



Herbein + Company, Inc.
www.herbein.com

Dear Client:

As December 31, 2020 rapidly approaches, we would like to take this opportunity to remind you that the Internal Revenue Service requires reporting of health or accident insurance premiums, paid by an S Corporation, on behalf of greater than 2% shareholder/employees, as wages or salary on the S Corporation federal corporate tax and employment tax returns. A greater than 2% shareholder is an individual owning more than 2% of the outstanding stock of the S Corporation. Health insurance includes dental and vision insurance.

The health and accident insurance premiums are also considered taxable wages for federal income tax withholding and, accordingly, the appropriate federal income taxes should be withheld and reported on the fourth quarter federal payroll tax returns. If paid pursuant to a qualified benefit plan, the premiums are exempt from Social Security, Medicare, and FUTA tax. During 2020, each shareholder affected by these provisions may be entitled to deduct 100% of the health insurance premiums paid in arriving at his or her adjusted gross income on Form 1040.

Also, if you qualify for the above-the-line deduction for health insurance premiums, you may be able to deduct your Medicare premiums. If you are a more than 2% shareholder in an S Corporation and you pay your health insurance premiums directly (including Medicare premiums), the S Corporation can reimburse you for those premiums. These reimbursements must be made before year-end in order to take a current year deduction. Also, the premium reimbursements must be reported on the shareholder's Form W-2 in the same year the premiums are paid. Failure to comply with this requirement may result in the loss of the deduction for the corporation and the shareholder. The Medicare insurance premiums are not subject to Social Security (FICA), Medicare or unemployment taxes (FUTA).

(NOTE: The Affordable Care Act (ACA) did not change the above rules regarding the federal tax treatment of health and accident premiums paid for a 2% shareholder. However, for tax years after 2013, the ACA may impose penalties on the S Corporation if it offers a health plan that fails to comply with certain market reform provisions, which may include plans under which the S Corporation reimburses employees for the cost of individual health insurance premiums. Please contact our office if you have any questions on the ACA provisions.)

Additionally, the health insurance premiums are generally not subject to Pennsylvania and local income tax withholding and are not required to be reported on quarterly or annual Pennsylvania or local tax filings. The amount of the health insurance premiums must be included in each individual's W-2 form as federal wages, but not as Pennsylvania or local wages.



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Note that group-term life insurance premiums are includable in income to S shareholder-employees and are subject to Social Security and Medicare taxes. However, the premiums are not subject to federal income tax withholding and generally are not subject to FUTA taxes if they are paid under an employer plan. In addition, the premiums are generally not taxable for Pennsylvania or local tax purposes.

For 2020, it will also be necessary to include in the income and W-2 form (for federal purposes only) of a more than 2% shareholder, any employer-provided parking costs. Employer contributions to a Health Savings Account of a 2% shareholder should be treated as distributions as determined by the facts and circumstances.

If you have any questions concerning these requirements, please do not hesitate to contact our office.

Sincerely,

A handwritten signature in black ink that reads "Herbein + Company, Inc." in a cursive script.

Herbein + Company, Inc.