec government transformed the old 9% sales tax into a special tax on insurance premiums (not to be confused with the 3% premium tax that is called “Tax on capital”). Consequently, the treatment of group insurance plans and self-insured group plans remained unchanged. These plans continue to be subject to the special sales tax at a rate unchanged at 9%. This rate is now lower than the current Québec sales tax rate (9.975% additive to the GST).

The taxation of self-insured plans is somewhat complex as it depends partly on whether or not the self-insured plan is supplemented by some form of insurance such as stop-loss or large amount pooling. The 9% special sales tax applies on claims paid under a self-insured plan (unless it is a salary continuance plan, which is not subject to the 9% tax). If the self-insured plan is supplemented by any form of insurance (such as a stop-loss or large amount pooling), the tax also applies to administrative expenses of the self-insured plan. However, if the self-insured plan is <u>not</u> linked to any form of insurance such as a stop-loss or large amount pooling arrangement, the 9% special sales tax applies only to claims paid under the self-insured plan while the regular sales tax (at a rate of 9.975%) applies to the administration expenses.

The special sales tax is charged only on the premiums (or contributions to a self-insured plan) paid by employees who are Québec residents and premiums (or contributions to a self-insured plan) paid by the employer regarding employees for whom a contribution is made to the Québec Health Insurance Plan.

3.3 Ontario

In 1993, Ontario began assessing an 8% retail sales tax (RST) on group insurance premiums and self-insured equivalents. Any person residing or conducting business in Ontario is required to pay

tax on group life and health premiums. For plan sponsors, the tax is based on where the employee reports to work each day. In the case of self-funded arrangements, the tax base depends on whether the plan is considered as being funded. To be funded, contributions must be sufficient to cover benefits and expenses foreseeable and payable within the next 30 days. The sales tax is applied to the contributions for a funded plan and to the claims plus expenses for an unfunded plan.

When Ontario replaced its most of its RST with a harmonized sales tax that includes the federal goods and services tax (GST) and uses the same tax base, they kept the 8% tax on group insurance premiums and self-insured equivalents. As in Québec, the 8% does not apply to anything taxable under the HST.

3.4 Manitoba

On July 15, 2012, Manitoba began assessing its retail sales tax (RST) on group insurance premiums that relate to:

- group basic life insurance covering the certificate holder;
- group optional life insurance covering the certificate holder;
- group dependant life insurance;
- group creditor insurance;
- group accidental death & dismemberment insurance;
- group disability insurance;
- group critical illness insurance.

The tax rate was initially 7% and was raised to 8% on July 1, 2013. Self-insured plans and group health and dental insurance plans are currently exempt from this tax.

Appendix 1
Authorized Medical Practitioners for the Purposes of the Medical Expense Tax Credit

