

Steps to Saving with the BASE® HRA

Prior to establishing an HRA, the business owner in this situation would only be able to deduct 100% of the family's health insurance premiums on the 1040, which amounts to a federal (15%) and state (5%) tax savings of approximately \$1,200. This same S Corporation would gain a tax advantage by implementing an HRA. Below you will see how enrolling in the BASE® HRA and making a few small modifications can lead to big savings.

Business Owner Facts	
Business Type	S Corporation
Salary	\$36,000
Health Insurance Premium	\$500 per month
Out-of-Pocket Medical	\$250 per month

Step 1

Shareholders must receive W-2 compensation (formal payroll) in order to achieve tax savings using an HRA. The business starts by restructuring the \$36,000 salary to include family health expenses. The monthly salary will stay the same (\$3,000), and is still subject to federal and state income tax. The FICA tax is now calculated on \$2,250 rather than \$3,000 ($\$3000 - \$500 \text{ HIP} - \$250 \text{ OOP} = \$2,250$), increasing take home pay by \$57.38 per month.

Step 2

The business must change the way they report income on the quarterly 941. Previously, the business owner would have reported \$9,000 as subject to Social Security and Medicare tax. With an HRA in place it is now \$6,750, reducing Social Security and Medicare tax. This will result in the business not having to match as much Social Security/Medicare Taxes.

HRA savings are a result of FICA tax savings each pay period based on medical expenses incurred during that period, as well as additional FICA tax savings each quarter, since the corporation will not have to pay matching FICA tax for the medical expenses incurred.

Step 3

The business reports the total \$36,000 W-2 income received by the shareholder on line 7 of the 1120s.

Step 4

The business must also adjust the W-2. The HRA allows shareholder employees to replace a portion of their existing W-2 income with an employee benefit that is not subject to Social Security/Medicare tax (FICA). Box 1 remains the same as in previous years (\$36,000). Boxes 3 and 5, however, are reduced (\$27,000). The business will also report the \$9,000 HRA employee benefit in box 14, as other income, to verify to the IRS that the \$9,000 is not subject to FICA/ FUTA tax.

Additional Information

- It is important that BASE® speaks to individuals handling payroll. This will insure that payroll is being handled properly for HRA documentation and compliance.
- The IRS requires you to have a formal written plan (HRA) in order to receive these savings.
- HRAs are considered non-discriminatory plans and therefore must also be offered to any qualified non-shareholder.
- Shareholder-employees should continue taking a standard self-employment health insurance premium tax deduction on their 1040 (if applicable) while using the HRA.
- HRA savings are a result of FICA tax savings each pay period based on medical expenses incurred during that period, as well as additional FICA tax savings each quarter, since the corporation will not have to pay matching FICA tax for the medical expenses incurred.
- See [Publication 15-B](#) if you are interested in learning more about how employee fringe benefits relate to your BASE® HRA.
- See [Coordinated Issue Papers](#) for more detailed information and clarification on the deductibility of health insurance for the self-employed and the issue of retroactivity and the HRA.

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