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## **Subject: S CORP HEALTH INSURANCE & 125**

Most “S” corporations are aware that their “owner-employees” have special tax laws/rules in place regarding their health insurance premiums AND their participation in the “S” corporation’s Section 125 “cafeteria” plan. The 2 primary “owner-employee” rules are:

- ✓ Owner/employees can NOT PARTICIPATE in the company’s Section 125 “cafeteria” plan. Owner-employees of a “S” corporation can not “pre-tax” any payroll withholdings for insurance premiums, flexible spending accounts for medical or childcare expenses, HSA’s and the like; and
- ✓ The ONLY WAY for owner-employees to deduct their health insurance premiums is for the “S” corporation to directly pay the premiums or to reimburse the owners’ premiums before the end of each year.

### **WHO IS AN “OWNER – EMPLOYEE”?**

An “owner-employee” subject to these unique tax “rules” is an employee who owns 2% or more of the “S” corporation’s stock on any day of the year, OR a child, grandchild, or parent of the actual owner of the stock. Section 318 of the tax code treats employed children, grandchildren or parents of the actual stockholders AS IF they themselves owned the stock. AS SUCH, an adult employee of an S corporation owned by his/her grandparents is treated “as if” they own their grandparents’ stock. They are therefore treated as “owner-employees” of the S corporation.

### **SO WHAT DO WE DO?**

- ✓ Health insurance premiums paid by “S” corporations on behalf of “owner-employees” should be reported on the owner-employee’s W-2 form each year. The “S” corporation deducts the insurance premiums as “officer’s compensation” (which could help with your “reasonable compensation” tax position) and the owner-employee then writes-off the premium on page 1 of their Form 1040 personal income tax return;
- ✓ S corporation “owner-employees” AND their employed children, grandchildren and parents can not participate in the “S” corporation’s pre-tax Section 125 plan. Participation by an “owner-employee” can result in a termination of the plan’s tax benefits for the non-family member employees; AND

- ✓ We also recommend that “S” corporations establish general ledger expense accounts for each “owner-employee” in order to “track” health insurance premiums for annual W-2 reporting.

If you have any questions or concerns about your specific fact pattern, please call us at 885-7600. Also be advised that we have authored over 100 PayDay’s since mid-2008, all of which are archived at [www.accupay.com/newsletters.htm](http://www.accupay.com/newsletters.htm). -- You may wish to check them out!

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