Questions And Answers
About The TaxSaver™ Tax-Avoidance Program

1. What is the TaxSaver program?

The TaxSaver program is a process that establishes a series of factors in a self-employed's business and allows the business owner to pay for his/her family's health care expense as a part of the cost of doing business. This allows all health care expense to be deducted on a pre-tax basis, which means avoiding paying federal and state income taxes as well as avoiding payment of FICA and Medicare taxes on the health care deduction.

Usually the self-employed does not use the business as a means for deducting health care expense because the usual advice is that the owner is an employer and cannot give himself tax-free employee benefits. However, the owner can hire his/her spouse and provide health care coverage for the spouse and all dependents including the spousal owner to the degree the owner desires. Naturally, the owner would want to cover every cent of health cost to maximize deductions that avoid tax as pre-tax expense.

2. What are the factors that must exist to create a legitimate program?

There are several factors:

a. The spouse must truly be an employee, perform work and be compensated.
b. A benefit plan for this employee must exist and will apply to other employees also.
c. The benefits cannot include health care events that occurred before the existence of the program. This is because we are dealing with risk and insurance, and there is no such thing as retroactive insurance for an event in the past – and that includes yesterday.
d. If other employees exist and are eligible for employee benefits under the rules as set by the owner, then no discrimination will be tolerated as set by law.
e. The kinds of health expense, which are allowable as tax deductions, are documented as part of the Tax Code.
f. In addition, employees may fund all or some of their own benefits on a pre-tax basis.

3. Why should anyone use a special program if health care is already deductible?

Over 99% of all eligible self-employed sole proprietors still use the old approach for taking health care deductions, which is to use their 1040 and Schedule A for their health care expense. Using the 1040 and Schedule A means that they are **not** avoiding any FICA taxes (this is 15.3% of total health care expense which is worth almost $1000 in reduced taxes). In addition, the insurance reached 100% deductibility in 2003. Also, a hefty bite is taken out of the deductible uninsured expense when the 7-½% is calculated, and the result is usually so small that the taxpayer settles for the standard deduction. The bulk of taxpayers (80%) take the standard deduction, and probably with some relief.

The potential deductions are thrown in the wastebasket, because they could have been deducted as a business expense and the taxpayer could still take the standard deduction legally. TaxSaver offers the alternative of taking 100% of all health deductions but also allows the standard deduction to be taken as well.

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4. How does anyone know whether health care deductions are being maximized?

Just take a look at your Schedule C (or farmer's Schedule F) and see whether for employee benefits amount is zero – zero equals no maximized deduction – the probability is high that health care deductions taken in past tax returns resulted in overpaying taxes by 30% or more.

5. How much can be saved?

The savings depend on the taxpayer's tax brackets and how much is spent on health care. People in the higher brackets usually spend more on health care. Assume that the business owner is in the 25% bracket and spends $6,000 a year on health care, with $3,600 a year for insurance and $2,400 for uninsured health expense. The entire $6,000 is deductible on a pre-tax basis at a rate of 44.3% (25% for federal, 4% for state plus 15.3% for FICA and Medicare) equals $2,658 plus the full standard deduction.

The usual approach emphasized by the IRS lost all of the FICA potential for tax avoidance and also until 2003 got only a partial deduction for the premium expense. The TaxSaver approach still retains the possibility of an itemized deduction if the miscellaneous deductible items (casualty losses, mortgage interest, local and state taxes, charity) exceed the standard deduction. The IRS promotes using only the 1040 for taking the $6,000, which may not get deducted at all because the standard deduction is better. Check the tax avoidance charts for your situation. The tax avoidance charts reflect changes made by Public Law 108-27, The Jobs and Growth Tax Relief Reconciliation Act of 2003 signed into law on May 28, 2003.

6. What health care expense is deductible?

TaxSaver provides its clients with a lengthy list of deductibles. TaxSaver is available to its clients by calling **(800) 829-7287** to answer questions in this area. There are selected areas where special facilities and even standard household products can be deductible. TaxSaver has a maintained file of about 1,000 deductibles and non-deductibles for reference by technical staff. Of course, health insurance is generally deductible, but there are exceptions.

In September 2003, theirs established a revenue ruling (2003-102) in which OTC (Over The Counter) products are identified as being tax deductible. Heretofore deductions for health care drug store items had to be prescribed by a medical professional in order to be deductible. This new IRS ruling, as authority in tax law is founded on the basic tax language that deductions are allowed for expenses incurred for the diagnosis, care, mitigation (easing), treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body. The prevention applies only to the disease and not for good health purposes like vitamins.

