



# Reducing Business Healthcare Costs

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# Rising Cost of Health Insurance

- According to The Kaiser Family Foundation's Employer Health Benefits Annual Survey published September 2009, and titled, "Cost of Health Insurance," the average annual premium for family coverage in 2009 was \$13,375.
- There has been an increase in average family premiums of 131% since 1999.

# Total U.S. Healthcare Costs

- \$1.5 trillion\* in 2009
- \$4.5 trillion\* by 2018
- Every year more and more Americans lose their health insurance for one simple reason: they can't afford it.

*\*Source: Centers for Medicare & Medicaid Services, "National Health Expenditure Projections 2009-2019" – February 3, 2010*



# How Can Healthcare Costs Be Reduced?

## Fringe Benefits

By introducing fringe benefits, you can help to alleviate healthcare expenses.

- HRA – Health Reimbursement Arrangement
- FSA – Flexible Spending Arrangement
- HSA - Health Savings Account

# Section 105 Health Reimbursement Arrangements

Large corporations can deduct 100% of medical expenses. Typically, small business owners cannot.

Section 105 (HRA) levels the playing field for small business owners!

# Section 105 Health Reimbursement Arrangements

- Section 105 is a 1954 tax law that allows for an employer to reimburse an employee for qualified medical expenses.
- Converts normal insurance and out-of-pocket expenses into an employee benefit program and becomes 100% deductible!

# Section 105 Health Reimbursement Arrangements

- Health Reimbursement Arrangements are also known as HRAs or Medical Reimbursement Plans.
- Employees do not contribute to an HRA; the employer reimburses the employee, up to a set dollar amount, when an expense is incurred and reimbursement is requested.
- The amounts reimbursed to employees by the employer are not subject to Federal, State or FICA taxes, and the amount reimbursed is tax-free to the employee.

# Health Reimbursement Arrangements

- 100% employer-funded plan.
- To limit the risk, the employer can define what expenses are eligible for Section 105 HRA reimbursement.
- IRC Section 105 is instrumental in characterizing the payments as tax-free compensation to employees while ensuring tax deduction to employers.

# The Basic Concept

- Cash wage (W-2 employee)
- Employee benefits
- Tax deductible for the business
- Tax free for the employee

**very simple**

# What is the Benefit of Utilizing an HRA?

## **DECREASE Taxable Income!**

Taxable Income = Income – Expenses

Taxable Income x Tax Rate = Taxes Payable

Goal of individuals and businesses is to reduce taxes payable by wisely increasing allowable expenses.

# Self-Employment Tax

## What is Self-Employment (SE) Tax?

- Equivalent to FICA on W-2 Wage (Employee pays 7.65% of gross wage and employer matches 7.65%)
- Must be paid if earnings are more than \$400

This tax equals 15.3% (FICA multiplied by 2) of Net Profit or Loss from Schedule C or Schedule F

# Self-Employment Tax

Because the Net Profit (Loss) has been reduced by a Section 105 Plan (HRA) the Self-Employment tax payable will also be reduced, increasing the total amount of savings.

Employer pays 6.2% OASDI

Employee pays + 6.2% OASDI  
12.4%

Employer pays 1.45% Medicare HI

Employee pays + 1.45% Medicare HI  
2.9%

**Total OASDI + Medicare HI = 15.3%**

# Period of Coverage

Period of Coverage applies if first Plan Year begins mid-year.

Example:

**Enrolled in Section 105 Plan on March 14th**

Premiums	January 1st
Out-of-Pocket Expenses	March 1st

# Can't I Already Do This?

## Schedule A

Medical expenses that exceed 7.5% of AGI are 100% deductible

**Average savings \$0**

## Standard Deduction for Self-Employed

Health insurance premiums 100% deductible on Federal Income Tax

**Average savings \$1,008 per family**

### Deduction examples:

- Medical & Dental Expenses
- Property Taxes
- Mortgage Interest
- Charitable Gifts

# Available Benefits



Health Related  
Insurance Premiums

Non-Insured Medical  
Expenses (Out of  
Pocket Expenses)

Long-Term Care  
Premiums

Term Life and  
Disability Insurance  
Premiums

# Eligible Expenses

- Deductible
- Co-insurance
- Co-pay
- Prescriptions
- Dental
- Orthodontia
- Vision
- Over-the-counter medicines
- Individually purchased insurance - premiums

