



## Tax Reduction Letter

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### Announcement 92-16

FICA Taxation of Health Insurance Premiums for 2%-Shareholder-Employees of S Corporations

February 3, 1992

In response to taxpayer questions, this Internal Revenue Service announcement is intended to clarify the social security and Medicare tax treatment of accident and health insurance premiums paid by an S corporation on behalf of 2%-shareholder-employees.

On April 15, 1991, the Service published Revenue Ruling 91-26, 1991-1 C.B. 184, regarding employer-provided accident and health insurance for S corporations and 2%-shareholder-employees. Revenue Ruling 91-26 indicates that amounts paid by an S corporation for accident and health insurance covering a 2%-shareholder-employee must be reported as wages on his or her Form W-2, Wage and Tax Statement.

Revenue Ruling 91-26 does not directly address the treatment of the amounts for such purposes. The Service has been asked whether these amounts are wages for purposes of social security and Medicare taxes. The facts presented in the ruling are insufficient to ascertain whether tax would be imposed in these circumstances. A basic analysis is provided below to assist taxpayers.

Like other employees of an S corporation, 2%-shareholder employees are subject to social security and Medicare taxes on "wages" paid to them by the corporation. The term "wages" generally includes fringe benefits provided in cash or in kind to an employee. However, under section 3121(a) of the Code certain payments are expressly excluded from "wages" for purposes of social security and Medicare taxes.

Section 3121(a)(2)(B) excludes from wages certain amounts paid by an employer to or on behalf of an employee (including amounts paid by an employer for insurance, annuities, or into a fund) for medical and hospitalization expenses in connection with sickness or accident disability. For this exclusion to apply, the payments must be made under a plan or system for employees and their dependents generally or for a class (or classes) of employees and their dependents. Thus, whether amounts of this type are actually subject to social security or Medicare tax depends on whether in the particular case the taxpayer satisfies the requirements for the exclusion.

If the requirements for the exclusion under section 3121(a)(2)(B) are satisfied, amounts paid by an S corporation for accident and health insurance covering a 2%-shareholder-employee are not wages for social security and Medicare tax purposes, even though the amounts must be included in wages for income tax withholding purposes on the 2%-shareholder-employee's Form W-2. On the other hand, if the requirements for an exclusion are not satisfied, amounts paid by an S corporation for accident and health insurance covering a 2%-shareholder-employee must be

included in wages for social security and Medicare tax purposes, as well as for income tax withholding purposes, and reported in the appropriate boxes on the 2%-shareholder-employee's Form W-2.

The principal author of this announcement is Gregory Stull of the Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations). For further information regarding this announcement contact Gregory Stull on (202) 566-4747 (not a toll-free call).