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MERPs: Medical that benefits the solopreneur

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What is the biggest concern for small business owners, sole proprietors and basically anyone in business? The rising cost of health care and health benefits.

Most real estate brokers, as small business owners, know if you pay for your own health insurance you can deduct it as an adjustment to income on your tax return. And if you itemize deductions, you can deduct any un-reimbursed medical and dental expenses... as long as it totals more than 10% of your adjusted gross income. NOTE: if your broker provides group healthcare, the portion you contribute to pay for benefits is tax-deductible. Unreimbursed expenses are not.

You probably didn't know that with some planning, you can write off medical bills as business expenses and pay those expenses using pre-tax instead of after-tax dollars.

How? By setting up a Medical Expense Reimbursement Plan (MERP) or Section 105 Plan.

A MERP is an employee benefit plan and requires an employee to be valid. If you operate your business as a sole proprietorship, partnership, LLC, or S-Corp, you're considered self-employed, not an employee. BUT, you can hire your spouse and be eligible for a MERP; if you're not married, you can qualify by setting up a C-Corp.

There is an exception if you are an S-Corp and own more than 2% of the stock. Then, you and your spouse are both considered self-employed and will need to use another source of income, not taxed as an S-Corp, as the basis for your MERP.

Hiring your spouse gives you the employee needed to make the plan work. Employees covered under a MERP can be reimbursed for any medical expenses incurred by themselves, their spouse, and their children. So even though you're considered self-employed, your expenses can qualify because you're the spouse of an employee.

Complicated? Here's a simple example: You're a real estate broker operating as an LLC, so you're considered self-employed. You hire your husband. Even if he has another job, he's still an employee, not self-employed... so he qualifies. As the spouse, your expenses are now deductible - and so are your children's.

It may sound convoluted, but that's how the tax law works.

MERPs also cover un-reimbursed medical and dental expenses. Say your health insurance covers 80% of a $100 procedure; you're still on the hook for $20. Under a MERP you can be reimbursed for the $20 you owe; the company in effect pays the bill using pre-tax dollars instead of the after-tax dollars you would have spent.

Here's a summary of covered expenses:

* Employee portion of medical and dental insurance (if the employer pays a percentage of the insurance cost);
* Co-pay and deductible amounts;

* Major medical, long-term care, Medicare, and "Medigap;"
* Dental care, braces, vision care, and chiropractor visits;
* Fertility treatments;
* Non-prescription medicines and supplies (with prescription or letter from the doctor);

Essentially, if it's health-related it's probably covered.

The true power of the MERP is when pre-tax dollars comes into play. You're already paying for check-ups, prescriptions, emergency care, etc., right? With some planning you can easily pay with pre-tax instead of after-tax dollars and reduce the impact rising healthcare costs on your bottom line.

Due to the implementation of the Affordable Care Act (ACA) it is more important than ever that you use a competent tax advisor to help you comply with the IRS and ACA requirements.

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