

Owner and Directors Benefits – Eligibility & Taxation

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Companies are generally permitted to offer employer-sponsored group benefits to owners, and some plans even extend benefits to board members and directors, but there are several things to keep in mind in regard to eligibility and taxation.

Owners Defined

When we use the term “owner,” it can mean lots of things. Below are common examples:

- Sole proprietor
- Partner in a partnership
- >2% shareholder in an S-Corp
- C-Corp shareholder

Many owners, board members, and directors are not considered common law employees. This can impact their ability to participate in employer-sponsored benefits and affects the taxation of any benefits received. Under §4980H (the “employer mandate”), §125 (cafeteria plan), and §105 rules, sole proprietors, partners in a partnership, and >2% S-Corp shareholders are not considered employees. C-Corp shareholders, directors or board members who are not also providing services as an employee to a corporation are not considered employees either. Limited liability corporations (LLCs) can take different organizational forms. When there is an LLC involved, it’s important to understand how the entity has chosen to be taxed – i.e. as a sole owner, partnership, S-Corp, or C-Corp.

Eligibility

Plan eligibility rules typically recognize “employees” and their family members as eligible participants. As discussed above, owners, board members, and directors are not often common law employees and therefore, in order to include such non-employees, the plan eligibility rules should be written to permit “owners” or non-employees to participate in the benefit plans (subject to carrier approval). Covering them otherwise risks the carrier’s refusing to provide claim coverage for such individuals.

While plan eligibility rules may include owners, board members, and directors, it’s important to keep in mind that covering non-employees likely creates a multiple employer welfare arrangement (MEWA), although there is an exception when including partners of a partnership. Under a fully-insured plan, that may be okay as long as the carrier is aware and agrees to it, plan documents recognize the MEWA status, and required government filings (e.g. Forms 5500 and M-1) are handled correctly. For a self-funded plan, it can be more complicated because self-funded MEWAs are subject to applicable state law. Some state laws completely prohibit self-funded MEWAs, whereas others have varying requirements in regard to financing, reporting and participation.

Taxation

If non-employees (e.g. owners, board members, or directors) are permitted to participate in employer-sponsored benefits, they cannot participate on a tax-favored basis in the same way that benefits are treated for tax purposes for regular employees. In addition, those who are not common law employees cannot participate in a cafeteria plan, HRA, or health FSA.

In general, contributions made by non-employees should be made on an after-tax basis, and contributions made by the employer should be treated as additional taxable compensation. It is really up to the owner, board member, or director to work with their tax advisors to determine any tax deductions that may apply because it can vary depending on the structure of the organizations and the nature of the contributions.

Non-employees are permitted to make contributions to HSAs as long as they are otherwise eligible (i.e. enrolled in a qualifying HDHP, no other disqualifying coverage, and not claimed as a tax dependent). Any contributions made by the non-employee should be made on an after-tax basis and then may qualify as a deduction when filing the personal tax return. The taxation of employer HSA contributions varies slightly depending upon the type of owner. See more detail in IRS Notice 2005-8 – <https://www.irs.gov/pub/irs-drop/n-05-08.pdf>.

If an owner's spouse or dependents are also employees of the company, the spouse or dependent may generally participate in benefits on a tax-favored basis (subject to the plan eligibility rules). However, spouses and dependents of a >2% S-Corp shareholder are not eligible to participate on a tax-favored basis, even if they are also employees, due to ownership attribution rules.

	Group Health Plan	Cafeteria Plan	HRA / FSA
Sole Proprietor	Eligible (subject to plan eligibility rules), but cannot participate on the same tax-favored basis as employees	Ineligible	Ineligible
Partner in a Partnership	Eligible (subject to plan eligibility rules), but cannot participate on the same tax-favored basis as employees	Ineligible	Ineligible
>2% S-Corp Shareholder	Eligible (subject to plan eligibility rules), but cannot participate on the same tax-favored basis as employees	Ineligible	Ineligible
C-Corp Shareholder	Eligible (subject to plan eligibility rules), but can participate on the same tax-favored basis only if they are also employees	Eligible to participate only to the extent of any Form W-2 wages (dual status individuals)	Eligible to participate only to the extent of any Form W-2 wages (dual status individuals)
Board Member or Director	Eligible (subject to plan eligibility rules), but can participate on the same tax-favored basis only if they are also employees	Eligible to participate only to the extent of any Form W-2 wages (dual status individuals)	Eligible to participate only to the extent of any Form W-2 wages (dual status individuals)

Employer Mandate (§4980H) and Employer Reporting

Owners, board members, and directors who are not common law employees are NOT considered full-time employees and therefore do not require an applicable large employer to offer coverage or report on offers of coverage via a Form 1095-C. Reporting is required for non-employees on a Form 1095 only for those who enrolled in a self-funded group health plan (e.g. in Part III of a Form 1095-C).

Employee Benefit Nondiscrimination Rules

Owners, board members, and directors who are not permitted to participate in employer-sponsored benefits on the same tax-favored basis as other employees are not included in benefit discrimination testing. In other words, the employer could choose to offer more generous benefits or contributions to such individuals without running afoul of the nondiscrimination rules.

§125 contains nondiscrimination rules that restrict an employer's ability to offer benefits on a tax-favored basis in a manner that discriminates in favor of highly compensated and key employees. However, since owners, board members, and directors are generally not permitted to participate in a §125 cafeteria plan, they are not considered in the §125 discrimination testing.

Similarly, §105(h) contains rules that limit an employer's ability to provide self-insured health plan coverage on a tax-favored basis in a manner that discriminates in favor of highly compensated individuals. Owners, board members, and directors who are not common law employees and not permitted to participate on the same tax-favored basis as other employees are not subject to §105(h) discrimination testing because the tax treatment of their benefits is regulated by different tax rules.

Summary

Plan eligibility rules are often written to include only employees and their family members, although they can certainly be written to include non-employees such as owners, board members, and directors if the carrier is willing to insure such individuals. That being the case, if the employer chooses to offer benefits to such individuals, the employer needs to be careful to handle the taxation of such benefits appropriately based upon the type of entity involved.

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