

# TLC Plan Services LLC

## FAQ/Blog/Solutions

### 1) How can you help us if we are being audited by the IRS?

by Tom Luker on 09/07/15

*We were called a few months ago by a client that they are being audited by the IRS for their 2013 Schedule F sole prop business return. They are a Christmas tree "choose and cut" farm in Wisconsin.*

- **What might trigger an audit?** All kinds of things. TLC, a one-employee Schedule C business, was audited twice because of about 47,000 business automobile mileage.
- **What does an audit due to mileage have to do with a MERP?** Well, while they were probing into my Schedule C return, the auditor, located in San Diego, said "While we're with you let's look at your Employee Fringe Benefit line." This is the line in a Schedule C or F where the total MERP expenses are recorded. By the way, the mileage issue was quickly quelled because of my Day-Timer records.
- **"How can you?"** The auditor asked, "How can you have a cost of labor of \$100 and fringe benefits of \$12,000?" I told her that I employ my wife. She said "But you can't do that!" So I told her that she better check with her supervisor and get back to me next week. She did and told me that it's okay to hire a spouse.
- **"But how can you?"** Then she said that it's impossible to pay more in tax-free benefits than you pay in wages. So I again asked her to get to her supervisor and check out that arrangement. Next week's call resulted in, "Yes you can." Side note: Even if it's Joe Lunch Bucket and not your spouse, it's okay.
- **"Show me your paperwork."** The dreaded question. I told her I'll ship the paperwork via PDF to her ASAP. The paperwork included a three-ring Administrative Manual binder and employee folder which TLC prepares for all clients, and an Annual Report to the participating employees summarizing the benefits. All this completes "communication" requirements of ERISA and the DOL.
- **"We find no reason. . ."** A few weeks later, the nicest letter from the IRS was received stating "We find no reason to adjust your last three years of Federal Tax returns. Note that they actually went back the legal three years, even though their initial inquiry was for just 2008!"

### So, what did TLC do for the Christmas tree producer?

- **Provided them with all past MERP records, which they had not been able to find.**
- **This was done even though the client had not paid a service renewal fee since 2007.**
- **The past records might be enough to allay the fears of the IRS. The client has not yet heard the final result, which may come in October or November just when a Christmas tree producer is at their heaviest work load!**
- **Also, TLC is prepared to provide the client with summaries past the year 2007 if the IRS asks for it. We want to do anything to help the client!**

**THIS IS HOW WE BUILD OUR BRAND – TLC Plan Services –**

**"Improving YOUR Bottom Line is OUR Bottom Line"**

**"Caring for You, Your Family & Your Business"**

**Contact us at 888-TLC-PLAN or [tlcplan@outlook.com](mailto:tlcplan@outlook.com) or visit us at [www.tlcplan.com](http://www.tlcplan.com)!**

## **2) Is tax-free health insurance reimbursement still allowed in 2015 under the new rules established by the PPACA?**

by Tom Luker on 09/06/15

***Yes, the Tax Code still allows tax-free reimbursement under the current Internal Revenue Code [IRC]. The following comments are taken from a recent blog dated 08/26/2015 from Christina Merhar of Zane Benefits of Utah, a major TPA.***

- **IRC Section 105:** Allows tax-free reimbursements from a self-insured medical reimbursement plan if the reimbursements are for expenses incurred for “medical care” as defined in Sec. 213(d).
- **IRC Section 213(d):** Defines “medical care” for personal deduction and Sec. 105 distributions.
- **IRC Section 106:** Allows the value of the self-insured medical reimbursement plan to be tax-free to employees.
- **IRC Section 162:** Allows reimbursements to be tax-deductible to the employer as a business expense, for example, on self-employed Schedule C or Schedule F in the “Fringe Benefits” line.

**As you can see, one key piece is a formal [written] self-insured reimbursement plan is used, sometimes called a Healthcare Reimbursement Plan or Section 105 Plan [MERP].**

**Another key piece is that a self-insured medical reimbursement plan is a group health plan. As such, it must also comply with the new Affordable Care Act [PPACA] Market Reforms.**

To reimburse employees tax-free and to avoid costly fees, the reimbursement plan must be designed to comply with the PPACA PHS 2711 and PHS 2713, as well as existing federal regulations ERISA, HIPPA, COBRA, and IRS.

PHS 2713 requires all group health plans to cover basic preventative health services without cost-sharing. To comply, the MERP covers preventative care on an unlimited basis.

PHS 2711 provides that no annual or lifetime limits may be placed on essential health benefits:

- The MERP may not place an annual limit on the basis preventative health services.
- Health insurance premiums are not essential health benefits – so, a premium reimbursement plan can place a “premium-specific” annual limit on premium reimbursements.

**Conclusion: Under current tax code, tax-free reimbursement of individual health insurance is still allowed through a self-insured MERP. The MERP, however, must be structured to comply with the new group health plan reforms. An example of a compliant plan for tax-free individual health insurance reimbursement is a Health Reimbursement Plan [HRP].**

### 3) We employ a nanny to care for our children. Can a MERP be used as part of her compensation? Any advantage to her or us?

by Tom Luker on 05/12/15

*Sure, a domestic employee can be treated just like an EE of any “business,” except that the W-2 issuer is a non-business person, which can have certain expenses connected to any employee's compensation package.*

- The nanny would receive a portion of her comp in the form of a tax-free MERP.
- **For simplicity, a fixed amount of health insurance premium would be best.**
- **The same is true of other domestic workers like lawn care, but usually those type services are provided by a 1099 biz.**
- The advantage is that the EE receives a portion of a “wage agreement” in a tax-free form and thus saves FICA and income taxes which might be 7.65% to 20%.
- **Finally, the family saves FICA and WC taxes, which amount to at least 8% savings.**
- **We provide the same paper work back-up, of course.**

### 4) We are investors in an apartment building. Can we have a MERP when we file a Schedule E and not a Schedule C or F?

by Tom Luker on 05/01/15

*In cases where the husband/wife are listed as joint owners, it's often thought that it's not advisable to hire the other person.*

- Similar to partners not hiring partners.
- **On one hand, spouses who jointly own farms can be hired by the business-owner because whose name is on the top of the Schedule F is the ER and the spouse is the EE. This has been allowed in thousands of cases.**
- **However, both spouses might be listed as names on the Schedule E, then no.**
- But if the Schedule E's business name is “XYZ Properties,” then it would seem that XYZ could legitimately hire a family member to do many tasks involved with running a real estate property.
- **Thus, a MERP can cover any EE of a property as long as Sec. 105 rules are followed.**
- **There's nothing wrong with even hiring Joe Lunch-Bucket and providing benefits in lieu of W-2 wages in the form of a MERP.**
- Oftentimes, other services such as the cleaning or other maintenance issues, outsourced independent contractors can be utilized.
- **While on the subject of outsourcing, or using “independent contractors” rather than W-2 employees [to save payroll taxes] you should seek the advice of your tax professional as to the definitions of an “employee” before you get into trouble.**

