MoneyWise Solutions

Section 105 Plans

Let Us Break It Down For You!

Section 105 plans are a win-win for employers and employees. They offer customizable, tax-advantaged healthcare solutions that improve financial efficiency and employee satisfaction. Whether you're a small business owner or part of a larger organization, Section 105 plans can help you take control of healthcare costs while supporting your team. **Ready to explore your options? Let's make it simple for you.**

WHAT IS A SECTION 105 PLAN?

Section 105 plans are employer-sponsored health reimbursement plans that allow employers to reimburse employees for qualified medical expenses on a tax-free basis. These plans are governed by Section 105 of the Internal Revenue Code (IRC) and can be tailored to meet the specific needs of both employers and employees.

BENEFITS OF SECTION 105 PLANS

Tax Savings

- Employers can deduct reimbursements as a business expense.
- Employees receive reimbursements for qualified expenses tax-free.

Flexibility

- Plans can be customized to cover specific medical expenses, including premiums, copays, deductibles, and more.

Cost Efficiency

- Employers can design plans to manage costs effectively, often reducing the need for high-premium group plans.

Employee Satisfaction

- Providing tax-free health benefits helps attract and retain top talent.

TYPES OF SECTION 105 PLANS

- **Health Reimbursement Arrangements (HRAs):** Employer-funded accounts that reimburse employees for eligible medical expenses, including insurance premiums.
- **Medical Expense Reimbursement Plans (MERPs):** Self-funded plans where employers directly reimburse employees for qualified medical expenses.
- **Accident and Health Plans:** Plans that specifically reimburse for medical expenses related to accidents or health conditions. (These differ from HRAs or MERPs, which can reimburse a broader range of medical expenses.)
- **Qualified Small Employer HRAs (QSEHRAs) and Individual Coverage HRAs (ICHRAs):** Specialized HRAs for small employers or those integrating with individual health insurance policies.
- **Excepted Benefit HRAs (EBHRAs):** Employer-funded accounts providing tax-free reimbursements for limited medical expenses, separate from traditional group health plans.

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SECTION 105 COMPARISON TABLE

The table below provides a summarized overview of the different types of Section 105 plans, outlining their focus, structure, scope, and relationship to group health plans. Please note, this is not an exhaustive list of all benefits but is intended to offer a general understanding. For more detailed information, please refer to the resources provided below.

	FOCUS	STRUCTURE	SCOPE	RELATION TO GROUP HEALTH PLAN
HRA	Reimburse eligible medical expenses, including premiums	Employer-funded, tax-free for employees	Broad, defined by employer, often includes insurance premiums	Can be offered standalone or alongside a group health plan
MERP	Reimburse any qualified medical expenses	Self-funded by employer, flexible design	Comprehensive, includes premiums, copays, deductibles, and out-of-pocket expenses	May complement or replace group health plans
QSEHRA	Reimburse individual premiums and medical expenses	Employer-funded, IRS contribution limits	Limited to premiums and out-of-pocket expenses for small employers	Cannot be offered with a traditional group health plan
ICHRA	Reimburse individual premiums and medical expenses	Employer-funded, no contribution limits, flexible classes	Includes individual health premiums, Medicare, and medical expenses	Designed to integrate with individual health insurance
ACCIDENT & HEALTH PLANS	Reimburse expenses related to accidents or health conditions	Employer-funded, often self-funded	Specific to accident-related injuries or illnesses	Typically supplements group health plans but can also stand alone
EBHRA	Provide tax-free reimbursements for limited medical expenses	Employer-funded, capped at annual IRS limit (e.g., $2,000 in 2024)	Limited to dental, vision, COBRA premiums, and out-of-pocket expenses	Must be offered alongside a traditional group health plan

ADDITIONAL RESOURCES

MoneyWise Solutions HRA Comparison Document

IRS resources:

