

Deducting Health Insurance Premiums for S Corporations

Health and accident insurance premiums paid on behalf of a greater than 2% S corporation shareholder-employee are deductible by the S corporation and reported as wages on the shareholder-employee's W-2. These wages are subject to income tax withholding, but they are NOT subject to Social Security, Medicare, or Unemployment taxes. Therefore, the additional compensation is included in the shareholder-employee's Box 1, but not Boxes 3 and 5 of their W-2. The amount paid for health insurance must also be reported in Box 14 of the W-2 for informational purposes as required by the IRS.

Be careful not to double dip...An S corporation deducts the premiums it pays for accident and health insurance to cover a greater than 2% shareholder-employee (and his/her spouse & dependents) as compensation paid to the shareholder-employee. The premiums are included in the shareholder-employee's salary and reported on their W-2. Do not then deduct them again with a separate expense account called "Health Insurance Premiums".

A greater than 2% S corporation shareholder-employee is eligible for an above the line deduction on his/her personal 1040, thereby reducing his/her Adjusted Gross Income if the medical coverage was established by the S corporation and the shareholder met the other self-employed medical insurance deduction requirements. ***If the shareholder or shareholder's spouse was eligible to participate in a subsidized health care plan, then the shareholder is NOT entitled to the above the line deduction.***

If the shareholder purchased the health insurance in his/her own name and paid for it with his/her own funds, the shareholder would not be allowed an above the line deduction. If the shareholder purchased the health insurance in his/her own name but the S corporation either directly paid for the health insurance or reimbursed the shareholder for the health insurance AND also included the premium payment in the shareholder's W-2, the shareholder would be allowed an above the line deduction.

In a nutshell, in order for a shareholder to claim an above the line deduction for health insurance premiums, they need to be paid by the S corporation (either directly or reimbursed) and must be reported as taxable income on the shareholder's W-2.

See examples below...

Example 1

The S corporation obtains an accident & health insurance policy in the business' name to cover its greater than 2% shareholder-employee (and his/her spouse & dependents too).

- The business makes all of the premium payments.
 - The business reports the amount of premium payments as part of gross wages on the shareholder-employee's W-2.

Here, the plan is established by the S corporation and each greater than 2% shareholder-employee may take the deduction on form 1040, line 29. The amount paid for health insurance premiums would be included in Box 1 of shareholder-employee's W-2 as gross wages and Box 14.

Example 2

The greater than 2% shareholder obtains an accident and health insurance policy in his/her own name.

- The business makes all of the premium payments.
 - The business reports the amount of premium payments as part of gross wages on the shareholder-employee's W-2.

Here, the plan is established by the business even though the policy is not in the business' name. Each greater than 2% shareholder-employee may take the deduction on form 1040, line 29. The amount paid for health insurance premiums would be included in Box 1 of shareholder-employee's W-2 as gross wages and Box 14.

Example 3

A greater than 2% shareholder-employee obtains a policy in his/her name to cover themselves, their spouse and their children.

- The shareholder-employee pays all of the premiums.
- Proof of payment is provided to the business.
- The business reimburses the greater than 2% shareholder-employee for the premiums paid.
- The business includes the amount of the premiums reimbursed to the 2% shareholder-employee in his/her W-2, box 1 as gross wages and Box 14.

Here, the health insurance plan is considered established by the business even though the plan is not in the business' name because the business reimbursed the premiums to the greater than 2% shareholder-employee. Each greater than 2% shareholder-employee

may take the deduction on form 1040, line 29. The amount paid for health insurance premiums would be included in Box 1 of his/her W-2 as gross wages and Box 14.

When a greater than 2% shareholder may not claim the deduction on Form 1040, line 29:

- A greater than 2% shareholder-employee pays for the health insurance policy premiums.
- The business does not make any premium payments and does not reimburse the premium payments made by the greater than 2% shareholder-employee.

Here, the plan was not established by the business because the business neither paid for the premiums nor reimbursed the greater than 2% shareholder-employee for the premiums. The premiums may NOT be deducted on Form 1040, line 29. They can be claimed on Schedule A as medical expenses subject to the 10% floor if the taxpayer is under 65 or 7 ½% floor if the taxpayer is over age 65.

Health insurance premiums are not deductible as a business expense by the S Corporation!

The greater than 2% shareholder-employee might prefer to have the health insurance premiums added to each paycheck throughout the year so that they can pay the taxes with each paycheck instead of having all of the taxes due at year-end.

However, the amount of the tax is relatively small, so some individuals prefer doing a single adjustment (zero-dollar paycheck) at the end of the year before the W-2s are prepared.

Here is a simple approach for handling greater than 2% shareholder health insurance:

- During the year, simply record and pay your bills for health insurance just like all of the other company bills.
- Code the bills separately for employees and shareholders into separate GL accounts (i.e. "Health Insurance Expense" and "Shareholder Health Insurance").
- After the last insurance bill for the year is paid, use the total health insurance expense amount to create an adjustment in QuickBooks Payroll to increase wages in Box 1. Also include that amount as a separate line item in Box 14 on the W-2.