Canada Revenue Agency

Tax tips

Warning: Buyer beware when it comes to Health Spending Accounts

The Canada Revenue Agency (CRA) is always on the lookout for tax schemes and opportunities to warn Canadians about them. Lately, the CRA has noticed several businesses improperly claiming deductions related to Health Spending Accounts (HSA), and it wants to alert potential participants about this scheme.

What are tax schemes?

Tax schemes are plans and arrangements that contravene the Income Tax Act and deceive taxpayers by promising to reduce the taxes they owe. For example, these schemes may promise large deductions or tax-free income.

What are HSAs?

HSAs are self-insured health plans arranged by employers for their employees residing in Canada. They provide a way that small businesses can provide tax-free health and dental benefits to their employees (and their employees' family members). This makes the HSA appear to be an extremely attractive and cost-effective way of getting and providing health and dental benefits.

However, a valid HSA plan must conform to private health service plan rules set out in the Income Tax Act. The information below clarifies the rules on what are acceptable Health Spending Accounts.

What HSAs are acceptable

Incorporated businesses, including shareholder employees and all other corporate employees, are eligible to participate in an HSA. Corporations with as few as one employee can be eligible as well. However, the HSA cannot be solely for shareholders unless the shareholders are also employees earning a T4 income.

In the case of unincorporated businesses or sole proprietors, the owner and their employees are also eligible **if** the owner has at least one arm's-length employee.

What HSAs are not acceptable?

Some insurance agents/brokers and financial planners are marketing HSAs to businesses operating as sole proprietorships that have no arm's-length employees. Participants are told that they will be onside with meeting the Income Tax Act rules for private health services plans if they purchase additional types of insurance.

Bottom Line:

If the business is a sole proprietorship with no arm's-length employees, the CRA does not consider an HSA to be a private health services plan and any costs incurred for amounts paid to this account are not deductible business expenses.

What can you do?

The CRA encourages all Canadians to seek an independent second opinion from a reputable tax professional on important tax matters.

If you suspect tax evasion, you can report it online at Canada.ca/taxes-leads or by contacting the Informant Leads Centre line at 1-866-809-6841. Steps will be taken to protect your identity, although you may provide information anonymously.

In addition, the CRA continues to encourage taxpayers to come forward and correct their tax affairs through the Voluntary Disclosures Program (VDP): Canada.ca/taxes-voluntary-disclosures.

For more information about misleading statements and myths about Canada's tax laws, resources are available online at the CRA website: Debunking tax myths.

For more information on tax schemes, please go to Canada.ca/tax-schemes.

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