

Health Care Reform Update

Small Business Health Care Tax Credit

The 2010 Health Care Act establishes a two phase “Small Business Health Care Tax Credit” (“HCTC”). The HCTC is available to all employers with fewer than 25 full-time employees and with average annual wages of less than \$50,000. Special rules apply to tax-exempt employers.

The first phase of the HCTC runs from 2010 through 2013, and can result in a small business receiving up to a 35% tax credit for premiums paid by the employer on behalf of its employees. The second phase begins in 2014 and runs for two years. It raises the HCTC to 50% of the premiums paid by a small business on behalf of its employees.

Qualifying Plans

A qualifying plan is one in which the employer pays premiums for each employee enrolled in health care coverage in an amount equal to a uniform percentage (not less than 50 percent) of the premium cost of the coverage. However, in 2010, the IRS is offering transition relief in two important ways:

- An employer does not have to pay a uniform percentage of the premium for each such employee as long as the minimum premium paid is 50%.
- The 50% premium only applies to single (employee-only) coverage and does not have to apply to “employee and spouse” or family coverage, but the amount paid for “employee plus” coverage must be the same as for employee only (i.e. employer pays 50% of employee only coverage of \$200 per month; the employer must pay at least \$200 for “employee plus” coverage, even if that amount is less than 50% of the premium).

Calculation of Full-time Employees and Average Annual Wages

In calculating the number of full-time employees, an employer will generally look at the total number of hours for all employees, including part time employees, with a maximum number of annual hours capped at 2080, and divide the total number of those hours by 2080. That number will be rounded down.

- **Example:** An employer has 4 full-time employees who worked 2080 hours each, 4 part-time employees who worked 1100 hours each and 1 employee who worked 2400 hours. The employer would calculate the following: $(4 \times 2080) + (4 \times 1100) + (1 \times 2080)$ divided by 2080 = 7.11, which is rounded down to 7 full-time employees.

In calculating the average annual wages, the employer will calculate the total wages for FICA purposes paid to its employees during the year and then divide that number by the number of full-time employees (as calculated above). That number is rounded down to the nearest 1000.

- **Example:** The same employer from the previous example paid \$147,000 in wages to its employees. The annual average wages would be equal to \$147,000 divided by 7 full-time employees = \$21,000 which does not have to be rounded down.

Caveats and Exceptions

1. Seasonal workers who work less than 120 days in the calendar year are disregarded in calculating the number of full-time employees and average annual wages.
2. The owner of a business and most extended family members of the owner are not included in the calculations for determining the number of full-time employees and average annual wages. For purposes of calculating the credit, the premiums paid for the owner and his/her family members are also disregarded.
3. Members of a controlled group or an affiliated service group are treated as *one employer* for purposes of the HCTC.

Calculation of Total Premiums

The amount of premiums counted in calculating the credit is only the portion paid by the employer (pre-tax premiums paid under a cafeteria plan by the employees are not considered to be paid by the employer). However, the amount of the employer's premium payments that count for purposes of the HCTC is capped by the average premium for the small group market in the State (or area within the State) in which the employer offers coverage. These average amounts will be published by the IRS by the end of April 2010.

The Tax Credit

For calendar years 2010 through 2013, the maximum HCTC of 35% of the employer-paid portion of the premiums to a qualifying health plan is available to those employers with less than 10 full-time employees and with annual average wages of less than \$25,000. The HCTC is phased down as the number of full-time employees increases and the annual average wage increases. For 2010, the HCTC is retroactive to January 1.

Beginning in 2014, the eligible HCTC will be 50% of the employer's contribution towards the health insurance premium. This 50% HCTC will be available for two years. Also, it appears that in order to claim the tax credit in 2014, the employer would need to purchase insurance through the Exchange.

If the number of full-time employees is greater than 10, the reduction is determined by multiplying the otherwise applicable credit amount by a fraction, the numerator of which is the number of FTEs in excess of 10 and the denominator of which is 15. If the annual average wage is greater than \$25,000, the reduction is determined by multiplying the otherwise applicable credit amount by a fraction, the numerator of which is the amount by which average annual wages exceed \$25,000 and the denominator of which is \$25,000.

- **Example:** An employer has 14 full-time employees with annual average wages of \$32,000. The employer has paid \$75,000 in premiums towards an applicable health plan. The HCTC for this employer is calculated as follows:
 - Initial credit before reduction: $75,000 \times 35\% = \$26,250$
 - Reduction for full-time employees over 10: $26,250 \times (4/15) = \$7,000$
 - Reduction for annual average wages over \$25,000: $26,250 \times (7,000/25,000) = \$7,350$
 - Total HCTC: $\$26,250 - \$7,000 - \$7,350 = \$11,900$

Claiming the Credit

Employers will claim the HCTC on their tax return. The HCTC cannot be claimed if the employer has no taxable income for the year, as it only offsets the employer's actual income tax liability (or alternative minimum tax liability) for the year. However, as a general business credit, an unused HCTC can generally be carried back one year and carried forward 20 years. Because an unused HCTC amount cannot be carried back to a year before the effective date of the credit, an unused HCTC amount for 2010 can only be carried forward.

The HCTC can be reflected in determining estimated tax payments for the year to which the credit applies in accordance with regular estimated tax rules. 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 HCTC. Finally, an employer cannot apply the HCTC against employment taxes, as it only applies against income tax.

For more information see <http://www.irs.gov/newsroom/article/0,,id=220809,00.html?portlet=6>.

FEDERAL GRANTS FOR SMALL BUSINESS WELLNESS PROGRAMS

The 2010 Health Care Act would also create a \$200 billion, five-year program to provide grants to certain small employers (fewer than 100 employees) for comprehensive workplace wellness programs. The grants would go to small employers that did not have a wellness program when the law was enacted. More information on these grants will be disclosed as it becomes available.



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