

**MEDICAL BENEFIT ALTERNATIVES
FOR THE SELF-EMPLOYED**

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- (1) A self-employed individual may deduct 70% of the cost of health insurance for himself/herself and his/her family as an adjustment to income. The limit is 70% in 2002, and 100% in 2003 and all years thereafter. The insurance deduction cannot reduce earned income (Schedule F - net profit and wages) below zero. The balance of the insurance and additional medical expenses in excess of 7.5% of AGI may be taken as an itemized deduction. To be eligible for the deduction, neither the spouse or the self-employed individual may be able to participate in any subsidized health plan maintained by their employer or the spouse's employer.
- (2) A self-employed individual may provide health insurance coverage for a spouse who is an employee in the business. This coverage may cover the family of the employee, even when this includes the employer. The cost of the insurance is a business deduction. No non-discrimination rules apply requiring coverage on other employees.
- (3) A self-employed individual may provide a medical reimbursement program for a spouse who is an employee in the business. The program would provide a business deduction for not only health insurance, but could also provide coverage for uninsured medical, dental and vision expenses. Other deductible fringe benefits could be provided for the employee. A key to this deduction is a written employer/employee arrangement with assigned duties.

If the employer provides a self-insured medical reimbursement plan, the plan must be in writing and must meet non-discrimination requirements set out in I.R.C. §105(h). A master type plan has been set up by AgriPlan/BizPlan which is available through tax practitioners. Under those rules, the following employees may be excluded from the plan:

1. Employees who have not completed three years of service.
2. Employees who have not attained age 25.
3. Part-time or seasonal employees
 - a. Part-time is defined as under 25 hours per week, but if other employees with similar work have substantially more hours, then the part-time employee may work up to (but not including) 35 hours per week.
 - b. Seasonal is defined as under seven months per year, but if other employees with similar work have substantially more months, then the seasonal employee may work up to (but not including) nine months per year.
4. Employees represented by a collective bargaining agreement in which health benefits were the subject of good faith bargaining.
5. Employees who are non-resident aliens and who receive no earned income from the employer which constitutes income from a source within the United States.

(4) Employee Flexible Spending Arrangement (FSA).

An FSA is a benefit program that provides employees with coverage under which specified, incurred expenses may be reimbursed out of a fund withheld from the employee's salary before taxes. The plan must be very detailed and non-discrimination rules apply. If the withheld funds are not spent, they revert to the employer. Because of set-up and administration costs, these plans are only feasible for large employers.

Medical Savings Accounts (now called Archer)

Starting in 1997 and now extended through 2002, a self-employed individual or an employee of an employer with a high deductible medical plan can set up an MSA. The employer can have no more than 50 employees in the two preceding years. Contributions can be made either by the employee or employer, but cannot exceed 65% of the deductible for an individual (75% for family coverage). Deductibles under the plan must be at least \$1,500 and no more than \$2,250 for individual coverage (\$3,000 to \$4,500 for family coverage). Contributions to the plan are deductible if made by the employee and excludable if made by the employer.

Distributions from the MSA to cover medical expenses are excludable from income.