One example as to how we helped a farm family several years ago was a “Heritage Farm” over 150 years in the same family. When they told us they were an LLC, we asked, “How many members?” When they said, “15,” we said “Whoa, who are they?” The LLC members were the parents and all of the children and grandchildren, done so to preserve the Heritage Farm in the family as a forever entity. Of course they couldn't set up a MERP unless the LLC was taxed as a corporation, which it wasn't – just multiple partners. **We then asked the father if he had any other business interests, which he did. They were a few apartment buildings and an office building. He said he had a non-related partner in those enterprises, and that his wife did the books for them. Easy family MERP there.** When we asked if his real estate partner was married, he answered in the positive, but that his partner's wife was not involved such that she could be employed. We asked, “Could she be trained to be ‘useful?’” The answer was, “Yes.” So a 2-EE MERP was established. The other adult kids in the Heritage Farm was another project that we're working on.

## 5) Can a MERP be beneficial with a minor child that earns a large income?

by Tom Luker on 05/01/15

*Several examples come to mind:*

- **If you actually perform employable services to your child [other than just feeding or changing diapers for the baby model,] the child's enterprise could hire you. A MERP can cover EEs like any business, and the beneficiaries will be all persons on your joint IRS 1040.**
- If you work as your child's agent [for that NFL-bound hunk or that American Idol singer] you might be employed as a W-2 EE. In that case, does the child's enterprise have other EEs?
- Whether your child is still a "dependent" on your IRS 1040 will affect the benefits accruing to the child.
- If your child is self-employed, such as many artists/athletes are, then that person can also establish a MERP if it fits. Then you and/or the child's spouse can be EEs as well as others.

## 6) How do I use a MERP when I'm not married?

by Tom Luker on 05/01/15

*We have consulted in a variety of situations like this, such as same-sex partners or others living together but not married, and thus are not on the same joint tax return.*

- If you are a solo operator, you can incorporate as a C-Corp or S-Corp, making yourself an EE. Incorporating has a more complicated record-keeping, so it's up to you and your tax/legal adviser if that's the route to take. Same answer if you have a few EEs.
- **We once did a seminar to a large Women Business Owner Association and the question was posed by a lady, "Do I have to be married to make this work?" I responded, "Yes." She said "I'll be darned if I'm gonna get married again!" My response, "Then that's not the reason to get married!"**
- In cases where two persons are "life partners" [male-female or same-sex] and not married, the corporate track might be recommended. However, if each person owns a biz, filing a Schedule C or F, then they could hire each other, assuming legitimate employable services are provided.
- **Also, if you just have a good friend [not a life partner], you can hire each other as described above.**
- Currently, in many states same-sex marriage is legal, and the IRS along with the states allow the joint tax filing. Thus, a simple 1-EE MERP can be great. All regular MERP rules apply.

## 7) Because of excellent advice from our tax professional, we've been employing our children in our Schedule C business. Do we have to set up a MERP for them separately?

by Tom Luker on 05/01/15

*It's great that you are taking full advantage of family employment.*

- **Especially for children under age 18 working in a non-corporate business [Schedule C or F.] That even saves FICA payments for the child, and court cases have approved proper employment at age 7. What kid can hardly wait to go out and clean the barn in a dairy farm?**
- When our kids were young we paid them as much as ten cents for each envelope stuffed and stamped.
- There would be no reason to include them in the MERP as long as they are dependents on your tax return. Later, as adults, all of the regular employment and MERP rules apply.

**8) We've recently taken over our family business. My parents have “retired” but still stick their noses in “our” business [actually, we really welcome their help.] Should my folks be employed on a formal basis in order for us to include them in our MERP?**

by Tom Luker on 05/01/15

**Perhaps.**

- This can frequently happen in a family farm where the business might be sold to the kids with them leasing part or all of the land from the folks who still live next door.
- **Or, the parents/grandparents might move to warmer climes and return to help during seasonal periods and/or provide help from afar. They could be legitimately employed and be made part of the MERP.**
- One of our clients is a Christmas tree producer whose dad moved to Texas. The father returned periodically to help. He also provided consultation assistance while in Texas. He could have been included in the MERP.
- **One advantage of growing older is that even the premiums for Medicare that come off the Social Security check are eligible for a MERP.**
- **Some “macro-sized” businesses include continuing benefits for retirees. This can be written into your MERP Adoption Agreement to make it part of a “micro-sized” biz fringe benefit “package” – just be careful that the definition of a “retiree” is clear and is a reward for loyal service.**
- However, you don't want to obligate yourself to expensive obligations in the future for non-family EEs. The Adoption Agreement can be revised annually to fit your needs.

**9) We're a small non-profit [501(c)(3)] organization and don't pay income taxes. Should we do a MERP?**

by Tom Luker on 05/01/15

***Yes. We have several non-profit clients, including charitable organizations, small churches and business associations, all of whom do not pay corporate income taxes, under various categories of the 501 (c)(\_) charter.***

- One big advantage of using a MERP or HRA [Health Reimbursement Arrangement] is that it can help in recruiting good talent, competing against the larger non-profit organizations “big boys” who probably have a Cafeteria Plan/Sec 125/FlexPlan or other benefit formats installed for their employees.
- **Sometimes the only full-time EE of a “micro-sized” non-profit is the executive director, founder, or chief fund-raiser. Key-employee benefits can be important in retention recruitment.**
- Any non-profit organization who provides non-W-2 compensation [such as a 403(b) annuity or a MERP] will save 7.65% FICA and will also save Worker's Comp insurance, which can be at least 1% of payroll or more.
- **The employee will also save income tax plus 7.65% FICA. The result is that the non-profit employer saves about 9% payroll costs while the employee saves a conservative 25% of the amount reimbursed. A WIN-WIN for the ER and EE!**

**10) We've recently had a loss in our business. We're not paying taxes attributable to business profits, so how can a MERP be an advantage? Also, a relative who is just starting a business expects no profit through the initial years – should they use a MERP?**

by Tom Luker on 05/01/15

*The MERP can still be useful, especially if there is other taxable income [earned or unearned] on the front of the 1040.*

- **The business loss can then offset otherwise taxable income and maybe cause little or no income tax due on the entire 1040 tax return.**
- In some cases, a farm could qualify for Farmland Conservation Credits with the lower taxable business income.
- **A true “hobby” business does not legitimately qualify for Sec 105 plan [that might be indicated by several years of very low GROSS revenues.] But if any business is really trying to make a profit, even several years of loss could possibly qualify.**
- **One thing about a MERP or any fringe benefit: don't just implement the plan in profitable years and then “un-implement” in loss years! The IRS takes a dim view of adjusting deductions like that to fit changing years of profit/loss.**
- As always, consult your tax/legal professional to determine what is best for you.