Profession	AB	BC	MB	NB	NL	NS	NT	NU	ON	PE	QC	SK	YT
Acupuncturist	Yes	Yes	N/a	N/a	Yes	N/a	N/a	N/a	Yes	N/a	Yes	N/a	N/a
Audiologist	Yes	Yes	Yes	Yes	Yes	N/a	N/a	N/a	Yes	N/a	Yes	Yes	N/a
Chiropodist	N/a	N/a	Yes	Yes	N/a	N/a	N/a	N/a	Yes	N/a	N/a	N/a	N/a
Chiropractor	Yes	Yes	Yes	Yes	Yes	Yes	N/a	N/a	Yes	Yes	Yes	Yes	Yes
Combined lab and x-ray technologist	Yes	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a
Counselling therapist	N/a	N/a	N/a	N/a	N/a	Yes	N/a	N/a	N/a	N/a	N/a	N/a	N/a
Dental assistant	Yes	N/a	Yes	Yes	Yes	Yes	N/a	N/a	N/a	Yes	N/a	Yes	N/a
Dental hygienist	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Dental nurse	N/a	N/a	Yes	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a
Dental technician or technologist	Yes	Yes	Yes	Yes	Yes	Yes	N/a	N/a	Yes	N/a	Yes	Yes	N/a
Dental therapist	N/a	N/a	N/a	N/a	Yes	N/a	Yes	Yes	N/a	N/a	N/a	Yes	Yes
Dentist	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Denturist, dental mechanic, denturologist	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Dietician	Yes	Yes	Yes	Yes	Yes	Yes	N/a	N/a	Yes	Yes	Yes	Yes	N/a
Emergency medical technician	Yes	Yes	N/a	N/a	N/a	N/a	N/a	N/a	N/a	Yes	N/a	Yes	N/a
Hearing aid practitioner	Yes	Yes	Yes	N/a	Yes	N/a	N/a	N/a	N/a	N/a	Yes	N/a	N/a
Homeopath	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a	Yes	N/a	N/a	N/a	N/a
Kinesiologist	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a	Yes	N/a	N/a	N/a	N/a
Licensed or registered practical nurse	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Marriage and family therapist	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a	Yes	N/a	N/a
Medical laboratory technologist	Yes	N/a	Yes	Yes	Yes	Yes	N/a	N/a	Yes	N/a	Yes	Yes	N/a
Medical radiation technologist	Yes	N/a	N/a	Yes	N/a	Yes	N/a	N/a	Yes	N/a	Yes	Yes	N/a
Midwife	Yes	Yes	Yes	Yes	N/a	Yes	Yes	Yes	Yes	N/a	Yes	Yes	N/a
Naturopath	Yes	Yes	Yes	N/a	N/a	Yes	N/a	N/a	Yes	N/a	N/a	Yes	N/a
Occupational therapist	Yes	Yes	Yes	Yes	Yes	Yes	N/a	N/a	Yes	Yes	Yes	Yes	N/a
Ophthalmic medical assistant	N/a	N/a	N/a	N/a	N/a	N/a	Yes	Yes	N/a	N/a	N/a	N/a	N/a
Optician	Yes	Yes	Yes	Yes	Yes	Yes	N/a	N/a	Yes	Yes	Yes	Yes	N/a
Optometrist	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Pharmacist	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Physician	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Physiotherapist or physical therapist	Yes	Yes	Yes	Yes	Yes	Yes	N/a	N/a	Yes	Yes	Yes	Yes	Yes
Podiatrist	Yes	Yes	Yes	Yes	N/a	N/a	N/a	N/a	Yes	N/a	Yes	Yes	N/a

Profession	**AB**	**BC**	**MB**	**NB**	**NL**	**NS**	**NT**	**NU**	**ON**	**PE**	**QC**	**SK**	**YT**
Professional technologist in orthoses/prostheses	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a	Yes	N/a	N/a
Psychological associate	N/a	Yes	Yes	N/a	N/a	N/a	N/a	N/a	Yes	N/a	N/a	N/a	N/a
Psychologist	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	N/a
Registered massage therapist or massage therapist	N/a	Yes	N/a	Yes	Yes	N/a	N/a	N/a	Yes	N/a	N/a	N/a	N/a
Registered nurse (including nurse practitioner)	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Registered nursing assistant	N/a	N/a	Yes	N/a	N/a	N/a	Yes	N/a	N/a	N/a	Yes	N/a	N/a
Registered nutritionist	Yes	N/a	N/a	Yes	N/a	Yes	N/a	N/a	N/a	N/a	Yes	N/a	N/a
Registered psychiatric nurse	Yes	Yes	Yes	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a	Yes	Yes
Registered psychotherapist	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a	Yes	N/a	N/a	N/a	N/a
Respiratory therapist	Yes	N/a	Yes	Yes	Yes	Yes	N/a	N/a	Yes	N/a	Yes	Yes	N/a
Sexologist	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a	Yes	N/a	N/a
Social worker	Yes	Yes	Yes	Yes	Yes	Yes	N/a	N/a	Yes	Yes	Yes	Yes	N/a
Speech language pathologist	Yes	Yes	Yes	Yes	N/a	N/a	N/a	N/a	Yes	N/a	Yes	Yes	N/a
Surgeon	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Traditional chinese medicine practitioner	N/a	Yes	N/a	N/a	N/a	N/a	N/a	N/a	Yes	N/a	N/a	N/a	N/a

Ref.: http://www.cra-arc.gc.ca/tx/ndvdls/tpcs/ncm-tx/rtrn/cmpltng/ddctns/lns300-350/330-331/ampp-eng.html

N/A stands for “Not Applicable”