
SMALL EMPLOYER HEALTH INSURANCE TAX CREDIT

The new health insurance reform package includes an immediate tax break for small businesses: the small business health insurance tax credit. Qualified small employers, including nonprofit employers, may reduce the cost of providing health insurance to their employees this year. However, the credit is complex and there are important limitations, especially when calculating the number of employees and other provisions. Don't let the complexity of the credit discourage you from exploring its benefits. This letter provides a high-level description of the credit; please contact our office so we can explain in detail how the credit may help cut your health insurance costs.

Small employers. The small business health insurance tax credit is targeted to employers that have no more than 25 full-time equivalent (FTE) employees paying wages averaging less than \$50,000 for each employee per year. According to the U.S. Department of Health and Human Services (HHS), a qualified small business can choose to start offering health insurance coverage to employees in 2010 and be eligible for the credit. HHS has also indicated that the credit is retroactive to January 1, 2010.

For tax years beginning in 2010 through 2013, the maximum credit reaches 35 percent of qualified premium costs paid by for-profit employers (25 percent for tax-exempt employers). For tax years beginning in 2014 through 2015, the maximum credit climbs to 50 percent of qualified premium costs paid by for-profit employers (35 percent for tax-exempt employers). However, an employer may claim the credit after 2013 only if it offers one or more qualified health plans through a state insurance exchange. The health care reform package requires states to create insurance exchanges by January 1, 2014.

Let's look at an example of how the credit works in 2010. A small manufacturer employs nine individuals with average annual wages of \$23,000 for each employee in 2010. The manufacturer pays \$72,000 in health care premiums for its employees. Assuming that the manufacturer meets all the other requirements, its credit for 2010 is \$25,200 (35 percent x \$72,000).

Employees. To determine eligibility for the credit, employers have to calculate their number of FTEs. The number of an employer's FTEs is determined by dividing the total hours for which the employer pays wages to employees during the year (but not more than 2,080 hours for any employee) by 2,080. The result, if not a whole number, is rounded to the next lowest whole number. Lawmakers selected 2,080 hours because 2,080 hours comprise the number of hours in a 52-week assuming a 40-hour work week. Any hours beyond 2,080, such as overtime hours, are not taken into account when calculating FTEs.

The following example illustrates how to calculate FTEs. A small business has nine employees. The small business pays five employees wages for 2,080 hours each for 2010; three employees wages for 1,040 hours each for 2010; and one employee wages for 2,300 hours for 2010.



KUENZI & COMPANY, LLC

Certified Public Accountants · Business Consultants
503-399-7306

SMALL EMPLOYER HEALTH INSURANCE TAX CREDIT

The total hours not exceeding 2,080 per employee is the sum of:

- * --10,400 hours for the five employees paid for 2,080 hours each (5 x 2,080) plus
- * --3,120 hours for the three employees paid for 1,040 hours each (3 x 1,040) plus
- * --2,080 hours for the one employee paid for 2,300 hours (lesser of 2,300 and 2,080), which add up to 15,600 hours.

To calculate the number of FTEs, 15,600 is divided by 2,080 which results in 7.5, rounded to the next lowest whole number.

Average annual wages. Employers also need to calculate average annual wages. The amount of average annual wages is determined by first dividing the total wages paid by the employer to employees during the employer's tax year by the number of the employer's FTEs for the year. The result is then rounded down to the nearest \$1,000 (if not otherwise a multiple of \$1,000).

Additional requirements. Congress imposed some important limitations on the credit. Employers must exclude certain individuals from the calculation of FTEs and average annual wages. These individuals include 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 businesses. Certain family members of these individuals are also excluded from the calculation of FTEs and average annual wages. These include a child, a parent, a sibling, and others. This list is not exhaustive. Please contact our office for more details about who is excluded from these calculations.

Additionally, the credit applies only to premiums paid by the employer under a qualifying plan. An employer's contribution is also linked to the average cost of health insurance in its state or part of a state. Our office can review your plan and determine if it meets the criteria for the credit.

The credit also affects an employer's deduction for the cost of health insurance premiums paid on behalf of employees. The amount of premiums that an employer may deduct is reduced by the amount of the small employer health care tax credit.

Guidance. The IRS has posted general information about the credit on its web site and is also sending postcards about the credit to more than four million small businesses nationwide. The IRS is expected to issue formal guidance shortly. Our office will keep you posted of developments.

Please contact our office if you have any questions about the new small employer health insurance tax credit.



KUENZI & COMPANY, LLC

Certified Public Accountants · Business Consultants
503-399-7306