**11) We've been a simple freelancer sole prop Schedule C operation, but now we'll be having an employee, my husband. Will we need to obtain Workers Comp, and do we need payroll help if we use a MERP?**

by Tom Luker on 05/01/15

*You might, but that is for your tax professional, regarding payroll, or your insurance professional, regarding Workers Comp to help you determine.*

- It might be especially helpful to have an outside “payroll department” so you can concentrate on operating the profit end of the business.
- **As additional EEs come on board, it's even more important that you consider payroll help, so all of the IRS complexities are met including, but not limited to, IRS, DOL and State payment schedules.**
- **It's often asked if the spouse-EE needs to be covered for Workers Comp [WC]. States have varied rules, most allowing the spouse to be exempt for the Sole Prop. So you should check your state rules with your insurance professional.**
- TLC's accountant, who is a sole prop, was able to arrange that his wife and daughter, both EEs, in addition to himself, were covered by Workers Comp.
- **He had an accident going into an office-supply store to buy supplies and was fully covered by WC for the bad injuries incurred. Because he was engaged on a business purpose the WC benefits kicked in!**

## 12) We're a business with less than 10 eligible EEs. Why and how should we provide this MERP thing under Section 105, rather than using Section 125, and without increasing overhead?

by Tom Luker on 05/01/15

*First of all, do you need a MERP or HRA to deduct the cost of insurance?*

- No, but you may not be able to afford the entire cost of your EEs health insurance.
- **You might be sharing the cost of health insurance and wish to select a budgeted portion for categories of employees, which can be done with fully insured plans. This allows you to control your insurance costs, regardless of the future size of your company.**
- **You can also go another step, more fitted to a small company like yours, regarding “negotiated” wage changes for EEs which we’ll discuss in a later posting.**
- Also, there’s a big reason why a small or micro-sized family owned business can’t effectively use Sec. 125, since those who are related to the owner are automatically classed as “highly compensated” EEs, sort of like the pension plan definitions, regardless of the actual income of those family owner/employees. Thus they can’t have more than 25% of total plan benefits, which can greatly decrease their use of Sec 125.
- **Sec. 105 has no such rules, as the owners and relatives can have 100% of benefits. We helped a CPA on a case of a 155-EE wreath-making business in Northern Wisconsin with only the seven family/EE C-Corp stockholders being eligible for Sec 105 because they were the only EEs who worked more than seven months per year.**
- **A physical therapy firm that we helped had 13 EEs and was operating as a Schedule C business. The owner was the only male in the business, and his wife was already a full-time EE as receptionist. The referring CPA thought we should use Sec. 125 so that Dependent Care could be used by several of the employees.**
- At the time of the EE orientation meeting, we explained that all the EE needs to do for the Dependent Care qualification is to give us an invoice [even hand-written] which includes the DC provider’s name and SS number.
- **All three of the women who were looking forward to using the DC benefit came back and said none of the DC providers would sign or give out the info!**
- **Guess what, the DC providers were accepting their fees without reporting the income to the IRS! So, \$15,000 of benefits [\$5,000 x 3] were taken off the top of the plan. The owner and his wife were the only ones who had much medical costs [spouses of the other EEs had benefits in other employment] so the total of \$33,000 potential plan usage went crashing to \$18,000 and thus the owner’s \$8,000 was way over the new 25% limit of \$4,500.**
- Solution: We switched to a Sec. 105 plan immediately [since the owner’s brother was a CPA, it was fully understood what the difference was,] and the owner received 100% of the \$8,000 need. Previously they were planning on giving the wife an \$8,000 wage, and she was going to put it all into the Sec. 125 FSA plus insurance. Now she could be given any wage she wanted [maybe \$100?] and given the rest in tax-free benefits.
- **Another example was the Executive Director of the Chamber of Commerce/Visitor’s Bureau of a very popular county in vacation-land, being compensated over \$100,000, thus meeting the normal “highly comp” definition. The staff were few, and many were part-time or seasonal. Therefore, Sec. 125 was not practical, and Sec. 105 fit in perfectly.**
- **Note: Some of the recommendations above may now have to be changed because of the many restrictions placed by PPACA.**

### 13) Will I lose Social Security retirement benefits by lowering FICA deposits or self-employment taxes?

by Tom Luker on 05/01/15

**Not really.**

- We've done hypothetical calculations of a regular employee using \$5,000 of Flex Plan Medical or Dependent Care tax-free benefits. Thus their FICA income is lowered which does lower future benefits.
- **With a \$5,000 lower income, a FICA/SS contribution of about \$620 [12.4% EE/ER] is made. We then "invested" \$620/year. From various age/marital groups we calculated that the difference in Social Security retirement income at age 65 was:**
  - Increased by eight times annual income for an EE age 25, single or married;
  - Increased six times for age 35;
  - Increased five times for age 45;
  - Increased three times for age 55; and even;
  - Increased annual income of two times if the EE began at age 60.
- **Assumption: Using an ROI of 6% during the period accumulation and income withdrawal [not even considering that this might be a Simple IRA or Roth IRA, which increases the advantage] – And still having money left over at age 100.**
- The problem is, "Will you save?" But that is always a problem.
- **The change in benefits is very small, because benefit levels are based on an average 40 years of earning years and not just the last 5 years of earnings, like many people think.**
- **There was no consideration made to the slight changes in potential Survivors Benefits or potential Disability Benefits.**
- Finally, an independent, personally-owned retirement fund will leave a remaining estate value for survivors, whereas the only lump-sum SS benefit is \$255.

