Section 105

Stanley Greenfield, RHU

Are you practicing on your own? One of the benefits of being in business and not working for someone else is the tax deductions you get. Don't you just hate it at tax time when you see how much you have spent on medical insurance and the out-of-pocket expenses you cannot deduct? That's thousands of dollars, and not one penny of it is deductible. Wouldn't it be great if you could deduct 100% of those expenses?

Well, happy days are here again, because you can deduct it all and stay out of jail! To qualify for this deduction, you must meet the following qualifications:

1. Be self-employed;
2. Have a spouse who is active in the practice; and
3. Have fewer than three employees.

That's it! If you fit the above, you can have a potential tax savings each year of $2,450.00!

This tax savings falls under Section 105 of the Internal Revenue Code, which allows self-employed business owners a 100% deduction of family health care expenses. By the way, this includes health insurance premiums, as well as term life, disability and qualified long term care premiums. In addition, non-insured medical, dental and vision care expenses are also deductible at 100%.

This code section has been around since 1954, but has been a well-kept secret! By establishing the spouse as an employee, you can then offer the spouse-employee a benefits package. The plan establishes a "reimbursement" from the practice to all eligible employees, including an employed spouse, for all family medical expenses incurred. At tax time, the employer deducts the full amount of these reimbursements as an employee benefit expense. By the way, the spouse does not have to put in a full 40-hour week to qualify for this benefit. In fact, the spouse can be working full-time for someone else and you can still qualify for this deduction.

Yes, there are other plans that work almost like the 105 plan. They are the MSAs, medical savings accounts, but they require that you buy a special insurance plan with a very large deductible and put money aside to reimburse yourself at the end of the year. Section 105 allows you to keep your current plan and not change a thing.

One reason why most people have not taken advantage of Section 105 is the fact that it requires you to have a plan and have it filed properly with the IRS. In the past, this has been costly and did present some problems if the plan was not filed. I have recently found a firm that administers Section 105 plans. They make sure that everything is done properly, and they will assume financial responsibility for any penalty and interest charges incurred as a result of an audit as it pertains to your plan. Quite a guarantee!

Let's take a look at an example of how Section 105 can save you money. Dr. Jim is in solo practice. His wife, Mary, helps out in the office from time to time. Dr. Jim decides to put Mary formally on the payroll so he can take advantage of Section 105. Dr. Jim decides to pay Mary in the following way:

1. Reimbursement of family health insurance premiums (fully deductible to business & non-taxable to Mary)	$4,000
2. Reimbursement of family non-insured medical expenses (fully deductible to business & non-taxable to Mary)	$3,000
3. W-2 wages	$3,000
Total Compensation:	$10,000

The $7,000 of reimbursed medical costs is now fully deductible as an employee benefit. Dr. Jim multiplies this $7,000 by 35% (I'm using just a 15% federal tax rate, plus a 5% state tax rate and a 15% self-employment tax). The results are a tax savings of $2,450. A higher tax bracket will yield higher tax savings.

Yes, you have to include current employees in your plan, but there are ways to exclude the majority of them. For example, you can exclude all part-time and seasonal employees, and anyone under the age of 25. Any new employees that you hire must work for you at least three years before you have to add them to your plan. As I said, most employees can be excluded.

This program can be set up before December 31st, and it will be as if you set it up on January 1st. All expenses can be reimbursed and deducted this year. Can the government change this? Have you ever seen anything that the government can't change?

So that is the "good news-bad news" about Section 105. The good news is that this plan can save you thousands of dollars every year. The bad news is that like any law, it can be changed. Don't forget that it has been a law since the 1950s. The other bad news is you have not been taking advantage of this for all this time and you are still sitting there contemplating this. That's not bad news, that's sick!

MAY 2002