

# The Self-Employed Health Insurance Deduction

David M. Fogel, CPA

IRC §162(l)(2)(A) limits the deduction to the net profit from the taxpayer's self-employed business "with respect to which the plan providing the medical care coverage is established."

## INTRODUCTION

The self-employed health insurance deduction allowed by IRC §162(l) (that's a lower case "l") has become one of the most important deductions for small businesses. For the 2022 tax year (the most recent year for which the IRS has published statistics regarding this deduction), 3.7 million individual returns with Schedule C, E or F claimed a total of \$31.5 billion in self-employed health insurance deductions,<sup>1</sup> which is an average of about \$8,500 per return.

Many questions have been asked about this deduction, including:

1. Whether Medicare premiums qualify for the deduction;
2. Whether insurance premiums paid by the spouse who is not self-employed may be deducted;
3. Whether insurance must be purchased in the name of the business;
4. Whether a self-employed individual who also receives wages from an employer is entitled to the deduction;
5. Effect on the deduction if an S corporation's health plan is a qualified small employer health reimbursement arrangement;
6. Whether insurance premiums paid by registered domestic partners in a community property state are deductible; and
7. Whether the self-employed spouse may deduct the payment of both spouses' Medicare premiums when the other spouse is not self-employed.

## LEGISLATIVE BACKGROUND

The self-employed health insurance deduction was first added in 1986 as IRC §162(m), effective for tax years after 1986.<sup>2</sup> At that time, a self-employed taxpayer could deduct 25% of medical insurance

premiums covering the taxpayer, spouse and dependents. The deduction was later moved to IRC §162(l).<sup>3</sup>

Presently, IRC §162(l)(2)(A) limits the deduction to the taxpayer's net profit from the self-employed business for which the medical coverage was established. IRC §162(l)(2)(B) provides that no deduction is allowed if the taxpayer is eligible to participate in any subsidized plan maintained by an employer of either the taxpayer, the taxpayer's spouse, or the taxpayer's dependents. IRC §162(l)(3) provides that if health insurance premiums are deductible under IRC §162(l), then they can't also be claimed for the Schedule A medical deduction. IRC §162(l)(4) provides that the deduction is not allowed for purposes of computing self-employment tax. IRC §162(l)(5) provides that S corporation shareholders can claim the deduction, but it is limited to the shareholder's wages received from the S corporation.

Over the years, legislation has increased the deduction from 25% to 100% of the health insurance premiums paid,<sup>4</sup> and has made the deduction permanent.<sup>5</sup>

## IRS GUIDANCE

Before 1991, there were no precise rules explaining how the deduction worked in the case of partnerships or S corporations. In 1991, the IRS issued guidance to provide these rules.<sup>6</sup> The IRS explained that a partnership's payment of accident or health insurance premiums on behalf of a partner would be treated as a guaranteed payment. The partner would then be entitled to deduct the premiums under IRC §162(l).

The IRS also explained that if an S corporation paid accident or health insurance premiums on behalf of a "2-percent shareholder" (an individual who owns at least 2% of an S corporation's stock on any day of the tax year), then the shareholder would be treated the same as a partner in a partnership in that the S corporation's payment of accident or health insurance premiums on behalf of that shareholder would be treated as a guaranteed payment. The S corporation's payment of the premiums would have to be included in the shareholder's gross income and the shareholder could take a deduction for those premiums under IRC §162(l).

IRC §162(l)(2)(A) limits the deduction to the net profit of the taxpayer's self-employed business if the plan providing the medical care is established in the business. Many taxpayers have asked, "What if the self-employed taxpayer purchased the health insurance policy in his or her name and not in the name of the business?" In 2005, the IRS said that the self-employed taxpayer could purchase the health insurance policy either in his or her own name or in the name of the business.<sup>7</sup>

In the same guidance, the IRS also said that a taxpayer may not aggregate the net profits and losses of two or more self-employed businesses for purposes of determining the limitation on the deduction and may only claim the deduction with respect to the net profit of the specific business for which the coverage is established.