**14) I deduct health insurance because of “self-employed” rules on my 1040 and can also deduct OOP expenses on Schedule A. Why do I need a MERP and a TPA? Also, with an HSA I can deduct those deposits on Form 1040 and then make withdrawals tax-free.**

by Tom Luker on 05/01/15

*In many postings we’ve discussed the values of using a formal MERP and an outside TPA.*

- **Regarding the difference between the current Form 1040 deductions that the government has graciously provided [“Vote for me – look what I’ve given you!”], the use of a proper MERP is a BUSINESS deduction rather than a PERSONAL deduction.**
- The 1040 deduction is “above the line”, thus saving only INCOME tax and NOT FICA/SELF-EMPLOYMENT tax or other payroll taxes.
- **The Self-Employment Insurance premium deduction is restricted or eliminated if you or your spouse is offered health insurance through other employment.**
- **The MERP also removes the potential of needing or even using Schedule A “itemized deductions” and thus qualify for the generous Standard Deduction.**
- Also, Schedule A deductions might be affected by the AMT restrictions (discussed elsewhere) and also removes the loss of the first 10% of AGI not being able to be moved at all to Schedule A.
- **Therefore, with the use of the Standard Deduction you indeed get to sort of “double dip” because the Standard Deduction includes an allowance of sorts for medical costs, in addition to mortgage interest and charitable donations.**
- **The bottom line is that if you can treat a “personal” expense as a “business” expense, it’s always better than using only “partial” deductibility on the front of the Form 1040.**
- The advantage of a MERP when an HSA is used is that the HSA deposit can be counted as an “insurance” reimbursement to the EE, thus saving payroll taxes as well as income taxes.
- **An advantage of using a TPA is that changes in rules will be monitored and passed on to clients. Also, TLC Plan Services will refund the Admin fee if taxes saved don’t exceed five times the fee. One of the major TPAs that TLC uses [TASC] guarantees IRS representation in event of an IRS audit and the payment of penalties if the client properly set up the MERP. Any good TPA will also make available to the IRS all paper-work backup.**

**15) Our business is mature and has employed family members. We’re expanding and hiring non-family employees. We’ve deducted the cost of our health insurance and doing the MERP on our own, with a one-page agreement we bought online. Why can’t we do the same?**

by Tom Luker on 05/01/15

*The main question here is “why can’t we use a one-page form we downloaded from the Internet and administer our own MERP?”*

You can, but it helps to use professional help, just as you use a tax professional to advise you on tax matters and keep certain records in order to keep the IRS happy. A good TPA will be sure your plan is current.

- **There have been many changes recently because of the PPACA. If you just have family members as eligible EEs, then a Sec. 105 MERP/HRA can suffice, but if you are adding non-family EEs you might want to add a Sec. 125 Cafeteria/Flexible Spending Account.**
- **Can you have both? Yes, as long as all non-discrimination rules are followed as described in ERISA established in 1974, expanded in 1978 [Flex Plans] and major Sec. 105 changes in 1980.**
- A good TPA will work with your tax professional to be sure your plan or plans are in compliance with little or no increase in overhead.
- **An outside TPA will also help to maintain privacy when employees submit reimbursement requests, a very important part of HIPPA.**
- **Finally, if you’ve been self-administering a “do-it-yourself” MERP/HRA in the past, without any problem, and now have decided to use a TPA, be sure to apprise the TPA how you have been doing it.**

## 16) What kind of court cases or IRS rulings support the use of a MERP or HRA and what expenses are eligible?

by Tom Luker on 05/01/15

*This would be a good time to post a Time Line of IRC Sec. 105:*

- World War II - Wage freezes caused employers to do tax-creative fringe benefit strategies.
- 1954 – [Section 105](#) of the IRC was enacted into law, clarifying a 1918 law and lobbied by General Electric, in order to give extra benefits to its executives.
- 1971 – [Revenue Ruling 71-588](#) was issued. This very important ruling held that a partnership can pay benefits to the spouse of one of the partners, as a bona fide employee of the business, under an “accident and health plan” covering all employees and are (a) excluded from the spouse-employee’s gross income [Section 105(b)] and (b) deductible as an ordinary business expense [Section 162(a).]
- 1974 – ERISA was enacted. ERISA stands for the Employee Retirement Income Security Act of 1974. This law and all future amendments established the rules of employee benefits in general, but was enacted primarily due to the bankruptcy of Studebaker Auto Company when their employees (retired and active) lost all retirement “guarantees.” ERISA presents all of the hoops any size employer (from 1 to > 1,000 employees) must dance through to get satisfactory tax-qualification for tax benefits (both employer and employee).
- Some people call ERISA “Every Ridiculous Idea Since Adam” but the hoops are still “the law” for any employer and even “micro-sized” employers must dance through those hoops!
- 1978 – [Section 125](#) was enacted, of which [Sec. 105](#) was a part (this is the “Flexible Spending Account” – FSA.) This allows the employee to reduce W-2 wages to help pay for eligible insurance premiums or out-of-pocket medical costs. Also, [Dependent Care costs up to \\$5,000 per year is allowed](#). However, one restriction in [Sec. 125](#) is that the owners of the business are automatically classed as “highly compensated” (including the spouse and relatives of the owners.) This class, as a group, can’t have more than 25% of the benefits for the entire employee participants. This restriction is not present in [Section 105](#), which makes it ideal for the “micro-sized” employer.
- 1980 – Non-discrimination rules were applied to [Sec. 105](#), based on ERISA concepts. This was very important in emphasizing the strict following of rules and procedures and having a written plan.
- 1994 – [T.A.M. Letter Ruling 9409006 \(Technical Advice Memorandum\)](#) was issued. This letter ruling, which was applied only to the particular taxpayer, but it established the strong legitimacy of a WRITTEN PLAN providing employee benefits to an employee who happened to be a spouse of the business-owner, who was filing taxes as a sole proprietor under Schedule C of Form 1040.
- 2002, 2003 and 2004 – [Health Reimbursement Arrangement \(HRA\) was enacted into law and Health Savings Account \(HSA\)](#).
- 2004 was the first full year of liberalized definitions of “eligible medical expenses” under [Section 213](#) and [IRS Publication 502](#). “Over the counter” medicines were now included, added to “supplies,” such as contact lens solutions, bandages, etc. Specifically, this brought in such items as aspirin, sinus treatment, pain ointments and many items not requiring a prescription. As in the past, however, such items as vitamins are still excluded, unless required by a doctor’s prescription. Also, any modifications to your home or office, because of illness or disability, should be prescribed by your physician.
- For example, TLC’s accountant has a very bad back and must use a hot tub each night to relax his back so he can sleep well. Therefore, the construction and maintenance of the hot tub/whirlpool were deductible on his Schedule C as a “fringe benefit” for his wife, who is one of his two employees. You guessed it – his other employee is his adult daughter and they are both included in his TLC [Section 105 Medical Reimbursement Plan!](#)
- 2011 – [OTC meds require a prescription, or “Certificate of Medical Necessity” \(CMN\) in order to be included. Supplies, such as bandages, are not restricted – even the hot tub is still okay. Contact TLC to get a CMN.](#)
- 2014 – The first full year of the PPACA (Patient Protection and Affordable Care Act) brings MANY new rules of establishing tax-favored employee benefits which require careful administration of all of the TLC Flexible Employee Benefit plans under the IRS Code [Sec.105, 125](#) and TLC has amended the plans. TLC also utilizes the services of major TPAs in our consultations.
- Finally, see news release [IR-2010-95](#), which also has links to [Notice 2010-59](#), [Revenue Ruling 2010-23](#), and their questions and answers. For a complete list of all eligible as well as non-eligible expenses plus a list of insurance premiums that ONLY can be reimbursed in a [Sec. 105 MERP/HRA](#), go to the [IRS Publication 502](#). Also, a new [Publication 969](#) covers rules for HSAs and HRAs. To receive a “Certificate of Medical Necessity” for your physician, contact us at (888) 852-7526 or e-mail [tlcplan@outlook.com](mailto:tlcplan@outlook.com).