# Eligible Expenses

Acupuncture	Deductibles	Laboratory fees
Ambulance hire	Dental fees	Laetrile by prescription
Artificial limbs/teeth	Dentures	Lead-base paint removal for children with lead poisoning
Birth control pills	Diagnostic fees	Membership fee in association with furnishing medical services, hospitalization, and clinical care
Birth prevention surgery	Drug and medical supplies	Needed medical supplies, prescribed by doctor
Braces	Education for the blind	Nurses' fees
Braille - books and magazines	Eyeglasses, including exam fee	Obstetrical expenses
Care for handicapped child	Healing service fee	Operations
Chiropractors	Hearing devices and batteries	Hospital Expenses
Christian Science fees	Home improvements motivated by medical consideration.	
Co-insurance	Hospital bills	
Communication equipment/deaf	Insulin	
Contact lenses and cleaning solution		

# Eligible Expenses

Insurance	Psychiatric care	Tuition at special school for handicapped
Insulin	Psychologist fees	Wheelchair
Laboratory fees	Routine physicals and other non-diagnostic services and treatments	Wigs (prescribed by a physician)
Laetrile by prescription	“Seeing Eye” dog and its upkeep	X-rays
Lead-base paint removal	Sterilization fees	
Membership fees (certain fees with doctor certification)	Surgical fees	
Needed medical supplies	Therapeutic care for drug/alcohol addiction	
Nurses’ fees	Therapy treatments	
Obstetrical expenses	Transportation expenses primarily for purpose of receiving medical services	
Operations		
Orthodontia		
Orthopedic shoes		
Osteopaths		
Oxygen		
Prescribed medicines (including over-the-counter)		

# Over-the-Counter

- Allergy prevention and treatment
- Antacids and acid reducers
- Anti-histamines
- Anti-diarrhea and laxatives
- Anti-itch lotions and creams
- Cold sore/fever blister meds
- Cough suppressants
- Decongestant
- Cold remedies
- First-aid supplies
- Migraine meds



# Limits, Regulations & Qualifications

**Set employee eligibility requirements to avoid discriminating among employees.**

- Hours worked per week (1-25)
- Months worked per year (1-7)
- Employee age (up to 25)
- New employee waiting period (up to 36 months)
- Current employee waiting period (up to 36 months)