- IRS Revenue Ruling 2003-102: This document discusses the tax treatment of reimbursements for medical expenses under Section 105(b) of the Internal Revenue Code.
- IRS Revenue Ruling 2005-24: This ruling addresses the tax implications of amounts paid to employees under reimbursement plans that provide for the payment of unused amounts in cash or other benefits.
- IRS Revenue Ruling 2002-41: This ruling examines employer-provided coverage and medical care expense reimbursements made under a reimbursement arrangement that allows unused amounts to be carried forward.
- IRS Tax Code, Regulations and Official Guidance: IRS Official Page on Tax Code, Regulations, and Official Guidance.
- Fringe Benefit Guide: IRS Document that includes information on various employee benefits, including health plans under Section 105.

Section 105 Plans

Accident and Health Plans

SECTION 105 PLAN AS IT PERTAINS TO AN ACCIDENT AND HEALTH PLAN

The IRS allows for an Accident and Health Plan under Section 105 of the Internal Revenue Code. This type of plan is supported by Revenue Ruling 71-588 and Letter Ruling 9409006, and it complies with regulations from government agencies such as the Department of Labor (DOL) and the Employee Retirement Income Security Act (ERISA).

Under these rulings and the Code, a self-employed individual can employ their spouse (if actively involved in the business) and provide them with a medical benefits package. This package can extend coverage to:

- The employee (spouse),
- The employee’s spouse (self-employed individual), and
- The employee's dependents.

TAX BENEFITS

Under a Section 105 Accident and Health Plan, a self-employed individual can deduct 100% of their family's healthcare costs from federal, state, and FICA/Medicare taxes. While standard tax laws typically allow healthcare premiums to be deducted only from federal and state taxes, this plan provides significant additional tax savings by encompassing broader deductions.

Healthcare related costs include:

Health Insurance Premiums:

- Includes medical, dental, and qualified long-term care insurance premiums for eligible employees and their families.

Out-of-Pocket Expenses:

- Covers uninsured medical, dental, and vision care costs for eligible employees and their families.

Additional Insurance Premiums:

- Includes premiums for life insurance, disability income insurance, contact lenses, hearing aids, Medicare Part A, Medicare Supplemental policies, optical/vision, and cancer insurance for eligible employees.

QUALIFIED MEDICAL EXPENSES

Medical expenses included under this type of plan are defined in Section 213(d) of the Internal Revenue Code. In general, medical care includes amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease. Covered expenses typically include, but are not limited to:

- Health Insurance Premiums
- Dental Care Fees
- Hospital Bills
- Deductibles
- Vision Care Fees
- Laboratory Fees
- Physician Fees
- Chiropractor Care Fees
- Orthodontia Costs
- Prescription Costs
- Psychiatric Care Fees
- Medical Supplies Costs

Section 105 Plans

Accident and Health Plans (Continued)

QUALIFIED BUSINESS FILING STATUS

While these rulings focus on family employment in a sole proprietorship, corporations, partnerships, and employers with non-related employees can also implement a Section 105 Plan. Here's how it works across various business types.

Sole Proprietorships
Section 105 works well for sole proprietors who can legitimately employ a spouse actively involved in the business. The employed spouse is treated as any other employee, and the business owner can offer medical benefits as part of the spouse's compensation package.

Partnerships
A partner in a partnership operates similarly to a sole proprietorship regarding Section 105. The partner's spouse must be a bona fide employee to receive plan benefits. However, a partnership between a husband and wife does not qualify for a Section 105 plan.

Limited Liability Companies (LLCs)
The treatment of an LLC under a Section 105 plan depends on how the entity elects to file its federal tax return. LLCs may choose to file as a sole proprietorship, partnership, or corporation, and the applicable Section 105 rules will align with the selected filing status.

C-Corporations
In a C-corporation, it is unnecessary for the owner's spouse to be employed to qualify for benefits. The corporation can provide and deduct benefits for the owner-employee or director. However, to remain compliant with the Internal Revenue Code, DOL, and ERISA regulations, the corporation must have all required plan components properly implemented.

