

Dear Client,

As we approach year-end it is an important time to review the proper reporting of health insurance premiums paid on behalf of greater than 2 percent shareholders of S corporations. If important steps are missed prior to year-end you risk limiting or losing the deduction all together.

The self-employed health insurance deduction allows self-employed individuals to deduct their health insurance premiums on the front of Form 1040 as an adjustment against income. Even though an S corporation shareholder is not technically self-employed, the IRS requires a more than 2 percent S corporation shareholder to report the deduction as if they were self-employed and not on the S corporation return.

Below are the necessary steps to ensure the self-employed health insurance deduction can be taken. Make sure you follow these steps closely; an error can result in the loss of substantial tax savings.

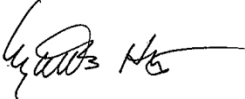
1. An S corporation cannot deduct health, dental, and other medical premiums for a shareholder who owns more than 2 percent. Their premiums should be tracked separately throughout the year.
2. If the corporation did not pay the premiums during the year, make sure the corporation reimburses the shareholder before year-end.
3. Before the final payroll run of the year, calculate the total shareholder health, dental, and other medical insurance premiums paid or reimbursed by the corporation as this figure is needed for the final payroll and the shareholder's W-2.
4. The amount of premiums for the year is paid to shareholder as payroll, but there is special payroll tax treatment for this payment. The amount is subject to Federal and State withholding, but it is not subject to social security or Medicare tax. If you use a payroll service, they will have a pay item for this specific payment.
5. On the W-2, the amount of the premiums is recorded in box 1 wages, in the state wages, and in box 14 as "S/H Health Ins" or a similar description.

If you use a payroll service provider (or we prepare payroll reports on your behalf) it is imperative the necessary health insurance information be provided to the payroll service provider prior to year-end so the steps outlined above can be accurately followed.

If a greater than 2 percent shareholder's health insurance premiums fail to be reported on their W-2, technically the IRS will not allow the self-employed health insurance deduction. This results in the loss of substantial tax savings which is why proper reporting prior to year-end is imperative.

If you should have any questions regarding this information, please do not hesitate to contact our office.

Sincerely,

A handwritten signature in black ink, appearing to read "Matthew B. Hitt", with a stylized flourish at the end.

Matthew B. Hitt, CPA