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Income Tax Tips: Business Insurance

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Insurance serves many purposes for a business. You'll need insurance to protect your business from property damage, personal injury suits, and other forms of financial loss. In addition, you may want to provide your employees with certain types of insurance (e.g., group health and life insurance) to attract and retain them. One of the issues you'll face as a business owner involves the tax treatment of business-related insurance. Just what can you deduct, and how do you handle insurance reimbursements? Here's an overview of what you should know.

Your business may be able to deduct insurance premiums paid

A business can deduct certain business expenses that it has properly paid. To be deductible, business expenses must be both ordinary (i.e., common and accepted in your field of business) and necessary (i.e., appropriate and helpful for your business). Your company may be able to deduct--as a business expense--insurance premiums paid for a variety of coverages. These include:

- Fire, theft, flood, or other casualty insurance
- Employee group medical insurance
- Life insurance provided for the benefit of employees
- Business liability insurance
- Professional malpractice insurance
- Business interruption insurance (pays for lost profits in certain cases if your business is shut down)
- Auto and other vehicle insurance used for business (unless the standard mileage rate is used to figure car expenses)
- Credit insurance (covers losses from unpaid debts)

However, if your business is the beneficiary of a life insurance policy (either directly or indirectly), it can't deduct the life insurance premiums it pays on behalf of an owner, employee, or any person who has a financial interest in the business. This also applies to split dollar life insurance coverage on key employees--the business can't deduct the premiums.

What happens if your business property is damaged, destroyed, or stolen?

If your business suffers a property-related loss, you should read your business insurance policy carefully to find out what is and isn't covered. Your policy should explain the types of property coverages, list the specific perils that your business is insured against (e.g., damage caused by fire, theft, and hail), describe the exclusions from coverage (e.g., damage caused by a flood or earthquake), and detail any conditions you must meet for coverage to apply.

In many cases, your business insurance policy will reimburse your business for a given loss. Sometimes, though, you'll be only partially reimbursed or not compensated at all. In such cases, your business may be entitled to some tax relief. In general, a reasonable insurance reimbursement is not taxable. If you receive reimbursements, subtract them from your total loss. The unreimbursed portion of your loss may be deductible. But if the amount of your reimbursement exceeds the loss, you may have to report taxable income (see a tax professional for exceptions to this rule).

If your business property is damaged or destroyed in an accident, by an act of nature (e.g., storm), or through theft or vandalism, and your policy does not completely reimburse your business for the loss, your business may be entitled to claim a casualty loss tax deduction. (A casualty is direct damage, destruction, or loss of property resulting from an identifiable event that is sudden, unexpected, or unusual.)

Calculating the amount of your casualty or theft loss deduction

If there's a casualty loss, a company can deduct 100 percent of the loss against business income (assuming there's no insurance reimbursement). To compute a business casualty loss deduction, you've got to know three things:

- The decrease in the fair market value (FMV) of the property as a result of the loss
- Your adjusted basis in the property before the casualty or theft (adjusted basis is usually the property's original cost, plus the cost of improvements, minus depreciation)
- The amount of the insurance reimbursement that you receive (or the salvage value)

If your property was damaged but not destroyed, the casualty loss equals the decrease in the property's FMV as a result of the damage, minus any insurance reimbursements. If your property was completely destroyed, ignore the FMV and compare the adjusted basis of the property before the incident to the insurance reimbursement. You can deduct the amount by which the adjusted basis exceeds the insurance reimbursement.

Remember, if your property is covered by insurance, an insurance claim must be filed; otherwise, the casualty loss deduction is not allowed. Use IRS Form 4684 to calculate and report all casualty losses or gains.

Handling other types of business insurance proceeds

Business interruption insurance pays for lost profits if your business is shut down due to a fire or other covered cause. You should report any insurance proceeds as ordinary income. Any credit insurance proceeds should also be reported as ordinary income.

What if you're self-employed?

If you own your own business, you can also deduct most ordinary and necessary business expenses against business income. However, different rules may apply if you're self-employed and your business provides group insurance benefits to its employees. Although a business can generally deduct the cost of group insurance premiums, you may be unable to deduct those insurance premiums that benefit you personally. Alternatively, your deduction may be limited. This is true even if you provide similar benefits to your employees and are able to deduct the cost of those benefits.

For example, assume you are a sole proprietor and maintain a group health employee benefit plan. Your business deducts the costs associated with the plan. However, any expenditures (e.g., premiums) made for your own benefit are generally not deductible as a business expense. You can get around this, though, if your spouse is an employee of your business, participates in the group health plan, and covers you under a family plan.

If you're self-employed and can't deduct your health insurance premiums and other medical costs as a business expense, you may qualify for the self-employed health insurance deduction. This deduction enables you to deduct 100 percent of the cost of health insurance that you provide for yourself, your spouse, and your dependents. If some of your health insurance premiums do not qualify for the self-employed health insurance deduction, you may still be able to deduct them on Schedule A of your Form 1040, assuming that you itemize and meet all other requirements. (The definition of self-employed for this purpose includes sole proprietors, partners, and owners of more than 2 percent of an S corporation.)

For more information, speak with a tax professional.

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