December 2018

2018 Last-Minute Year-End Medical and Retirement Deductions

Time's running out on 2018.

Take a few minutes to review the two retirement and four medical tax-reduction strategies in this article.

You might find several thousand dollars (and maybe much more) in your pocket by reading this article. However, you'll need to act now to get the cash.

Big Picture

Here are the six opportunities we will explain in this article:

1. Establish your 2018 retirement plan before December 31.
2. Convert to a Roth IRA.
3. Reimburse your 2018 Section 105 or other health. reimbursement account (HRA) medical expenses now.
4. Implement a qualified small employer health reimbursement arrangement (QSEHRA).
5. Ensure that you take your S corporation health insurance deduction correctly.
6. Claim the tax credit for the health insurance you give your employees.

1. Establish Your 2018 Retirement Plan

First, a question: Do you have your (or your corporation's) retirement plan in place as you read this?

If not, and if you have some cash you can put into a retirement plan, get busy and put that retirement plan in place so you can obtain a tax deduction for 2018.

For most defined contribution plans, such as 401(k) plans, you (the owner-employee) are both an employee and the employer, whether you operate as a corporation or as a proprietorship. And that's good because you can make both the employer and the employee contributions, allowing you to put a good chunk of money away.

In general, your plan document will define when you can make employee or employer contributions that will produce 2018 tax deductions. Make sure you know exactly when you can make (a) employer contributions and (b) employee contributions.

Example. You operate as a one-owner S corporation, and you want an individual 401(k) plan deduction for the 2018 calendar year. You must have an individual 401(k) plan in place on or before December 31 to obtain a 401(k) deduction for this calendar year.

If you have your S corporation 401(k) plan in place on or before December 31, 2018, then you can make your personal employee contribution on or before December 31, 2018. You also can make the employer contribution on or before December 31 or anytime before the 2018 tax return is due, such as on March 15, 2019, or with extensions, say, to September 15, 2019.

2. Convert to a Roth IRA

Consider converting your 401(k) or traditional IRA to a Roth IRA.

If you make good money on your IRA investments and you won't need your IRA money during the next five years, the Roth IRA over its lifetime can produce financial results far superior to the traditional retirement plan's.

You first need to answer this question: How much tax will I have to pay now to convert my existing plan to a Roth IRA? With this answer, you know how much cash you need on hand to pay the extra taxes caused by the conversion to a Roth IRA.

Here are five reasons why you should consider converting your retirement plan to a Roth IRA:

1. You can withdraw the monies you put into your Roth IRA (the contributions) at any time both tax-free and penalty-free because you invested previously taxed money into the Roth account.[1]

2. You can withdraw the money you converted from the traditional plan to the Roth IRA at any time tax-free. (If you make that conversion withdrawal within five years, however, you pay a 10 percent penalty. Each conversion has its own five-year period.[2])

3. When you have your money in a Roth IRA, you pay no tax on qualified withdrawals (earnings), which are distributions taken after age 59 1/2, provided you've had your Roth IRA open for at least five years.[3]

4. Unlike with the traditional IRA, you don't have to receive required minimum distributions from a Roth IRA when you reach age 70 1/2—or to put this another way, you can keep your Roth IRA intact and earning money until you die.[4] (After your death, the Roth IRA can continue to earn money, but someone else will be making the investment decisions and enjoying your cash.)

5. You can continue contributing to a Roth IRA after age 70 1/2.[5]

Here are four reasons why keeping your money in a traditional retirement plan or IRA (versus the Roth IRA) can cost you:

1. You'll generally pay tax and a 10 percent penalty on withdrawals before age 59 1/2.[6]

2. You could owe big taxes when you withdraw your money from your traditional IRA.

3. Once you turn age 70 1/2, the law requires you to start taking out money annually—even if you don't need it or want it.[7]

4. If you die and leave a traditional IRA to your heirs, they could owe big taxes when they take the money from the inherited IRA.

Make sure you have the cash to pay the tax on the conversion to a Roth IRA. Don't invade your existing 401(k) or traditional IRA for the cash to pay the taxes, because that is likely to trigger the double whammy of paying both income taxes and the 10 percent penalty on the invasion.[8]

Planning note. If you are going to have a business loss this year, consider the conversion of your traditional IRA to a Roth IRA as we explain in Five Strategies for Your Business Loss after Tax Reform.

3. Reimburse 105 Expenses Now

If you previously put your Section 105 medical reimbursement plan in place, make sure the reimbursements take place before midnight on December 31 so they qualify as business deductions this year.

For how the 105 medical reimbursement works best, see Blueprint for Employee-Spouse 105-HRA (Health Reimbursement Arrangement).

4. Reimburse the 2018 QSEHRA, and Make Sure You Have It Set Up for 2019

As you know from being a member, if the spouse only 105-HRA will not work for you and you have fewer than 50 employees, the QSEHRA is the nontaxable fringe benefit of choice.[9]

The QSEHRA limits on reimbursements for individually purchased health insurance and out-of-pocket medical expenses are

- $5,050 for self-only coverage and $10,250 for family coverage (2018 limits),[10] and
- $5,150 for self-only coverage and $10,450 for family coverage (2019 limits).[11]

If you don’t have your 2019 plan in place and you want a January 1 start date, the IRS can assess a penalty of $50 per employee for your failure to give written notice to employees at least 90 days prior to the start of the QSEHRA.[12]

(If you want to give your employees the QSEHRA benefit on January 1 and you face the $50-per-employee penalty, bite the bullet and do it. First, $50 is not much. Second, the IRS has to audit, find the problem, and then assess the penalty—your odds of non-detection are good.)

