

Small Business Owner HSA Contribution Guide



Purpose: This Guide identifies some of the tax issues of health insurance and Health Savings Accounts (HSAs) for Small Business Owners: sole proprietors, partners, LLC members and >2% shareholders of S-Corporations. HSA Resources [Employer Funding Guide](#) covers HSA contribution issues for employees. HSA Resources [Employer Guide](#) covers other issues for employers considering HSAs. Please consult with your tax or legal counsel. HSA Resources does not provide tax or legal advice.

Overview

HSA contributions and health insurance payments for employees are usually deductible expenses for most businesses however, HSA contributions and Health Insurance payments made on behalf of Small Business Owners are subject to different rules. Further, the specific treatment varies depending on the particular form of organization; sole proprietorship, LLC, partnership or S-corporation. A high level overview of the treatment for each organization is discussed further below.

Sole Proprietors

Sole proprietors are treated similarly to individuals making HSA contributions on their own, the sole proprietor may deduct the amount of their HSA contributions and health insurance payments on their personal income tax. Sole proprietors are not allowed to deduct their own HSA contributions as a business expense; however, amounts contributed on behalf of employees may be deductible on their Schedule C. The owners HSA contribution is not a deduction attributable to the self-employed individual's trade or business so it is not taken as a deduction on Schedule C, nor is it taken into account in determining net earnings from self-employment on Schedule SE.

Partnerships, LLC's and S-Corporations

Partnerships, LLC's¹ and S-corporations are generally treated as flow through entities for purpose of HSA contributions made on behalf of the owners. That is, HSA contributions and health insurance payments benefiting the owners are not deductible by the business but flow through to the owner.

Partnerships and multiple member LLCs^{2,3} Contributions on behalf of partners by the partnership are treated as distributions to the partners (under §731), they are not deductible by the partnership and do not affect the distributive shares of partnership income and deductions. The contributions are reported as distributions of money on Schedule K-1 and the partner can then take a deduction for the HSA contribution on their personal income tax return. Contributions made pursuant to a Section 125 plan will be added back to the owners as a taxable fringe benefit negating any tax benefit they might have otherwise received from a Section 125 plans.

Note – an exception exists for Guaranteed Payments⁴ to partners, if the partner is entitled to a Guaranteed Payment from the partnership, then a special rule applies. The HSA contributions are still not treated the same as contributions to other employees. These contributions are deductible by the partnership (under IRC §162) and are includable in the partner's gross income. The contribution is also reported as a Guaranteed Payment on the K-1. The partner can then deduct the HSA contribution on his or her personal income tax return.

>2% shareholders of S-corporations – anyone that owns more than 2% of an S-corporation is regarded as an owner of the corporation with regards to HSA contributions. This means the rules above under partnership apply to employer HSA contributions to anyone owning 2% or more of an S-corporation. Plus, they can not make pre-tax contributions to their HSA via a salary reduction. Any contributions made on their behalf by the corporation are taxable and they may be deducted on their personal income tax.

Notes:

1. LLC tax treatment varies state by state, check with your tax counsel for determination of the treatment that applies in your state.
2. Single member LLCs are treated the same as sole proprietors.
3. Does not include multiple member LLCs that have elected to be treated as a corporation.
4. Guaranteed Payments as defined in section 707(c) include contributions by a partnership to a partner's HSA for services rendered to the partnership (See IRS Notice 2005-8 Q&A 2 for further details). Guaranteed payments to partners are reported on the partner's K-1, are not excludable from the partner's gross income and HSA contributions of eligible individuals may be deducted from the partner's personal income tax return.

Learn More or Open an HSA. Go to www.HSAResources.com and review the [Employer Resource Center](#) for more information. See also HSA Resources' Employer Guide. HSA Resources, 1010 West St. Germain St. , St. Cloud, MN 56302. Questions? Call 866.757.4727, extension 2 or 4 or e-mail employer@hsaresources.com.

Sole Proprietor - Example

J's Pizzeria is a sole proprietorship with 5 employees. This year Jay, the owner, decided to pay \$2,500 towards the insurance costs of himself and each of employees as well as up \$2,000 towards everyone's HSA (for eligible individuals).

The contributions that Jay makes for his own expenses are included on his Form 1040 in the Adjusted Gross Income Section (see Form 1040 example). Note: self-employed health insurance deductions may be limited based on net income, see the IRS' Self-Employed Health Insurance Deduction Worksheet for further details.

The contributions that Jay makes on behalf of his employees are included in Jay's Schedule C Line 14, Employee benefit programs (see Schedule C example). In this case Jay would have \$12,500 in employee related insurance expenses and \$10,000 in HSA contributions for a total \$22,500.

