

## **Small Business Healthcare Tax Credit and Shared Responsibility Requirements**

**Patient Protection and Affordable Care Act (Public Law 111 - 148) and Healthcare and Education Reconciliation Act (Public Law 111 - 152)**

### **QUALIFYING REQUIREMENTS FOR THE TAX CREDIT**

#### **Who is eligible for the tax credit?**

Small employers that provide healthcare coverage are eligible (a “qualified employer”) if:

- They have fewer than 25 full-time equivalent employees (FTEs) for the tax year
- The average annual wages paid are less than \$50,000\* per FTE
- The employer pays at least 50% of the premium cost under a “qualified arrangement”

\* Wage limits will be indexed to the Consumer Price Index for Urban Consumers (CPI-U) for tax years beginning in 2014.

A “qualified arrangement” means:

The employer pays 50% or more of the cost of the employee-only premium for coverage through a state-licensed company.

#### **Is a tax-exempt organization a qualified employer?**

Yes. The same definition of qualified employer applies, but the amount of the tax credit is lower and special rules apply.

### **CALCULATING THE TAX CREDIT**

#### **How much is the tax credit?**

There is a sliding-scale tax credit of up to 35% of the employer’s eligible premium expenses for tax years 2010–2013. Employers with 10 or fewer full-time employees, paying annual average wages of \$25,000 or less, qualify for the maximum credit.

Beginning in tax year 2014, the maximum tax credit increases to 50% of premium expenses and coverage must be purchased from a state health insurance exchange. This tax credit is available for a total of any two years.

**For tax-exempt employers**, the same employee and wage requirements apply, but the maximum tax credit is 25% of eligible premium expenses for tax years 2010 – 2013, increasing to 35% in 2014.

The amount of the tax credit cannot exceed the total income and Medicare tax the employer is required to withhold from employees’ annual wages, plus the employer’s share of the Medicare tax.

### **What expenses are counted in calculating the credit?**

- Only the employer contribution to the premium amount counts as an eligible expense, subject to the limit described below. If an employer pays 80% of the premium, then 80% of the premium expense is counted.
- An employer's eligible premium contribution is capped at the average cost of health insurance for the small group market in their state (or an area of the state). If an employer pays 80% of the premium, then the amount that counts is limited to the same portion - 80% of the average cost of health insurance in the state. This provision is designed to avoid an incentive to choose a high-cost plan.
- Any premium paid through a salary reduction arrangement under a section 125 cafeteria plan is **not** counted in determining the premium expense.

### **How is the average premium for the small group market in the state determined?**

The Department of Health and Human Services (DHHS) will determine the rate for a state (or within a state) and the information will be published on the IRS on website (IRS.gov) by the end of April 2010.

#### **Example: Calculating the credit for an employer (non-tax-exempt)**

For tax year 2010, an employer has 9 FTEs with average annual wages of \$23,000 per employee. The employer pays \$72,000 in premiums for those employees (which does not exceed the benchmark premium) and meets the requirements for the credit. This employer's credit for 2010 equals \$25,000 (35% X \$72,000).

#### **Example: Calculating the credit for a tax-exempt employer**

For tax year 2010, a tax-exempt employer has 9 FTEs with average annual wages of \$23,000 per FTE. The employer pays \$72,000 in premiums for those employees (which does not exceed the benchmark premium) and meets the requirements for the credit. The total for the employer's income tax and Medicare tax withholding, plus the employer's share of the Medicare tax withholding, equals \$30,000.

Here's how the credit is calculated:

- 1) The initial amount of the credit is determined before any reduction: (25% X \$72,000) = \$18,000
- 2) The employer's withholding and Medicare taxes are \$30,000
- 3) Total tax credit for 2010 is \$18,000

### **How soon can the tax credit be taken?**

The credit is available this year: Eligible small businesses can claim the tax credit for the 2010 tax year, to be filed in 2011. The credit may be included in determining estimated tax payments for the year in which the credit applies, following regular estimated tax rules.

For tax-exempt organizations, the IRS will provide information at a later date on how to claim the tax credit.

**Do premiums paid by an employer in 2010, before healthcare 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.

**Will there be any transition relief for tax years beginning in 2010 to make it easier to meet the requirements for a qualifying arrangement?**

Yes. The IRS and Treasury will provide specific guidance on this. To begin with, under transition rules:

- *As long as an employer pays at least 50% of the premium for each enrolled employee, s/he will still qualify for a tax credit even if s/he doesn't pay a uniform percentage of the premium for each employee.*

- *The 50% employer premium contribution requirement applies to an employee-only premium rate.*

For those with family or employee-plus-one coverage, the employer contribution is met if the contribution is equal to 50% of the employee-only rate, not 50% of broader coverage.