IRC §162(l)(4) provides that the deduction may not be claimed for

**David M. Fogel** is a self-employed tax consultant with over 50 years of experience in tax controversies. David provides tax research and consulting services to other tax practitioners. He is a CPA, EA, and is also admitted to practice before the United States Tax Court. David can be reached at [dfogel@surewest.net](mailto:dfogel@surewest.net) or at <https://fogelcpa.com>.

self-employment tax purposes. In 2006, the IRS said that the deduction may not be claimed as a business expense of the self-employed business.<sup>8</sup> Rather, it is deductible in arriving at adjusted gross income.

In 2008, the IRS provided additional rules for an S corporation.<sup>9</sup> The IRS said that either the 2-percent shareholder could pay the accident or health insurance premiums and be reimbursed by the S corporation, or the S corporation could pay the premiums directly. In either case, the S corporation's payment of the premiums must be included as wages on the shareholder's W-2 form, and the shareholder may take a deduction for those premiums under IRC §162(l).<sup>10</sup> But if the 2-percent shareholder pays the premiums and is not reimbursed by the S corporation, then no deduction is allowable.<sup>11</sup>

Questions have been asked about whether Medicare premiums may be used to claim the deduction. In 2012, the IRS provided the following answers:<sup>12</sup>

1. Premiums for all Medicare Parts qualify for the deduction.
2. A partner in a partnership may pay the Medicare premiums directly and be reimbursed by the partnership or the partnership may pay the premiums directly.
3. A 2-percent shareholder in an S corporation may pay the Medicare premiums directly and be reimbursed by the S corporation or the S corporation may pay the premiums directly, as long as the reimbursement or payment is reported as wages on Form W-2.
4. A sole proprietor must pay the Medicare premiums directly.
5. Medicare premiums paid for coverage of the self-employed individual's spouse, dependent or a child who has not attained age 27 qualify for the deduction.
6. Self-employed individuals who didn't deduct the Medicare premiums paid in a prior year may file an amended return to claim the deduction.

In 2013, the IRS answered 27 frequently-asked questions about individuals who are in registered domestic partnerships, civil unions, or other similar formal relationships that are not marriages under state law.<sup>13</sup> In Q&A-25, the

IRS said that if a registered domestic partner is self-employed and pays health insurance premiums for both partners out of community property funds, only the cost of the self-employed partner's health insurance premiums is deductible under IRC §162(l).

In 2017, the IRS issued regulations to address how the deduction should be coordinated with the Premium Tax Credit.<sup>14</sup> Other than that, no regulations have been issued to provide any additional guidance.

In 2019, the IRS addressed how the deduction could be claimed by a family member of a 2-percent shareholder of an S corporation.<sup>15</sup> The IRS said that if the family member is also a 2-percent shareholder of the S corporation under the stock attribution ownership rules of IRC §318, then the family member may claim the deduction limited to the wage income reported on the family member's W-2 form.

Up until 2023, the IRS provided a worksheet in Pub. 535, *Business Expenses*, for taxpayers to calculate the allowable deduction. Beginning with the 2023 year, the IRS required taxpayers claiming the deduction to file with the return Form 7206, *Self-Employed Health Insurance Deduction*.

## CASE LAW

Several Tax Court cases have addressed whether the deduction is allowable. Some taxpayers deducted the health insurance premiums as a business expense of their self-employed business (as an employee benefit program expense). The Tax Court upheld the IRS's disallowance, and instead, allowed the premiums to be deducted in arriving at adjusted gross income, limited to the net profit from the business.<sup>16</sup> In a few cases, the Tax Court upheld the IRS's disallowance of the deduction because either the taxpayer wasn't self-employed or the IRS determined that the business wasn't engaged in for profit.<sup>17</sup> In other cases, the Tax Court upheld the IRS's disallowance of the deduction in full or in part because the taxpayer was unable to substantiate the amount paid for health insurance premiums.<sup>18</sup>

In summary, these cases have not provided much guidance regarding

the different factual situations in which taxpayers can claim the deduction, which is why many questions remain unanswered.

## UNANSWERED QUESTIONS

Here are some of the unanswered questions:

1. Whether insurance premiums paid by the spouse who is not self-employed may be deducted under IRC §162(l);
2. Whether a self-employed individual who also receives wages from an employer is entitled to the deduction;
3. Effect on the deduction if an S corporation's health plan is a qualified small employer health reimbursement arrangement; and
4. Whether the self-employed spouse may deduct the payment of both spouses' Medicare premiums when the other spouse is not self-employed.

