



# S Corporation Fringe Benefits

As year-end approaches, we wanted to take a minute to remind you about the proper income tax treatment of fringe benefits provided to greater than 2% shareholders of S Corporations. The IRS has issued commentary indicating that if these benefits are not treated properly, the greater than 2% shareholder would not be entitled to applicable deductions on their tax return. Please read the following rules carefully.

If your S Corporation provides fringe benefits such as these items listed below for its greater than 2% shareholders, then the amount paid by the corporation **must** be included in the employee's W-2 taxable income.

- Premium payments for employee owned life insurance
- Health insurance premiums (including dental & vision)
- Accident insurance premiums
- Disability insurance premiums
- Long-term care insurance premiums
- Personal use of company car (see separate letter)

## **Employee Owned Life Insurance Paid by Employers**

Generally, for an S corporation to deduct from taxable income the payment of an employee's insurance premiums, the employer must show:

1. The premium payments are in the nature of additional compensation (i.e., included in the employee's W-2 taxable income),
2. Total compensation of the employee, including the premium payments, are not unreasonable for the services rendered, AND
3. The employer is not directly or indirectly a beneficiary under the policy.

This is the general rule for all employees regardless of whether they are shareholders or not.

There is an exception for non-shareholder employees and 2% or LESS shareholder employees. Employer paid premiums on up to \$50,000 of group-term life insurance coverage per employee may be deducted from taxable income by the corporation and it is not considered additional compensation to the employee and need not be included in the employee's W-2 taxable income.

If the employer pays premiums for coverage exceeding \$50,000, they may be deducted by the employer if the value is included in the employee's compensation. The amount to include on the employee's W-2 is computed using the IRS uniform cost table for group-term coverage (see attached) less any amount paid by the employee. Income from taxable group-term coverage is not subject to income tax withholding but is subject to employment taxes.

### **Health (Medical Care), Accident (Payable for other than medical care such as indemnity for loss of income, of life, limb or sight) Disability and Long-Term Care Insurance Premiums Paid by the Employer**

The rules regarding premiums paid for health, accident and disability insurance on employees who are greater than 2% shareholders are as follows:

1. Health insurance: Premiums paid are deductible to the employer if they are included in the employee's compensation. On the employee's individual return, 100% of the premiums are a deduction from adjusted gross income.
2. Accident and disability insurance: Premiums paid are deductible to the employer if they are included in the employee's compensation. The employee will not receive a tax deduction for the premiums included in his/her compensation.
3. Long-term care insurance: Premiums paid are deductible to the employer if they are included in the employee's compensation. On the employee's individual return, the premiums are a deduction from adjusted gross income subject to limits based on the age of the employee.

In addition to disallowing the deduction by the greater than 2% shareholder, in the event the S corporation fails to properly report fringe benefits as compensation, the IRS may determine that unequal distributions have been made which creates a "second class of stock", violating the S Corporation rules. This may potentially result in termination of the company's S Corporation election.

If you use a payroll service, please contact them prior to their W-2 deadline, to have any fringe benefit amounts included in the employees' W-2's. You will need to give the payroll service the name of each fringe benefit and the amount paid to the employee for that benefit in 2023.

If you prepare your own W-2's, these fringe benefits should be included in box 1 of Form W-2 as wages and, if applicable, also in boxes 3 and 5 of Form W-2 as social security and Medicare wages. We will be glad to assist you with any questions you may have completing your W-2's.

Please feel free to call if you have any questions concerning this or any other tax issue.

Leeper, Kean & Rumley, L.L.P.

Employees' cost of group-term life insurance in excess of \$50,000:

Age	<u>Cost per \$1,000 for one-month period</u>
Under 25.....	\$ .05
25 to 29.....	.06
30 to 34.....	.08
35 to 39.....	.09
40 to 44.....	.10
45 to 49.....	.15
50 to 54.....	.23
55 to 59.....	.43
60 to 64.....	.66
65 to 69.....	1.27
70 and above.....	2.06