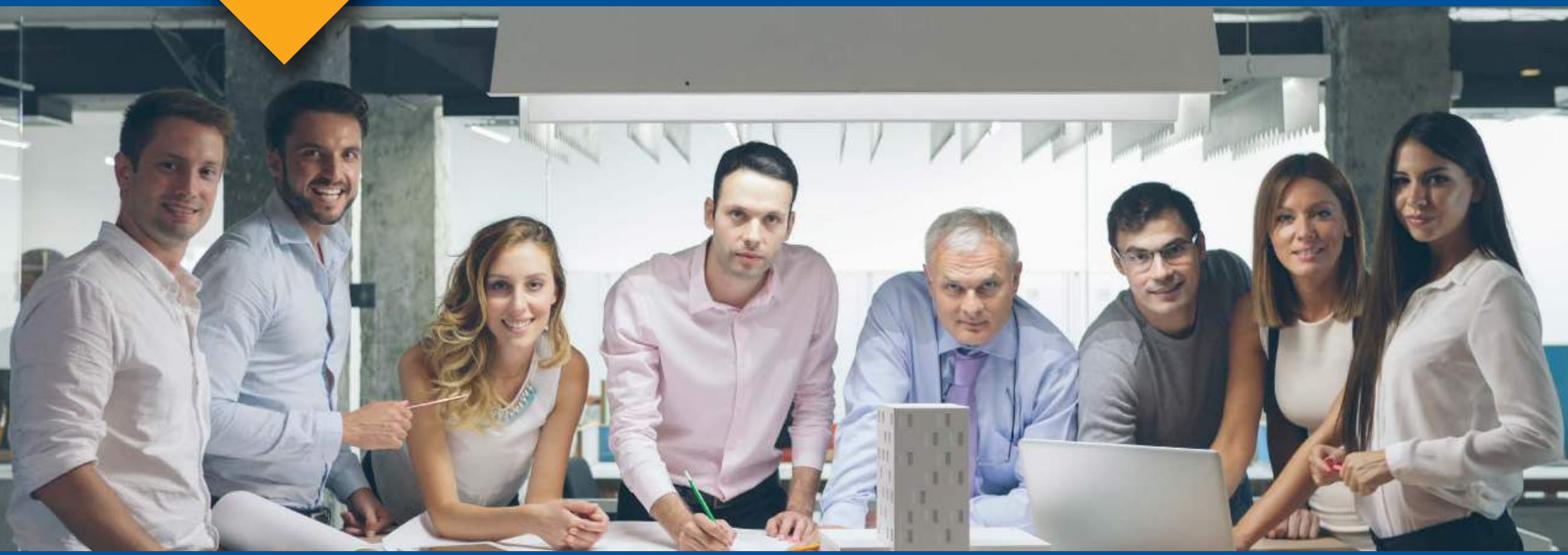
the benefits trust



The Smart Employer's Guide to Healthcare Spending Accounts

Healthcare Spending Accounts (HCSA) are a popular addition to conventional group health and dental plans. They are practical, affordable, flexible, and a cost-effective way to meet the changing needs of many employers and diverse needs of many employees.

Many employers are considering HCSAs as an alternative when reviewing or initiating their employee benefits plan. It is important to take the time to understand the ins and outs of HCSA, to determine if they are an appropriate solution for your organization.

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Part 1
What Are Healthcare Spending Accounts?

A Healthcare Spending Account is a pre-determined amount of money provided to employees at the beginning of each benefit year for coverage of their medical and dental expenses.

Employees and their families submit claims to cover Canada Revenue Agency (CRA) approved health and dental expenses, and are reimbursed in a similar fashion to a traditional benefits plan. Eligible expenses are reimbursed at 100% up to the total dollar amount available in the HCSA.

A Healthcare Spending Account can replace or exist alongside traditional medical and dental coverage.

Healthcare Spending Accounts ensure controlled benefit costs for the employer and complete claim flexibility for the employees

HOW DOES IT WORK?

At the beginning of each benefit year, the plan sponsor determines the amount of HCSA dollars available in each employee's individual account (normally by class of employee).

For example, executives could receive $5,000 per year, and all other employees $1,000 per year. Or employees could receive increasing amounts depending on seniority.

It's up to you to define how to compensate the groups within your group!

WHICH EXPENSES ARE ELIGIBLE FOR COVERAGE?

Under the Income Tax Act, any item that qualifies for the Medical Tax Credit is eligible for coverage through an HCSA (see Appendix A).

