



Tax Reduction Letter

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CCA 200524001

This Chief Counsel Advice responds to your request for assistance dated March 18, 2005 regarding I.R.C. § 162(l). In accordance with I.R.C. § 6110(k)(3), this advice may not be used or cited as precedent.

ISSUES

1. Whether a self-employed individual who is a sole proprietor may deduct, pursuant to I.R.C. § 162(l), insurance costs for the medical care of the sole proprietor and his or her spouse and dependents from the earned income derived from his or her trade or business when the health insurance policy purchased by the sole proprietor is issued in his or her individual name and not in the name of the sole proprietor's trade or business.
2. Whether a self-employed individual may aggregate the profits and losses of two or more businesses to establish the net income ceiling up to which he or she may claim insurance costs deductions under I.R.C. § 162(l).

CONCLUSIONS

1. Yes. A self-employed individual who is a sole proprietor may deduct the medical care insurance costs of the sole proprietor and his or her family from the earned income of his or her trade or business when the health insurance policy purchased by the sole proprietor is issued in his or her individual name and not in the name of the sole proprietor's trade or business.
2. No. Under I.R.C. § 162(l), the health insurance costs deductions must be claimed for a specific plan providing medical care coverage that is established under a specific trade or business and the deductions are limited to the earned income of that specific trade or business.

DISCUSSION

I.R.C. § 162(l)(1)(A) allows an individual who is an employee within the meaning of I.R.C. § 401(c) to deduct amounts paid during the taxable year for insurance which constitute medical care for the taxpayer and the taxpayer's spouse and dependents.

I.R.C. § 162(l)(2)(A) provides that no deduction is allowed to the extent that the amount of the deduction exceeds the taxpayer's earned income (within the meaning of I.R.C. § 401(c)) derived by the taxpayer from the trade or business with respect to which the plan providing the medical care coverage is established. The deductible amount has been limited in the past to certain percentages of the amount paid. But, for the taxable year 2003 and thereafter, 100% of the amount paid is allowed up to the earned income limit. I.R.C. § 162(l)(1)(B). The deduction is further limited in that no deduction is allowed for costs during a month in which the taxpayer is

eligible to participate in any subsidized health plan maintained by any employer of the taxpayer or of the spouse of the taxpayer. I.R.C. § 162(l)(2)(B).

One of the reasons for enacting the § 162(l) deduction was that the existing rules relating to the exclusion from gross income for benefits under employer accident or health plans created unfair distinctions between self-employed individuals and the owners of corporations. Owners of corporations could exclude from gross income health benefits provided by the corporation, whereas no similar exclusion was available to self-employed individuals. See, S. Rep. No. 99-313, 99th Cong., 2d Sess. 666 (1986), 1986-3 (Vol. 3) C.B. 666. The legislative history contrasts the tax benefits available to owners who are corporate employees with the lack of similar benefits for self-employed individuals. Similarly, the deduction was increased in 1998 for taxable years beginning after December 31, 1998 "in order to reduce the disparity of treatment between insurance expenses of self-employed individuals and employer-provided health insurance and to help make health insurance more affordable for self-employed individuals." H.R. Rep. No. 105-817, 105th Cong., 2d Sess. 55 (1998), 1998-4 C.B. 307

When I.R.C. § 162(l) was enacted in 1986, § 162(l)(2)(A) did not limit the taxpayer's earned income to one trade or business. The language "derived by the taxpayer from the trade or business with respect to which the plan providing the medical care coverage is established" was added by section 1011B(b)(3) of the Technical and Miscellaneous Revenue Act of 1988, retroactive to the enactment of § 162(l). I.R.C. § 162(l) also included a provision under which the § 162(l) deduction was not available to any taxpayer for any taxable year unless coverage was provided under one or more plans meeting the requirements of section 89 (nondiscrimination requirements), treating such coverage as an employer-provided benefit. This provision was deleted in 1989 by section 203(a)(4) of Pub. L. No. 101-140, 1990-1 C.B. 207, retroactive to the enactment of § 162(l). The reason for the retroactive deletion was that section 89 was retroactively repealed by the same Act and never took effect.

Thus, the statute has always required that a plan be established under a trade or business. Generally, the earned income from only that trade or business can be considered. However, if the self-employed individual establishes, for instance, a medical plan under business A and a dental plan under business B, the earned income from each business is considered.

Therefore, taking into consideration the limitations under section I.R.C. § 162 (l) discussed above:

1) A sole proprietor who purchases health insurance in his or her individual name has established a plan providing medical care coverage with respect to his or her trade or business, and therefore may deduct the medical care insurance costs for himself, his spouse and dependents under I.R.C. § 162(l) but only to the extent that the cost of the insurance does not exceed the earned income (as defined in I.R.C. § 401(c)) derived by the sole proprietor from the specific trade or business with respect to which the insurance was purchased;

2) A self-employed individual may deduct the medical care insurance costs for the self-employed individual and his or her spouse and dependents under a health insurance plan established for his trade or business up to the net earnings of the specific trade or business with respect to which the plan is established, but a self-employed individual may not add the net profits from all his or her trades and businesses for purposes of determining the deduction limit under I.R.C. § 162(l)(2)(A). However, if a self-employed individual has more than one trade or business, he or she may deduct the medical care insurance costs of the self-employed individual and his or her spouse and dependents under each specific health insurance plan established under each specific business up to the net earnings of that specific trade or business.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

None

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 622-6080 if you have any further questions.

Harry Beker

1 Section 162(l) was originally enacted as section 162(m). It was redesignated as section 162(l) by section 301(b)(3) of the Miscellaneous Revenue Act of 1988. This document refers to the section as section 162(l) both before and after the redesignation.