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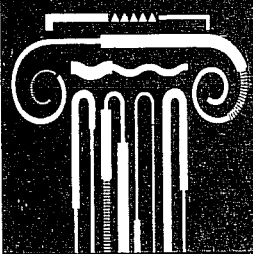
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# FINANCIAL

# ADVISOR

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## GREATER ROCHESTER



# FINANCIAL

# ADVISOR

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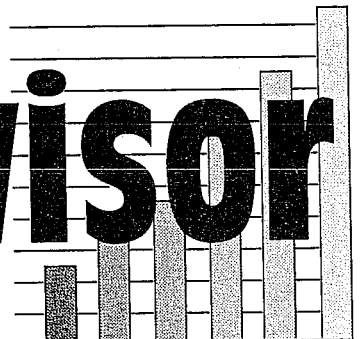
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## BUFFALO



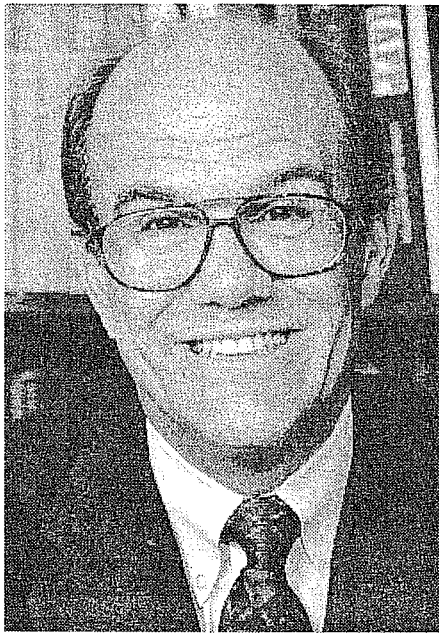
# Financial Advisor

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*Special New Year's Kickoff Event*



Douglas K. Hyer

# New Tax Laws Open Doors Of Opportunity In Business Market

by Douglas K. Hyer, AEP, CFS, ChFC, CLU, CSA, MSFS, RFC

*The full amount of health insurance premiums is now tax-deductible for virtually all businesses. This has positive implications across-the-board, but especially for a special product tailored to executives and key employees.*

A new federal tax law that became effective January 1 makes Group Excess Medical Reimbursement policies (GEMPs) – currently available from only a few companies – even more attractive and valuable.

These are policies that reimburse many of the costly exclusions and limitations found in primary health plans. They cover a wide-range of out-of-pocket health care services, including medical, hospital, surgical, dental, psychiatric and pharmaceutical.

Heretofore, only the large C-Corporations were permitted to deduct 100% of health insurance expenses, including insurance premiums, under Section 162 of the IRS Code. Other forms of businesses – S-corporations, partnerships, LLPs and sole proprietorships – had limitations.

The premiums had to be passed through to the individual business owners, who could then adjust their gross incomes. The adjustment allowed was 60% in 2001 and 70% in 2002. The remainder was allowed as a medical deduction on 1040 Schedule A if it exceeded 7.5% of adjusted gross income when added to the other deductible medical

expenses.

Now all this is gone. Now, any type of business can deduct 100% of its health insurance premiums. This opens a door of opportunity for you to sell GEMPs, which allow business owners, executives and selected employees to:

- Provide payment for expenses not covered by primary insurance;
  - Select who is to be covered (as few as two individuals);
  - Manage cash flow more effectively;
  - Offer a tax-favored compensation incentive to selected key employees;
- and
- Turn limited or uncovered after-tax expenses into fully-covered benefits, using tax-deductible premium dollars.

