

## Understanding Benefits and Tax Implications for Company Owners

Companies are generally permitted to offer employer-sponsored group benefits to owners, and some plans even extend benefits to board members and directors, but there are several things to keep in mind regarding taxation.

### OWNERS DEFINED

When we use the term “owner,” it can mean lots of things. Below are common examples:

- + Sole proprietor
- + Partner in a partnership
- + >2% shareholder in an S-Corp
- + C-Corp shareholder

Many owners, board members, and directors are not considered common law employees. This can impact their ability to participate in employer-sponsored benefits and affect the taxation of any benefits received.

Under §4980H (the “employer mandate”), §125 (cafeteria plan), and §105 rules (self-funded), sole proprietors, partners in a partnership, and >2% S-Corp shareholders are not considered employees.

C-Corp shareholders, directors, or board members who are also not providing services as an employee to a corporation are not considered employees either.

Limited liability corporations (LLCs) can take different organizational forms. When there is an LLC involved, it’s important to understand how the entity has chosen to be taxed – i.e. as a sole owner, partnership, S-Corp, or C-Corp.

### TAXATION

If non-employees (as described above) are permitted to participate in employer-sponsored benefits, they cannot participate on a tax-favored basis in the same way that benefits are treated for tax purposes for regular employees. In addition, those who are not common law employees cannot participate in a Cafeteria Plan, HRA, or Health FSA.



In general, contributions made by non-employees should be made on an after-tax basis, and contributions made by the employer should be treated as additional taxable compensation. It is up to the owner, board member, or director to work with their tax advisors to determine any tax deductions that may apply because they can vary depending on the structure of the organization and the nature of the contributions.

Non-employees are permitted to make contributions to HSAs if they are otherwise eligible (i.e. enrolled in a qualifying HDHP, no other disqualifying coverage, and not claimed as a tax dependent). Any contributions made by the non-employee should be made on an after-tax basis and then may qualify as a deduction when filing the personal tax return.

The taxation of employer HSA contributions varies slightly depending on the type of owner.

See more detail in [IRS Notice 2005-8](#).

The chart below is a quick summary of eligibility and taxation by owner groups.

	GROUP HEALTH PLAN	CAFETERIA PLAN	HRA / FSA
SOLE PROPRIETOR	Eligible (subject to plan eligibility rules), but cannot participate on the same tax-favored basis as employees	Ineligible	Ineligible
PARTNER IN A PARTNERSHIP	Eligible (subject to plan eligibility rules), but cannot participate on the same tax-favored basis as employees	Ineligible	Ineligible
>2% S-CORP SHAREHOLDER	Eligible (subject to plan eligibility rules), but cannot participate on the same tax-favored basis as employees	Ineligible	Ineligible
C-CORP SHAREHOLDER	Eligible (subject to plan eligibility rules), but can participate on the same tax-favored basis only if they are also employees	Eligible to participate only to the extent of any Form W-2 wages (dual status individuals)	Eligible to participate only to the extent of any Form W-2 wages (dual status individuals)
BOARD MEMBER OR DIRECTOR	Eligible (subject to plan eligibility rules), but can participate on the same tax-favored basis only if they are also employees	Eligible to participate only to the extent of any Form W-2 wages (dual status individuals)	Eligible to participate only to the extent of any Form W-2 wages (dual status individuals)

## EMPLOYEE BENEFIT NONDISCRIMINATION RULES

Owners, board members, and directors who are not permitted to participate in employer-sponsored benefits on the same tax-favored basis as other employees are not included in benefit discrimination testing. In other words, the employer could choose to offer more generous benefits or contributions to such individuals without running afoul of the nondiscrimination rules.

§125 contains nondiscrimination rules that restrict an employer’s ability to offer benefits on a tax-favored basis in a manner that discriminates in favor of highly compensated and key employees. However, since owners, board members, and directors are generally not permitted to participate in a §125 cafeteria plan, they are not considered in the §125 discrimination testing.

Similarly, §105(h) contains rules that limit an employer’s ability to provide self-insured health plan coverage on a tax-favored basis in a manner that discriminates in favor of highly compensated individuals. Owners, board members, and directors who are not common law employees and not permitted to participate on the same tax-favored basis as other employees are not subject to §105(h) discrimination testing because different tax rules regulate the tax treatment of their benefits.

## SUMMARY

Plan eligibility rules are often written to include only employees and their family members, although they can certainly be written to include non-employees such as owners, board members, and directors if the carrier is willing to insure such individuals. That being the case, if the employer chooses to offer benefits to such individuals, the employer needs to be careful to handle the taxation of such benefits appropriately based on the type of entity involved.

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## AUTHOR



**MICHELLE CAMMAYO**  
Compliance National Practice Lead

*michelle.cammayo@imacorp.com*