Often, this definition of eligible expenses is broader than that of a conventional employee benefits plan, allowing for additional flexibility for employees and executives in particular.

- **Paramedical Practitioners**
- **Vision Care**
- **Medical Facilities**
- **Medical Devices**
- **Nursing Care**
- **Expenses Related to Disabilities**
- **Dental Services**
- **Out of Country Expenses**
- **Prescription Drugs**
- **PHSP Premiums**

HEALTHCARE SPENDING ACCOUNTS AND INSURANCE

Healthcare Spending Accounts provide no “insurance” coverage. HCSAs are strictly a reimbursement plan.

Traditional insurance products, like group life insurance, accidental death and dismemberment insurance, critical illness insurance, and out of Canada emergency medical coverage can be added to an employer sponsored benefits plan. Many employers also add stop loss insurance protection to pay for medical expenses that exceed a certain pre-determined threshold.

This helps plan sponsors protect employees and their families from unexpected catastrophic medical expenses that may occur in a given year, such as high cost prescription drugs.

It's important to know that some providers will offer HCSAs as a supplement to a conventional package of pooled benefits, while others can offer only the HCSA without the option for other pooled benefits.

Part 2
What Are the Advantages of Healthcare Spending Accounts?

WHAT ARE THE BUDGETING ADVANTAGES?

The employer has complete cost control over HCSA plan funding. They decide how much to provide for different groups of employees. Once the budget is decided, employee expenditures may not exceed the HCSA maximum set by the plan sponsor.

If the employee's expenses in one benefit year exceed their HCSA benefit amount, the employee must pay out of pocket for the remaining expenses. In this way, employees share in the cost of their expenses.

Employer costs will not exceed the total employee HCSA amounts (plus administration costs and taxes).

> 20% of employees drive 80% of the cost of a conventional plan. A healthcare spending account turns that on its head.
>
> *Robert Crowder*
> *President of The Benefits Trust*

No unplanned increases in HCSA contributions annually.

There is no increase in HCSA contributions annually unless the employer chooses to change the total HCSA dollar amounts available to the employees.

Employers can choose to be billed for HCSA costs on a monthly basis rather than paying a large lump sum at the beginning of the benefit year or lump sums as employee claims are processed.

This budgeted approach is particularly attractive to companies who need predictable expenses each month. No more budget surprises.

WHAT ARE THE TAX ADVANTAGES FOR AN EMPLOYER?

Under the terms of the Income Tax Act, to qualify as a tax-deductible expense to the company, Healthcare Spending Accounts must be a pre-set limit, fully funded by the employer.

Healthcare Spending Accounts provide a way for plan sponsors to deliver benefits to their employees, using pre-tax dollars. As with a traditional employee benefits plan, the costs are tax deductible business expenses and the benefits are received tax-free.

Owners, executives, and key employees find substantial value in paying for significant medical and dental expenses with corporate dollars in the most tax-effective way possible.

Remember an increase of $10,000 in gross pay for a highly compensated employee is worth only $5,000 with a 50% marginal tax rate. However, $10,000 in an HCSA is worth every penny.

The employer has complete cost control over all HCSA expenses.

It must be noted that the funds cannot be used to purchase additional insurance (i.e. Life Insurance). The amount of reimbursement is limited to the amount allocated to the account by the employer and to the eligible expenses defined in the Income Tax Act. Unused HCSA amounts cannot be paid out at year-end as cash to the employees.

WHAT ARE THE ADVANTAGES FOR EMPLOYEES?

Employees have greater control with HCSAs. They have more claim flexibility than with a conventional benefits plan that operates according to specifically defined benefits.

> HCSAs encourage employees to be smart consumers.
>
> *Gary McCaslin*
> *President of McCaslin Horne Insurance Brokers*

An HCSA allows employees to spend their funds on the expenses that they and their families actually incur, rather than being restricted to dollar limits or a more limited list of eligible expenses.

In some cases employees who would normally be restricted by the limits in a traditional plan (i.e. $200 for vision care) may spend more as their entire claim would be eligible (i.e. $400 pair of glasses).

Part 3
What Happens to Unspent Funds?

Employers should understand that employees may claim their full Healthcare Spending Account balance each year. Employees are aware of their balance on an ongoing basis which can encourage "using up" the funds available to them.

Some employees may have additional expenses that remain unpaid after their HCSA funds are exhausted, while others will have unspent funds at the end of the benefit year. There are different plan design options that you can choose from, depending on how you would like to handle these unpaid expenses and unspent funds .

