

Health Care Reform: An Incentive For Small Businesses

Are you a small business that currently provides health insurance to your employees? Or are you a small business that would like to provide health insurance to your employees but haven't done so due to cost constraints? If so, you may benefit from the provisions of Health Care Reform that created a tax credit for eligible small employers that provide qualifying health benefits to their employees. The credit is available beginning in the 2010 tax year.

Small Employer Defined. For purposes of this credit, a "small employer" is defined as an employer that employs fewer than 25 full-time equivalent employees ("FTEs") for the tax year. The number of FTEs is determined by dividing (i) the total hours for which the employer pays wages to employees during the year (but no more than 2,080 for any employee) by (ii) 2,080. The result is rounded down to the lowest whole number to determine the number of FTEs. There are special rules for seasonal workers and for the first year an employer is in business. All members of a controlled group or an affiliated service group are treated as a single employer for purposes of the credit.

Qualifying for the Credit. To qualify for the credit the average annual wages of the employer's employees must be less than \$50,000 per FTE. Average annual wages are determined by first dividing (i) the total wages paid by the employer to employees during the employer's tax year by (ii) the number of FTEs for the year. The result is rounded down to the nearest \$1,000 to determine the average annual wages.

To be eligible for the credit, small employers must contribute a uniform percentage of at least 50% toward their employees' health insurance coverage. Only the portion of the premiums paid by the employer are counted in calculating the credit. For purposes of this credit, amounts paid pursuant to a salary reduction agreement under a cafeteria plan are not treated as paid by the employer.

There is a cap on the premium payments that count for purposes of the credit equal to the average premium for the small group market in the State where the employer offers coverage will be counted as expenses when calculating the credit. If an employer only pays a portion of the premium and the premium exceeds the amount of the average small market premium, the amount of premium expense that counts for the credit is calculated by multiplying the percentage the employer pays by the average premium in the small group market. The IRS has stated that it will publish on its website the average premiums on a State-by-State basis by the end of April, 2010.

Amount of the Credit. For tax years beginning in 2010 through 2013, the maximum credit available to employers that are not tax-exempt is 35% of the employer's premium expense that counts towards the credit. For tax-exempt employers, the maximum credit is 25% of the allowable premium expense. For tax years beginning in 2014, the maximum credit is increased to 50% for non tax-exempt employers and 35% for tax-exempt employers. However, the increased credit is only available to employers for up to two-consecutive tax years.

The maximum credit amount is reduced by the result of a fraction if the employer has more than 10 FTEs or if the average annual wages exceed \$25,000. If the number of FTEs exceeds 10, the numerator of the fraction is the number of FTEs in excess of 10 and the denominator is 15. For average annual wages in excess of \$25,000, the numerator is the excess of average annual wages over \$25,000 and the denominator is \$25,000. In both cases, the result of the fraction is subtracted from the otherwise applicable credit to determine the employer's credit amount.

Self-employed individuals, including partners and sole proprietors, 2% or more shareholders of S-Corporations, and 5% or more owners of other businesses are not treated as employees for purposes of the credit, even if the business owner is also an employee of the company. Further, certain family members of business owners are not considered employees for purposes of the credit. Therefore, any expenses spent on these employees are not considered expenses when calculating the credit. However, business owners and their family members are also not counted when calculating FTEs or average annual wages, which will often be helpful in satisfying the average annual wage requirement.

Claiming the Credit. If an employer is eligible for the credit, it will be claimed on the employer's annual income tax return. The credit may be reflected in determining estimated tax payments (including estimated tax payments in 2010). Tax-exempt employers may claim the credit even if they have no taxable income, but the amount of the refund may not exceed the total amount of income and Medicare tax the employer is required to withhold from employees' wages for the year and the employer's share of Medicare tax on the employees' wages.

Employers may not deduct the costs of the health insurance coverage for which they receive a credit. However, they may still deduct employee health insurance expenses (as ordinary and necessary business expenses) that do not qualify for the credit.

Transition Guidance for 2010. The IRS and the Treasury are supposed to issue guidance that will provide transition relief for the 2010 tax year for employers that would otherwise qualify for the credit except that they didn't provide a uniform percentage of premiums equal to at least 50% of the premium cost. On its website, the IRS has stated that the transition relief will provide that: (i) an employer that pays at least 50% of the premium for each employee will be eligible for the credit even if the percentage of premium it pays for each employee is not uniform; and (ii) an employer will be deemed to be paying 50% of the premium for each employee if the employer is paying at least 50% of the cost of single coverage for every employee, even if some employees are enrolled in more expensive coverage (e.g., family coverage) and the employer is not paying at least 50% of the cost of the more expensive coverage.