Therefore, there can be an added deduction when using antacids (Maalox), aspirin, band-aids to protect a cut or wound, salves, ointments, Ambesol for toothaches, cough drops or syrup, or a host of non-prescription items which can cure or ease pain. Most OTC items are much cheaper than Rx items, but they can add up in a year's time and be several hundred dollars in annual deductions for married sole proprietors. This deduction can then impact social security, as well as state and federal income tax. Now any taxpayer can avoid more taxes by itemizing, but only the married sole proprietor can reduce these three taxes as business expense legally.

It would be prudent for the taxpayer to keep records of these items the same as prescription expense. Such can be added to the current reporting system by including these OTC items in the Rx column or as OTC in the OTHER column.

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7. What happens if the IRS says that a taxpayer is wrong about taking a particular deduction?

It is always the responsibility of the Taxpayer to prove his deductions if challenged, and that applies to health deductions as well. TaxSaver will back the taxpayer on any subject where TaxSaver has provided guidance. TaxSaver is confident that it has better-organized references and better access to those records than even the IRS has. All information is in the public domain (which largely is limited to law libraries or law firms). Most taxpayers depend on the IRS to inform the public. And by not publicizing alternative ways of taking health care deductions, the public wrongly assumes that the IRS has no other alternatives. The bottom line is the taxes collected are greater than what they could be. A key IRS Revenue Ruling made in 1971 has been used by TaxSaver to get auditors to reverse themselves.

TaxSaver has collected and, most importantly, has organized about 300 rules or guidelines on what is required to set up a program for sole proprietor and another 1,000 rules on the deductibility of health care expenses and that includes partial deductions. In addition, TaxSaver researchers review some 15,000 pages annually released by the IRS in the form of rulings, plus Tax Court opinions (a group within the IRS), opinions from all levels of federal courts, and new or changed regulations caused by Congressional actions.

8. Why hasn't my tax return preparer ever told me about this approach?

Simply because the tax preparer never heard about it. First, the IRS has never gone out of its way to emphasize it. This results in IRS staff and tax practitioners being uninformed. The program is not a secret – it is simply not broadcast like alternative approaches. The approach is also not part of an accountant's normal training. With over 10 million married sole proprietors who can qualify for the program, there is about $30 billion a year lost to taxpayers.

9. Can anyone else use this health care deduction program?

It is basic that any taxpayer can use whatever legal means available to reduce or avoid the payment of taxes (this comes from the U.S. Supreme Court as far back as 1864). Having done all of the research described above, it is evident that some parts of the TaxSaver research are useful to other types of business organizations. While the program highlighted above applies best mainly to married sole proprietors, there some aspects of the program that can also be applied to personal tax returns as well as other types of business entities. A sole owner of an LLC files a sole proprietor tax return (Schedule C).

For example, it is possible that while the business is providing tax-free benefits to the self-employed owner through the owner's spouse, the owner can realize lower operating costs by having employees reduce their pay to cover more of their own benefits while the owner and the employees both pay less in their shares of applicable employment taxes (FICA).

Partners in a partnership or owners of S Corporations who own 2% or less of the business can use the TaxSaver approach for these critical people. The self-employeds who own 2% or less can be the recipients of benefits as the equivalent of employees. The reason why the over-2% owners cannot participate is that it is attributed to their spouses and other family members that each owns as much of the business as the owner owns and therefore that relative becomes another owner (employer), regardless of their age or job.

There are other savings which involve the use of the self-employed's deduction on a portion of term life insurance; use of salary reduction by employees so that the owners incur lower expense in matching employment tax contributions; or planning that employees pay for some benefits totally or partially.

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10. How soon can the TaxSaver program be effective for me as a sole proprietor?

Your program is effective on the same date as you apply to participate in the TaxSaver program. If you already have an insurance policy, and have TaxSaver newly offered to you, the effective date of the program is the date you are advised that the program is established. An employee can use the program even if he has no policy in place – technically, he is self-insured. The program cannot be backdated as noted in Q & A #2 above.

