



SBLC WEEKLY

Via E-mail
March 23, 2009

Volume XI, Issue 13

SELF EMPLOYED HEALTH CARE DEDUCTION

Prior to 1986, the tax code treated the deduction for health insurance premiums for business owners differently depending on the structure of the company. If the entity operated as a C corporation, the premiums were fully deductible by the corporation, were not income to the owner, and therefore were fully tax deductible from both the income tax and the FICA tax. If the same entity operated exactly the same in every detail, except the entity was not a C corporation, that is, it operated as a sole proprietor, partnership, or S corporation, the health insurance premiums for the sole-proprietor, partner, and S corporation shareholder were not deductible from either income tax or the FICA tax liability.

The self-employed health insurance deduction, authorized by the Tax Reform Act (TRA) of 1986, began to address this problem. The TRA allowed self-employed taxpayers to deduct a portion of the premiums. As a result of subsequent changes in the law, 100 percent of health insurance premiums for the self-employed are now deductible from income tax liability. However, this does not fully level the playing field.

Since the self-employed health insurance deduction was (and is) not considered an ordinary and necessary business expense for the self-

employed, as it is for the corporate entity, the premiums, while deductible from the income tax, are still subject to the self-employment tax. Schedule C filers (sole-proprietors), Schedule E filers (partners in partnerships with earned income) and S corporation shareholders do not receive a "business deduction" for health insurance premiums. The deduction for their health insurance premiums, on page one of Form 1040, is authorized under the rules for the "self-employed health insurance deduction" and is not included on Schedule C, Schedule E, or Schedule SE.

Therefore, the premiums are not deductible for the purposes of the self-employment tax and, accordingly, the sole proprietor, partners in partnerships and S corporation owners pay self-employment tax (15.3 percent on self-employment income) on health insurance premiums.

Representatives Ron Kind (D-WI) and Wally Herger (R-CA) have introduced the Equity for Our Nation's Self-Employed Act to fix this anomaly. The bill number is H.R. 1470. A Senate bill has not been introduced.

HEALTH CARE REFORM

The President's budget request included a placeholder for health care reform. The big question is how would we pay for it? The President had proposed limiting itemized deductions for folks with incomes over \$250,000

in income. As we predicted, that was pretty much DOA. What seems to be gaining interest is eliminating the tax free status of employer provided health care. As we have reported over the years, the nation largely backed into the notion of a system relying on the tax code to facilitate the provision of health care benefits through a series of IRS rulings a long time ago. The question you should be asking in your industry is whether this is a good idea. If it became taxable income to the employee what would be consequences? Would employees prefer to get the cash instead of benefits? Of course, this would not be done in a vacuum. Likely it would come with a mandate that individuals obtain health care coverage. The interest in taxing the benefits crosses party lines.

A second hot debate over health care reform is if you create a system like the one in Massachusetts, in which there is an individual mandate and play or pay, do you offer a government run plan (sort of like Medicare for under 65) in addition to the private insurance options? In Massachusetts, coverage is provided through private plans only. On this topic, the lines have already been drawn largely on party lines with the Democrats favoring the public option and the Republicans favoring the private plans only approach.

We would welcome any thoughts you have on these issues.