How to reduce health care costs with taxes

By Frank Sommerville

Frequently ministers complain about rising health insurance costs. This cost is expected to continue rising. While I cannot do anything about these rising costs, there are several ways that the church can help reduce the financial burden its ministers incur to pay health care expenses. This article explores tax breaks for health care fringe benefits.

Pay expenses with nontaxable dollars. The tax code is frequently used by Congress to manage the US economy. Since health care costs have increased dramatically, Congress has enacted several tax breaks to help health care consumers. All these tax breaks work the same way: If you pay health care costs with money that is not subject to tax, it costs less.

For example, to pay a $100 health care expense with wages after taxes were deducted, the individual would typically need to earn $140. On the other hand, if the taxpayer could pay this expense with untaxed wages, the individual would only need $100.

Since Congress wants employers to fund health care expenses, all these methods involve the employer working with the employee to minimize the employee's tax burden. This is why the church must take the steps to create the health care benefits that allow the health care expenses to be paid with untaxed wages.

Health insurance. The church may provide health insurance to its employees with untaxed compensation. Further, federal law requires employers not to discriminate in how they provide health insurance. This means that if the church could pay the full premiums for the minister and his family, while agreeing to pay the premium that covers only the secretary, then the additional premiums represent a discriminatory fringe benefit.

While church plans are exempt from the penalties for operating a discriminatory plan, churches should be wary of unintended tax consequences. Note that some state laws and some insurance companies require all employees to be enrolled and prohibit discrimination. You should check with your tax advisor and insurance agent for the details in your situation.

Medical expense reimbursement plans. Sections 105 and 106 of the Internal Revenue Code allow employers to adopt a plan to reimburse employees their qualifying medical expenses. The reimbursement is tax free to the employee. The plan must be in writing and must not discriminate in favor of the highly compensated employees. The church is the sole funder of the benefits of this type of plan.

The church is free to select the health care expenses it will reimburse and set any limits that it desires.

For example, the church could adopt a plan that reimbursed up to $3,000 of qualifying health care expenses per employee per year. Qualifying health care expenses could include doctor and dentist visits not covered by insurance.

This plan may include reimbursement for all medical expenses that would qualify for a tax deduction, including prescription medicines. For 2011, the IRS approved a plan that includes nonprescription medicines where the physician wrote a written prescription for the nonprescription medicine.

Health care savings accounts. Since 2004, qualifying individuals/employees may setup personal health care savings accounts. These accounts are patterned after the Individual Retirement Accounts. To participate in the health savings account, the individual must be covered by a high deductible health insurance policy. For 2011, a high deductible policy is defined as an insurance policy with a deductible in the amount of $5,950.00 (single), or up to $11,900.00 (family).

Employers/employees may contribute up to $3,050 in 2011 for single employees to the account while employers/employees covering families may contribute up to $6,150 in 2011. Further, if the employee is 55 years of age or older, the contribution may be increased by $1,000. These contributions are tax free. Employees may submit qualifying health care expenses to the account administrator for reimbursement. The reimbursement is tax free.

Further, any amounts left over may be carried forward into future years until reimbursements drain the account to zero. If one withdraws from the account without qualifying documentation, or if the account owners just wants access to the funds for nonmedical reasons before they turn 65 years of age, then a 20 percent penalty will apply to the withdrawal.

Cafeteria plans. A cafeteria plan provides a convenient way for employees to fund their own fringe benefits. The health insurance premiums and the Section 105/106 plans can be funded with employee salary reductions. In addition to these health care expenses, the cafeteria plan can reimburse other qualified expenses, such as child care expenses. The church saves money because the amounts paid into the cafeteria plan by lay employees are not subject to payroll taxes.

First the church must adopt a cafeteria plan that meets all the technical requirements. Second, the employees must sign a form authorizing the salary reduction. The amounts that go into the cafeteria plan are not taxed. This method achieves the same goal as providing the health expense benefits described in the prior paragraphs.

The Internal Revenue Service has made it even easier for churches to adopt a "premium only cafeteria plan." The IRS removed all filing requirements for premium only cafeteria plans. This means that the church can adopt a qualifying plan that reduces taxes without requiring a third party administrator.

None of the tools can be implemented without expert advice. They all have technical requirements. For example, a premium only cafeteria plan will typically run 25 pages. Also, they have continuing requirements that must be met. A church cannot adopt any of these plans and simply forget it.

Frank Sommerville, JD, CPA is a shareholder with the law firm of Weycer, Kaplan, Pulaski & Zuber, P.C., Arlington, TX. ***www.wkpz.com***

Share / Save