

Legislative Brief

Small Businesses Eligible for Health Care Tax Credit



EXECUTIVE SUMMARY

Under the recently enacted health care reform law, many small businesses and tax-exempt organizations that provide health insurance coverage to their employees now qualify for a special tax credit. The credit is:

- designed to encourage small employers to offer health insurance coverage for the first time or maintain coverage they already have,
- in general, available to small employers that pay at least half the cost of single coverage for their employees, and
- available for tax years beginning in 2010 (an enhanced version of the credit will be effective beginning in 2014).

The Internal Revenue Service has issued [Notice 2010-44](#) which provides guidance on determining eligibility for, calculating and claiming the credit. Also, more information about the credit, including [tax tips](#), [guides](#) and [answers to frequently asked questions](#), is now available on the IRS Web site, www.irs.gov.

For a tax credit calculator, please see www.smallbusinessmajority.org/tax-credit-calculator/ or www.nfib.com/issues-elections/healthcare/credit-calculator.

This Seubert & Associates Legislative Brief describes the tax credit and explains which employers are eligible and how it can be claimed. Read below for more information on the tax credit.

OVERVIEW OF THE SMALL BUSINESS HEALTH CARE TAX CREDIT

The health care reform law includes the Patient Protection and Affordable Care Act, which was signed into law by President Obama on March 23, 2010, and the Health Care and Education Reconciliation Act of 2010, which was signed into law on March 30, 2010. These two laws together make sweeping changes to the nation's health care system, including many changes that affect employers.

One positive change for some small employers is a Federal income tax credit for health insurance premiums they pay for certain employees. The credit is available for tax years beginning in 2010.

Eligible Employers

The credit is specifically targeted to help small businesses and tax-exempt organizations that primarily employ low and moderate income workers. It is generally available to employers that have fewer than 25 full-time equivalent (FTE) employees paying wages averaging less than \$50,000 per employee per year.

Because the eligibility formula is based in part on the number of FTEs, not the number of employees, many businesses will qualify even if they employ more than 25 individual workers. The number of an employer's FTEs is determined by dividing (1) the total hours for which the employer pays wages to employees during the year (but not more than 2,080 hours for any employee) by (2) 2,080.

The following employees are not considered in counting an employer's FTEs:

- Seasonal workers,

Legislative Brief

Small Businesses Eligible for Health Care Tax Credit

- Business owners (including a sole proprietor, a partner in a partnership, a shareholder owning more than two percent of an S corporation, and any owner of more than five percent of other businesses), and
- Members of a business owner's family or household.

The amount of average annual wages is determined by first dividing (1) the total wages paid by the employer to employees during the employer's tax year by (2) the number of the employer's FTEs for the year, then rounding down to the nearest \$1,000.

Credit Amount

The maximum credit is 35 percent of premiums paid in 2010 by eligible small business employers and 25 percent of premiums paid by eligible employers that are tax-exempt organizations. In 2014, this maximum credit increases to 50 percent of premiums paid by eligible small business employers and 35 percent of premiums paid by eligible employers that are tax-exempt organizations.

The maximum credit goes to smaller employers — those with 10 or fewer FTEs — paying annual average wages of \$25,000 or less. The credit is reduced if the number of FTEs exceeds 10 or if average annual wages exceed \$25,000.

Only premiums paid by the employer under an arrangement meeting certain requirements (a "qualifying arrangement") are counted in calculating the credit. In computing the credit for a tax year beginning in 2010, employers may count all eligible premiums described for that tax year, including those paid before the health care reform law was enacted.

A qualifying arrangement is one where:

- the employer pays premiums for each employee enrolled in health care coverage offered by the employer,
- in an amount equal to a uniform percentage (not less than 50 percent) of the premium cost of the coverage.

If an employer pays only a portion of the premiums for the coverage provided to employees under the arrangement (with employees paying the rest), the amount of premiums counted in calculating the credit is only the portion paid by the employer.

For purposes of the credit (including the 50-percent requirement), any premium paid pursuant to a salary reduction arrangement under a section 125 cafeteria plan is not treated as paid by the employer. Also, the amount of an employer's premium payments that counts for purposes of the credit is capped by the average premium for the small group market in the employer's geographic location, as determined by the Department of Health and Human Services.

Example. For the 2010 tax year, a qualified employer has 9 FTEs with average annual wages of \$23,000 per FTE. The employer pays \$72,000 in health care premiums for those employees (which does not exceed the average premium for the small group market in the employer's State) and otherwise meets the requirements for the credit. The credit for 2010 equals \$25,200 (35 percent x \$72,000).

Transition Relief for the 2010 Tax Year

The IRS is planning to issue guidance to help employers meet the requirements for a "qualifying arrangement" for the 2010 tax year. Specifically, the guidance will help the following employers:

- **Employers that do not pay a uniform percentage of the premium for each employee.** The IRS guidance will state that an employer will not be disqualified for the credit just because it does not pay a uniform percentage of the premium for each employee enrolled in coverage offered by the employer. If

Legislative Brief

Small Businesses Eligible for Health Care Tax Credit

the employer otherwise satisfies the requirements for the, it will qualify for the credit even though the percentage of the premium it pays is not uniform for all employees.

- **Employers that do not pay 50 percent of the premium cost of the coverage.** The requirement that the employer pay at least 50 percent of the premium for an employee applies to the premium for single (employee-only) coverage for the employee. Therefore, if the employee is receiving single coverage, the employer satisfies the 50 percent requirement with respect to the employee if it pays at least 50 percent of the premium for that coverage. If the employee is receiving coverage that is more expensive than single coverage (such as family or self-plus-one coverage), under the definition of "qualifying arrangement" the employer usually must pay 50 percent of the premium for the coverage he employee is actually receiving. However, under the transition relief, the employer will be considered to satisfy the 50 percent requirement if it pays at least 50 percent of the premium for single coverage for that employee (even if it is less than 50 percent of the premium for the coverage the employee is actually receiving).

How to Claim the Credit

Eligible small businesses can claim the credit as part of the general business credit starting with the 2010 income tax return they file in 2011. For tax-exempt employers, the IRS will provide further information on how to claim the credit.

Employers (other than tax-exempt employers) generally cannot claim the credit unless they have taxable income for the year. Also, claiming the credit will affect an employer's deduction for health insurance premiums. The amount of premiums that can be deducted is reduced by the amount of the credit.

The IRS will use postcards to reach out to millions of small businesses that may qualify for the credit. The postcards will encourage small business owners to take advantage of the credit if they qualify.

This Seubert & Associates Legislative Brief is not intended to be exhaustive nor should any discussion or opinions be construed as legal advice. Readers should contact legal counsel for legal advice.

Content © 2010 Zywave, Inc. Images © 2000 Getty Images, Inc. All rights reserved.

ES 4/10; 5/10; 6/10