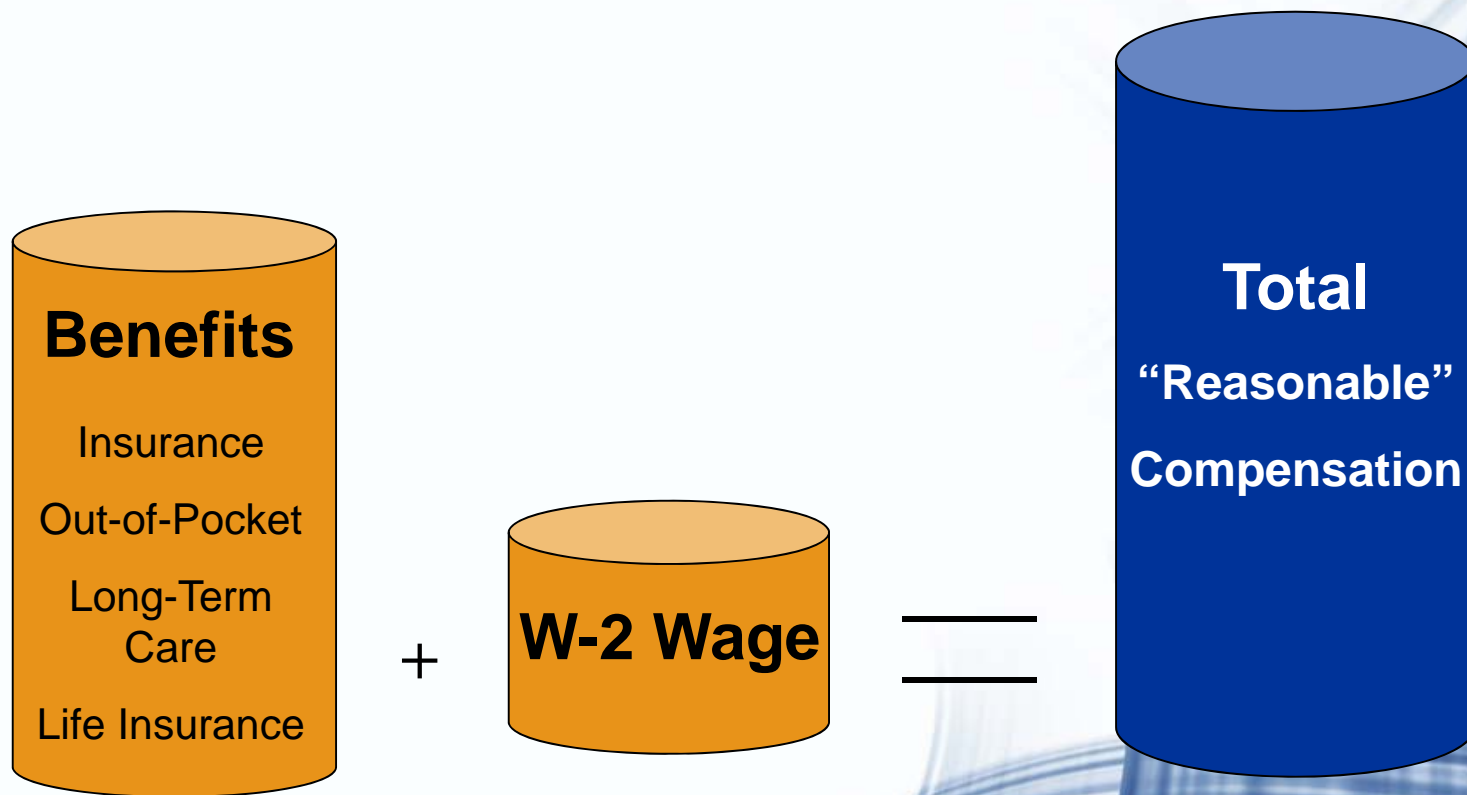


# Limits, Regulations & Qualifications

- IRS and DOL do not set minimum or maximum reimbursement amounts. The employer does.
- Ensure reasonable compensation.
  - **Establish total medical expenses.**
  - **Establish W-2 based on 25% of total medical expenses.**

**Plan Must Make Sense!**

# Limits, Regulations & Qualifications



# What is Reasonable Compensation?

$$\begin{array}{|c|} \hline \text{Total} \\ \text{Benefits} \\ \hline \end{array} + \begin{array}{|c|} \hline \text{Total W-2} \\ \text{Wage} \\ \hline \end{array} = \begin{array}{|c|} \hline \text{Total} \\ \text{Comp} \\ \hline \end{array}$$

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$$\begin{array}{|c|} \hline \text{Total} \\ \text{Comp} \\ \hline \end{array} \div \begin{array}{|c|} \hline \text{Number of} \\ \text{Hours} \\ \text{Worked} \\ \hline \end{array} = \begin{array}{|c|} \hline \text{Hourly} \\ \text{Wage} \\ \hline \end{array}$$

Is the hourly wage reasonable for duties, location, tenure?

# Reasonable Compensation Example

## 1. What is the total of the health expenses?

Health Insurance = \$12,000

Out-of-pocket = \$5,000

**Total Expenses = \$17,000**



## 2. Calculating W-2 Wage

Total Expenses = \$17,000

% Multiplier (i.e. 25%) = \$4,250

**Total W-2 Wage = \$4,250**

# Reasonable Compensation Example

## 3. Calculating Total Compensation

Total Expenses = \$17,000  
Total W-2 Wage = \$4,250  
**Total Compensation = \$21,250**



## 4. Calculating Hourly Wage

Number of Annual Hours = 1080  
Total Comp ÷ Hours = \$19.67  
**Hourly Wage = \$19.67**

# Carry Over

With Carry Over, unused funds from previous years are available in subsequent years where expenses might be more than expected.

The employee will have more money available to them without affecting Reasonable Compensation calculations!

## 2009

OOP Maximum = \$5,000

Used OOP = \$2,500

## 2010

OOP Maximum = \$5,000

Carryover Balance = \$2,500

**Total Available = \$7,500**

# Health Reimbursement Arrangements

## Without Section 105

Premium Deduction	
Premium =	\$6,719
Federal Tax Rate	
$\$6,719 \times 15\% =$	\$ 1,008
Tax Savings =	\$ 1,008
Non-Insured Expenses	
Out-of-Pocket Medical =	\$4,797
Federal & State Tax	0%
Tax Savings =	\$ 0
Total Expenses =	\$11,516
Total Deduction =	\$6,719
Total Tax Savings	\$1,008

## With Section 105

Premium Deduction	
Premium =	\$6,719
Federal, State & SE Tax Rate	
$\$6,719 \times 35\% =$	\$2,352
Tax Savings =	\$2,352
Non-Insured Expenses	
Out-of-Pocket Medical =	\$4,797
Federal, State & SE Tax	35%
Tax Savings	\$1,679
Total Expenses	\$11,516
Total Deduction	\$11,516
Total Tax Savings	\$4,031

# Who Qualifies?

- Sole Proprietor (Schedule C and F)
- S-Corporation
- C-Corporation
- Partnership
- Limited Liability Company
- Non-Profit



# Sole Proprietor Example

Jack owns ABC Company and files a Schedule C.

