

HealthCare Annuity Plus® WBP

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Appendix

Fox & Lalonde's HealthCare Annuity Plus® WBP Single Employer VEBA & IRC §419(e) Welfare Benefit Plans (WBPs) make available the following benefits:

I. Pre-retirement: death, disability, accidental death & dismemberment and long term care benefits. Generally it is assumed that the plan will pay/deduct the appropriate premiums for insurance policies that will provide the benefits.

II. Post-retirement: medical and death benefits. An actuarially calculated post-retirement medical "sum" is available to plan participants, as well as, optionally spouses and/or dependents of plan participants.

Plan sponsors may choose which benefits to provide.

III. Questions:

Can any business entity sponsor a welfare benefit plan (WBP) and tax deduct the annual cost?

Depending on the type of business entity/Plan Sponsor *does the plan participant experience a different tax result* i.e. inclusion of part or all of the benefits' cost in the plan participant's current taxable income? In other words just what is the impact on individual plan participants with respect to contributions made in any particular year?

This Appendix's purpose is to examine these questions. It will detail the participant's current inclusion in taxable income as to type of business entity (C Corp, S Corp, LLC, LLP, partnerships) and the type of benefit provided (pre-retirement death, disability, AD&D and LTC; post-retirement medical and death.

Sole Proprietors

It is generally agreed that a sole proprietor cannot have a tax deductible welfare benefit plan.

C Corp – 100% deductible, only term life insurance cost pass thru for benefits in excess \$50,000.

S Corp – 100% deductible w/certain modifications and clarifications; term life insurance cost pass thru for death benefits in excess of \$50,000.

With regard to **health insurance premiums**, IRC §1372 treats more than 2% shareholders of S corporations as if they were partners in a partnership for fringe benefit purposes. The IRS explained the income tax treatment of health insurance provided by an S corporation to a more than 2% shareholder in *Rev. Rul. 91-26 and Announcement 92-16*.

The health insurance premiums paid by the corporation are deductible by the corporation but includible in the shareholder's gross income and are to be reported on his Form W-2 each year (although the shareholder may be able to deduct a portion of these amounts on his personal income tax return).

S Corp (con't)

IRC §162(l) allows the more than 2% shareholder to deduct health insurance premiums paid by the corporation for the corporation's health insurance on his personal income tax return up to the amount of his "earned income" from the S corporation. For this purpose, the more than 2% shareholder's wages from the S corporation are treated as his "earned income."

The **long-term care insurance premiums** that may be taken into account in determining the overall health insurance premium deduction under IRC §162(l) allowed for a self-employed individual are limited to eligible long-term care premiums, as defined in IRC §213(d)(10) and limited to the amounts set forth in that provision as increased for inflation. **Important Note: Owner employees are not however subject to the 7.5% of AGI itemization requirement.**

The IRS has informally taken the position that the above income tax treatment applies only if the health insurance is sponsored by the corporation — it does not apply to personal health insurance obtained by the S corporation's shareholder.

IRS Chief Counsel Advice 200524001 (that may not be cited as precedent) provided that a sole proprietor who purchases health insurance in his own individual name, rather than in the name of his business, has established a health plan with respect to his business and may, therefore, deduct the insurance premiums under IRC §162(l), but only to the extent that the premiums do not exceed his earned income from the business with respect to which the insurance was purchased.

When taxpayers tried to extend the logic of that advice to S corporations, the IRS issued a "headliner" on its website on May 15, 2006 in which the IRS stated that: (i) an S corporation has not established a health insurance plan itself when an S corporation shareholder purchases health insurance in his own name, (ii) because the S corporation has not established a fringe benefit plan, *Code section 1372* is not triggered, (iii) as a result, the S corporation shareholder is not treated as a partner of a partnership, and (iv) therefore, IRC §162(l) is not available to allow an income tax deduction by the S corporation shareholder for the health insurance premiums.

LLCs - The income tax treatment of the members of a limited liability company (LLC) depends on how the LLC is taxed.

If the LLC has only one owner, it will automatically be treated as if it were a sole proprietorship, unless an election is made to be treated as a corporation. *Treasury Regulations Section 301.7701-2(a)* provides: *A business entity with only one owner is classified as a corporation or is disregarded; if the entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner.*

So, the sole member of an LLC would be treated as a sole proprietor (see discussion above) unless an election has been made to treat the LLC as a corporation. Such an election is made using *Form 8832, Entity Classification Election*.

If the LLC has two or more owners, it will automatically be considered to be a partnership unless an election is made to be treated as a corporation. A limited liability partnership (LLP) is going to be taxed as a partnership unless an election is made to treat the LLP as an association that is taxed as a corporation. Certain state laws recognize LLPs only for the practice of specific professions e.g. accountancy, architecture, and law.

Planning Note: A management company established as a C Corp may compliment an established pass thru business entity and provide an effective benefit and tax planning dynamic.