

Small Business Health Care Credit Summary



For tax years beginning in 2010 through 2013, eligible small employers that purchase health insurance coverage for their employees may be eligible for a tax credit to help offset the cost of the insurance coverage.

The Patient Protection and Affordable Care Act authorized a new tax credit ¹ to encourage small businesses employing low and moderate income workers to offer health insurance coverage.

To be eligible for the credit the employer must pay at least 50% of its employees health insurance costs. An otherwise eligible small employer that is not currently paying any of its employee's health insurance costs that establishes a new arrangement requiring it to pay a uniform percentage of at least 50% of premiums for enrolled employees, will presumably be entitled to the credit for the payments it makes under the plan.

It's not entirely clear, however, how an employer that currently has an arrangement that requires it to pay less than 50% of its employee's premiums can correct this situation so that it can qualify for the credit. Hopefully, the IRS will provide guidance on this sometime soon.

Eligible Small Employers

Only eligible small employers qualify for the credit. An eligible small employer is an employer that meets all the following requirements²:

- a) It employs no more than 25 Full-time Equivalent (FTE) employees during its tax year. FTE employees are determined by dividing the total hours worked by all employees during the year by 2,080 (rounded down to the nearest whole number). However, the maximum hours counted for any one employee is 2,080.

¹ [IRC Sec. 45R](#)

² [IRC Sec. 45R\(d\)](#)

- b) It pays annual FTE wages that average no more than \$50,000. This is determined by dividing the total wages the employer pays by the number of its FTE employees and then rounding that number down to the nearest \$1,000. For this purpose, wages means wages as defined for FICA purposes (without regard to the wage base limitation).
- c) The employer has a qualified health insurance plan (or arrangement) that requires it to pay at least 50% of the premiums (on a uniform basis) on behalf of all of its employees who enroll in the plan.

The hours worked by seasonal workers aren't counted in the FTE employee calculation unless they work for the employer on more than 120 days during the tax year. Wages paid to seasonal workers are likewise excluded if the worker's hours are excluded in determining the number of FTE employees.

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 work part-time. For example, an employer with 46 half-time employees (meaning they are paid wages for 1,040 hours) has 23 FTEs and therefore may qualify for the credit.

Amount of the Credit

The maximum credit is available only to an employer with 10 or fewer FTE employees and whose employees have an average annual FTE wages of less than \$25,000. If the number of FTEs exceeds 10 or if average annual wages exceed \$25,000, the credit available to the employer is reduced by a fraction of the excess employees or wages. The credit is completely phased out for employers that have 25 FTEs or more or that pay average wages of \$50,000 per year or more.

For employers eligible for the maximum credit (see table following this letter), the credit generally equals 35% (25% for tax-exempt employers) of the lesser of³

- a) the employer's contributions during the tax year to a health arrangement to purchase qualifying health coverage, or

³ [IRC Sec. 45R\(g\)\(2\)](#)

- b) the amount of contributions that the employer would have made during the tax year to its qualified health arrangement if each employee had enrolled in coverage with a small business benchmark premium in the state where the employer is offering coverage.⁴

Qualifying health insurance coverage is basically health insurance purchased from an insurance company licensed under state law. Only nonelective employer contributions qualify. Therefore, employee elective contributions to the plan that are used by the employer to pay for the employee's coverage don't qualify for the credit. Premiums paid in 2010 before the Health Care Act was enacted can qualify for the credit.

Generally, to qualify for the credit, the employer must pay the same percentage (which has to be at least 50%) of all its employees' health insurance premiums. However, the IRS intends to issue guidance that will provide a transition rule for 2010 only. Under this transition rule, an employer can qualify for the credit even if it pays differing percentages of different employees' premiums as long as all the payments it makes are at least 50% of each employee's premium (based on single—employee only—coverage).

If the employee is receiving single coverage, the employer satisfies the 50% requirement with respect to the employee if it pays at least 50% 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), the employer satisfies the 50% requirement with respect to the employee if the employer pays an amount of the premium for such coverage that is no less than 50% of the premium for single coverage for that employee (even if it is less than 50% of the premium for the coverage the employee is actually receiving).

If the employer pays only a portion of the employee's premium, the benchmark premium rate must be multiplied by the portion paid by the employer. For example, if the employer pays 80% of the employee's premium, the employer's contribution for purposes of the credit will be 80% of the benchmark premium within that state when calculating the credit.

⁴ The small business benchmark premium will be determined by the Secretary of Health and Human Services (HHS) each year on a state-by-state basis. The 2010 table can be found in [Rev. Rul. 2010-13](#). The HHS may issue additional 2010 small business benchmark premium rates for certain high cost areas within a state.

Claiming the Credit

The small employer health insurance credit will be claimed on the employer's annual income tax return. The credit is a specified general business credit⁵. As such, it is available against AMT. Also, any unused credit can be carried back for one year and carried forward for 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.

In addition, 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.

Self-employed Individuals

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 businesses⁶ are not considered employees for purposes of the credit⁷. 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.

A family member of any of the business owners or partners, 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.

⁵ See [IRC Sec. 38\(b\)\(36\)](#) and (c)(4)(B)(vi).