Jill has done bookkeeping for ABC and has interest in working for the company.

Jack hires Jill and provides compensation:

- A W-2 cash wage.
- Reimbursement of family medical insurance.
- Reimbursement of family out-of-pocket expenses.

# Sole Proprietor Example

Jack formalizes the working relationship by providing a written employment agreement.

Jack, as Jill's employer, keeps track of Jill's hours worked and duties performed.

Jack provides a compensation package as follows:

- Health insurance premium \$12,680
- Medical expense reimbursement \$5,000
- W-2 wage \$3,536

# Sole Proprietor Example

Jack and Jill can deduct medical expenses as follows:

- Medical premiums
- Qualified long-term care (up to IRS maximum)
- Term-life insurance (up to \$50,000, employee only)
- Accident
- Disability
- Out-of-pocket expenses (including dental and vision)

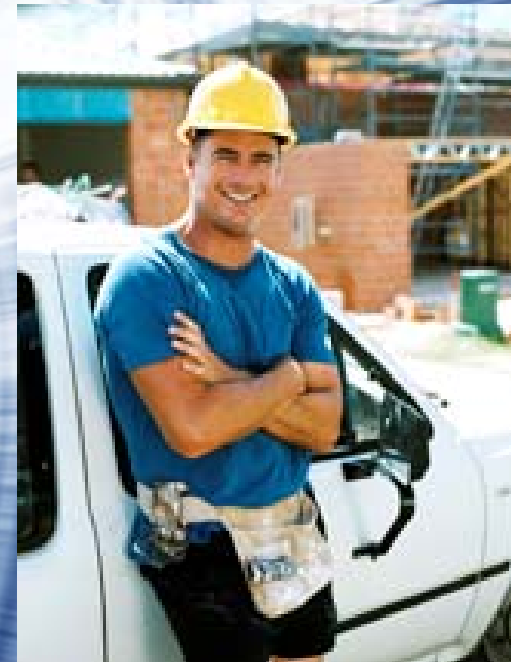
# Partnerships

Two partners who are married but not to each other are eligible.

Husband and wife partnerships will never be eligible as there is no employable interest.

Example: two brothers own a construction business...

- They can both hire spouses
- Tax deductions will be treated just like sole proprietors.

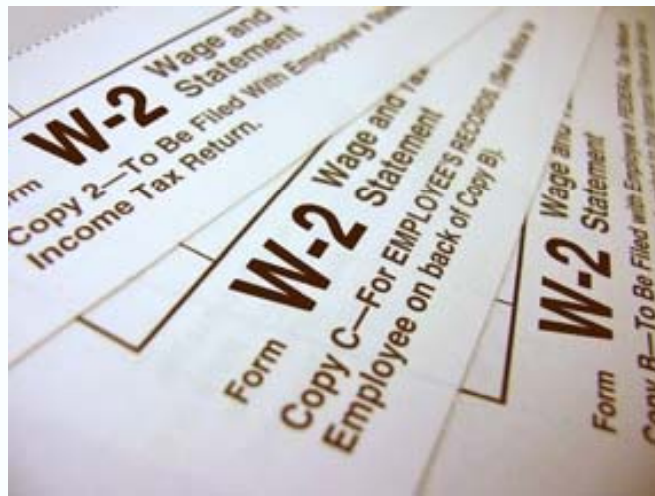


# C-Corporation

- Savings will match that of a Sole Proprietor.
- NO spousal employment is required.

# S-Corporation

- If owner is greater than a 2% shareholder, all reimbursements from the corporation to the shareholder must be added back to his or her personal W-2 (box 1).
- Spousal employment is not necessary as long as owner/employee is taking a W-2 wage.



# S-Corporation Example

Assumptions: \$25,000 Wage, \$6,000 health care premium, \$4,000 out-of-pocket medical, \$50,000 in business income.