HCSA plans can be structured in one of three 'carry forward' options. The designs are mutually exclusive and cannot be combined within a plan.

3 CARRY FORWARD OPTIONS:

1. BALANCE CARRY FORWARD

2. EXPENSE CARRY FORWARD

3. NO CARRY FORWARD

OPTION 1: BALANCE CARRY FORWARD

Balance carry forward is the most popular structure for HCSA plans. With this plan design, any remaining balance an employee has at the end of year one will be carried forward and added to their balance for year two.

If the employee has carry-forward funds from year one remaining at the end of year two, the remaining carry-forward amount is returned to the employer. However, if an employee exhausts their full HCSA balance, additional expenses cannot be carried forward to the next year under Income Tax Act guidelines.

The accounting required for a balance carry forward plan is typically managed by a third party administrator or benefit provider on the employer's behalf.

3 CARRY FORWARD OPTIONS:

1. BALANCE CARRY FORWARD
2. EXPENSE CARRY FORWARD
3. NO CARRY FORWARD

This type of plan allows the employee to plan and budget for large expenditures, such as orthodontic expenses, over a two year period by saving some funds from the previous year. Balance carry forward plans are a great option for employers looking to empower employees to make their own decisions about their benefits dollars, and to allow employees the longest time period to make use of their HCSA funds.

OPTION 2: EXPENSE CARRY FORWARD

Expense carry forward plans allow expenses that remain unclaimed at the end of the benefit year to be carried forward and reimbursed from the next year's funds. However, if the employee does not use their HCSA funds within the benefit year, the funds are returned to the employer and may not be carried forward.

Entrepreneurs or small business owners may appreciate the flexibility in budgeting that an expense carry forward plan allows. If they incur an unanticipated expense during the benefit year which is too large for the current HCSA funding to cover, that expense can be carried forward and paid from the following year's funds.

3 CARRY FORWARD OPTIONS:

1. BALANCE CARRY FORWARD
2. EXPENSE CARRY FORWARD
3. NO CARRY FORWARD

OPTION 3:
NO CARRY FORWARD

Plans with no carry forward operate on a "use it or lose it" principle. Employees have 12 months to use their HCSA funds, after which any unspent funds are returned to the employer. Neither funds nor expenses can be carried forward to the next benefit year.

Employers report that no carry forward plans are straightforward and very easy to communicate to employees, for example, when introducing a benefits plan for the first time.

A plan with no carry forward can also be used as a one-time benefit on a reward basis, such as recognizing extraordinary company performance. A no carry forward HCSA can be added to a conventional plan for all employees for a 12 month period, after which any unspent funds return to the employer.

3 CARRY FORWARD OPTIONS:

1. BALANCE CARRY FORWARD
2. EXPENSE CARRY FORWARD
3. NO CARRY FORWARD

Part 4
Where Do Healthcare Spending Accounts Fit?

One of the most important questions about Healthcare Spending Accounts is "How will this fit in with our business goals?"

An HCSA can actually be designed to achieve specific results.

Support Your Business Goals:

- Reward Seniority
- Encourage Higher Sales Revenues
- Retain Key Employees

DO YOU UNDERSTAND THE ‘GROUPS WITHIN YOUR GROUP’?

Owners, sales teams, and administrative employees, for example, are compensated differently. Why should their benefits be identical?

You can customize your HCSA for each group to reflect these differences and make benefits a more meaningful and tax effective part of overall compensation.

WHAT IS YOUR COMPENSATION PHILOSOPHY?

How do you want to compensate your employees (and yourself) within your organization?

HCSA amounts can be used to actively reward staff loyalty and recognize company and individual achievement.

There are many ways to determine particular amounts:

- Your HCSA amount could be a percentage of a staff member's earnings
- It could be a percentage of new sales revenue for your sales teams
- You could designate an amount for every year of service to reward particularly loyal and high-achieving employees – and to retain them, too

Benefit classes can be designed to accomplish many different results, based on legitimate distinctions within your company. It's up to you.

When you determine your groups within your group and your compensation philosophy, you will be able to design an HCSA plan that enables you to customize benefits across your organization.

DEFINING 'GROUPS WITHIN YOUR GROUP' EXAMPLES

The following are examples of different ways an employer can define the groups within their group to compensate and reward specific sets of employees.

