Moore Financial Strategies
Tax-Saving Tips

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2023 Health Insurance for S Corporation Owners: An Update

Here's an update on the latest developments in 2023 health insurance for S corporation owners. As a more-than-2-percent S corporation owner, you are entitled to some good news when it comes to your health insurance.

To ensure that your health insurance deductions are in order, and to avoid the $100-a-day penalties for violating the rules of the Affordable Care Act (ACA), you should take the following steps:

1. Get the cost of the health insurance on the S corporation's books, either by making the premium payments directly or through reimbursement.

2. Ensure that the S corporation includes the health insurance premiums on the owner-employee's W-2 form, including the additional compensation in box 1 but not in boxes 3 or 5.

3. If you are an owner-employee with more than 2 percent ownership, claim the health insurance deduction as "self-employed health insurance" on line 17 of Schedule 1 of Form 1040. You must meet the two rules of not having access to employer-subsidized health insurance and having adequate salary.

For rank-and-file employees, the S corporation does not have to provide health insurance benefits, but if it does, it must use an acceptable ACA plan, such as (among others) the qualified small employer health reimbursement arrangement (QSEHRA) or the individual coverage HRA (ICHRA).

The S corporation can reimburse more-than-2-percent owners for individually purchased insurance without any penalties, but if it reimburses rank-and-file employees without using the QSEHRA or ICHRA, it faces the $100-a-day penalty per employee.

If you are looking to provide health benefits to employees through the S corporation, there are many tax-advantaged options available. If the S corporation provides group health insurance to all employees, including the shareholder-employee, the same rules apply.

SECURE 2.0 Act Creates New Tax Strategies for RMDs

As you are likely aware, if you have an IRA or other tax-deferred retirement account, you must start taking

required minimum distributions (RMDs) once you reach a certain age.

The SECURE 2.0 Act raises the age at which RMDs must first be taken, from age 72 to age 75, over the next 10 years. Specifically, the RMD age will be 73 for those born between 1951 and 1959 and 75 for those born in 1960 or later.

The purpose of RMDs is to ensure that you use the funds in your retirement accounts while you are still alive, rather than using those accounts as an estate planning device to pass money to your heirs tax-free.

The amount you are required to withdraw as an RMD depends on your age and the balance of your retirement account as of December 31 of the previous year. RMDs are required for traditional IRAs; SEP-IRAs; SIMPLE IRAs; solo 401(k) plans; and all employer-sponsored tax-deferred retirement plans, including 401(k) plans, 403(b) plans, profit-sharing plans, and 457(b) plans.

Your first RMD must be taken by April 1 of the year following the year you reach the age of RMD. For example, if you turn 73 in 2024, you have until April 1, 2025, to take your first taxable RMD. And then, including in 2025 and every year thereafter, you must take an annual RMD on or before December 31.

It's important to note that taking two RMDs in one year could increase your tax bracket and even your Medicare premiums. If you are faced with this situation, it's best to take the first RMD in the year you reach the age of RMD.

In the past, the IRS imposed an "excess accumulation" penalty tax of 50 percent if you failed to take your full RMD by the deadline. But starting in 2023, the SECURE 2.0 Act reduces the penalty to 25 percent. If you correct the shortfall within the "correction window," you can reduce the penalty to 10 percent. The correction window begins on January 1 of the year following the RMD shortfall and ends on the earlier of

- when the IRS mails a Notice of Deficiency,
- when the penalty is assessed, or
- the last day of the second tax year after the penalty is imposed.

If the shortfall was due to reasonable error and you took reasonable steps to remedy it, you may request a penalty waiver by filing IRS Form 5329 and a letter explaining the reasonable error. Before filing the waiver request, you should make a catch-up distribution from your retirement accounts to make up for the RMD shortfall.

Plan Your Passive Activity Losses for Tax-Deduction Relevance

In 1986, lawmakers drove a stake through the heart of your rental property tax deductions.

That stake, called the passive-loss rules, causes myriad complications that now, 37 years later, are still commonly misunderstood.

The Trap

In 1986, lawmakers made you shovel your taxable activities into three basic tax buckets. Looking at the buckets from a business perspective, you find the following:

1. Portfolio bucket for your stocks and bonds
2. Active business bucket for your material participation business activities
3. Passive-loss bucket for your rentals plus other activities in which you do not materially participate

This letter explains three escapes from the passive-loss trap so that you can realize the tax benefits from your rental losses.

Escape 1: Get Out of Jail Free

Lawmakers allow taxpayers with a modified adjusted gross income of $100,000 or less to deduct up to $25,000 of rental property losses. Once your income goes above $100,000, the get-out-of-jail-free loss deduction drops by 50 cents on the dollar and disappears altogether at $150,000 of modified adjusted gross income.

Escape 2: Changes in Operations

If you, or you and your spouse, have modified adjusted gross income that exceeds the threshold, you need a different plan to obtain immediate benefit from your rental property tax losses.

To begin, let's review how the tax-benefit dollars get trapped in the first place. As you may remember, to benefit from your rental property tax loss, you must either

1. have passive income from other properties or another source, or
2. both qualify as a real estate professional and materially participate in the rental property.

Example. Say the taxable income on your Form 1040 is $200,000 and you have one rental property. Say further that rental has produced a tax loss of $10,000 a year for the past six years, none of which you have been able to deduct because you have no other passive income and you do not qualify as a tax-law-defined real estate professional.

So here you sit: $60,000 in tax deductions trapped in the passive-loss bucket—not available for deduction against the income from the other buckets.

Not Lost, Just Waiting

This is sad, no doubt, but there's some good news even in this bucket as you now see it. The $60,000 is not going to drown, disappear, or lose its tax-deduction attributes in some other way. That $60,000 simply waits in the bucket for you to give it an escape route.

Here are four possibilities for the escape route:

1. Generate passive income.
2. Change the character of the rental to non-passive.
3. Change your status to that of a real estate professional, and pass the material participation test for this property.
4. Sell the property, as explained in Escape 3 below.

Escape 3: Total Release

The $60,000 that's trapped in the passive-loss bucket is like money in the bank. You can tap the trap when you want to release the deductions. It's really quite easy.

Here we are talking about releasing the entire $60,000 at once (a major jailbreak). You might want to do this right now, or you can wait. You have many options, and the good news is that you are the one in charge of this total release of your passive losses.

To release the losses, you need to make a complete disposition. For example, say you sell 100 percent of the property to a third party. Presto! You now deduct the entire $60,000 in trapped passive losses.

Takeaway

The one thing to know is that if you have rental property losses that are trapped by the passive-loss rules, you have some strategies available.