**17) I'm under age 65 and my spouse who operates the business and also works outside our home is over age 65. Will this MERP work for us?**

by Tom Luker on 05/01/15

***Yes, a MERP will work regardless of the age of the business owner or employee.***

- As long as the non-owner spouse can be employed by the biz, any health insurance premiums covering either person that are being paid after-tax are eligible to be reimbursed.
- **An added plus is that the Part A, Part B and Part D of Social Security [Hospital, Medicare and Drug Plan] coming off of the SS check is reimbursable.**
- **This can also be great for the business who can hire their parent or grandparent. We've had some clients whose parents have moved away in "retirement" but come back enough to provide legitimate employment, or actually do employable activities like a "telecommuter."**

**18) I'm a single parent and am operating my business as a sole proprietorship. Can I use a Medical Expense Reimbursement Plan or Health Reimbursement Arrangement?**

by Tom Luker on 05/01/15

***Yes you can, but there are gymnastic exercises you must master. If you can't do the requirements indicated below, then the answer is that you don't qualify.***

- If you're a C-Corp or an LLC electing to be taxed as a C-Corp or S-Corp, you can, because you are your own EE and can give yourself 100% benefits. We'll discuss S-Corp treatment at another time.
- **However, if you're filing a Schedule C or F, you can't "hire yourself" – you just "own the shop."**
- **A MERP is a Flexible "Employee" Benefit. To get a benefit, the person must be an EE. If you are filing a Schedule C or F, or are in a Partnership, then you must have an opportunity for spousal employment. It's an advantage to be married, but certainly not a reason to get married!**
- One solution we set up was a child operating another business, who arranged to hire his mother and set up a MERP/HRA as we've described in other questions.
- **Another example was a single person being hired as an EE in a friend's business and participating in her MERP as comp.**
- **Remember, the "employment" must be legitimate. Services performed and not a sham arrangement. And, the employment doesn't have to be full time, as long as you're eligible according to the Adoption Agreement.**

**19) My husband works outside our home. He also helps me in my business. He has health insurance coverage there that covers our entire family. He pays part of the premium. His ER does not have a Flex Plan so the premiums can't be pre-taxed. Can we use a MERP?**

by Tom Luker on 05/01/15

***Yes. It doesn't make any difference who is the "named insured" for the insurance as long as it isn't already pre-taxed [you can't "double dip."]***

We've worked with many Home Child Care Providers whose spouses do a lot of work in the business [like farmers] and even direct selling representatives [such as Mary Kay Consultants] whose spouses are helping to put together promotional packages, traveling to sales conferences, etc.

- **Also, Long Term Care [LTC] insurance is included for Sec 105 whereas it isn't with a Sec 125 plan [currently].**
- **Other types of insurance that can be included in most Sec. 105 plans [including TLC's] are Term Life Insurance [on the EE, up to \$50,000 coverage,] Dental, Vision, Hospital, Cancer, Accident and Disability Income [on the EE, but if benefits are paid, the income is subject to taxation.]**
- Even Health Savings Account [HSA] deposits can be included as a "business expense" rather than on the front of the 1040. Thus the HSA sort of acts as an added retirement plan if the account does not have to be totally used for OOP expenses. This can be very important to high-income business owners and is free from the evil machinations of the Alternative Minimum Tax [AMT], which tends to surprise hard-working self-employed persons who don't even consider themselves to be in the "top 5%."
- **For further info about the AMT see the Center on Budget and Policy Priorities, [\*"Myths and Realities about the Alternative Minimum Tax."\*](#) Be sure to consult your tax professional for this and other items.**
- **My understanding of the AMT is that it's a special additional tax levied to taxpayers over a certain amount of A.G.I. It impacts those who have a lot of itemized tax deductions, investors with capital gains, parents with several children, business owners and landlords. Those who have been impacted by the AMT or who might be, are very much aware of the AMT. It's sort of a "gotcha" tax.**

**20) What records must I keep so I won't be bothered by the IRS? I've been audited because of high mileage and entertainment costs [I'm a manufacturer's rep,] and I don't want to open any more windows and start flying red flags if it's only to have a MERP!**

by Tom Luker on 05/01/15

***In the past we've discussed having a properly-administered plan and audit protection.***

- Proper records, including ER to EE communications, non-discrimination rules and other rules make it imperative that the business do the MERP/HRA by dancing through all of the same hoops of a 1000-EE business.
- **The turn-key administration procedure provided by a good TPA will give the business the assurance that the plan meets all of the rules.**
- **These rules are outlined by the alphabet soup of the IRS, ERISA and the DOL [Department of Labor.] ERISA stands for the Employee Retirement Security Act of 1974, and all future amendments. Some people think that ERISA really stands for "Every Ridiculous Idea since Adam!" This may be, but they're still THE RULES.**
- One example of how we have helped our clients is with a 1-EE business where the only EE/Spouse was paid a \$100 W-2 wage each December.
- **The total "wage package" of course, was actually enhanced with over \$9,000 of tax-free [not on the W-2] benefits which lowered the taxable profit of Schedule C [increased spendable income to the family.] This really only amounted to about an "hourly" wage of less than \$20, assuming 500 hours of work per year [10 hours weekly on the average.]**
- **In this particular case the client was indeed audited for having over 47,000 automobile miles on his Schedule C and simply had to prove he kept good trip-records in his daily planner. The IRS auditor in San Diego readily approved those records [catch the "proper records" theme.] But she asked the sole proprietor how he could actually hire his spouse?**
- We asked the auditor to go back to her supervisor and see if spousal employment is okay. Next week, the auditor called back and agreed. But then asked how could he have a "Cost of Labor" total of only \$100 and yet an "Employee Fringe Benefits" line of over \$9,000.
- **Again, with our help, the auditor was asked to go back to her supervisor. The third week she called back and said, "Okay, but show me the paperwork!" [Sort of like, "show me the money.]"**
- **So, we sent copies of the three years of paperwork that included enrollment, plan renewals, annual EE communications including reimbursement request approvals, brief job description, etc.**
- The next thing the client received from the auditor was a letter stating, "We see no reason to change your last three years of tax returns!" Good news from the good ol' IRS, indeed! A copy of that letter is in the files at TLC! If you wish to see a copy, we'll send it as the client has given permission.

