

STEPS TO SAVINGS WITH THE BASE® HRA – WITH 1 EMPLOYEE

S Corporations have to be vigilant when it comes to weighing their options for utilizing a Section 105 BASE® HRA. With an HRA, the business has the opportunity to gain a tax advantage within the S Corporation when applicable. However, there is something to consider before enrolling in this type of plan:

Prior to establishing an HRA, the business owner, along with their tax preparer, needs to determine the best option for the business - Reclassify or Increase Current Salary. Both options are outlined below for you to reference as an example.

The following examples assume:

Salary = \$36,000 • Health Insurance Premiums (HIP) = \$500 per month • Out-of-Pocket Medical (OOP) Expenses = \$250 per month • 1 Employee

Reclassifying Current Salary	STEPS	Increasing Current Salary
<p>Shareholders must receive W-2 compensation (formal payroll) in order to achieve tax savings using an HRA. The business starts by reclassifying the \$36,000 salary to include family health expenses. The monthly salary will stay the same (\$3,000), and is still subject to federal and state income tax. The FICA tax is now calculated on \$2,250 rather than \$3,000 (\$3,000 - \$500 HIP - \$250 OOP = \$2,250), increasing take-home pay by \$57.38 per month.</p>	<p>1</p>	<p>Shareholders must receive W-2 compensation (formal payroll) in order to achieve tax savings using an HRA. However, an employer may increase wages for purposes of medical fringe benefits which are exempt from FICA taxation. The business starts by increasing the \$36,000 salary to include family health expenses. The monthly salary will now become \$3,750 and is still subject to federal and state income tax. The FICA tax is calculated on \$3,000, which excludes the health insurance premium and out-of-pocket (\$3,750 - \$500 HIP - \$250 OOP = \$3,000).</p>
<p>The business must change the way they report income on the quarterly 941. Previously, the owner would have reported \$9,000 as subject to Social Security and Medicare tax. With an HRA in place it is now \$6,750, reducing Social Security and Medicare tax. This will result in the business not having to match Social Security/Medicare Taxes.</p> <p><i>HRA savings are a result of FICA tax savings each pay period based on medical expenses incurred during that period, as well as additional FICA tax savings each quarter, since the corporation will not have to pay matching FICA tax for the medical expenses incurred.</i></p>	<p>2</p>	<p>The business must change the way they report income on the quarterly 941. Previously, the business would have reported \$9,000 as Wages, Tips, and Other Compensation. With the HRA in place, the business will report \$11,250 as Wages, Tips, and Other compensation. However, only \$9,000 will be subject to Social Security and Medicare taxation. This will result in the business not having to match Social Security/Medicare Taxes.</p> <p><i>HRA savings are a result of FICA tax savings each pay period based on medical expenses incurred during that period, as well as additional FICA tax savings each quarter, since the corporation will not have to pay matching FICA tax for the medical expenses incurred.</i></p>
<p>The business reports the total \$36,000 W-2 income received by the shareholder on line 7 of the 1120s.</p>	<p>3</p>	<p>The business reports the total \$45,000 W-2 income received by the shareholder on line 7 of the 1120s.</p>
<p>Box 1 remains the same as in previous years at \$36,000. Boxes 3 and 5, however, are reduced to \$27,000. The business will report the \$9,000 HRA employee benefit in Box 14, as other income, to verify to the IRS that the \$9,000 is not subject to FICA/FUTA tax.</p>	<p>4</p>	<p>Box 1 will now report \$45,000 as Wages, Tips, and Other Compensation. Boxes 3 and 5, however, are reduced to \$36,000. The business will report the \$9,000 HRA employee benefit in Box 14, as other income, to verify that the \$9,000 is not subject to FICA/FUTA tax.</p>

ADDITIONAL INFORMATION

- It is important that BASE® speaks to individuals handling payroll. This will insure that payroll is being handled properly for HRA documentation & compliance.
- The IRS requires you to have a formal written plan (HRA) in order to receive these savings.
- HRAs are considered non-discriminatory plans & therefore must also be offered to any qualified W-2 employee.
- Shareholder-employees should continue taking a standard self-employment health insurance premium tax deduction on their 1040 (if applicable) while using the HRA.
- See [Publication 15-B](#) if you are interested in learning more about how employee fringe benefits relate to your BASE® HRA.
- See [Coordinated Issue Papers](#) for more detailed information & clarification on the deductibility of health insurance for the self-employed & the issue of retroactivity and the HRA.