With a standard plan, it would not be possible to increase benefits for different employees in this way. An advisor can help build a custom benefits plan according to your organization's needs and goals:

EXAMPLE 1

For Under 2 Years
Provide a $1000 HCSA.

For 2 to 4 Years
Provide a $1500 HCSA.

For 4 to 8 Years
Provide a $2500 HCSA.

For 8 Years and Up
Provide a $4500 HCSA.

EXAMPLE 2

For All Employees
Provide an extra $200 per year, maxing out at $3000.

EXAMPLE 3

Proportional Benefits Example
Set the HCSA amount as a percentage of employees' earnings. For example: 1.5% of an employee's January 1st annual earnings.

Part 5
How Big of a Part Should HCSAs Play in a Benefits Plan?

The answer is quite simple: however much you would like it to.

In the extreme case, you can make your HCSA amount 100% of your benefits program. This allows your employees maximum flexibility and provides a pool of money to choose for themselves which specific healthcare services—orthodontia, physiotherapy, vision care, and so forth—they will spend their HCSA dollars on.

However, the more comprehensive approach is to provide a basic core benefits plan complemented by an HCSA. This is known as a 'hybrid benefits plan design'.

WHAT IS A HYBRID BENEFITS PLAN DESIGN?

A hybrid plan is a balance between a defined benefit plan and a defined contribution plan.

Defined Benefit Plan: A defined benefit plan is a conventional employee benefits package. The percentage of reimbursement, eligible and ineligible expenses, and annual and lifetime maximums, are all defined. The insurance company establishes defined benefits premiums annually to cover future insurance risks, routine expenses, and administration costs.

These packages typically include Life, AD&D, Long Term Disability, Extended Healthcare, and Dental Care. Defined benefit plans offer the most familiar type of coverage.

They can offer tax advantages if defined properly for key executives. With a conventional benefit plan, cost control is in the hands of the insurer.

Defined Contribution Plan: A defined contribution plan is a Healthcare Spending Account (HCSA). The contribution amount is set annually in advance by the plan sponsor.

Very flexible and cost-effective solution

Employees can then claim from their HCSA as they incur Canada Revenue Agency (CRA) eligible expenses. With an HCSA, control over costs is maintained by the employer.

HOW DO HYBRID PLANS WORK?

A hybrid plan combines the advantages of both conventional benefits plans and HCSAs, resulting in a very flexible and cost-effective solution. The employer can choose where they would like their plan to fall along the defined benefit – defined contribution spectrum.

This means they can decide on larger or smaller HSCA amounts for different groups within their organization, along with more comprehensive or limited conventional core benefits. This allows an employer to create a truly customized plan that is designed to meet the unique goals of their business.

" Nothing else offers complete flexibility for employees and cost control for employers. "

Adam C. Lewis
President and CEO of The MultiCare Group

HYBRID PLAN EXAMPLE

The following is an example of a hybrid plan for a 10 person group in a highly profitable professional services company.

Originally, this group had a 100% non-contributory conventional plan, with standard plan maximums. They were looking for a more flexible alternative, and wanted to provide different coverage for three distinct groups with different roles in the company.

Their advisor helped them to build a customized hybrid solution with the following key elements:

For All Employees		
Keep the conventional pooled benefits (Life, AD&D, Long Term Disability, $5,000 Stop Loss, Out of Canada Emergency Medical Coverage). This provides essential insurance protection in case of a catastrophic event.		
For 3 Executives	**For 2 Key Team Leaders**	**For 5 Staff**
Provide a 100% defined benefit plan, covering all CRA eligible medical and dental expenses with no deductibles or caps. For individuals in the top tax bracket, this provides a tax-effective way to pay for medical and dental expenses through the business, rather than out of pocket.	Add a $2,000 HCSA to the existing conventional plan design. This supplements the conventional benefit plan with a flexible HCSA to cover expenses in excess of the defined maximums, or expenses not covered by the conventional plan.	Revise the conventional plan to provide an 80% drug plan, semi-private hospital, and a $500 HCSA + $250 for each year of service (capped at $2,000). This continues the convenience and familiarity of the drug card, and adds an HCSA targeted at rewarding employees for longer service with the company. For the employer, overall compensation costs for this group of employees are reduced.

A benefits plan is a promise between an employer and their employees; an HCSA can be an important component of that promise. Adding an HCSA onto a conventional plan allows you to customize your plan for the groups within your group according to your specific goals.