**Benefits** paid under a fully-insured Medical Reimbursement Policy are non-taxable as income to the owner or executive. Furthermore, the insurance premium paid by the business is deductible as a business expense. Benefits paid under a medical reimbursement policy are usually defined as any legitimate expense under IRS Code Section 213. (See box.) *continued on following page*

## Common Legitimate Expenses Under IRS Code Section 213

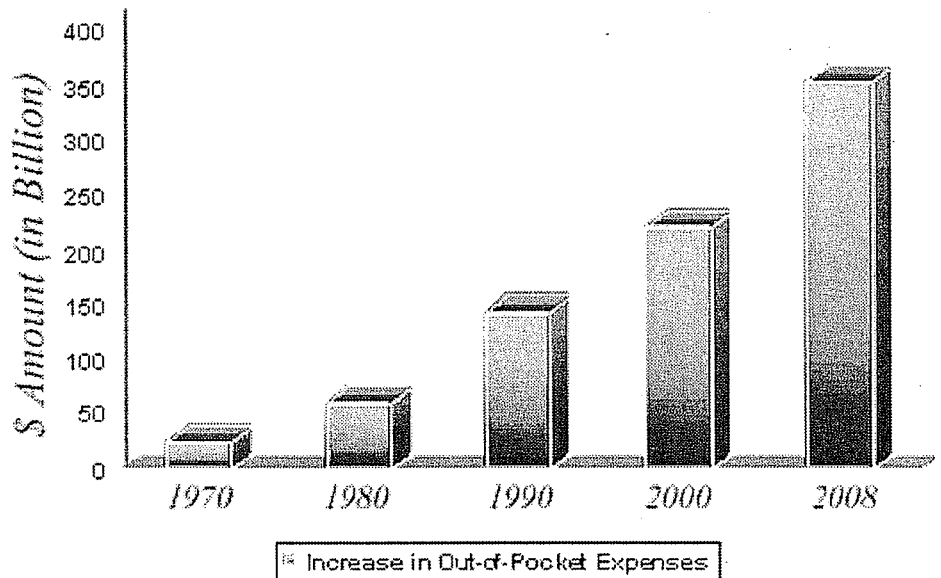
- √ Out-of-Pocket Medical Expenses
- √ Co-Insurance Payments
- √ Prescription Drug Costs
- √ Deductibles
- √ Out-of-Network Expenses
- √ Dental
- √ Orthodontia - Eye Care
- √ Long Term Home & Nursing Care
- √ Private Duty Nursing
- √ Drug & Alcohol Rehabilitation
- √ Chiropractic/Acupuncture Costs
- √ Physical & Occupational Therapy & Rehabilitation
- √ Medically Supervised Weight Loss Programs
- √ Infertility
- √ Experimental Treatments
- √ Lasik Surgery
- √ Plastic Surgery
- √ Well Baby Care Benefits
- √ Custodial & At-Home Services
- √ Sanitarium & Convalescent Care
- √ Special Education Services & Materials
- √ Cutbacks in Reasonable & Customary Benefits

A typical medical reimbursement plan would fully cover some expenses far out of the reach of normal health plans, including out-of-network doctors and even such things as:

- The doctor says your client needs to swim three times a week. The plan would cover the cost of installing and maintaining a swimming pool.
- Your client does a lot of public speaking and needs to improve his appearance. The plan would cover a drug to grow hair or plastic/cosmetic surgery.
- Your client is hyper-active; can't sleep at night. The plan would cover sleeping pills.

In effect, expenses that heretofore had to exceed 7.5% of adjusted income before they could be deducted on a personal return can now be deducted by using corporate dollars to turn a non-deductible expense into a deductible one to benefit business owners, executives and selected key employees.

Since 1981, the nondiscrimination rules of the Internal Revenue Code (Sec. 105(h)) have prevented employers from establishing self-funded medical reimbursement plans for just a few highly-compensated employees. However, no federal laws or rules prevent an employer from setting up a *fully insured* medical reimbursement plan for a few key employees only. Such a benefit plan that is part of a Group Insurance Arrangement (GIA) is exempted from the requirement to file a form 5500 if a consolidated form 5500 was filed for all plans offered by the employer. A schedule



F (Fringe Benefit Plan Annual Information Return) is still required for Section 125 plans as part of the 5500 form.

The new tax law and the resulting new attention it is bringing to medical reimbursement policies calls for a review of the rising cost of health care in the U.S.

Much of it stems from Americans living longer.

