Leverage insurance and uninsured losses into tax benefits:

Business insurance costs and losses may be deductible

Business insurance is an important protection for your business. It's your shield against property damage, personal injury lawsuits, and other business losses. Insurance is also a way for you to provide benefits for your employees through group life, health, or dental coverage. Business insurance not only provides you with peace of mind, but some of your insurance costs may be tax-deductible.

Deducting premiums

Your small business is likely paying significant amounts as premiums for your insurance, but the good news is you may be able to deduct those premiums on your business taxes. Insurance premiums are deductible if they are an ordinary (common and accepted) expense in your type of business and are a necessary (appropriate and helpful for your business) expense. The types of insurance premiums you can deduct 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 (which pays for lost profits in certain cases if your business is shut down)
- Auto and other vehicle insurance used for business (unless you use the standard mileage rate to calculate car expense deductions)
- Credit insurance (which covers losses from unpaid debts)

One type of insurance premium that is not deductible is life insurance premiums if the premium is paid on behalf of an owner, employee, or anyone with a financial interest in the company. Split dollar life insurance coverage on a key employee is also not deductible.

TIP

You can only deduct insurance premiums your business has actually paid, not outstanding invoices.

Self-employment and premiums

There is one small hiccup in the tax law you need to know about when it comes to deducting insurance premiums. When you are self-employed and your business provides group insurance to employees, you cannot deduct the cost of the premiums that benefit you personally (that actually pay for your own policy). You can deduct the cost of premiums for your employees, but not yourself.

If you're self-employed (in the eyes of the IRS this includes sole proprietors, partners and owners of more than 2% of an S corporation), you may be able to deduct 100% of the cost of your health insurance that you provide for yourself, your spouse, and your dependents using the self-employed health insurance deduction. You qualify for it if you have no other health insurance. You can deduct the amount of the premium up to the amount of your business income (if you made less than the premium, you can only deduct the amount you've earned).

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.

TIP

If you want to make your own health insurance premiums deductible for your company, hire your spouse as an employee and have him or her select a family insurance plan that will cover you. Then the premiums are deductible for the business.

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Insurance coverage for losses

Your business insurance is designed to protect you if business property is damaged, destroyed, or stolen. If you've suffered a loss, check your policy to determine exactly what is covered. The policy will explain:

- The types of property coverages
- The specific perils that your business is insured against (for example, if damage caused by fire, theft, or hail)
- Any exclusions from coverage (for example, damage caused by a flood or earthquake)
- Conditions you must meet for coverage to apply

TIP

You may have to file a claim within a certain time period after the loss, so be sure to determine that and file in a timely way.

Tax deductions for losses

Your insurance policy may reimburse your business for your entire loss, but you may be in a situation where your insurance only covers part of the value of the damage, or even none of it at all. Tax deductions can step in and fill the void for you in these situations. If you're reimbursed for only part of the damage, you may be entitled to deduct the difference between the damage and the reimbursement on your taxes as a casualty loss deduction if:

- The property is destroyed by an accident, an act of nature (such as a storm,) or theft or vandalism
- The event that caused the damage is identifiable
- The damage was sudden, unexpected, or unusual

TIP

Reimbursement for damage that you receive from the insurance company is not taxable, as long as it doesn't exceed the value of the actual loss (if so, the overage could be taxable income).

How to calculate your deduction

To compute a business casualty loss tax deduction, you will need to know:

- The decrease in the fair market value (FMV) of the property that resulted from the loss
- Your adjusted basis in the property before the casualty or theft (adjusted basis is 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)

Here's how to determine the amount of your deduction:

- **Property that was damaged, but not destroyed**
  Determine the decrease in the property's FMV as a result of the damage, then subtract any insurance reimbursements from that decrease. The answer is how much you can deduct.
- **Property that was completely destroyed**
  Subtract the insurance reimbursement from the adjusted basis of the property before the incident. The answer is how much you can deduct.

When you suffer a casualty loss, but your insurance doesn't offer any coverage at all, your company can deduct 100% of the loss against business income.

TIP

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.

Other business insurance

There are tax implications for other types of business insurance payments. 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 from this as ordinary income. Any credit insurance proceeds should also be reported as ordinary income.

TIP

Be sure to run all of your deductions past a tax professional so you can be sure you are complying with current tax laws.

For more information, please contact your Key Private Bank Advisor.

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Source consulted: https://www.nolo.com/legal-encyclopedia/the-self-employed-health-insurance-deduction-a-valuable-personal-deduction.html