⁶ within the meaning of [IRC Sec. 416\(i\)\(1\)\(B\)\(i\)](#)

⁷ [IRC Sec. 45R\(e\)\(1\)](#)

Tax Exempt Employers

For tax-exempt organizations, instead of being a general business credit, the credit is a refundable tax credit. The credit is limited to the total amount of Federal Income Tax (FIT) and Medicare (i.e., hospital insurance) tax the employer is required to withhold from employees' wages for the year, plus the employer's share of Medicare tax on employees' wages.

Controlled Group

Members of a controlled group (e.g., businesses with the same owners) or an affiliated service group (e.g., related businesses of which one performs services for the other) are treated as a single employer for purposes of the credit. Thus, for example, all employees of the controlled group or affiliated service group, and all wages paid to employees by the controlled group or affiliated service group, are counted in determining whether any member of the controlled group or affiliated service group is a qualified employer.

3 SIMPLE STEPS

If you are a small employer (business or tax-exempt) that provides health insurance coverage to your employees, determine if you may qualify for the **Small Business Health Care Tax Credit** by following these three simple steps:

1

Determine the total number of your employees (not counting owners or family members):

Full-time employees: _____
(enter the number of employees who work at least 40 hours per week)

+

Full-time equivalent of part-time employees: _____
(Calculate the number of full-time equivalents by dividing the total annual hours of part-time employees by 2080.)

= total employees

If the total number of employees is fewer than 25 **GO TO STEP 2**

2

Calculate the average annual wages of employees (not counting owners or family members):

Take the total annual wages paid to employees: _____

÷

Divide it by the number of employees from STEP 1: _____
(total wages ÷ number of employees)

= average wages

If the result is less than \$50,000, **AND**

3

You pay at least half of the insurance premiums for your employees at the single (employee-only) coverage rate, then

» you may be able to claim the **Small Business Health Care Tax Credit**.
Find out more information at **IRS.gov**



Appendix 1

Short-cut Small Employer Insurance Credit Percentage¹

For-profit Business:

Number of employees	Average Wages					
	Up to \$25,000	\$30,000	\$35,000	\$40,000	\$45,000	\$50,000
Up to 10	35%	28%	21%	14%	7%	0%
11	33%	26%	19%	12%	5%	
12	30%	23%	16%	9%	2%	
13	28%	21%	14%	7%		
14	26%	19%	12%	5%		
15	23%	16%	9%	2%		
16	21%	14%	7%			
17	19%	12%	5%			
18	16%	9%	2%			
19	14%	7%				
20	12%	5%				
21	9%	2%				
22	7%					
23	5%					
24	2%					
25	0%					

Nonprofit Entity:

Number of employees	Average Wages					
	Up to \$25,000	\$30,000	\$35,000	\$40,000	\$45,000	\$50,000
Up to 10	25%	20%	15%	10%	5%	0%
11	23%	18%	13%	8%	3%	
12	22%	17%	12%	7%	2%	
13	20%	15%	10%	5%		
14	18%	13%	8%	3%		
15	17%	12%	7%	2%		
16	15%	10%	5%			
17	13%	8%	3%			
18	12%	7%	2%			
19	10%	5%				
20	8%	3%				
21	7%	2%				
22	5%					
23	3%					
24	2%					
25	0%					

Note:

¹ These tables are from the Congressional Research Service report *Summary of Small Business Health Insurance Tax Credit Under PPACA*, dated 4/5/2010.

Appendix 2

2010 Small Employer Benchmark Premiums

<u>State</u>	<u>Employee Only Coverage</u>	<u>Family Coverage</u>
Arkansas	4,329	9,677
Arizona	4,495	10,239
California	4,628	10,957
Colorado	4,972	11,437
Connecticut	5,419	13,484
District of Columbia	5,355	12,823
Delaware	5,602	12,513
Florida	5,161	12,453
Georgia	4,612	10,598
Hawaii	4,228	10,508
Iowa	4,652	10,503
Idaho	4,215	9,365
Illinois	5,198	12,309
Indiana	4,775	11,222
Kansas	4,603	11,462
Kentucky	4,287	10,434
Louisiana	4,829	11,074
Massachusetts	5,700	14,138
Maryland	4,837	11,939
Maine	5,215	11,887
Michigan	5,098	12,364
Minnesota	4,704	11,938
Missouri	4,663	10,681
Mississippi	4,533	10,501
Montana	4,772	10,212
North Carolina	4,920	11,583
North Dakota	4,469	10,506
Nebraska	4,715	11,169
New Hampshire	5,519	13,624
New Jersey	5,607	13,521
New Mexico	4,754	11,404
Nevada	4,553	10,297
New York	5,442	12,867
Ohio	4,667	11,293
Oklahoma	4,838	11,002
Oregon	4,681	10,890
Pennsylvania	5,039	12,471
Rhode Island	5,887	13,786
South Carolina	4,899	11,780
South Dakota	4,497	11,483
Tennessee	4,611	10,369
Texas	5,140	11,972
Utah	4,238	10,935
Virginia	4,890	11,338
Vermont	5,244	11,748
Washington	4,543	10,725
Wisconsin	5,222	12,819
West Virginia	4,986	11,611
Wyoming	5,266	12,163

Source: Rev. Rul. 2010-13.