An HCSA allows choice on every level, from the plan sponsor, who decides how much to spend when setting up the plan, to the employees, who decide where to spend their benefit dollars when submitting claims.

HCSAs provide employers with complete control over claims costs each year, because the employees can only claim up to their individual maximums. Many employers are looking for creative ways to control their health and dental expenditures; a Healthcare Spending Account can be an ideal solution.

APPENDIX A
GUIDELINES FOR CLAIM EXPENSES ELIGIBILITY

Subject to change according to the CRA

Whose Claims Are Considered Eligible?

You may submit claims for eligible expenses incurred by an employee, their spouse, or any other dependent for whom the employee is claiming a tax deduction in the taxation year the expense was incurred.

What Expenses Are Considered Eligible?

- Eligible expenses include:
- Unpaid portions of expenses from regular health and dental plans such as deductibles, co-insurance amounts and amounts which exceed plan maximums;
- Expenses not covered under any other benefit plan (group, provincial, or private);
- Expenses listed as eligible medical expenses in the Income Tax Act, its regulations and Interpretation Bulletins (see following list). This list is subject to change as the Act is amended.

Eligible Expenses under the Income Tax Act

Medical Practitioners (if registered in the province where the expenses occurred)

- Chiropodists or Podiatrists
- Chiropractors
- Christian Science Nurses
- Christian Science Practitioners
- Dentists
- Massage Therapists
- Medical Doctors
- Naturopaths
- Nurses
- Occupational Therapists
- Optometrists, Oculists, or Ophthalmologists
- Osteopaths
- Physiotherapists
- Psychologists
- Speech Therapists
- Therapists or Therapeutists

Care and Facilities

- Expenses of a full-time attendant, or of full-time care in a nursing home, for an individual who has a severe and prolonged mental or physical impairment. The condition must be certified by a medical doctor or optometrist, where applicable.
- Expenses of a full-time attendant, if an individual lives in a self-contained domestic establishment (e.g., the individual's home), provided a doctor certifies that the individual is likely to be dependent others for personal needs and care for an indefinite period because of a mental or physical infirmity.
- Expenses of full-time care in a nursing home for an individual who, due to a lack of normal mental capacity, is and will continue to be dependent upon others for personal needs and care. The certification of a doctor is required to support the need for this care.
- Expenses for the care and/or training at a school, institution or other place (e.g., nursing home) when an individual has been certified to be someone who, because of a physical or mental impairment, requires the equipment, facilities or personnel provided by such place. An appropriately qualified person must certify that the individual's condition requires such care.
- Expenses of a public or licensed private hospital, including hospitals outside Canada.

Assistance Devices, Supplies, and Equipment

- Eyeglasses or other devices for the treatment or correction of a defect in vision
- Artificial eyes and limbs
- Crutches
- Wheelchairs
- Walkers
- Spinal brace/support
- Brace for a limb
- Iron lung/portable chest respirator
- Rocking bed for poliomyelitis victims
- Ileostomy or colostomy pads
- Cloth diapers, disposable briefs, catheters, catheter trays, tubing or other products required by an individual who is incontinent by reason of illness, injury, or infliction
- Truss for a hernia
- Artificial kidney machine
- Laryngeal speaking aid
- Aids to hearing

Assistance Devices, Supplies, and Equipment (continued)