S-Corporations
S-corporations can qualify for a Section 105 plan, but special rules apply to medical benefits provided to 2% or greater shareholders (as defined by Revenue Ruling 91-26 and Announcement 92-16). These rules affect shareholders only, not non-owner employees, who may still realize significant tax savings under a Section 105 plan. The specific tax benefits and compliance requirements depend on the circumstances of each case.

USING SECTION 105 PLANS FOR EMPLOYEE COMPENSATION

The Internal Revenue Code allows self-employed business owners to compensate employees for services rendered in various forms. The most common form is **cash wages**, subject to appropriate withholding taxes. However, the IRS also permits employers to compensate employees through **tax-free medical benefits** as part of their total compensation package.

When combining cash wages and medical benefits, the total must equal what is **considered reasonable compensation** for the job performed. Benefit maximums must be carefully determined to ensure compliance with IRS guidelines.

Example
Jim owns a business and employs his wife, Mary, who provides essential services like bookkeeping, fieldwork, and running errands. Jim formalizes Mary's employment and implements a Section 105 Plan (HRA). He calculates her compensation as follows:

1. **Reimbursement for family health premiums**: $7,000
2. **Reimbursements for uninsured medical expenses:** $5,000
3. **W-2 cash wages:** $2,000

Total Compensation: $14,000
By reimbursing $12,000 in medical expenses under the Section 105 Plan, Jim can deduct 100% of the reimbursed amount for federal, state, and FICA taxes, **saving approximately $4,200 in actual tax dollars.**

NOTE: If Jim's farm files its taxes as a corporation, he would be the employee and a similar tax savings plan could be established without hiring Mary.

Section 105 Plans

Accident and Health Plans (Continued)

PLAN YEAR AND CARRY OVER

Plan Year

Section 105 Plans generally run on a calendar (tax) year, January-December. Tax deductions are then taken during tax filing the following year.

Carry Over

Revenue Ruling 2002-41 allows a Section 105 Plan to include a Carry Over option, enabling employees to roll over unused medical expense account funds to future years. This helps employees manage "shock" healthcare expenses while ensuring future deductions.

The Carry Over applies to all employees in the plan and accumulates on an individual basis. Employers may set a maximum Carry Over limit. Employees retain access to their Carry Over funds until the business ceases, the plan terminates, funds are depleted, or they become ineligible.

MANAGING THE PLAN

The key to a successful Section 105 Plan is establishing legitimate employment between spouses or any other employee. The IRS closely scrutinizes these relationships, so fabricated arrangements are strictly discouraged. To ensure compliance and maximize tax advantages, the following must be in place:

1. A written employment agreement.
2. A log of hours worked by the employee.
3. An established cash (salary) compensation amount and payment schedule.

TAX FILING FORMS

In accordance with Section 105, a spouse can be considered a bona fide employee if they are formally employed and perform legitimate work for the business. To qualify for the benefits of a Section 105 plan, the business owner must treat the spouse as a regular employee and comply with all necessary documentation and employment requirements. The forms required for related employees (such as a spouse) are the same as those required for non-related employees and include the following:

1. **W-2 Form:** Issued annually to report wages and taxes withheld.
2. **W-3 Form:** Filed annually with the Social Security Administration to summarize W-2 information.
3. **I-9 Form:** Completed one time to verify the employee’s eligibility to work in the U.S.
4. **941/943 Forms:** Filed quarterly (or other frequency based on circumstances) to report income and payroll taxes.
   - Form 941 is used for most businesses.
   - Form 943 is for agricultural employers.
5. **Form 940:** Filed annually to report federal unemployment taxes (FUTA) for employees other than spouses. Spouses may be exempt from FUTA, depending on the circumstances.

MoneyWise Solutions provides Section 105 Plan Administration Services, ensuring compliance, maximizing tax savings, and simplifying employee benefit management.

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