## INSURANCE PREMIUMS PAID BY THE SPOUSE WHO IS NOT SELF-EMPLOYED

Many tax return preparers have taken the position that on a joint return, it makes no difference whether the self-employed spouse or the spouse who is not self-employed pays the health insurance premiums, and that the total premiums paid by both spouses qualify for the deduction.

Although IRC §162(l)(1) states that a self-employed taxpayer may deduct insurance premiums for the taxpayer, spouse and dependents, IRC §162(l)(2)(A) limits the deduction to the net profit from the taxpayer's self-employed business "with respect to which the plan providing the medical care coverage is established." As a result, premiums paid by the spouse who is not self-employed aren't deductible under IRC §162(l) because that spouse has no self-employment income.

This also applies to Medicare premiums. Many tax return preparers have taken the position that on a joint return, Medicare premiums paid by both spouses qualify for the deduction even if only one spouse is self-employed. But there is no

family coverage under Medicare. Each person enrolled in Medicare is covered separately. One spouse's Medicare does not cover the other spouse. As a result, only the Medicare premiums paid by the self-employed spouse are deductible under IRC §162(l).

## SELF-EMPLOYED INDIVIDUAL RECEIVING AN EMPLOYER'S WAGES

Assume that the taxpayer operates a sole proprietorship and also receives wages from an employer. The taxpayer's employer covers the taxpayer under a group health plan where both the taxpayer and the employer pay the insurance premiums. The taxpayer also pays premiums for a supplemental plan to cover the taxpayer's spouse and children. Are the health insurance premiums deducted from the taxpayer's wages deductible under IRC §162(l)?

No. IRC §162(l)(2)(B) provides that the deduction is not allowed if the taxpayer is eligible to participate in any subsidized plan maintained by an employer of either the taxpayer, or of the taxpayer's spouse, or of the taxpayer's dependent. According to the legislative history, a "subsidized health plan" includes a plan where the employer pays for part or all of the health insurance premiums.<sup>19</sup>

As a result, none of the taxpayer's health insurance premiums, including the premiums paid for the supplemental plan, is deductible under IRC §162(l).

## QUALIFIED SMALL EMPLOYER HEALTH REIMBURSEMENT ARRANGEMENT

What if the S corporation's health plan is a qualified small employer health reimbursement arrangement (QSEHRA)?<sup>20</sup> Is the 2-percent shareholder entitled to deduct the premiums paid by the S corporation on the shareholder's behalf that are included as wages on the W-2 form, or is the deduction denied because of the rule in IRC §162(l)(2)(B) that no deduction is allowed if the employee is covered under a subsidized plan?

A QSEHRA is a subsidized health plan.<sup>21</sup> So, if the S corporation's health plan is a QSEHRA, then the shareholder can't deduct health insurance premiums that the S corporation paid on the shareholder's behalf.

## BOTH SPOUSES' MEDICARE PREMIUMS PAID BY SELF-EMPLOYED SPOUSE

Assume that one spouse is self-employed, the other spouse is not self-employed, and the self-employed spouse pays the Medicare premiums for both spouses. Can the self-employed spouse deduct both spouses' Medicare premiums under IRC §162(l)?

The IRS somewhat addressed this in Q&A-25 of the frequently-asked questions described above.<sup>22</sup> In Q&A-25, the IRS said that if a registered domestic partner is self-employed and pays health insurance premiums for both partners out of community property funds, only the cost of the self-employed partner's health insurance premiums is deductible under IRC §162(l).

The self-employed spouse is not liable for the other spouse's Medicare premiums. So, it could be argued that the self-employed spouse's payment of the other spouse's Medicare premiums doesn't satisfy IRC §162(l)(2)(A) that limits the deduction to the net profit from the taxpayer's self-employed business "with respect to which the plan providing the medical care coverage is established."