**Temporary re-insurance program for early retirees**

Temporary assistance will be established for employers who provide health coverage for early retirees who are 55 or over but not yet eligible for Medicare. The Department of Health and Human Services (DHHS) must establish a program within 90 days of the law taking effect that provides re-insurance coverage. The program will pay 80% of eligible claims over \$15,000, and will expire January 1, 2014.

**DETERMINING FTES AND AVERAGE ANNUAL WAGES**

**How is the number of employees determined for eligibility?**

Only employers with fewer than 25 FTEs are eligible for the tax credit. This is calculated by dividing the total hours for which the employer pays wages to the employees during a taxable year by 2,080. No more than 2,080 hours (equivalent to a 40-hour work week) should be counted for any employee.

**Example:** For the 2010 tax year, an employer pays 5 employees wages for 2,080 hours each, 3 employees wages for 1,040 hours each, and 1 employee wages for 2,300 hours.

The employer's FTEs would be calculated as follows:

- 1) Total hours (not exceeding 2,080 per employee) is the sum of:
  - a. 10,400 hours for the 5 employees paid for 2,080 hours each (5 X 2,080)
  - b. 3,120 hours for the 3 employees paid for 1,040 hours each (3 X 1,040)
  - c. 2,080 hours for the 1 employee paid for 2,300 hours (hours limited to 2,080)

Total: 15,600 hours

2) FTEs:  $7$  (15,600 divided by 2,080) = 7.5, rounded down to the next-lowest whole number).

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

Yes. The limit on the number of employees applies only to FTEs. Full-time employees are those who work 30 hours or more; part-time employees work less than 30 hours per week, figured on a monthly basis. This takes weekly fluctuations into account.

**Example:** An employer with 46 half-time employees has 23 FTEs and may qualify for the credit.

**Are seasonal workers counted in determining FTEs and average annual wages?**

Generally, no. They are only counted for FTE equivalents and average annual wages if they work for the employer more than 120 days during the tax year.

**Does the owner of a business count as an employee for purposes of the tax credit if s/he also provides services? Do family members of a business owner who work for the company count as employees?**

An owner is not counted if s/he is a sole proprietor, a partner in a partnership, a shareholder owning more than 2% of an S corporation or an owner of more than 5% of other businesses.

Family members are not counted if they are children or grandchildren; siblings or step-siblings; parents or grandparents; step-parents; nieces or nephews; aunts or uncles; sons- or daughters-in-law; fathers- or mothers-in-law; or brothers- or sisters-in-law.

This means their hours and wages do not apply to the FTE count, the amount of average annual wages or the amount of premium costs paid.

**How are annual average wages determined?**

Average annual wages are calculated by dividing total wages paid by the employer to employees during a taxable year (box 5 of W-2 wages) by the number of FTEs for the year. The result is rounded down to the nearest \$1,000.

**Example:** For the tax year 2010, an employer pays \$224,000 in wages and has 10 FTEs.

The employer's annual average wage would be: \$22,000 (\$224,000 divided by 10 = \$22,400, rounded down to the nearest \$1,000).

**How is the tax credit calculated for employers with more than 10 FTEs and/or average annual wages over \$25,000?**

As long as the employer has fewer than 25 FTEs and pays annual average wages under \$50,000 (and meets other specified requirements) they are eligible for a tax credit on a sliding scale basis. A standard formula is used to reduce the full tax credit.

***If there are more than 10 FTEs:*** The reduction is determined by multiplying the full credit amount by a fraction: the numerator is the number of FTEs over 10 and the denominator is 15.

***If average annual wages exceed \$25,000:*** The reduction is determined by multiplying the full credit amount by a fraction: the numerator is the amount by which average annual wages exceed \$25,000 and the denominator is \$25,000.

The amount calculated using the formula above is then subtracted from the full tax credit to determine the final credit the employer qualifies for. If the employer has both more than 10 FTEs and average annual wages over \$25,000, the credit is determined by adding both reduction amounts together and subtracting that sum from the full credit amount.

#### **Example: Calculating the sliding-scale tax credit**

For the 2010 tax year, a qualified employer has 12 FTEs and average annual wages of \$30,000. The employer pays \$96,000 in healthcare premiums for those employees (which does not exceed the benchmark premium) and otherwise meets the requirements for the credit. The credit is calculated as follows:

1. Initial amount of credit determined before any reduction:  $(35\% \times \$96,000) = \$33,600$
2. Credit reduction for FTEs in excess of 10:  $(\$33,600 \times 2/15) = \$4,480$
3. Credit reduction for average annual wages over \$25,000:  $(\$33,600 \times \$5,000/\$25,000) = \$6,720$
4. Total credit reduction:  $(\$4,480 + \$6,720) = \$11,200$
5. Total 2010 tax credit:  $(\$33,600 - \$11,200) = \$22,400$ .

