



Health Care Reform: Update for Small Businesses

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Last month we posted an article highlighting several provisions of the recently enacted health reform legislation, including a tax credit available to many small businesses (the article can be found at <http://www.wrpr.com/articles/HealthReformHighlights.pdf>). Since this credit is available immediately, we thought it would be helpful to provide a summary of this credit and identify which employers can qualify to use it.

The purpose of the credit is to provide an incentive to certain small employers, including tax-exempt entities, to offer health insurance coverage to their employees. The maximum credit available to most small employers is 35% of health insurance premiums paid by the employer. The maximum credit available to tax-exempt entities is 25%. Initially, the credit is available to qualifying businesses for the 2010 through 2013 tax years.

When the State-based exchanges are implemented in 2014, though, the credit is only available for two more years to qualifying small employers that purchase health insurance coverage from the State-based exchanges. Also starting with the 2014 tax year, the maximum credit amount increases to 50% of premiums paid by most small businesses and 35% of premiums paid by tax-exempt entities.

To qualify for the credit, a small employer must pay at least 50% of employees' health insurance premiums. Only premiums for single coverage are taken into account. For example, if an employee elects family coverage, the employer just has to make sure it pays at least 50% of the premium for single coverage for that employee, which may be less than half the premium for the family coverage the employee is actually receiving.

The plan must also require an employer to make contributions to employees based on a uniform percentage of the premium cost. For example, an arrangement where the employer pays 80% and employees pay 20% of the health insurance premiums can qualify (but only the employer's portion of the payment is used to calculate the credit). Also, for 2010, all of the qualifying premiums paid by the employer- even premiums paid prior to the date the new health care laws were enacted- are taken into account.

When calculating the credit, the amount of the employer's premium is capped by the amount of the average premium for the same arrangement for the small group market in the employer's State or area within a State. Also, premiums paid under a salary reduction arrangement under a section 125 cafeteria plan are not treated as paid by the employer.

Since the credit is designed specifically to help small businesses and tax-exempt organizations, a qualifying business must employ less than 25 full-time equivalent (FTE) employees (not necessarily the exact number of employees), who are paid, on average, wages of less than \$50,000 per employee. In addition, the full amount of the credit is only available to employers with up to 10 FTE employees, whose average wages are less than \$25,000. The credit starts to phase out once the number of FTEs exceeds 10 or average wages exceed \$25,000.

The following employees are excluded when calculating the number of FTEs and average wages: seasonal workers, business owners (defined as sole proprietors, partners, shareholders owning more than 2% of an S corporation and any person owning more than 5% of any other business), and business owners' family members and members of their households. Consequently, premiums paid on their behalf are not taken into account when calculating the tax credit.

Qualifying small businesses can claim the credit on their annual income tax returns if they have taxable income for that year. Since the credit is a general business credit, it can be carried back for 1 year and forward for 20 years. Taking the credit will reduce employers' deductions for health insurance premiums, however.

Finally, late last week, the IRS issued some helpful guidance and answers to frequently asked questions regarding this tax credit, which can be found on the IRS website. The IRS will also be issuing additional guidance in the near future to explain, among other things, how an employer can qualify without paying a uniform percentage of the premium for each employee.

If you have questions about this tax credit or anything discussed in this update, please do not hesitate to contact us.

This article should not be construed as legal advice and is intended for general informational purposes only. If you have any questions regarding this article, you should consult your legal counsel.