TaxSaver™
For America's Self-Employed

Extracts From An IRS Position Paper

COORDINATED ISSUE
ALL INDUSTRIES
HEALTH INSURANCE DEDUCTIBILITY
FOR SELF-EMPLOYED INDIVIDUALS

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The original IRS position paper is seven pages long and assumes the reader has some knowledge about the Tax Code. This write-up attempts to simplify the original paper and to emphasize some facets, which can be a problem, or lost opportunity, if ignored. The original paper is seven pages long, is repetitive in places, and can seem inconsistent. The date on the paper is 3/29/99, which is 45 years after the original legislation. AND, the IRS still does not broadcast widely that this alternative way for married sole proprietors to process their income tax returns can save the equivalent of cutting their health care premiums in half. You will see a symbol "§" which is used in tax law documentation to mean Section of the Tax Code – and "§§" simply means 2 or more sections.

The original law is called The Tax Reform Act of 1954, §105, where the self-employed person hires his/her spouse, provides accident and health care benefits for that employee and the employee's dependents, and the owner is covered by those benefits as a dependent spouse. (§§151,152). Such an owner cannot receive such benefits as an employer because the law provides that the benefits are limited to employees as being tax-free, and employers are not employees. Actually the employers can receive employee benefits but must report the value of the benefits as added income.

Sole proprietors are joined by other business owners and treated like sole proprietors... these include sole owners of LLCs, and 2% or less owners of S corporations or partnerships. There are close to 20 million sole proprietors. Where the benefits are acceptable, the cost is a business expense, which lowers business profit, which in turn reduces social security tax.

When the employee receives only health care benefits and no cash, then there is no employment tax. As a result, no W-2 needs to be prepared (neither the employer or the employee are paying any employment Social Security Tax). To receive benefits or pay, the employee must truly be a worker.

§213 covers health care benefits. Accident and health Insurance premiums are also deductible, having started at a low level and through time reached the 100% level on the face of the 1040. By taking the premium deduction as a 1040 income reduction under §162(l), the taxpayer has missed the opportunity to reduce his business profit to avoid some social security tax.

The IRS has recognized that a married sole proprietor can compensate his employee-spouse in benefits only. Providing the spouse with some cash is also common. The total cost of the compensation package should make sense. The employee tasks should be directly related to the business and purely for services. The IRS refers to a Revenue Ruling (71-58) (the 58th ruling decided in 1971) by IRS attorneys in which the owner's spouse works in the owner's business along with perhaps other employees and is compensated and treated as an employee. (The old ruling names the people and company involved.)

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The employee-spouse must meet whatever the owner establishes for all other employees. The IRS has established criteria of minimum age, prior length of service, number of weeks or months worked annually, minimum hours worked weekly, and such are to be applied to all employees. In other words, no special rules for the owner's relatives in order to enjoy special benefit treatment... this is usually simple to set up. A benefit plan should be established and documented. Every employee should receive a copy of the plan with records kept of who has a copy, including the spouse. It is easy for the owner to become casual about his relationship with the spouse employee, but the IRS expects the spouse to be truly working in the business and can be proven. Merely calling the spouse an employee is not sufficient to qualify a non-working spouse an employee. A job description helps, an *"employment contract"* could be in order, and a log of work performed all can help to establish the status of the spouse. The two may have some complications as to ownership but the point is that it is the owner who has *"employee control"* including what work is to be performed and how the work is to be done.

Also enclosed are several tax calculation alternatives, which go through the exercise to compare tax avoidance impacts. The TaxSaver approach has the effect of cutting the overall cost of health care because of where the health care deduction is taken (as a business expense on the owner's P&L vs. a 1040 personal expense). The tax avoidance figures are very dramatic. MSAs and HSAs are great, but they are not as rewarding as TaxSaver through taking deductions where they have the greatest impact.

The due diligence includes Federal Court cases, Tax Court cases, IRS Revenue Rulings made by groups of IRS legal specialists, IRS Letter Rulings generated by IRS specialists in answer to public queries, and the IRS attorneys who transform Congressional legislation into IRS Regulations. TaxSaver has collected 2,400 references, which have been organized into about 1,500 guidelines for use by TaxSaver clients.

A TaxSaver plan can start on any day of a year, but can never start retroactively. The basic reason for no retroactivity is that there is no such thing as any kind of insurance that is retroactive. The word "insurance" is in the regulation. Insurance is always applicable to an unknown future event. The IRS released another position paper on the same day (3/29/1999) as this sole proprietor, self-employed paper. Other relevant material is included in the Website covering a variety of related subjects. The IRS releases some 15,000 pages of tax material annually, all of which needs review to assure that tax-paying public are applying the right "rules" on their tax returns. TaxSaver has several attorneys, CPAs, and Enrolled Agents.

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