Employee Benefits: Don’t Let Your PHSP Benefits Lose their Tax-Free Status

Offering emergency travel benefits can be an effective way to attract and retain employees. But these benefits can also have unforeseen and unwanted federal income tax consequences. So, as we approach the winter get-away travel season, you might want to review the emergency travel benefits you provide your employees.

PHSP Tax Rules

Emergency travel insurance typically covers the travel costs an employee incurs due to illness or accident, e.g., a new booking for an employee who misses her flight home because she falls ill. Coverage may include family members travelling with employee who stays during any period of hospitalization.

The income tax term for extended health coverage is Private Health Services Plan (PHSP). Neither PHSP benefits paid to employees nor employer-paid PHSP premiums are taxable to employees for federal income tax purposes. But there are limits on the benefits or coverage a plan can offer to qualify as a PHSP under the federal *Income Tax Act*. As of 2016, at least 90% of the premiums paid under the plan must relate to items that qualify as a medical expense for purposes of the medical expense tax credit. (Before 2016, all PHSP offered benefits or coverage had to qualify as a medical expense.)

Risk of PHSP Tax-Free Status Revocation

Some of the emergency travel services included in extended health benefits don’t qualify as medical expenses for PHSP purposes. If the PHSP covers emergency travel benefits (or other benefits) that don’t qualify as medical expenses and the related premiums for these benefits exceed 10% of the overall costs, the CRA may revoke the plan’s tax-free status. Result: PHSP benefits would be subject to all normal payroll source deductions, including benefits that would otherwise themselves be medical expenses.

Given this risk, it’s prudent for employers and benefit professionals to review the coverage offered under extended health plans and ensure that at least 90% of the premiums relate to items that do qualify as a medical expense.

2 Types of Travel Costs = Medical Expenses

Only 2 basic types of travel costs do qualify as legitimate medical expenses:

Costs of travel by ambulance are deemed a medical expense if the travel is to or from a hospital, doctor's office or other place where medical services are provided. It's a legitimate medical expense if an employee is taken directly by air ambulance to a hospital while he/she's away from home. By contrast, returning by ambulance to home from a holiday resort is not a legitimate medical expense. Neither are the travel costs of a family member who stays with a person who's hospitalized during holiday travel.

Costs of travel to obtain medical services are a medical expense if:

- A patient travels from the place where the person lives to receive medical services;
- Substantially equivalent medical services aren't available at the place where the person lives;
- There are at least 40 kilometres between the place where the person lives and the place where medical services are sought; and
- The nature and cost of the travel is otherwise reasonable in the circumstances.

Example: In Qualicum Beach on Vancouver Island, where I live, certain medical treatments are only available in Victoria roughly 160 kilometres away. So, if I had to travel to Victoria for medical services that weren't available in Qualicum Beach, the related expenses, including food and accommodation, would be a medical expense for PHSP purposes.

What To Do

If you offer PHSPs, I suggest asking your benefit consultant or insurance carrier for a breakdown of premiums to show premiums related to benefits that do qualify as a medical expense and those that don't. If the PHSP is self-insured by the employer, there should be some mechanism allowing you to distinguish between costs that are and aren't medical expenses.

Finally, if the premium costs for non-medical expense items covered under a PHSP do exceed the 10% threshold, it might be wise to separate the non-medical expense items into a separate, self-insured, unfunded plan so there are only income tax consequences at the time benefits are provided to employees.

Québec Caveat

Note that the above doesn't apply for Québec income tax purposes to employees' subject to taxation at source in that province. Under Québec income tax rules, all PHSP are taxable employee benefits.

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