- Device or equipment, including replacement parts, designed exclusively for use by an individual suffering from a severe chronic respiratory ailment or a severe chronic immune system disregulation, but not including an air conditioner, humidifier, dehumidifier, or air cleaner
- Air or water filter or purifier for use by an individual who is suffering from a severe chronic respiratory ailment, or a severe chronic immune system disregulation, to cope with or overcome the ailments disregulation
- Electric or sealed combustion furnace acquired to replace a furnace which is neither, where the replacement is necessary solely because of a severe chronic respiratory ailment or a severe chronic immune system disregulation
- Device or equipment designed to pace or monitor the heart of an individual who suffers from heart disease
- Device that is designed to assist an individual with mobility impairment in walking
- Device designed exclusively to enable an individual with a mobility impairment to operate a motor vehicle
- Power-operated guided chair installation that is designed to be used solely in a stairway
- Mechanical device or equipment designed to assist an individual to enter or leave a bathtub or shower or to get on or off a toilet
- Power-operated lift designed exclusively for use by a disabled individual to allow access to different areas of a building or to assist the individual to gain access to a vehicle or to place the individual's wheelchair in or on a vehicle
- Electronic or computerized environmental control system designed exclusively for the use of an individual with a severe and prolonged mobility restriction
- External breast prosthesis that is required because of a mastectomy
- Hospital beds, including any necessary attachments prescribed for an individual
- Oxygen tent or equipment necessary to administer the oxygen (includes the oxygen)
- Custom made wig for an individual who has suffered abnormal hair loss as a result of disease, medical treatment or an accident
- Device designed to be attached to an infant diagnosed as being prone to Sudden Infant Death Syndrome in order to sound an alarm if the infant ceases to breathe
- Extremity pump or elastic support hose designed exclusively to relieve swelling caused by chronic lymphedema
- Inductive coupling osteogenesis stimulator for treating non-union of a fracture or aiding in bone fusion
- Infusion pump, including disposable peripherals, used in the treatment of diabetes, or a device designed to enable a diabetic to measure blood sugar levels
- Needles and syringes for injections
- Orthopaedic shoe or boot, or an insert for a shoe or boot, custom made for an individual in accordance with a prescription to overcome a disability
- Device or equipment, including a synthetic speech system, Braille printer and large print-on-screen device, designed exclusively to be used by a blind individual in the operation of a computer
- Optical scanner or similar device designed to enable a blind individual to read print
- Device to decode special television signals to permit the vocal portion of the signal to be visually displayed
- A visual or vibratory signaling device, including a visual fire alarm indicator, for an individual who has a hearing impairment
- Electronic speech synthesizer that enables a mute individual to communicate by using a portable keyboard

Drugs

- Insulin
- Vitamin B12 and liver extract indictable for pernicious anaemia
- Drugs, medications or other preparations or substances prescribed by a medical practitioner or dentist and recorded by a pharmacist

Transportation, Meals, and Accomodation

- Expenses for transportation by ambulance to or from a public or licensed private hospital
- Transportation expenses paid to an individual who is in the business of providing transportation services to transport the patient and one additional person (if medically necessary, as certified by a medical practitioner) provided:
- Substantially equivalent medical services are not available locally
- The route taken is reasonable direct
- The medical treatment sought is reasonable and the distance traveled is at least 40 kilometres
- If hired transportation is not readily available, reasonable expenses for private transportation will be eligible.
- Reasonable expenses for meals and accommodation for a patient and, if medically required, an accompanying person, provided the conditions for transportation expenses (specified above) are satisfied and the distance traveled is at least 80 kilometres

Dental

- Preventive, diagnostic, restorative, orthodontic, and therapeutic care
- Making or repairing of dentures by a licensed dental mechanic

Other Expenses

- Diagnostic, laboratory, and radiological procedures or services for maintaining health and preventing disease, or assisting in the diagnosis or treatment of an injury, illness or disability of an individual, when prescribed by a doctor or dentist
- Acupuncture treatment when performed by a qualified medical doctor
- Reasonable expenses for rehabilitative therapy, including training in lip reading and sign language, incurred to adjust for an individual's loss of hearing or speech
- Reasonable expenses for modifications to a home for an individual who lacks normal physical development, or who has severe and prolonged mobility impairment, so as to enable the individual to gain access and move around the home
- On behalf of an individual who requires a bone marrow or organ transplant:
- Reasonable expenses to locate a compatible donor and arrange for the transplant
- Reasonable traveling, board and lodging expenses of the donor and the individual with respect to the transplant
- The cost of acquisition, care and maintenance (including food and veterinarian care) of an animal if the animal is specifically trained to assist an individual who is blind, profoundly deaf or has a severe and prolonged impairment that markedly restricts the use of the arms or legs. In addition, reasonable traveling, board, and lodging expenses incurred while in full-time attendance at a facility that trains individuals in the handling of such animals are eligible.

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About The Benefits Trust

We help successful business owners build a better benefits plan than they can get anywhere else.

For more than 20 years, The Benefits Trust has provided Third Party Administration services for employer groups of one or more. We are an independent and privately-owned firm with longstanding business relationships with more than 15 insurance companies.

We offer custom group benefits solutions with self-insured and insured options for small and mid-sized businesses in Canada. Our full suite of benefits plan services includes:

- Health Care Spending Accounts
- Drug, Medical and Dental Plans
- Hybrid Benefit Plans
- Executive Benefit Plans
- Life, AD&D, Disability, Critical Illness, Group Travel, and EAP billing
- Stop Loss attachment levels from $5,000 and up
- And more!

You have an alternative to conventional benefit plans. Contact us today.

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