

REDUCING HEALTH CARE COSTS WITH TAXES

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Frequently, ministers complain about rising health insurance costs. This cost is expected to rise another 15% in 2004, nearly doubling in the last 7 years. While I cannot do anything about these rising costs, there are several ways that the church can help reduce the financial burden its ministers incur to pay health care expenses. In December 2003, Congress added another tax tool to reduce health care costs. This article explores tax breaks for health care fringe benefits.

PAY EXPENSES WITH NONTAXABLE DOLLARS

The tax code is frequently used by Congress to manage the US economy. Since health care costs have increased dramatically, Congress has enacted several tax breaks to help health care consumers. All these tax breaks work the same way: if you pay health care costs with money that is not subject to tax, it costs less. For example, to pay a \$100.00 health care expense with wages after taxes were deducted, the individual would typically need to earn \$140.00. On the other hand, if the taxpayer could pay this expense with untaxed wages, the individual would only need \$100.00.

Since Congress wants employers to fund health care expenses, all these methods involve the employer working with the employee to minimize the employee's tax burden. This is why the church must take the steps to create the health care benefits that allow the health care expenses to be paid with untaxed wages.

HEALTH INSURANCE

The church may provide health insurance to its employees with untaxed compensation. Further, federal law allows employers to discriminate in how they provide health insurance. This means that the church could pay the full premiums for the minister and his family, while agreeing to pay the premium that covers only the secretary. Please note that some state laws and some insurance companies require all employees to be enrolled and prohibit discrimination. You should check with your tax advisor and insurance agent to see if you are in one of those states.

HEALTH CARE REIMBURSEMENT PLANS

Sections 105 and 106 of the Internal Revenue Code allow employers to adopt a plan to reimburse employees their qualifying health care expenses. The reimbursement is tax free to the employee. The plan must be in writing and must not discriminate in favor of the highly compensated employees. The church is free to select the health care expenses it will reimburse and set any limits that it desires.

This plan may include reimbursement for all medical expenses that would qualify for a tax deduction, including prescription medicines. Recently, the IRS approved a plan that included nonprescription medicines on the approved reimbursement list.

HEALTH CARE SAVINGS ACCOUNTS

In December 2003, Congress passed the Medicare reforms that included allowing certain employees to set up a personal health care savings account. These accounts are patterned after the Individual Retirement Accounts. To participate in the health savings account, the individual must be covered by a high deductible health insurance policy. High deductible policy is defined with a deductible in the amount of \$1,000.00, or up to \$5,000.00 under certain circumstances.

Employees may submit qualifying health care expenses to the account administrator for reimbursement. The reimbursement is tax free.

CAFETERIA PLANS

All the above methods involve only church funded benefits. For a variety of reasons, this may not always be possible. That is where cafeteria plans enter. A cafeteria plan provides a convenient way for employees to fund their own fringe benefits. The health insurance premiums and the Section 105/106 plans can be funded with employee salary reductions. In addition to these health care expenses, the cafeteria plan can reimburse other qualified expenses, such as child care expenses. The church saves money because the amounts paid into the cafeteria plan by lay employees are not subject to payroll taxes

First the church must adopt a cafeteria plan that meets all the technical requirements. Second, the employees must sign a form authorizing the salary reduction. The amounts that go into the cafeteria plan are not taxed. This method achieves the same goal as providing the health expense benefits described in the prior paragraphs.

In 2002, the Internal Revenue Service made it even easier for churches to adopt a “premium only cafeteria plan.” The IRS removed all filing requirements for premium only cafeteria plans. This means that the church can adopt a qualifying plan that reduces taxes without requiring a third party administrator.

CAVEAT

None of the tools can be implemented without expert advice. They all have technical requirements. For example, a premium only cafeteria plan will typically run 25 pages. Also, they have continuing requirements that must be met. A church cannot adopt any of these plans and simply forget it. My firm stands ready to assist your church in developing the best, most tax efficient benefit package for church. My email address is fsommerville@nonprofitattorney.com.