

Shareholder health insurance and medical reimbursements

A practical guide for S corporation owners who work in their business

Adopt a written benefit policy and coordinate payments with payroll. Insurance premiums and out-of-pocket medical bills have different tax treatment. A written policy does not make a more-than-2% shareholder's medical benefits tax-free.

1 Start with ownership

These rules apply to a shareholder-employee who owns more than 2% of the stock or voting power at any time during the year. Indirect ownership and family attribution can bring spouses and other family members under these rules. Tell us who owns the company and which family members receive benefits. Owners at or below 2% and nonowner employees require a separate review. [1, 2]

2 Keep premiums separate from medical bills

PAYMENT	CORPORATION AND PAYROLL	SHAREHOLDER'S FORM 1040
Health insurance premiums	Company pays the insurer or reimburses documented premiums. Generally deductible as compensation and included in W-2 Box 1.	May qualify for the self-employed health insurance deduction on Schedule 1, subject to eligibility and limits.
Copays, deductibles and other medical bills	If provided as employee medical benefits, generally taxable compensation reported on the W-2 and potentially deductible by the company.	Not the Schedule 1 insurance deduction. Eligible medical expenses may qualify on Schedule A, subject to itemizing and the 7.5% of adjusted gross income threshold.
Personal owner withdrawals	A payment that is actually a shareholder distribution is not a corporate expense deduction.	Distribution and stock-basis rules apply; do not treat it as deductible insurance compensation merely because the company paid it.

3 Make insurance eligible for the personal deduction

The insurance policy may be in the company's name or the shareholder's name. The corporation must pay the premiums or reimburse the shareholder after receiving proof of payment, and include the amount in the shareholder's W-2 for that same year. Paying personally without company payment or reimbursement generally does not establish the S corporation plan required for this deduction. [1, 3]

The deduction is limited by qualifying earned income from this business. It is unavailable for months when you are eligible for subsidized employer coverage through your own or your spouse's employer, even if you decline that coverage. Marketplace premium tax credits, Medicare and long-term-care premiums require additional review. [1, 3, 4]

Payroll caution: Box 1 reporting does not automatically mean Boxes 3 and 5 are excluded. Social Security, Medicare and unemployment tax exclusions depend on the applicable employer plan or system requirements. Have the payroll provider confirm treatment before processing. [1, 2, 5]

Put the policy in writing

Our recommendation: approve a written shareholder benefit policy before benefits begin, retain it with corporate records, and give a copy to payroll and your tax preparer. Use the actual adoption date; do not backdate documents.

4 Understand what the document accomplishes

For the shareholder insurance deduction, IRS Notice 2008-1 recognizes a plan established through qualifying company payments or reimbursements and W-2 reporting. A separate formal written plan is not, by itself, a universal condition for that deduction. Nevertheless, a written policy provides evidence of the company's benefit arrangement and helps it operate consistently. Actual payments, substantiation and reporting still matter. [3]

A shareholder benefit policy is also not a substitute for any plan documents, notices or compliance requirements that apply to a formal employee health arrangement. If the company has other employees, obtain a benefits review before implementing reimbursements.

5 What the written policy should address

- **Approval and effective date:** identify the corporation, approving officer or board, actual adoption date, and start date; retain the resolution or approval.
- **Eligibility:** identify covered shareholder-employees and the employee class, if any; specify eligible spouses and dependents and coordinate ownership attribution.
- **Covered benefits:** distinguish insurance premiums from copays, deductibles and other medical expenses. State which categories are covered and any annual limits.
- **Required proof:** require insurance statements or itemized bills, evidence of payment, dates of coverage or service, and the amount requested. An explanation of benefits alone may not prove payment.
- **Payment process:** identify who reviews claims, how reimbursement is paid, and the submission deadline early enough for payment and payroll reporting in the proper year.
- **No duplicate benefits:** prohibit reimbursement of amounts already paid by insurance or reimbursed elsewhere; require disclosure of subsidies and other reimbursements.
- **Tax and payroll treatment:** identify the responsible payroll contact, require annual reconciliation, and explain taxable W-2 reporting for more-than-2% shareholders.
- **Records and changes:** retain approvals, claims and payment records securely; document amendments and termination dates.

6 Do not assume an HRA makes owner benefits tax-free

More-than-2% shareholder-employees generally cannot receive the same tax-free accident and health benefits as ordinary employees. They are not eligible employees for a QSEHRA. A Section 105 plan or an HRA label does not remove this restriction. Reimbursing other employees' individual policies can raise separate health-plan compliance issues; shareholder-specific relief is not blanket permission for the entire staff. [1, 2]

This checklist is a planning aid, not an adopted plan or a complete employee-benefits legal document. Ask us to coordinate the policy with your payroll provider and benefits adviser.

Follow through during the year

7 A simple operating routine

During the year: submit premium statements and medical claims regularly; keep proof of company payments and reimbursements. Record premiums separately from other medical benefits and shareholder distributions. Notify us of ownership, employment or coverage changes.

Before the final payroll: reconcile benefits for each shareholder and family member, reimburse approved insurance costs in the proper year, and give totals to payroll. Confirm W-2 and employment-tax treatment before forms are issued. A bookkeeping entry alone does not replace a required payment or reimbursement. [1, 3]

8 If the company already paid the bills

Send us the bills, payment records, benefit documents and W-2. We will determine whether the payments were employee benefits, compensation, shareholder withdrawals or another type of transaction. Do not automatically move every medical payment to distributions, and do not deduct personal withdrawals as business expenses.

An already-filed W-2 can be corrected using Form W-2c; Form W-3c and employment-tax return corrections may also be needed. Reporting an amount as “other income” on Form 1040 does not replace required wage reporting. A written policy adopted now cannot manufacture a prior-year arrangement. [6]

Wages and K-1 income are not always tax-equivalent. Even when total income appears unchanged, payroll taxes, the qualified business income deduction, shareholder allocations and other limitations may change the final tax. Review the complete returns before deciding on a correction. [1, 7]

9 Example: premiums versus copays

Assume the company properly pays or reimburses **\$12,000 of insurance premiums** and **\$2,000 of copays** as shareholder-employee benefits. Both amounts generally belong in taxable W-2 compensation and may be corporate deductions. If eligible, the shareholder may deduct up to \$12,000 as self-employed health insurance. The \$2,000 of copays is not part of that deduction; eligible expenses may instead enter the Schedule A medical calculation. Payroll-tax treatment requires a separate plan review. Do not deduct amounts twice. [1-5]

What to send our office

Provide the ownership list, written policy and approvals, insurance statements, proof of premium payments, reimbursement ledger, itemized medical bills, W-2s and payroll totals. Also tell us about employer or spouse coverage eligibility, Marketplace coverage and premium tax credits.

References and scope

Federal tax guidance reviewed October 21, 2026. General taxpayer education; treatment depends on the facts. The links below provide the underlying IRS guidance and regulation.

[1] IRS: S corporation compensation and medical insurance issues

[2] IRS Publication 15-B: Accident and health benefits

[3] IRS Notice 2008-1: Shareholder health insurance

[4] IRS Publication 502: Medical and dental expenses

[5] Treasury Regulation 31.3121(a)(2)-1: Employer plan or system

[6] IRS: Form W-2c, Corrected Wage and Tax Statement

[7] IRS: Qualified business income deduction