TaxSaver is selected as the administrator for these programs because they can prove that they performed the due diligence (homework) and continue the effort due to a constantly changing IRS Tax Code. The insurance carrier delights in having their insurance premiums be the source of greater tax deductions. The carrier also prefers an administrator who supplies you with a sheet that offers the auditor assistance in explaining why deductions are taken and can cite the basis for same out of the Tax Code. TaxSaver also delights in your acquiring significant added spendable income. TaxSaver tends to squelch an audit before it could begin. We ask you to simply call us with the auditor's name and phone number. TaxSaver then calls the auditor to find out the nature of problem. TaxSaver will also contact the auditor's management and offer to prove the viability of deductions taken. We have left a standing invitation to visit our offices to review the extent of our due diligence. We are proud of our homework and asked to present our materials to IRS district auditing staff – their closing comment was "nobody does this much homework!"

11. How many clients does TaxSaver have?

TaxSaver clients number in the thousands. Annual savings now are well into the millions of dollars annually and grow as clients increase their spendable income and spread the word.

12. Is there a limit to the amount that employees can contribute to their own benefit program through salary reduction program?

The salary reduction (or redirection) process was established years ago in the Tax Code dealing with cafeteria plans and a limit was set as equal to 500% of the amount of the insurance premium associated with the employee as funded by the employer, employee, or both. In order to use any salary reduction funds, there must be some health insurance. If we assume an insurance policy costing only $100 monthly ($1,200 per year), then the salary reduction allows a maximum of an additional coverage of $6,000 for uninsured benefits. The employee must be at risk with a personal salary reduction, referred to as "use it or lose it". The basic rule for these employee benefits is that the employer is supplying insurance, which is really the transfer of risk to a third party, and generally there is no return of unused premium. Thus, when an employee reduces salary to pay for coverage, it is money that the employee never received but that money will be used for coverage instead of payroll.

Like premium payments, unused funds are not usually returned. This process is a bit different in that the salary reduction funds do not go to an insurance carrier but rather end up on paper in the employer's record on the employee. The money in the account is used to pay for health care but may not be completely spent. The employee cannot receive back the unused funds because the risk element (insurance) would be eliminated. The only one left is the employer. It is written into the regulations that the employer cannot give the unused funds to the employee but may keep the funds or accumulate such unused funds for redistribution to all employees but in no relationship to each employee's lost contribution. Where there is only an owner and spousal employee, there is no real family loss of the funds because the money ends up as a reduction in payroll expense. With return of the funds to the employer, the profit of the business rises modestly, and taxes are paid accordingly.

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13. Can a C Corporation use TaxSaver profitably?

Yes. The C Corporation is an employer and can provide a benefit program and offer the option for the employees (including owners who work in the business) to participate in a voluntary salary reduction program. Its value to employees is that the benefits are being funded with pre-tax dollars. Both employer and employees are avoiding their shares of the Employment tax (where each party pays 7.65% of gross income). There is some bookkeeping expense to track on deposits and disbursements. A unique aspect of this process is that the employer is also at risk by being required to disburse the full amount of the unused equivalent annual amount to be deposited for the year at any time during the benefit period. The employee is not responsible for paying planned deposits after separation.

14. What can happen to make the program invalid?

The plan can be nullified for failure to comply with IRS regulations. When the plan (truly a contract between employer and employees) is out of compliance, penalties and any taxes avoided must be paid or negotiated with the IRS. This applies to both parties. Both employer and employee contributions can be disallowed as deductible. Reasons for plan invalidation include:

- Discrimination.
- Lack of Plan notification to the employee.
- Retroactive start date.
- No Plan documentation/common knowledge of benefits.
- Lack of risk for either party.
- Plan must be specific as to Plan exceptions.
- Wording which would allow after-the-fact changes.
- Coverage for non-employees.

15. Can I administer the Plan myself?

It is possible but not advisable. TaxSaver has established over 1,300 guidelines from the Tax Code covering both the setup and administration for taking deduction. In addition, there is a continuing problem of reviewing the newly issued additions to the Tax Code that appear in some 15,000 pages of material annually. This material is not available to the general public in the usual reference facilities, but rather one must depend upon the IRS, law firms, or university law school libraries, or through the Internet by subscribing to services. Even CPAs generally do not elect to do research at length in this and other areas. It's impractical and nobody asked.

16. Will the IRS notice a big drop in tax receipts?

Consider $30 billion in tax avoidance as a share of over $200 trillion in tax revenue – equals 0.015 of 1% or $200,000 billion vs. $199,970 billion. A downturn in revenue would be invisible on a graph. In addition, this assumes all eligible taxpayers would be participating.

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