

**Office of Chief Counsel
Internal Revenue Service
Memorandum**

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to: Area Counsel (Mid-Atlantic Area)
(Tax Exempt & Government Entities)

from: Branch Chief, Health & Welfare Branch (Employee Benefits)
(Tax Exempt & Government Entities)

subject: Deductibility of Medicare Premiums Under Code Section 162(l)

This memorandum responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUES

1. Are all Medicare Parts, in addition to Medicare Part B, insurance that constitutes medical care coverage under section 162(l)?
2. Must a self-employed individual pay Medicare premiums directly in order for the premiums to be deductible under section 162(l)?
3. May Medicare premiums be deducted under section 162(l) for the coverage of a self-employed individual's spouse, dependent or child (as defined in section 152(f)(1) who as of the end of the taxable year has not attained age 27)?
4. If the self-employed individual failed to deduct the Medicare premiums in calculating the deduction under section 162(l) for prior years, may the individual file an amended return to claim the deduction?

CONCLUSIONS

1. All Medicare Parts are insurance that constitutes medical care under section 162(l).

2. A partner in a partnership may pay the premiums directly and be reimbursed by the partnership, or the premiums may be paid by the partnership. In either case, the premiums must be reported to the partner as guaranteed payments, and the partner must report the guaranteed payments as gross income on his or her Form 1040. A 2-percent shareholder-employee in an S corporation may pay the premiums directly and be reimbursed by the S corporation or the premiums may be paid by the S corporation. In either case, the premiums must be reported to the 2-percent shareholder-employee as wages on Form W-2 and the 2-percent shareholder-employee must report this amount as gross income on his or her Form 1040. A sole proprietor must pay the Medicare premiums directly.
3. If all the requirements of section 162(l) are satisfied, Medicare premiums may be deducted under section 162(l) for coverage of the self-employed individual's spouse, dependent or a child (as defined in section 152(f)(1) who as of the end of the taxable year has not attained age 27).
4. Self-employed individuals who failed to deduct Medicare premiums for prior years may file an amended return to claim the deduction.

LAW AND ANALYSIS

Section 162(l) allows an individual who is an employee within the meaning of section 401(c)(1) to take a deduction in computing adjusted gross income. Sole proprietors, partners in a partnership, and 2-percent shareholders in an S corporation are employees for this purpose. The deduction in section 162(l) is for amounts paid during the taxable year for insurance that constitutes medical care for the taxpayer, his or her spouse, dependents, or a child (as defined in section 152(f)(1) of the taxpayer who as of the end of the taxable year has not attained age 27).¹ The deduction is not allowed to the extent that the amount of the deduction exceeds the earned income (within the meaning of section 401(c)(2)) derived by the taxpayer from the trade or business with respect to which the plan providing the medical care coverage is established. Also, under section 162(l), the deduction is not allowed for amounts during a month in which the taxpayer is eligible to participate in any subsidized health plan maintained by an employer of the taxpayer or of the spouse of the taxpayer.

Notice 2008-1, 2008-1 C.B. 251, provides guidance on the section 162(l) deduction for 2-percent S corporation shareholder-employees. A 2-percent shareholder-employee in an S corporation, who otherwise meets the requirements of section 162 (l), is eligible for the deduction under section 162 (l) if the plan providing the medical care coverage for the 2-percent shareholder-employee is established by the S corporation. Rev. Rul. 91-26, 1991-1 C.B. 184. A plan providing medical care coverage

¹ The amendment to section 162(l) allowing deduction of health insurance premiums for a self-employed individual's child (as defined in section 152(f)(1) who as of the end of the taxable year has not attained age 27) is effective on March 30, 2010. See Notice 2010-38, 2010-1 C.B. 682.

for the 2-percent shareholder-employee in an S corporation is established by the S corporation if: (1) the S corporation makes the premium payments for the accident and health insurance policy covering the 2-percent shareholder-employee (and his or her spouse or dependents, if applicable) in the current taxable year; or (2) the 2-percent shareholder makes the premium payments and furnishes proof of premium payment to the S corporation and then the S corporation reimburses the 2-percent shareholder-employee for the premium payments in the current taxable year. If the accident and health insurance premiums are not paid or reimbursed by the S corporation and included in the 2-percent shareholder-employee's gross income, a plan providing medical care coverage for the 2-percent shareholder-employee is not established by the S corporation and the 2-percent shareholder-employee in an S corporation is not allowed the deduction under section 162 (l).

As discussed in Notice 2008-1, in order for the 2-percent shareholder-employee to deduct the amount of the accident and health insurance premiums, the S corporation must report the accident and health insurance premiums paid or reimbursed as wages on the 2-percent shareholder-employee's Form W-2 in that same year. In addition, the 2-percent shareholder-employee must report the premium payments or reimbursements from the S corporation as gross income on his or her Form 1040, U.S. Individual Income Tax Return. Thus, for a 2-percent shareholder, and by extension, a partner in a partnership, the shareholder or partner may claim the deduction under section 162(l) only if the requirements of Notice 2008-1 are satisfied.² Sole proprietors must pay the Medicare premiums directly.

Medicare is insurance that constitutes medical care under section 162(l). Therefore, all Medicare premiums are similar to other health insurance premiums and can be used to compute the deduction under section 162(l). This rule also extends to Medicare premiums for coverage of a self-employed individual's spouse, dependent, or child (as defined in section 152(f)(1) who as of the end of the taxable year has not attained age 27).

The instructions to Form 1040 for 2010, p. 28, indicate that Medicare premiums can be used to compute the deduction under section 162(l). The instructions to Form 1040 for 2009 and prior years omit mention of Medicare premiums. Self-employed individuals who failed to deduct Medicare premiums in prior years may file an amended return to claim a refund (subject to the statute of limitations).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

None.

² With respect to employee fringe benefits, section 1372(a) provides that an S corporation shall be treated as a partnership, and any 2-percent shareholder of the S corporation shall be treated as a partner of the partnership. See also Rev. Rul. 91-26, 1991-1 C.B. 184.