**21) Even though I operate a one-person business, I've never thought of employing my spouse because he doesn't really get involved. Wouldn't hiring him be illegitimate in order to establish a MERP?**

by Tom Luker on 05/01/15

***Not if the spouse can be "trained" to work in the business, and it doesn't have to be full-time. See our comments elsewhere where we've discussed the eligibility rules in detail.***

- Even 5-10 hours per week of contribution to the business. These duties can include, but are not limited to:
  - Doing some of the books.
  - Answering the phone.
  - Cleaning up after the messy business-owner.
  - Being sure the office has less clutter – that's one of TLC's EE's duties.
  - Keeping track of the owner's schedule.
  - Occasionally contacting the customers to be sure that all's going well and asking for referrals.
- **Even traveling with the ER was a "duty," and the travel to conferences/conventions, etc. added to the average number of hours put in the work. The many Mary Kay Consultants we've helped easily qualified their husbands by their help in putting together presentation baskets, plus the items mentioned above.**
- **Spousal involvement in farming is obvious and for Home Child Care businesses. The husband is already repairing toilets, building shelves, mowing the lawn and shoveling snow, etc.**
- A big advantage of spousal employment can be surprising while traveling, by using per diem meal allowances and other travel costs that the owner cannot take 100%.
- **Finally some business owners [usually husbands] exclaimed that "this is the first time in our married life that I can tell her what to do!"**

**22) We are a fast-food biz that opens in the summer. Our EEs haven't asked us to provide insurance. They're very young, or are covered on spouse's/parent's, or they also work elsewhere and work for us on a part-time, seasonal basis. Won't a MERP be costly?**

by Tom Luker on 05/01/15

*There are different ways to establish your MERP/HRA with legally required eligibility rules. In 1980, the IRS established special "non-discrimination" rules, based on ERISA concepts that were originally established in 1974 and further expanded in 1978 as part of the "Cafeteria Plan"/"Flex Plan" legislation.*

- The 1980 rules were specific to Section 105 MERPs, which until that time the eligibility rules could be limited to "groups" such as "all executive officers" or "all managers or higher." You can imagine how that was discriminatory!
- **Now, the rules of "non-eligibility" consists of the following definitions:**
  - [1] **Part-time employees working less than [ ] hours per week average up to 25 hours per week;**
  - [2] **Seasonal employees completing less than [ ] months per year up to a "safe harbor" seven months;**
  - [3] **Employee's age less than [ ] years of age up to 25;**
  - [4] **Current employees completing less than [ ] months service up to a maximum of 36 months;**
  - [5] **Future employees completing less than [ ] months service up to a maximum of 36 months.**
- **You can see with this legal arrangement, you could limit your plan participation to ONLY those who are:**
  - [1] **More than your definition of "part-time" or;**
  - [2] **More than your definition of "seasonal" or;**
  - [3] **More than your definition of "minimum" age or;**
  - [4] and [5] **Have been employed less than your definition of "loyal" EEs.**
- **In your case you could LIMIT your MERP just to these employees:**
  - **Who work MORE THAN seven months per year or;**
  - **Who AVERAGE more than 25 hours per week or;**
  - **Who are AT LEAST age 25 or;**
  - **Who have been employed by you for at least 36 months.**
- Please note that a major requirement of PPACA now in effect that EEs in a medical plan must be enrolled within 90 days, so the medical/dental/vision MERP is limited to 90 days waiting. Dependent Care [Sec. 129], Commuting [Sec. 132], Tools [Sec. 62] reimbursement plans do not have this element. TLC provides all of those plans.
- **You must remember, that if you have not yet FORMALLY employed your spouse at all in the past [with a W-2 income], you can't start with CURRENT EEs definition of more than 36 months. This is because your spouse would have to wait for three years to come into the plan, but you could use 36 months for FUTURE EEs before they're eligible.**
- **See the above comments regarding EEs who are limited-term, part-time, young or seasonal for strategies. These seasonal businesses can be quite varied, including seasonal-related peak activity like yours and might even be the bed-and-breakfast in a tourist area, tour guides/camps/fishing-hunting guides and the like. We've had interesting solutions that include:**
  - A wreath-making C-Corp in northern Wisconsin who had over 155 EEs. There were seven family stockholders in the business. Of the 155 plus EEs, only the seven stockholders worked more than seven months a year, since the main harvesting, building and shipping of wreaths all over the world was from October through December. These seasonal EEs were not expecting benefits or even wanting benefits and preferred to be paid a good cash wage.
- **Two other examples were restaurants:**
  - **One was a breakfast and lunch cafe with 11 EEs, with the sole proprietor and his wife putting in about 70 hours per week each. The wife had never been formally employed, and she had over \$25,000 uninsured cancer expenses in one year. With none of their other EEs working more than 25 hours per week, she was the only eligible EE. Even though their CPA had asked us to help, the TPA with whom we were working questioned putting \$30,000 as the maximum limit for OOP expenses as "too liberal." We explained that she works almost 80 hours per week and is certainly worth \$30,000 in compensation annually plus a modest W-2 cash wage! Sadly, she died within two years, and the restaurant was sold, but they saved lots of taxes for two years. Their CPA was happy.**
  - One other restaurant-type business was a popular banquet/wedding facility with 55 EEs. Again, the sole proprietor husband formally hired his wife for the first time, and she was the only EE working more than 25 hours per week, including the wait staff, three bartenders and two cooks. In this case, virtually all of the EEs had spouses who worked elsewhere and had generous benefits.
- **The Adoption Agreement can be changed once a year to reflect change.**

**23) I've never employed my wife in a formal sense. Won't a MERP mean a much higher overhead, paperwork and complication for our simple business, which has never had any employees before? Also, wouldn't Administrative Fees offset any tax savings we might have?**

by Tom Luker on 05/01/15

***It might seem to be, or start out to be more complicated, but soon will become routine, even if you are making W-2 wages in a monthly or quarterly mode. As your tax professional will inform you, you'll be filing a Form 941/943 each quarter of compensation.***

