



GeffenMesher

Dear Client,

As we come to the close of another year, we wanted to make you aware of the tax law concerning the proper treatment of health insurance premiums, qualified long-term care insurance premiums, and short- and long-term disability premium payments. Even though the tax law has been in effect for years, we continue to get questions about its implications. We want to provide you with some written guidance that we hope will prove useful as you prepare your year-end W-2s. This guidance is specific for >2% S-Corporation shareholders.

The IRS has mandated that health insurance premiums paid on behalf of a >2% shareholder are to be added to their W-2. The premiums are not subject to FICA, Medicare, FUTA, SUTA, or TriMet payroll taxes. The S-Corporation takes a “wages” deduction for the medical insurance premium. The >2% shareholder’s W-2 income reported in Boxes 1 and 16 includes the health insurance premiums, and a deduction for self-employed health insurance is taken “above the line” on the individual Form 1040 (as reported in Box 14 of the >2% shareholder’s W-2).

Below are the allowable premiums to be paid by the S-Corporation:

1. Health insurance premiums — “above the line” deduction on Form 1040
2. All Medicare premiums (not just Medicare Part B) — “above the line” deduction on Form 1040
3. Qualified long-term care insurance premiums — allowed as an “above the line” deduction on Form 1040, limited to the *smaller* of:
 - a. The amount paid for that person
 - b. A dollar amount based on age:
 - Age 40 or younger: \$420
 - Ages 41–50: \$780
 - Ages 51–60: \$1,560
 - Ages 61–70: \$4,160
 - Age 70 or older: \$5,200
4. Short- and long-term disability premium payments — *not allowed* as an “above the line” deduction on Form 1040

However, to be deductible, the premiums must be either directly paid by the S-Corporation or reimbursed to the >2% shareholder.

The IRS has mandated this method of reporting. Below are some examples of health insurance and the corresponding tax implications of each payment method.

Example 1:

Shareholder A obtains an accident and health insurance policy *in his/her own name* and makes the premium payments on the policy. The S-Corporation makes no payment or reimbursement with respect to the premiums.

Tax Effect — A plan providing medical care for Shareholder A is not established by the S-Corporation. Shareholder A is not entitled to an “above the line” deduction under 162(L).

Example 2:

The S-Corporation obtains an accident and health insurance plan *in its own name*. The health plan provides coverage for Shareholder B, Spouse B, and Dependents B. The S-Corporation makes all the premium payments to the insurance company. The S-Corporation reports the premium payments as *wages* on Shareholder B’s Form W-2, and Shareholder B reports that amount as *gross income* on Form 1040.

Tax Effect — A plan providing medical care for Shareholder B has been established by the S-Corporation. Shareholder B is allowed the “above the line” deduction under 162(L).

Example 3:

Shareholder C obtains an accident and health insurance policy *in his/her own name*. The S-Corporation makes all the premium payments to the insurance company. The S-Corporation reports the premium payments as *wages* on Shareholder C’s Form W-2, and Shareholder C reports that amount as *gross income* on Form 1040.

Tax Effect — A plan providing medical care for Shareholder C has been established by the S-Corporation. Shareholder C is allowed the “above the line” deduction under 162(L).

Example 4:

Shareholder D obtains an accident and health insurance policy *in his/her own name*. Shareholder D makes the premium payments to the insurance company and furnishes proof of payment to the S-Corporation. The S-Corporation reimburses Shareholder D for the premium payments. The S-Corporation reports the amount of the premium reimbursements as *wages* on Shareholder D’s Form W-2, and Shareholder D reports that amount as *gross income* on Form 1040.

Tax Effect — A plan providing medical care for Shareholder D has been established by the S-Corporation. Shareholder D is allowed the “above the line” deduction under 162(L).

Medical expense reimbursements (excluding health insurance) should be recorded as shareholder draws/distributions and taken on their individual Form 1040, Schedule A. If the S-Corporation pays the reimbursements and takes a deduction for the expense, the reimbursements need to be added to the shareholder's W-2 (just like the medical insurance premiums). However, the reimbursements are not an "above the line" deduction on the shareholder's individual tax return. The reimbursements would be reported on Schedule A, subject to the relevant limitations.

If you have a payroll service, you must report these amounts before their year-end close. You will need to specify that the amounts you are reporting are S-Corporation health insurance premiums. The premiums can be added as a year-end adjustment and needn't be included in each payroll run throughout the year.

If you have questions or concerns regarding the above payroll treatment, our team of experts at Geffen Mesher is eager and prepared to help you.