Form 1040

Adjusted Gross Income	Description	Amount	Form Reference
23	Educator expenses (see page 29)		23
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ		24
25	Health savings account deduction. Attach Form 8889	2,000	25
26	Moving expenses. Attach Form 3903		26
27	One-half of self-employment tax. Attach Schedule SE		27
28	Self-employed SEP, SIMPLE, and qualified plans		28
29	Self-employed health insurance deduction (see page 30)	2,500	29
30	Penalty on early withdrawal of savings		30
31a	Alimony paid b Recipient's SSN		31a
32	IRA deduction (see page 31)		32
33	Student loan interest deduction (see page 33)		33
34	Tuition and fees deduction (see page 34)		34
35	Domestic production activities deduction. Attach Form 8903		35

Schedule C (Form 1040)

Part II Expenses. Enter expenses for business use of yr			
8	Advertising	8	
9	Car and truck expenses (see page C-3)	9	
10	Commissions and fees	10	
11	Contract labor (see page C-4)	11	
12	Depletion	12	
13	Depreciation and section 179 expense deduction (not included in Part III) (see page C-4)	13	
14	Employee benefit programs (other than on line 10)	22,500	14
15	Insurance (other than health)	15	
16	Interest:		
16a	a Mortgage (paid to banks, etc.)	16a	
16b	b Other	16b	
17	Legal and professional services	17	

Partnership - Example

Bob's Copy Shop is a partnership with 2 employees. A and B, are equal partners in the business. This year Bob's decided to contribute \$1,500 towards everyone's insurance plus \$500 towards everyone's HSA.

The implications of offering the benefits to the employees are covered our [Employer Funding Guide](#).

The contributions by the partnership to the partner's HSA are not treated as contributions by the partnership to an employee so they are not deductible by the partnership. Instead the contributions are treated as distributions to the partner (shown on Line 19 to the right), not affecting distributive shares of the partnership income which may then be carried forward as a deduction on the partner's individual income tax. The payments for health insurance would be shown on as a deduction for health insurance (shown on Line 13 to the right).

Schedule K-1 (For Partner A)

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items			
1	Ordinary business income (loss)	15	Credits & credit recapture
2	Net rental real estate income (loss)		
3	Other net rental income (loss)		
4	Guaranteed payments		
5	Interest income	16	Foreign transactions
6a	Ordinary dividends		
6b	Qualified dividends		
7	Royalties		
8	Net short-term capital gain (loss)		
9a	Net long-term capital gain (loss)		
9b	Collectibles (28%) gain (loss)		
9c	Unrecaptured section 1250 gain	17	Alternative minimum tax (AMT) items
10	Net section 1231 gain (loss)		
11	Other income (loss)		
		18	Tax-exempt income and nondeductible expense
12	Section 179 deduction		
13	Other deductions	19	Distributions
M	1,500	A	500
		20	Other information
14	Self-employment earnings (loss)		

13. Other deductions

A Cash contributions (50%)	See Partner's Instr. (Form 1065)
B Cash contributions (30%)	See Partner's Instr. (Form 1065)
C Noncash contributions (50%)	See Partner's Instr. (Form 1065)
D Noncash contributions (30%)	See Partner's Instr. (Form 1065)
E Capital gain property to a 50% organization (30%)	See Partner's Instr. (Form 1065)
F Capital gain property (20%)	See Partner's Instr. (Form 1065)
G Cash Contributions (100%)	See Partner's Instr. (Form 1065)
H Investment interest expense	Form 4952, line 1
I Deductions—royalty income	Schedule E, line 18
J Section 59(a)(2) expenditures	See Partner's Instr. (Form 1065)
K Deductions—portfolio (2% floor)	Schedule A, line 22
L Deductions—portfolio (other)	Schedule A, line 27
M Amounts paid for medical insurance	Schedule A, line 1 or Form 1040, line 29
N Educational assistance benefits	See Partner's Instr. (Form 1065)
O Dependent care benefits	Form 2441, line 12
P Preproductive period expenses	See Partner's Instr. (Form 1065)
Q Commercial revitalization deduction from rental real estate activities	See Form 8582 Instructions
R Pensions and IRAs	See Partner's Instr. (Form 1065)
S Reforestation expense deduction	See Partner's Instr. (Form 1065)
T Domestic production activities information	See Form 8903 instructions
U Qualified production activities income	Form 8903, line 7
V Employer's W-2 wages	Form 8903, line 13
W Other deductions	See Partner's Instr. (Form 1065)

19. Distributions

- A Cash and marketable securities
- B Other property