A Healthy Rx for Tax Time

big money *Why O/O doesn't have to mean owe-owe. By Steve Mulligan*

This time of year, everyone wants a dose of tax relief. If you're an owner-operator prepared to do a little homework, a Private Health Service Plan (PHSP) may be just the prescription you're looking for.

First, in order to be eligible for PHSP and the programs I'm about to outline, you should be incorporated. (If you're an owner-op and still operating as a proprietorship, you had better have some compelling reasons.)

Next, talk to your insurance advisor to make sure your PHSP conforms to the legal interpretations as prescribed by the Canada Revenue Agency. (See "bulletin IT 339R2, Meaning of 'private health services plan,'" at www.cra-arc.gc.ca.)

Finally, let's define some of the terms used within both the insurance industry and the federal Income Tax Act:

1 Private Health Services Plan or PHSP: An insurance plan that provides coverage for the medical expenses of an employee—that's you, Mr. Incorporated O/O—where the premiums paid are expenses deducted for tax purposes by the employer and the benefits received by the employee are tax-free benefits.

2 Cost Plus Plan: An employer contracts with an insurance company to process employee 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.

3 Health Care Spending Account: An arrangement where an employer reimburses its employees for the cost of medical or hospital care may come within the definition of a PHSP.

Let's put these pieces together to understand how you can structure your PHSP and what the payoff can be.

Say an O/O's proprietorship taxable income is $34,000 and his eligible medical expenses for the year are $1,000. He does not have a PHSP. In this example, the threshold for a medical tax credit is $1,020. Because the total medical expenses for the year are less than $1,020, our O/O receives a tax credit of $0.

Now let's say our O/O is incorporated and enters into a qualified PHSP that includes a "Cost Plus" component, and that his insurance advisor has properly followed the guidelines for setting up and administering the program.

The O/O's T-4 income for the year is $34,000—identical to the previous example. Under the PHSP, he submits his $1,000 eligible medical expenses to the insurance underwriter. The O/O's incorporated company pays $1,000 according to the "Cost Plus" provision, where the employer indemnifies the employees' claims on defined risks under the plan. The insurer reimburses the employee, less an administration fee of $100.

Our O/O's incorporated company is out of pocket $1,000, plus the O/O is out $100 personally. However, he has lowered his corporate tax liability by $190 (assuming a 19-per-cent corporate tax rate). Further, he gets a $1,000 non-taxable benefit from his company's PHSP. This $1,000 benefit translates into a $220 saving when calculating his personal marginal tax had he drawn this amount from his corporation as a bonus or wage.

At the end of the day, our O/O is $150 ahead of the game through the intelligent use of a Cost Plus add-in to his existing PHSP.

This doesn't sound like much, but If your income exceeds $35,000 per year and your tax calculations are now in the next marginal bracket, expect the savings to increase again.

The savings can increase more if you use a Health Care Spending Account. By lowering the administration fees paid to the insurance carrier, you widen the gap between your tax planning and the other guy who is operating as a proprietorship.

Remember, it's not what you make that counts, it's what you have left after all taxes and fees have been paid.

Cost Plus plans and Health Care Spending Accounts are becoming popular among big companies for good reasons. With some good advice and proper planning, they can help boost the health of your tax savings, too. ▲

Steve Mulligan is vice-president of TFS Group, a Waterloo, Ont., company that provides accounting, permits, logbook compliance, and other business services for trucking companies and owner-operators. For information, visit www.tfsgroup.com, or call 1-800/461-5970.

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