

Planning for the Small Business Health Insurance Credit

One item in the healthcare reform bill passed last month which will be effective in 2010 is a new tax credit for small businesses. This credit will be available to small businesses which provide health insurance for their employees and pay for at least 50% of the employee's premiums. This is a complicated credit. But, in general, to be eligible for the credit a business has to have fewer than 25 full-time equivalent employees with an average full-time equivalent salary of less than \$50,000. Because this credit may first be claimed on the 2010 tax return, small businesses should start considering now whether they will be, or would like to be, able to take advantage of it.

Full-time Equivalent Employees - To calculate the number of full-time equivalent employees (FTEs), divide the total hours for which the employer pays wages to employees (not to exceed 2,080 for any one employee) by 2,080. Then round down to the nearest whole number. (Self employed individuals and their families are excluded from this group including partners, sole proprietors, 2% shareholders of an S corporation and 5% owners of the employer. Seasonal employees are also not included.) To be eligible for the credit, the resulting number of FTEs must be less than 25. Employers with between 10 and 25 FTEs are subject to a reduction in the credit. The reduction is 1/15 of the otherwise applicable credit for each FTE in excess of 10.

Average Annual Wages - To determine the average annual wages, divide the total wages paid during the year by the number of FTEs and round the result down to the nearest \$1,000. (Exclude wages for the same group of individuals as above.) To be eligible for the credit, the result must be less than \$50,000. For average annual wages between \$25,000 and \$50,000, the credit is subject to a reduction. The reduction is 1/25 of the otherwise applicable credit for each \$1,000 of average annual wages in excess of \$25,000.

Eligible Premiums - The employer must make non-elective contributions of at least 50% of the health insurance premiums for each employee enrolled in qualifying healthcare coverage offered by the employer. Through 2013, coverage purchased from health insurance companies generally should qualify, but of course, that should be confirmed with the health insurance provider. The 50% premium requirement applies only to coverage for the employee. If the employee carries additional individuals (e.g. spouse or dependents), the 50% requirement does not apply to that portion of the premium cost. The amount of the eligible premiums is capped at the average premium for the small group market in a state. Finally, the premiums included in the calculation only include those paid by the employer. Therefore, any premiums paid by the employee, including those paid through a salary reduction plan, are not eligible for the credit. However, premiums paid in 2010 prior to the date the healthcare legislation was enacted may be considered if they are otherwise eligible.

The Credit - The credit is calculated by multiplying the eligible premiums by 35% (25% for tax-exempt entities) and then reducing it for FTEs in excess of 10 and average wages in excess of \$25,000. After 2013 the credit increases to 50% of the premiums (35% for tax-exempt entities). An example follows:

An employer has 15 FTEs with average annual wages of \$32,000. The employer pays eligible premiums of \$50,000 during 2010. Its small business health insurance credit would be \$6,767.

Credit before reduction - $\$50,000 \times .35 = \$17,500$
Reduction for Excess FTEs - $\$17,500 \times 5/15 = \$5,833$
Reduction for Excess Wages - $\$17,500 \times 7/25 = \$4,900$
Credit - $\$17,500 - \$5,833 - \$4,900 = \$6,767$

Claiming the Credit - The credit is a general business credit and can be claimed beginning on 2010 income tax returns. The deduction for health insurance contributions is reduced by the amount of the credit. Generally the credit can be carried back one year and forward 20 years if not used in the year it is generated. However, for 2010, the credit cannot be carried back. Tax-exempt organizations are allowed to claim the credit against certain payroll taxes.

The IRS has recently issued guidance on the small business health insurance credit and posted frequently asked questions on its web site (www.irs.gov). It also has indicated that it will mail postcards to notify small businesses that may qualify for the credit. As with most of the items involved in the recent healthcare legislation, much more will be learned about this credit over time.

For more information, contact Joyce Waterbury at 919.301.6715.

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