- W-2 Form for employee of ABC Company
  - Box 1 for Federal and State = \$35,000
  - Boxes 3 and 5 for OASDI (Social Security) and Medicare = \$25,000
- Form 1120S
  - Line 8 will show salary of \$35,000 matching W-2
- Form 1040
  - Line 7 will show wages of \$35,000 from W-2
  - Line 12 will show \$50,000 in ordinary business income
  - Line 29 will show health insurance deduction of \$6,000
  - OOP medical of \$4,000 will flow through on Schedule A

# Two Ways to Save!

If S-Corporation shareholder is already receiving an adequate W-2 Wage...

- Show Box 1 same as it has always been.
- Reduce Boxes 3 and 5 by amount of HRA reimbursement.

**Result is a true OASDI and Medicare savings of  
15.3%**

# S-Corporation Example #2

If S-Corporation shareholder is taking a low wage base...

- Add HRA reimbursement to Box 1.
- Boxes 3 and 5 will remain the same.

**Results in increased W-2 Wage to satisfy IRS guidelines without increasing OASDI and Medicare liability!**

# Limited Liability Company

- The treatment of an LLC is dependent on how the entity files its taxes.
  - **Taxed as Sole Proprietor or Partnership = 100%**
  - **Taxed as C-Corporation = 100%**
  - **Taxed as S-Corporation = Limited to OASDI/Medicare savings only**
- Spousal employment MAY be required.

# Non-Profit

- Non-profit organizations can offer a Section 105 HRA benefit plan to their employees.
- A Section 105 HRA can offer a tax-free benefit to employees who typically don't have an employer-sponsored health plan in place.

# Employer Responsibilities

- Have employable interest
- Establish compensation package
- Pay a W-2 Wage monthly or quarterly
- Reimburse medical expenses
- Submit benefit expenses annually (if using a TPA)
- Renew benefits annually

# Provider Responsibilities

- Inform qualified clients of this tax savings opportunity.
- As trusted professional advisors, it is your duty to provide clients with strategies to save money and tax dollars.



# Choosing an Administrator

A qualified third-party administrator will:

- Ensure proper plan documentation.
- Track and adjudicate medical expenses.
- Produce year-end summaries.
- Ensure reasonable compensation and compliance testing.

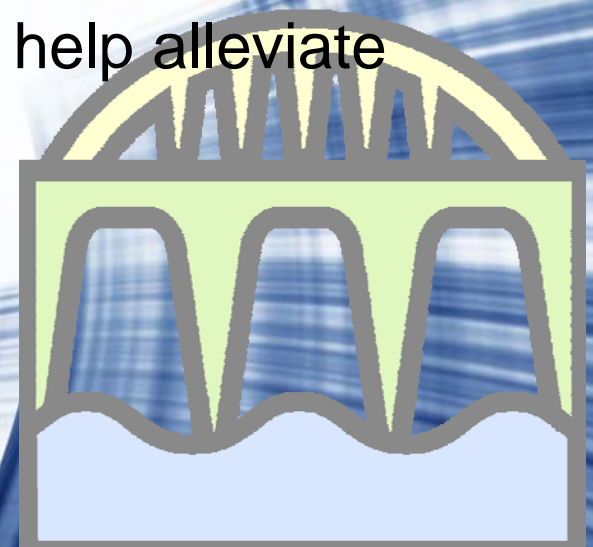
# Choosing an Administrator

- Plan Documents
- Adoption Agreement
- Summary Plan Description
- Claims review
- Re-election of benefits
- Annual renewal
- Audit guarantee
- Year-round, toll-free assistance
- Tax-savings guarantee

# Tax Awareness vs. Tax Avoidance

“I live in Alexandria, VA. Near the Supreme Court chambers is a toll bridge across the Potomac. When I rush, I pay the dollar toll and get home early. However, I usually drive outside the downtown section of the city and across the Potomac on a free bridge.

This bridge was placed outside the downtown Washington D.C. area to serve a useful social service – getting drivers to drive the extra mile and help alleviate congestion during the rush hour.



# Tax Awareness vs. Tax Avoidance

“If I went over the toll bridge and through the barrier without paying the toll, I would be committing tax evasion.

If, however, I drive the extra mile and drive outside the city of Washington to the free bridge, I am using a legitimate, logical and suitable method of tax avoidance and I am performing a useful social service by doing so.

For my tax evasion I should be punished. For my tax avoidance I should be commended. The tragedy of life today is that so few people know that the free bridge exists.”

**Justice Louis D. Brandeis**

The background of the slide features a dynamic, abstract pattern of curved, overlapping lines in various shades of blue and white. These lines create a sense of motion and depth, particularly on the right side of the image. The overall aesthetic is clean and modern.

**Questions?**