

December 2019

Section 105 Medical Expense Deduction Plan for Statutory Employee

Questions

Before I get to my questions, thank you for the incredible information in your (book/audio) Business Tax Deductions on-the-go course.

Because of you, I've found a few great new tools and have locked down on my documentation for this year's taxes.

One thing I'm not sure about is Section 105 medical expenses. I'm a full-time life insurance agent classified as a statutory employee. The company I work for takes the health premiums out of my statutory employee W-2 commission checks. In other words, I pay for my health insurance with a reduction in commissions.

I have three questions:

- **Question 1.** Does this arrangement preclude me from using the Section 105 plan entirely?
- **Question 2.** Could I have my employee-wife pay all the out-of-pocket expenses and then have my business reimburse those expenses through a 105 plan so that I'm at least getting the benefit of deductibles, prescriptions, etc. on my Schedule C?
- **Question 3.** My accountant and I debated for a while about filing two Schedule Cs. With two Schedule Cs, do the expenses have to be pro rata between the income I earn as a W-2 statutory employee and the income from my 1099 securities business? That's how we filed in 2018, but we couldn't find any definitive answer from the IRS. Any information you have would be greatly appreciated.

Answer

First, thanks for the accolades on the tax course.

Second, the answers here will likely make you smile more.

Creating the Best Section 105 Deduction

With the Section 105 medical plan done properly, you will deduct 100 percent of your family's medical expenses, including copays, deductibles, and the entire cost of the health insurance that the company takes from your commissions.

Here's how to deal with all the medical expenses and get them into a position where they are business deductions:

- **Step 1.** Have your spouse reimburse you for the cost of insurance that's taken from your statutory income. Also have your spouse reimburse you for any other expenses you pay personally. The goal is to get all the family medical expenses for insurance, out-of-pocket, etc. into your spouse's separate checking account.
- **Step 2.** Write a business check to reimburse your spouse for all the medical expenses, which she will submit to you on an expense reimbursement request form.

See Good News for 105 Plans for why we recommend that your employee-wife reimburse you for the health insurance costs taken from your commission income.

For the big picture on the 105 plan, see Blueprint for Employee-Spouse 105-HRA (Health Reimbursement Arrangement).

Two Schedule Cs Required

As to the Schedule Cs, you must file one for your W-2 statutory income and another for your 1099 securities income. Page C-5 of the Schedule C instructions states:¹

If you had both self-employment income and statutory employee income, you must file two Schedule Cs. You cannot use Schedule C-EZ or combine these amounts on a single Schedule C.

You will receive the most benefit from your Section 105 medical reimbursement plan if you can claim the expenses against your 1099 income because that will reduce your self-employment taxes.

But more than likely, your spouse is helping you in both your 1099 business and your statutory employee business, and that requires some type of allocation of the expenses. Gross income is the most common allocation method.

But perhaps the time your spouse spends on each business would give you a better result for the Section 105 plan allocation. If so, use the time-allocation method for the Section 105 expenses.

¹ 2018 Instructions for Schedule C, dated Nov. 16, 2018, p. C-5.
