

Healthcare Re-FORUM

Healthcare Re-Forum: Issue No. 6

Small Employer Health Insurance Tax Credits

The Patient Protection and Affordable Care Act (PPACA) provides eligible small business employers a tax credit on health insurance premiums paid on behalf of their employees. The tax credit is available beginning tax year 2010 and allows for a tax credit up to 35 percent. The credit increases to 50 percent by 2014.



To qualify for the small employer tax credit, employers must:

- have fewer than 25 full-time equivalent (FTE) employees
- have average annual employee wages less than \$50,000 per year, per FTE worker
- maintain a qualifying arrangement (requirements are in the [IRS notice 2010-44](#))

Eligible Employees

With certain exceptions, employees who perform services for the employer during the taxable year are taken into account for the credit. Sole proprietors, partners in a partnership, shareholders owning more than two percent of an S Corporation and any owners of more than five percent of other businesses are not taken into account as employees for purposes of the credit. Certain family members of these owners and partners are also not considered employees for this credit. Companies that are affiliated through common ownership may be treated as a single entity under this tax credit provision.

[IRS notice 2010-44](#) outlines three separate methods an employer can use to determine whether an employee is full time. The IRS website will provide formulas and examples for the calculation of FTEs. One of the means provided for definition of an FTE is arrived at by dividing the total

number of hours an employee works in a year by 2,080 and rounding down. Any over-time hours worked by the employee cannot be calculated into the formula. This definition is important to note, because an employer with 25 or more employees could possibly qualify for the credit if some of the employees work part time. Typically, seasonal workers are not counted in determining FTEs and average annual wages, unless the seasonal worker works for the employer more than 120 days during the tax year.

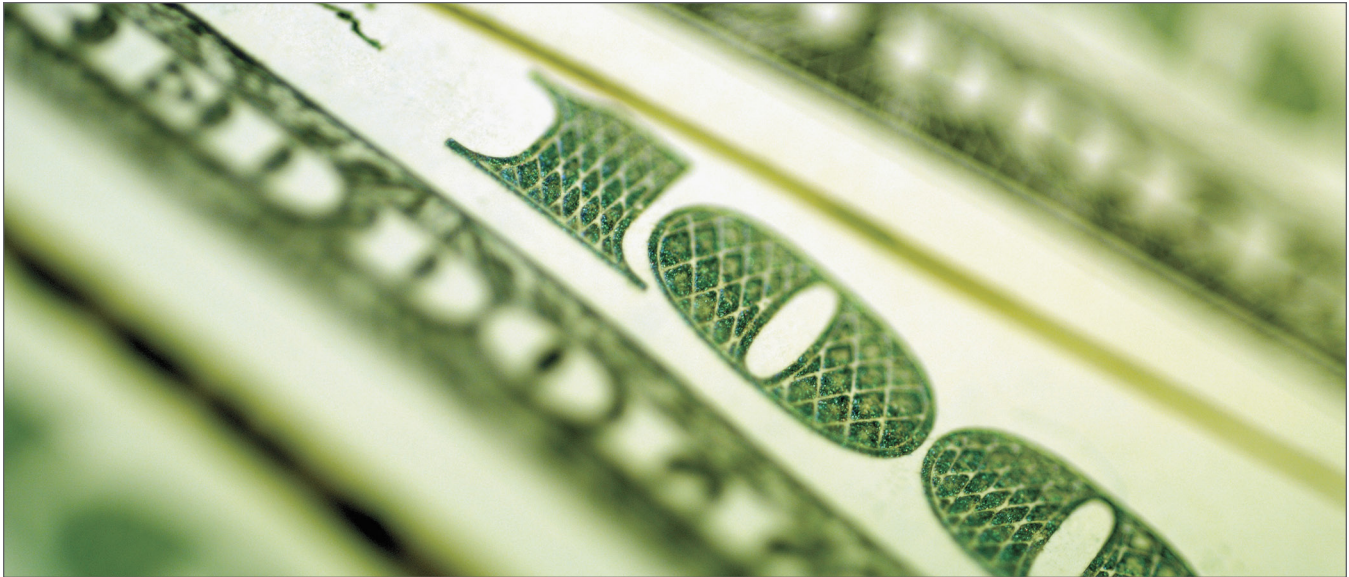
Average Annual Wages

FICA wages are used for this calculation without the wage base limitation. The average annual wage is determined by dividing the total wages paid to qualified employees by the number of FTEs for the year. The result is rounded down to the nearest \$1,000 or multiple of \$1,000.

Qualifying Arrangement

Only premiums paid by the employer under a qualifying arrangement are counted in the credit calculation. Under this qualifying arrangement, the employer pays premiums for each employee enrolled in healthcare 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. Also, small businesses can receive the credit not only for traditional health insurance coverage, but also for add-on dental, vision and other limited-scope coverage. The employer must pay at least 50 percent of the premium for all add-on coverage for the tax benefit to apply.

The premium taken into account for this credit is the lesser of the actual premium paid or the percent of the premium paid for their eligible employees multiplied by the average premium for the small group market in the employer's state.



Credit Phase-Out

The credit phases out if the number of FTEs exceeds 10 or if the average annual wages exceed \$25,000. The credit reduction for each additional FTE over 10 is equal to a 6.667 percent credit reduction. When the number of employees is 25, the credit is zero. The phase-out for each \$1,000 of wages is equal to 4 percent of the credit. When the wages are \$50,000, the credit is reduced to zero.

Tax-Exempt Businesses

A credit is also available for tax-exempt businesses, although the rules are different and the available credit is up to 25 percent smaller. Beginning in 2014, a credit of up to 35 percent will be available for two years for coverage purchased by nonprofit entities through an Exchange. Nonprofit entities can claim the credit, but it is limited to payroll tax paid or withheld by the tax-exempt entity.

As with any new law, the federal government may issue more regulations on how these credits will work. The IRS website is a good place to check for the most current information. The White House also released a “Fact Sheet” on the small business tax credits. A tax advisor or attorney should be consulted for questions pertaining to tax law.

For More Information

- **IRS Notice 2010-44**
<http://www.irs.gov/pub/irs-drop/n-10-44.pdf>
- **IRS FAQ**
<http://www.irs.gov/newsroom/article/0,,id=220839,00.html>
- **Fact Sheet**
http://www.irs.gov/pub/irs-utl/3_simple_steps.pdf

Future Topics:

- National High Risk Pool
- Glossary of Terms
- Questions About Healthcare Reform