- Some of our clients are making spousal wage payments in just one quarter, such as in December. In this case, the IRS has recognized such a method and has provided Form 944 for a one-time submission.
- **This sure makes the one-EE business whose only EE is your loving roommate to be a simple solution.**
- **The question of a slightly higher overhead is greatly overcome by \$2,000, \$3,000, \$5,000 or more of tax savings because of the MERP/HRA, translating to a lower profit on your Schedule C but giving you more spendable/investable income for the sole proprietor family.**
- In these cases it is actually a real advantage to LOWER your PROFITS on your business tax return!
- **Regarding the comparison of the FAMILY tax-savings with the TPA's Administrative Fee, consider the following:**
  - **Assume the business has one EE [the spouse] and the annual TLC fee is \$175;**
  - **In a 25% tax bracket, the medical costs would only have to be \$700** to offset the fee;
  - **In a 30% bracket, it is only \$583;**
  - **In a 50% bracket, it is only \$350;**
  - Usually, the medical expenses [and tax savings] would be several times those amounts.
- **Regarding the comparison of the EMPLOYER tax-savings with the TLC Administrative Fee, consider the following:**
  - **Assume the annual TLC fee for each EE is \$50;**
  - With no [0%] Workers Comp [WC] or Unemployment Comp [UC] – 7.65% FICA – the medical costs would only have to be \$624 to offset the fee;
  - **With low WC/UC – 10% FICA/WC/UC, it is only \$500;**
  - **With HIGH WC/UC – 20% FICA/WC/UC, the employee's medical costs would have to be only \$250.**
  - **Usually, the medical expenses [and tax savings] would be several times those amounts.**
- If you operate a logging or farming biz, the WC costs can be 25% of wages or even more!

**24) We are already into the current tax year. Can we start our Medical Expense Reimbursement Plan or Health Reimbursement Arrangement for this year, dating back to the first of January?**

by Tom Luker on 05/01/15

***If employment of the spouse has already been formalized, it's much easier to provide the benefits retroactively but caution must be exercised. Much depends when you submit the first quarterly report to IRS.***

- First of all, insurance premiums are a known entity and thus the premium reimbursement might be OK going back a few months or even many months.
- **However, the out-of-pocket costs are another matter. There have been IRS court cases settled in favor of the IRS which often has the effect of throwing out the plan for the entire year. One is a famous case involving American Family Mutual Insurance Company [WI] that started a Section 125 "Cafeteria/Flex Plan" late in the year and allowed EEs to put extra dollars into their Flexible Spending Account [FSA] to "catch up" with the expenses they've already incurred.**
- **The IRS correctly determined that the FSA was like an insurance policy where the employer was acting as an insurance company [which curiously, the ER was actually an insurance company!]**
- In a typical insurance policy, you don't just buy the insurance in October and have claims covered that occurred in January! Or, if your house was already burning, could you rush out and buy a policy?
- **Therefore, caution must be exercised. If it's December when you start a plan, just use the OOP costs for that month to qualify [or maybe in the 4th quarter of the year, if you're originally employing your spouse so that the Form 941 can be filed covering at least the immediate past quarter.] This can be the procedure for any initial hiring of the spouse [or ANY employee] for other times of the year.**
- **Insurance premiums, however, might be safely reimbursed retroactively to the beginning of the year.**
- If you've been self-administering a "do it yourself" MERP/HRA in the past, without any problem, and have now decided to use a Third Party Administrator [TPA], because of proper paper-work backup, it should be very safe to start the TPA-administered plan later in the tax year.
- **The TPA should be apprised of when and how you've been doing the MERP and even if you've used another TPA, the new TPA should be aware of the change.**
- **As always, we network with your tax professional when helping to set up a proper Sec. 105 Medical Expense Reimbursement Plan.**

## **25) How do we pay for the medical expenses in a Medical Expense Reimbursement Plan or Health Reimbursement Arrangement? Do we have to have a business account isolated only for this?**

by Tom Luker on 05/01/15

***Some “mom and pop” businesses pay for business costs out of one account, which is also used as one single family joint checking account. However, most tax advisers recommend a business account if you indeed operate a business!***

- In the case of the MERP/HRA you certainly don't need a totally separate account in addition to the general business account [which can often be a joint account] which can be used for MERP/HRA reimbursements [of out-of-pocket costs or insurance premiums], direct payments of medical costs and/or insurance premiums.
- **One major TPA with whom we work, TASC [and for whom we were a Regional Marketing Director in the 1990s] has a free Master Card [Debit Card] that the EE uses for qualified medical expenses and \$1,000 [up to \$2,000 in special cases] is advanced by TASC, and later reimbursed by the business. View a video about this at: [“Learn how the TASC can make the management of your AgriPlanNOW or BizPlanNOW easy.”](#)**
- **There have been some court cases caused by NOT using the business account, where the taxpayer lost, and the cleanest paper trail would be using the business account.**
- Note: In the case of the spouse-EE receiving those reimbursement checks, it's not wise to redeposit the check back in the same “family/business” account. Just deposit the check in the family or personal account, just like a “normal” EE would do, or maybe cash the check.
- **What happens if you don't have enough funds in the business account to cover the reimbursement checks? Some accountants have told us to just not deposit the check, and use only the business bookkeeping to record the MERP for tax purposes. This might come back to “bite the business” if an audit is performed for the benefit of the IRS.**
- **If the actual cashing of the check is recommended without funds to cover, the beneficiary-spouse-EE could provide a “loan” to the business from his/her personal account.**
- This does sound like bookkeeping gymnastics, but the most important aspect is the bookkeeping records and the MERP EE communications rules as stated by ERISA and DOL.
- **We'll discuss reasons for “following the rules” elsewhere in our Blog/FAQ/Solutions.**

## 26) We're a family partnership, with my parents, brothers and sisters. Will a Medical Expense Reimbursement Plan or Health Reimbursement Arrangement work for us?

by Tom Luker on 05/01/15

***A business that is a partnership means that the PARTNERS ARE NOT EMPLOYEES and thus can NOT receive EMPLOYEE BENEFITS.***