On the other hand, IRC §162(l)(1) provides that a self-employed taxpayer may deduct the health insurance premiums covering the taxpayer, spouse and dependents. So, why couldn't a self-employed spouse who pays the Medicare premiums of both spouses deduct both spouses' Medicare premiums under this section?

It appears that this question may have to be answered by the IRS or the courts.

## CONCLUSION

IRC §162(l) provides a valuable deduction for small business taxpayers. The rules are not simple. The IRS has answered many questions, but several unanswered questions remain. Hopefully, either the IRS or the courts will answer the remaining questions in future years.

## End Notes

<sup>1</sup> Publication 4801, *Statistics of Income* (Rev. 12-2024), Individual Returns for 2022 (3,716,722 returns claimed \$31,591,197,000 in self-employed health insurance deductions).

<sup>2</sup> §1161(a), Tax Reform Act of 1986 (P.L. 99-514).

<sup>3</sup> §3011(b)(3)(B), Technical and Miscellaneous Revenue Act of 1988 (P.L. 100-647).

<sup>4</sup> 25% (1987-1994), 30% (1995-1996); 40% (1997); 45% (1998); 60% (1998-2001); 70% (2002); and 100% (2003 and after).

<sup>5</sup> §1(a), Self-Employed Health Insurance Act, 1995 (P.L. 104-7).

<sup>6</sup> Rev. Rul. 91-26, 1991-1 C.B. 184.

<sup>7</sup> Chief Counsel Advice 200524001.

<sup>8</sup> Chief Counsel Advice 200623001.

<sup>9</sup> Notice 2008-1, 2008-2 I.R.B. 2.

<sup>10</sup> See Examples 2, 3 and 4 of Notice 2008-1.

<sup>11</sup> See Example 1 of Notice 2008-1.

<sup>12</sup> Chief Counsel Memorandum 201228037.

<sup>13</sup> "Answers to Frequently Asked Questions for Registered Domestic Partners and Individuals in Civil Unions" (8/29/2013), <https://www.irs.gov/newsroom/answers-to-frequently-asked-questions-for-registered-domestic-partners-and-individuals-in-civil-unions>

<sup>14</sup> Treas. Reg. §1.162(l)-1, issued by Treasury Decision 9822, 2017-33 I.R.B. 195.

<sup>15</sup> Chief Counsel Advice 201912001.

<sup>16</sup> *Kirsch v. Commissioner*, T.C. Memo. 1995-451; *Francis v. Commissioner*, T.C. Memo. 2007-33; *Snorek v. Commissioner*, T.C. Memo. 2007-34; *Albers v. Commissioner*, T.C. Memo. 2007-144; *Eyler v. Commissioner*, T.C. Memo. 2007-350; *Frahm v. Commissioner*, T.C. Memo. 2007-351; *Abrego v. Commissioner*, T.C. Memo. 2020-87; *Stephens v. Commissioner*, T.C. Summary Opinion 2008-18.

<sup>17</sup> *Spuler v. Commissioner*, T.C. Summary Opinion 2001-8; *Trudel v. Commissioner*, T.C. Summary Opinion 2002-39; *Thoma v. Commissioner*, T.C. Memo. 2020-67.

<sup>18</sup> *Coury v. Commissioner*, T.C. Memo. 2010-132; *Karkour v. Commissioner*, T.C. Memo. 2010-124; *Mendelson v. Commissioner*, T.C. Summary Opinion 2019-25; *Sellers v. Commissioner*, T.C. Memo. 2020-84; *Larkin v. Commissioner*, T.C. Memo. 2020-70, aff'd per curiam No. 21-1103 (D.C. Cir. 2022); *Sham v. Commissioner*, T.C. Memo. 2020-119.

<sup>19</sup> See Conf. Rept. 99-841, Tax Reform Act of 1986 (P.L. 99-514), 99th Cong., 2d Sess. (Sept. 18, 1986), p. II-538, 1986-3 C.B. (Vol. 4) 538.

<sup>20</sup> Section 9831(d)(1) defines a QSEHRA as an arrangement offered by an employer that has fewer than 50 full-time employees and that does not offer group health plans to any of its employees.

<sup>21</sup> Notice 2017-67, 2017-47 I.R.B. 517, Q&A-56.

<sup>22</sup> See footnote 13.