

Tax Savings for Employers and the Self-Employed

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Health and Welfare Trusts are a well kept secret...

The recent federal election has kept health care issues in the forefront of the news in Canada. The largest aspect is determining how to pay for it all. But this problem is not relevant solely on a grand national scale involving billion dollar budgets. Individual Canadians and employers have funding issues as well. This is because our universal health care has limitations. Although many Canadians are against two-tier medicine, it already exists for many medical procedures. Universal coverage does not fund every single expense and as we have seen with Ontario's recent de-listing of chiropractic services, provinces are increasing the number of treatments and procedures that we are required to self-fund. We must rely on benefit plans and our own deep pockets. For employee benefit plans, the ever-increasing costs are either being absorbed by employers or passed on to employees, sometimes in the form of reduced coverage.

For example, your child's million-dollar smile may not have cost you a million dollars but orthodontic bills will run well into the thousands of dollars. Provincial health plans and most private or group benefit plans do not fund orthodontics. These costs must be paid with after-tax dollars, right out of your pocket.

The only respite we get from the tax system for medical expenses is known as the 3% Rule, which provides medical tax credits. But it only applies to expenses that in 2003 were in excess of the lesser of \$1,755 or 3% of annual net income. The lowest tax rate is used

in the calculation. For example in 2003, a taxpayer with a net income of \$80,000 could expect a federal tax credit of less than \$360 after claiming \$4,000 worth of medical expenses.

Fortunately, there is relief available for the self-employed. There is a little known section of the Income Tax Act that authorizes the use of Health and Welfare Trusts (HWTs). Details can be found in the Canada Revenue Agency's (CRA) Interpretation Bulletin IT-85R2. Briefly, all funds that are contributed to the trust may be fully deducted for tax purposes if they are used for qualified medical expenses. The money stays within the trust and may be used at any time without tax implications to fund medical expenses. It may even be done the next day. The list of qualified expenses is the same list that is eligible under the above-mentioned 3% Rule. In other words, just about anything that applies to your health needs. These include cosmetic treatments, vision care including laser surgery, dental care including cosmetic work, services of licensed practitioners such as chiropractors and speech therapists, care for special needs family members and much, much more. The extensive allowable expenses are laid out in CRA's Interpretation Bulletin IT-519R2.

So while the 3% Rule provides tax credits for medical expenses, they may only be utilized once a threshold has been reached and are calculated using the lowest tax rate. Alternatively, a Health and Welfare Trust permits the full amount to be 100% deducted at an individual's highest marginal tax rate, which may be up to 46% in Ontario.

Thus, someone with a net income of \$80,000 and a \$4,000 orthodontic bill could generate a tax refund of about \$1,700, much higher than the medical tax credit under the 3% Rule.

There will be costs associated with the process. For example, one Health & Welfare Trust plan is Flexsave. They charge a one-time fee of \$200 to set up the plan and 10% of each withdrawal to manage and administer the trust (all fully deductible). Unincorporated and incorporated entities are treated differently, with the former being subject to additional limits and conditions as set out by the CRA.

Employers may find that HWTs provide advantages for employee group benefit plans. The wide choice of qualified medical services provides flexibility. Some staff might really like the dental savings while others might make better use of the coverage for drugs or eyeglasses. Since each employee has a spending cap, employers are also able to keep control of costs.

With health care expenses eating up increasingly higher amounts of government budgets, it is inevitable that fewer services and procedures will be fully funded under provincial health plans. HWTs offer an opportunity for individuals and employers to protect themselves from escalating medical costs.

Health and Welfare Trusts are a well kept secret, but don't let that prevent you from finding out how they may be used to reduce your medical expenses or the costs of your company's benefit plan.



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