

REALLY Immediate Healthcare Reform: Small Business Healthcare Tax Credit...Already Effective

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Many of the provisions of the recently enacted Patient Protection Act and “sidecar” Reconciliation Act have caused confusion as to their exact meaning, and sometimes, their exact effective date.

Among one of the more immediate provisions of the healthcare reform package is the “Small Business Healthcare Tax Credit.” The provision of the law provides tax credits to certain “qualified small business employers” to encourage them to voluntarily offer healthcare coverage to their employees.

The Internal Revenue Service recently issued a set of clear and helpful questions and answers that flesh out the requirements of the small business healthcare tax credit. This guidance is both necessary and welcome, since **the credit is effective on the date of the legislation’s enactment, so it’s already in effect.**

Eligibility

Under the health reform law, the small business tax credit is available to each “qualified small business employer,” which means an employer with no more than 25 full-time equivalent employees (FTEs) (determined on a controlled group basis) employed during the employer’s taxable year, and whose employees have annual full-time equivalent wages that average no more than \$50,000.

The full amount of the credit is available only to an employer with 10 or fewer FTEs, and whose employees have average annual full-time equivalent wages from the employer of less than \$25,000. These wage limits are indexed to the CPI-U for years beginning in 2014.

To be eligible for the subsidy, the eligible small employer must make a non-elective contribution on behalf of each employee who enrolls in a “qualifying health insurance” plan or program in an amount equal to a uniform percentage (not less than 50%) of the premium cost of the qualifying health plan.

The credit is equal to the applicable percentage of the small business employer’s contribution to the health insurance premium for each covered employee. Only non-elective contributions (i.e., not salary reduction contributions) by the employer are taken into account in calculating the credit.

The credit is equal to the lesser of: (1) the amount of contributions the employer made on behalf of the employees during the taxable year for the qualifying health coverage, and (2) the amount of contributions that the employer would have made during the taxable year if each employee had enrolled in coverage with a benchmark premium (based on comparable group market coverage) multiplied by an applicable tax credit percentage.

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The credit is reduced for employers with more than 10 FTEs, but not more than 25 FTEs. The credit is also reduced for an employer for whom the average wages per employee is between \$25,000 and \$50,000.

In addition, it appears that the credit may be limited to a two year period prior to the onset of the exchanges (2014), and taking advantage of the credit may obligate such an employer to obtain future coverage through the exchange once it has been established.

Tax-exempt organizations

Special rules apply to tax-exempt organizations that otherwise qualify for the credit under which the “applicable percentage” is reduced. Tax-exempt organizations are eligible to apply the tax credit against the organization’s liability as an employer for payroll taxes within certain limits.

Self-employed individuals, including partners and sole proprietors, 2% shareholders of an S Corporation and 5% owners of the employer (who provides services to the entity) 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. **(Q&A 13)**

An employee of a self-employed individual is eligible for the credit if the employee performs services in the trade or business of the employer. (Thus, the credit is not available for a domestic employee of a sole proprietor of a business.) Nor may a sole proprietor receive credit for the owner and their family members.

Other FAQ Highlights

- 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. **(Q&A 3)**
- For years before 2014, the “benchmark” premium, which is the average premium for the small group market in a state (or an area within the state), will be determined by the Department of Health and Human Services and published by the IRS. This guidance is expected to be posted on the IRS Web site by the end of April. **(Q&A 4)**
- Average annual wages are determined by first dividing the total wages paid by the employer to employees during the employer’s tax year by the number of the employer’s FTEs for the year, rounded down to the nearest \$1,000. Wages for this purpose means FICA wages but without regard to the wage base limitation. **(Q&A 10)**
- Because the “25 or more employee” limitation is based on FTEs, an employer with 25 or more employees could qualify for the credit if some of its employees work part-time (e.g., an employer with 46 half-time employees has 23 FTEs and therefore may qualify for the credit). **(Q&A 11)**
- Neither family members of a business owner who work for the business, nor a member of a business owner’s household, count as employees. **(Q&A 14)** 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.
- Employers claim the credit on the employer’s annual income tax return. **(Q&A 16)** So, an employer (other than a tax-exempt employer) generally cannot claim the credit if it has no taxable income for the year. However, an unused credit amount can generally be carried back (but not before the effective date of the legislation) one year and carried forward 20 years. **(Q&A 17)**
- 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. **(Q&A 20)**

For a complete list of the Frequently Asked Questions regarding this topic, you may visit the IRS website: <http://www.irs.gov/newsroom/article/0,,id=220839,00.html>