- A famous IRS case coming down in 1971 as Revenue Ruling 71-588 was a partnership with one of the partners hiring his wife, who was not a partner. This landmark ruling established that as long as the spouse was a legitimate employee and all eligible employees were covered under an “accident and health plan” it was okay. The benefits also accrued to the husband who was “a member of the family” of the employee.
- **The key here is that the wife was NOT a partner. If your business wants to continue in the partnership mode, and you want to use the advantages of a MERP/HRA, you might look into other business operations under which it might be used, if you have multiple enterprises going in your life.**
- **Finally, you might want to consider terminating the partnership and re-establishing it as a C-Corporation, thus making each stockholder also employees. All of these deliberations need to be made in consultation with your legal and tax professional advisers.**
- Sometimes in multiple-family partnerships, financial gymnastics are necessary. We've helped several farm partnerships where several family members are partners.
  - **One was where the father and four sons were partners in a dairy operation. There were no daughters, and mom had not been previously been a “paid” EE.**
  - **All 5 partners were working 60 plus hours per week. I explained the spousal employment route, but as we were sitting around the large dining room table, each son described his wife's involvement in the business.**
  - Of the three oldest, two wives were already involved either full time or part time on the farm with one working in town. For those three plus Dad, spousal employment was no problem.
  - **I turned to the fourth son and asked, “How about you?” Mom spoke up and said, “He's not married, but we're trying to get him married!” Then she followed up with, “Can you fix him up with some woman in town who wants to come out to the country and live on a dairy farm?”**
  - **I actually did fix him up with a blind date some months later, but nothing developed in the form of romance!**
  - In this case, when the MERP was established, their accountant arranged for their various “profit sharing” amounts at the end of the year to be altered based on the extent of each of their MERP tax-free benefits, from very large to nothing [in the case of the single brother].
  - **This type of accounting/financial “gymnastics” might also be used in any kind of a partnership or even a corporation.**
- **Elsewhere in our Blog/FAQ we discuss “compensation gymnastics.”**

## 27) We're taxed as an S-Corporation. How does a Medical Expense Reimbursement Plan or Health Reimbursement Arrangement affect us?

by Tom Luker on 05/01/15

*In a small way "S" stands for "screwed" or "short-changed" because an employee who owns 2% of stock or more, must "recapture" the EE benefits [including Term Life Insurance and corporately-paid direct Health Insurance premiums (which don't need a full MERP)] on the front of his/her Form 1040.*

- Attribution rules radiate that treatment of "rich corporate owners" [otherwise known as "highly compensated employees"] to all relatives, up or down and sideways.
- **Therefore, even the spouse of the 100% corporate owner can't JUST be hired for the benefits of the MERP.**
  - **Some consolation is available, however, because FICA would be saved on the business and personal side and not just health and term life premiums, but would also include out-of-pocket [OOP] medical costs.**
  - Also, the benefit package would enhance the total "W-2 type" compensation to the owner. Thus this helps to protect that person from the increasing IRS scrutiny of paying the executive less than they "should be" as an S-Corp which usually tries to pass as much income/profits to the owners in the form of a "dividend" free of FICA.
  - **The other consolation is that the health insurance premiums might qualify for the "self-employed" personal deduction on the front of the 1040, and the OOP expenses might be used on Schedule A if they qualify.**
  - **Also, HSA deposits would additionally be an "above the line" deduction on the 1040, as well as saving FICA on the business and personal side.**
- Another solution would be to use another business relationship that might be operated by the members of the family.
  - **In this case, there is another "catch," in that for "controlled" businesses, comparable benefits must be offered in each of the "controlled" operations.**
  - **However, there is no disadvantage to the business owner to offer similar benefits in other controlled entities, because the bottom line of these types of benefits [Sec. 105 MERPs (Medical Expense Reimbursement Plan)/HRAs (Health Reimbursement Arrangement), Sec. 125 "Flex" Plans/"Cafeteria" Plans] are that they should never increase the overhead expenses since payroll taxes and income taxes saved should always exceed the admin costs of providing benefits for employees.**

**28) We hire lots of young people helping collate packets and get out mailings – does this make us more than a “micro-sized” biz, since they number almost 100 different people over the years? Will we have to include them in our Flexible Employee Benefit Plan?**

by Tom Luker on 05/01/15

***There are different ways to establish your MERP/HRA with the legally required eligibility rules.***

- In 1980, the IRS established special “non-discrimination” rules, based on ERISA concepts that were originally established in 1974 and further expanded in 1978 as part of the “Cafeteria Plan”/“Flex Plan” legislation.
- **The 1980 rules were specific to Section 105 MERPs, which until that time, the eligibility rules could be limited to “groups” such as “all executive officers” or “all managers and higher.” Very discriminatory, right?**
  - **The rules of “non-eligibility” now consist of the following:**
    - [1] Part-time employees working less than [\_\_\_\_] hours per week average up to 25 hours per week;
    - **[2] Seasonal employees completing less than [\_\_\_\_] months per year up to a “safe harbor” seven months;**
    - **[3] Employees less than [\_\_\_\_] years of age up to age 25;**
    - [4] Current employees completing less than [\_\_\_\_] months up to a maximum of 36 months; and
    - **[5] Future employees completing less than [\_\_\_\_] months up to a maximum of 36 months.**
  - **You can see with this legal arrangement, you could limit your plan participation to ONLY those who are:**
    - [1] More than your definition of “part-time” or,
    - **[2] More your definition of “seasonal” or,**
    - **[3] More than your definition of “minimum” age or,**
    - [4] and [5] have been employed less than your definition of “loyal” employees.
  - **In your case you could LIMIT your MERP just to:**
    - **Those employees who work MORE THAN seven months per year, or;**
    - Those who AVERAGE more than 25 hours per week or,
    - **Those who are AT LEAST age 25 or,**
    - **Those who have been employed by you for at least 36 months.**
  - You must remember, that if you have not yet FORMALLY employed your spouse at all in the past [with a W-2 income], you can’t start with CURRENT EEs’ definition of more than 36 months, because your spouse would have to wait for three years to come into the plan. But you could use 36 months for FUTURE EEs before they’re eligible.

**29) We are a husband and wife team set up as a two-person LLC taxed as a partnership. Will a Flexible Employee Benefit Plan or a Medical Expense Reimbursement Plan or a Health Reimbursement Arrangement work for us?**

by Tom Luker on 05/01/15

***A two-person LLC, such as you have is usually taxed as a partnership, and partners can't hire partners. Therefore, neither of you are an employee – you just OWN the shop!***

- A famous IRS case coming down in 1971 as Revenue Ruling 71-588 was a partnership with one of the partners hiring his wife, who was not a partner.
  - **This landmark ruling established that as long as the spouse was a legitimate employee and all eligible employees were covered under an “accident and health plan” it was okay. The benefits also accrued to the husband who was “a member of the family” of the employee.**
  - **The key here is that the wife was NOT a partner.**
- If your business wants to continue in the partnership mode, and you want to use the advantages of a MERP/HRA, you might look into other business operations under which it might be used, if you have multiple enterprises going in your life.
- **Finally, you might want to consider terminating the two-member LLC and re-establishing it as a single-member LLC, so you can file a simple Schedule C tax return instead of a Partnership return and then hire your spouse as the only employee, a great “no-brainer” MERP setup.**
  - **As always, seek out counsel from your legal/tax professional before making such a move.**
- If your LLC is being taxed as a C-Corp and both husband and wife are receiving a W-2 wage, then they can both be given fringe benefits.
- **In a different blog/FAQ we'll discuss what would be the situation if the LLC is being taxed as an S-Corp.**