We are better educated and informed about our own medical, dental and mental health. We have more available and affordable access to health care providers and treatment, including the modern medicine that has produced an aging population that is larger and healthier. The proliferation of health insurance over the past 50 years has encouraged middle-income Americans to seek treatment sooner and more frequently. Government-subsidized programs such as Medicare and Medicaid have brought expensive care to those

with lower incomes.

Still, out-of-pocket health care expenses represent a big chunk of our overall cost of living. In 2000, Americans spent an estimated \$236 billion out-of-pocket for health care. By 2008, these expenses are estimated to rise by another \$150 billion to \$386 billion. (See chart above.)

To make matters worse, only those medical expenses representing over 7.5% of an individual's adjusted gross income are tax deductible (1040 line 36, Schedule A, line 28).

For example, with an annual income of \$100,000, only expenses over \$7,500 are deductible. If uninsured medical expenses amount to, say, \$17,500 (not uncommon), only \$10,000 is tax-deductible. For one in a federal tax bracket of 31% and an estimated state tax of 9%, a total of only 40% is deductible. Thus, only \$4,000 would be saved out of the \$17,500. (See IRS Publication 502 – Medical and Dental expenses.)

These high out-of-pocket expens-

es result from a variety of situations including office visits to specialists and out-of-network physicians, co-payments, deductibles, routine annual physicals and prescription drugs. They are escalated further if an ongoing condition requires continuous treatment (See box below.)

Out-of-pocket expenses also result from cutbacks in the reimbursement

## Out-of-Pocket Health Care Expenses Rise With...

- √ pre-existing conditions
- √ infertility treatment
- √ experimental treatment
- √ alcohol and drug rehabilitation
- √ occupational & physical therapy
- √ private duty nursing
- √ special education services
- √ expenses for disabled child
- √ orthodontia and dental implants
- √ dental expenses without dental insurance coverage
- √ excess cost of psychiatric care and visits
- √ uncovered chiropractic treatments
- √ acupuncture
- √ artificial limbs, eyeglasses & hearing aids
- √ wheelchair & maintenance
- √ guide dog expense
- √ nutrition & medically prescribed weigh loss programs
- √ birth control pills & other methods, abortions
- √ medically necessary massages
- √ some spa's facial treatments
- √ smoking quitting classes

### PLAN COMPARISON

Section 125	GEMPs (Section 105(h))
Administered	Insurance Plan
Payroll deduction plan	Non-contributory plan (employer pays full premium)
Must be offered to all employees (can't be carved out)	Can be given to select employees (carved out by class)
May not be top heavy	Executive class can have larger benefits
Use it or lose it	Possible refund, if money is not used

for "reasonable and customary" charges and procedures. Ask a claimant, health insurance agent and a carrier what is "reasonable and customary" and you'll get three different answers – and numbers.

For businesses, the most common way out of this dilemma is the Cafeteria Plan (or Flexible Spending Account, FSA), based on IRS Code Section 125. But this must be offered to all employees; it does not give the option to offer enhanced benefits exclusively to a small, selected group of employees such as owners and key executives.

A Group Medical Reimbursement policy does. (See Plan Comparison box.)

Benefits to executives are limited and restricted. Business owners and executives are advised to contact their insurance agent/broker and

corporate financial planner, along with their accountants and legal advisors.

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***Disclaimer:** No warranty is made as to tax information in this article except as a guide solely to assist the reader's qualified tax advisor. While the information presented is believed to be accurate and up-to-date at the time of publication, questions regarding tax issues should be referred to the appropriate tax advisor. Consulting the [www.irs.gov](http://www.irs.gov) website is also suggested. IRS instructions for tax forms 1040, 5500 and publication 502 are important resources for current tax information.*

*Special thanks to Richard J. Weinstein, Vice President, and John W. Baldwin, President of The First Rehabilitation Life Insurance Company of America for their technical and editorial assistance in the preparation of this article.*

#### **PUBLISHER'S NOTE:**

**The First Rehabilitation Life Insurance Company of America is one of the few carriers offering Group Excess Medical Reimbursement Insurance. See folder insert in this magazine.**