## **HOW TO CLAIM THE TAX CREDIT**

### **How does an employer claim the tax credit?**

The credit is taken on the annual tax return. The IRS will provide information on how tax-exempt employers can claim the new credit.

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

Yes. The amount taken for the tax credit must be subtracted from the deduction.

### **May an employer reduce employment tax payments during the year in anticipation of the tax credit?**

No. The credit applies against income tax, not employment tax (i.e. withheld income tax, social security tax, and Medicare tax).

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

Generally, no. Except for a tax-exempt employer, the credit for a year only offsets an employer's actual income tax or alternative minimum tax (AMT) liability for that year.

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

Yes. The tax credit is a refundable credit and the employer is eligible for a refund as long as it's not more than the income tax withholding and Medicare tax liability.

**Can the tax credit be counted in determining estimated tax payment for a year?**

Yes. The credit may be included in determining estimated tax payments for the year in which the credit applies, following regular estimated tax rules.

**SHARED RESPONSIBILITY REQUIREMENTS**

**Are small employers that don't offer health insurance required to pay a penalty?**

Most small businesses are exempt. Employers with fewer than 50 FTEs are not subject to the shared responsibility (or "free rider") provision that takes effect January 1, 2014. If you have more 50 FTEs but no employee receives an individual premium tax credit or cost-sharing reductions (both based on income), there's no penalty—whether or not you offer health insurance.

**How are employees counted under the Shared Responsibility requirement?**

A business is defined as "large" if it has more than 50 FTEs, not counting seasonal workers. Full-time employees are those who work 30 hours or more; part-time employees work less than 30 hours per week, figured on a monthly basis. This calculation involves taking the total number of hours worked divided by 120. Also, the first 30 employees are subtracted from the total when calculating the total amount of the assessment.

**How is the shared responsibility payment calculated?**

If you have at least one full-time employee who receives a premium tax credit or cost-sharing reductions under the health plan they're enrolled in through the state insurance exchange, the payment assessed depends on whether or not you offer health coverage.

***Doesn't offer health insurance:***

If the employer does not offer coverage, and at least one full-time employee receives a premium tax credit or cost-sharing reductions, the business must pay \$2,000 for each full-time employee, not counting the first 30 employees.

**Example:** An employer with 51 employees who doesn't offer health insurance and has one employee who receives an individual tax credit or cost-sharing reductions will be assessed \$42,000 (\$2,000 multiplied by 21).

### ***Does offer health insurance***

If the employer does offer coverage, and at least one full-time employee receives a premium tax credit or cost-sharing reductions, the employer will be required to pay \$3,000 for each employee who receives assistance or \$2,000 per full-time employee (not counting the first 30 employees), whichever is less. In this case, the coverage offered to an employee and his or her dependents must have a minimum essential value (to be determined and defined by the secretary of Health and Human Services) and not be considered “inadequate” or “unaffordable.”

- Coverage is considered “inadequate” if it covers less than 60% of the total allowed costs of benefits.
- Coverage is considered “unaffordable” if the employee’s share of the premium is more than 9.5% of the employee’s household income.

**Example:** An employer with 51 employees who offers coverage but has one employee who receives an individual tax credit or cost-sharing reductions will be assessed \$3,000 (\$3,000 x 1).

### **WHERE CAN I GET ADDITIONAL INFORMATION?**

- Check the Small Business Majority website (<http://www.smallbusinessmajority.org/>) and sign up for our alerts.
- Check the IRS website, <http://www.irs.gov/newsroom/article/0,,id=220839,00.html>; the new front page at IRS.gov has tips, a detailed FAQ and eligibility worksheets.
- Also, the Department of Health and Human Services will be creating a new website where small employers can access up-to-date information. The site will include information about small business tax credits, coverage options, reinsurance for retirees and more. Check <http://healthreform.gov/> for more information.

### **Sources:**

1. Small Business Health Care Tax Credit – White House Fact Sheet, March 24, 2010
2. Affordable Health Care for America: Small Business Guide, Office of House Speaker Nancy Pelosi (D-CA) ([http://docs.house.gov/energycommerce/SMALL\\_BUSINESS\\_G.pdf](http://docs.house.gov/energycommerce/SMALL_BUSINESS_G.pdf))
3. Small Business Health Care Tax Credit: Frequently Asked Questions, IRS (<http://www.irs.gov/newsroom/article/0,,id=220839,00.html>)
4. Senate Democratic Policy Committee Section by Section Analysis, [dpc.senate.gov](http://dpc.senate.gov)
5. CCH Tax Briefing Special Report, March 30, 2010 (<http://tax.cchgroup.com/legislation/Senate-Healthcare-Fixes-Bill-03-25-10.pdf>)