

SMALL BUSINESS HEALTH CARE TAX CREDIT

Recently, as part of the 2010 Health Care Act, a new tax credit was created to provide relief to certain small employers that provide insurance. This new credit, the “Small Business Health Care Tax Credit,” was designed to help small businesses and small tax-exempt organizations afford the cost of covering their employees and was specifically designed for those with low- and moderate-income workers. In general, the credit is available to small employers paying at least half of the cost of single coverage for their employees.

The new law provides small employers with a tax credit (i.e., a dollar-for-dollar reduction in tax) for non-elective contributions to purchase health insurance for their employees. For non-exempt entities, the credit can offset an employer's regular tax or its alternative minimum tax (AMT) liability. However, the credit is also available to tax-exempt entities, even for those that do not otherwise have an income tax liability or that do not normally file a Form 990-T.

Small business employers eligible for the credit: To qualify, a business must offer health insurance to its employees as part of their compensation and contribute at least half the total premium cost. The full amount of the credit is available only to an employer with ten or fewer FTEs and whose employees have average annual full-time equivalent wages from the employer of less than \$25,000. In order to claim any amount of the credit, the business must have no more than 25 full-time equivalent employees (FTEs), and the employees must have annual full-time equivalent wages that average no more than \$50,000.

Phase-out of credit: If the number of FTEs exceeds ten or if average annual wages exceed \$25,000, the amount of the credit is reduced as follows: If the number of FTEs exceeds ten, 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 ten and the denominator of which is 15. If average annual wages exceed \$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. In both cases, the result of the calculation is subtracted from the otherwise applicable credit to determine the credit to which the employer is entitled. For an employer with both more than ten FTEs and average annual wages exceeding \$25,000, the reduction is the sum of the amount of the two reductions. This sum may reduce the credit to zero for some employers with fewer than 25 FTEs and average annual wages of less than \$50,000.

Years the credit is available: The credit is initially available for any tax year beginning in 2010, 2011, 2012, or 2013. Health insurance that qualifies for claiming the credit under the first phase is health insurance coverage purchased from an insurance company licensed under state law. For tax years beginning after 2013, the credit is only available to an eligible small employer that purchases health insurance coverage for its employees through a state exchange and is only available for two years. The maximum two-year coverage period does not take into account any tax years beginning in years before 2014. Thus, an eligible small employer could potentially qualify for this credit for six tax years; four years under the first phase and two years under the second phase.

Calculating the amount of the credit: For tax years beginning in 2010, 2011, 2012, or 2013, the credit is generally 35% (50% for tax years beginning after 2013) of the employer's non-elective contributions toward the employees' health insurance premiums. The credit phases out as firm-size and average wages increase. Tax-exempt small businesses meeting these requirements

are eligible for tax credits of up to 25% for tax years beginning in 2010, 2011, 2012, or 2013 (35% in tax years beginning after 2013) of the employer's non-elective contributions toward the employees' health insurance premiums.

Claiming the credit: Both small businesses and tax-exempt organizations will use new Form 8941 to calculate the small business health care tax credit. A draft form is currently available for viewing on the IRS.gov website. Small businesses will include the amount of the credit as part of the general business credit on its income tax return. Tax-exempt organizations will instead claim the health care tax credit on a revised Form 990-T. Form 990-T will be revised for the 2011 filing season to enable eligible tax-exempt organizations — even those owing no tax on unrelated business income — also to claim the health care tax credit. The tax-exempt organization does not need to be liable for other taxes in order to get a benefit; any credit not applied against other tax will be fully refundable. The final version of Form 8941 and its instructions will be available later this year.

If you have any questions, please contact Jared Yeaton, CPA, of Nathan Wechsler & Co. at (603) 410-2712.