The QSEHRA is a winning compensation strategy for the small-business owner:

- You deduct the reimbursements as a business expense and don’t owe payroll taxes on the reimbursements.
- Your employees pay neither income taxes nor payroll taxes on the reimbursements.

Review Avoid Penalties – Give Notice of 2019 HRA Medical Plan on Oct. 2 for more information on how the QSEHRA works.

5. Comply with S Corporation Rules for Health Insurance Deduction

If you are the owner of an S corporation, make sure you comply with these two requirements before December 31:[13]

1. The S corporation has either paid for your health insurance or reimbursed you for the cost of the insurance.
2. The S corporation includes the cost of your health insurance on your W2.

You still have time to get your S corporation health insurance on both the corporate books and your W-2; however, don't put this off—time is getting short.

If you, the owner-employee of your S corporation, don't run your health insurance premiums through your S corporation, you get no above-the-line deduction on your Form 1040. Instead, you deduct the insurance as an itemized deduction subject to the 7.5 percent of adjusted gross income floor, which can mean either a limited or no deduction for your health insurance.

We go over this and additional issues you need to consider in Update: 2018 Health Insurance for S Corporation Owners.

6. Claim the Health Insurance Tax Credit

Do you now provide health insurance as a fringe benefit to your employees? If so, you may be eligible for the tax credits we first described in How You, the Small-Business Owner, Can Cash In with Tax Credits for Health Insurance on Employees.

If you are an Affordable Care Act–defined small employer and you are about to cover your employees with group health insurance, you can claim a tax credit of 50 percent in tax years 2018 and 2019 (limited to two consecutive tax years).

To qualify for the credit, you must cover at least 50 percent of the cost of single health care coverage for each of your employees.[14]

You earn full credit when you have 10 or fewer full-time-equivalent employees and those employees have average annual full-time-equivalent wages of less than $25,000. If you have more employees and/or the earnings are higher, then the tax law phases out part or all of the credit.

You may not claim the credit on health coverage you give to yourself, your spouse, or other specified relatives.[15]

This is only the big picture, of course, but here are some planning thoughts:

- If you earned the credit but failed to claim it in 2015, 2016, or 2017, file an amended return now.
- If you plan on providing health insurance for your employees and you have not yet done so, you need to hurry so you can earn that 50 percent credit this year. On the other hand, you might want to start in 2019 so you have a full year of payments eligible for the credit.
- The 50 percent tax credit is huge—that's a great incentive, but health insurance is expensive and you get the subsidies for two years only. After that, you're on your own and your cost of health insurance likely will continue to increase.

Takeaways

Here are the six strategies from this article that you can implement before the end of the year to increase your retirement or medical tax deductions:

1. Put your retirement plan in place no later than December 31 so you are absolutely sure that you have a plan. In fact, be sure to make a contribution to the plan before December 31.

2. Convert to a Roth IRA. The long-term savings here can be huge. Make sure to leave the converted funds in the Roth for at least five years.

3. If you have a Section 105 plan in place and you have not been reimbursing expenses monthly, do a reimbursement now to get your 2018 deductions, and then put yourself on a monthly reimbursement schedule in 2019.

4. If you have not reimbursed your QSEHRA, make sure to get that done properly now. If you have not yet put a QSEHRA in place and you plan to do so on January 1, do that now and just suffer that $50-per-employee penalty should you be found out.

5. If you operate your business as an S corporation and you want an above-the-line tax deduction for the cost of your health insurance, you need the S corporation to (a) pay for or reimburse you for the health insurance and (b) put it on your W-2. Make sure that happens before December 31.

6. Claim the tax credit for the health insurance you give your employees. If you provide your employees with health insurance, see whether your pay structure and number of employees put you in a position to claim a 50 percent tax credit for some or all of the monies you paid for health insurance in 2018 and, possibly, prior years.

Client Letter on This Article for Use by Tax Pros. Click Here.

1 Reg. Section 1.408A-6, Q&A-9.
2 Reg. Section 1.408A-6, Q&A-5.
3 IRC Section 408A(d)(2)(A) 2018.
4 IRC Section 408A(c)(5) 2018.
5 IRC Section 408A(c)(4) 2018.
6 IRC Sections 408(d)(1) 2018; 72(t).

7 IRC Section 408(a)(6) 2018.
8 IRC Sections 408(d)(1) 2018; 72(t).
9 IRC Section 9831(d).
10 Rev. Proc. 2017-58, Section 3.56.
11 Rev. Proc. 2018-57, Section 3.62.
12 IRC Section 9831(d)(4).
13 Notice 2008-1.
14 Instructions for Form 8941, Credit for Small Employer Health Insurance Premiums (2017), updated December 6, 2017, p. 3.
15 Ibid, p. 6.