

Health Care Tax Credit for Small Businesses
Congressman Mark Schauer
Small Business & Tax-exempt Organization Update

The **Patient Protection and Affordable Care Act** that became law on March 23, 2010, gives a tax credit to qualifying small businesses that provide health care coverage to their employees, effective with tax years beginning in 2010. Eligible small employers can qualify for a credit worth up to 35% of premiums paid in 2010 (for businesses) or 25% of premiums paid (for tax-exempt groups).

SMALL BUSINESS HEALTH CARE TAX CREDIT: FREQUENTLY ASKED QUESTIONS



The following **Q & A** from the IRS provides information about this new credit as it applies for years 2010 through 2013. An enhanced version of the credit will be effective beginning in 2014.

Which employers are eligible for the small employer health care tax credit?

In order to be a qualified employer, (1) the employer must have fewer than 25 full-time equivalent employees (“FTEs”) for the tax year, (2) the average annual wages of its employees for the year must be less than \$50,000 per FTE, and (3) the employer must pay health insurance premiums for employees under a “qualifying arrangement” as described below.

How does an employer claim the credit?

The credit is claimed on the employer’s annual income tax return.

What expenses are counted in calculating the credit?

Premiums paid by the employer under an arrangement meeting the requirements of a “qualifying arrangement” as described below are counted in calculating the credit. Under a *qualifying arrangement*, 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 example, if an employer pays 80 percent of the premiums for employees’ coverage (with employees paying the other 20 percent), the 80 percent premium amount paid by the employer counts in calculating the credit. 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.

In addition, the amount of an employer’s premium payments that counts for purposes of the credit is capped by the premium payments the employer would have made under the same arrangement if the average premium for the small group market in the State (or an area within the State) in which the employer offers coverage were substituted for the actual premium. The average premium for the small group market in a State (or area within a State) will be determined by the Department of Health and Human Services and published by the IRS. Publication of the average premium for the small group market on a State-by-State basis will be posted on the IRS website by the end of April. (Once these numbers are posted by the IRS, this will be easier to figure out than it sounds right now.)

Do premiums paid by an employer in 2010, before health care reform was enacted, count toward the tax credit?

Yes. All qualified premium expenses paid beginning January 1, 2010 may be counted for that tax year.

What is the maximum credit for a qualified small business?

For tax years beginning in 2010 through 2013, the maximum credit is 35 percent of the employer’s premium expenses that count towards the credit, as described above. *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% x \$72,000).

How is the number of FTEs determined for purposes of the credit?

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 result, if not a whole number, is then rounded to the next lowest whole number.

How is the amount of average annual wages determined?

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. The result is then rounded down to the nearest \$1,000 (if not otherwise a multiple of \$1,000). For this purpose, wages means wages as defined for FICA purposes (without regard to the wage base limitation). *Example.* For the 2010 tax year, an employer pays \$224,000 in wages and has 10 FTEs. The employer's average annual wages would be: \$22,000 (\$224,000 divided by 10 = \$22,400, rounded down to the nearest \$1,000)

Can an employer with 25 or more employees qualify for the credit if some of its employees are part-time?

Yes. Because the limitation on the number of employees is based on FTEs, an employer with 25 or more employees could qualify for the credit if some of its employees are part-time. For example, an employer with 46 half-time employees (meaning they are paid for 1,040 hours) has 23 FTEs and therefore may qualify for the credit.

Are seasonal workers counted in determining the number of FTEs and the amount of average annual wages?

Generally, no. Seasonal workers are disregarded in determining FTEs and average annual wages unless the seasonal worker works for the employer on more than 120 days during the tax year.

If an owner of a business also provides services to it, does the owner count as an employee?

Generally, no. 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 are not considered employees for purposes of the credit. Thus, the wages or hours of these business owners and partners are not counted in determining either the number of FTEs or the amount of average annual wages, and premiums paid on their behalf are not counted in determining the amount of the credit.

Do family members of a business owner who work for the business count as employees?

Generally, no. A family member of any of the business owners or partners listed above or a member of such a business owner's or partner's household, is not considered an employee for purposes of the credit. Thus, neither their wages nor their hours are counted in determining the number of FTEs or the amount of average annual wages, and premiums paid on their behalf are not counted in determining the amount of the credit. For this purpose, a family member is defined as a child (or descendant of a child); a sibling or step-sibling; a parent (or ancestor of a parent); a step-parent; a niece or nephew; an aunt or uncle; or a son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law or sister-in-law.

Can an employer (other than a non-profit) claim the credit if it has no taxable income for the year?

Generally, no. Except in the case of a not-for-profit employer, the credit for a year offsets only the employer's actual income tax liability (or alternative minimum tax liability) for the year. However, as a general business credit, an unused credit amount can generally be carried back one year and carried forward 20 years. Because an unused credit amount cannot be carried back to a year before the effective date of the credit, though, an unused credit amount for 2010 can only be carried forward.

Does taking the credit affect an employer's deduction for health insurance premiums?

Yes. In determining the employer's deduction for health insurance premiums, the amount of premiums that can be deducted is reduced by the amount of the credit.

SMALL TAX-EXEMPT ORGANIZATION HEALTH CARE TAX CREDIT: FREQUENTLY ASKED QUESTIONS



The following **Q & A** from the IRS provides information about this new credit as it applies for years 2010 through 2013. An enhanced version of the credit will be effective beginning in 2014.

Can a tax-exempt organization be a qualified employer?

Yes. The same definition of qualified employer applies to an organization described in Code section 501(c) that is exempt from tax under Code section 501(a). However, special rules apply in calculating the credit for a tax-exempt qualified employer. A governmental employer is not a qualified employer unless it is an organization described in Code section 501(c) that is exempt from tax under Code section 501(a).

What is the maximum credit for a tax-exempt qualified employer?

For tax years beginning in 2010 through 2013, the maximum credit for a tax-exempt qualified employer is 25 percent of the employer's premium expenses that count towards the credit. However, the amount of the credit cannot exceed the total amount of income and Medicare (i.e., hospital insurance) tax the employer is required to withhold from employees' wages for the year and the employer share of Medicare tax on employees' wages. *Example:* For the 2010 tax year, a qualified tax-exempt employer has 10 FTEs with average annual wages of \$21,000 per FTE. The employer pays \$80,000 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 total amount of the employer's income tax and Medicare tax withholding plus the employer's share of the Medicare tax equals \$30,000 in 2010.

The credit is calculated as follows:

- (1) Initial amount of credit determined before any reduction: $(25\% \times \$80,000) = \$20,000$
- (2) Employer's withholding and Medicare taxes: \$30,000
- (3) Total 2010 tax credit is \$20,000 (the lesser of \$20,000 and \$30,000).

Can a tax-exempt employer claim the credit if it has no taxable income for the year?

Yes. For a tax-exempt employer, the credit is a refundable credit, so that even if the employer has no taxable income, the employer may receive a refund (so long as it does not exceed the income tax withholding and Medicare tax liability).

Where can I find more information?

For more information you can visit www.irs.gov/newsroom/article/0,,id=220809,00.html which has links to these FAQs plus additional information, or www.smallbusinessmajority.org/hc-reform-faq/index.php#2d or <http://www.irs.gov/newsroom/article/0,,id=220839,00.html>

