

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. A separate [Employer Funding Guide](#) covers HSA contribution issues for employees and a separate Small Business Guide covers issues for small business owners. Please consult with your tax or legal counsel. This is not 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.

