Small Employer Tax Credit

Nuts and Bolts

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Agenda

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- General Information
- Who are Eligible Employers?
- How to Determine Full Time Equivalents
- How to Determine Average Annual Wages
- Qualifying Arrangements
- Uniformity
- Determining Premium
- Calculating Credit
- Claiming Credit

General Information

- Helps small businesses afford cost of coverage
- Targeted for employers with low and moderate income employees
- Encourages small employers to offer insurance coverage
- First available for 2010 tax year

Which Employers are Eligible for Tax Credit?

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- Fewer than 25 FTEs for tax year
- Average annual wages less than $50,000 per FTE
- Pay premiums under “qualifying arrangement”
- Tax-exempt employers – special rules to calculate credit
- Household employers
- Employers outside US
- No government employers
- Controlled group rules apply

Who is Excluded for Purposes of Calculating FTEs, Average Annual Wages and Premiums Paid?

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- Business owners, partners and family members
  - Self-employed individuals, including sole proprietors and partners in partnerships
  - Individuals owning more than 2% of S corporation
  - Individuals owning more than 5% of corporation
  - Certain family members and dependants of these individuals
    - Employee-spouses
- Seasonal workers unless worked more than 120 days during taxable year

How to Determine FTEs

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- Count/aggregate all employees who perform services
- Include
  - Leased(but not for premium)
  - Controlled group
  - Seasonal if >120 days
  - Former employees
  - Collectively bargained employees
  - Employees not in health plan
- Divide total hours of service by 2,080
- Round to next nearest lowest whole number

What are an Employee's Hours of Service?

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- Include each hour employee paid or entitled to payment for:
  - Performance of duties; and
  - Paid leave
- Methods to calculate
  - Actual hours of service
  - Days worked equivalency
  - Weeks worked equivalency
- Different methods ok for different classifications – if reasonable and consistent
- Can change method for each taxable year

Examples -- How to Determine FTEs

- Employer's payroll records show employee worked 2K hours and was paid for additional 80 hours for vacation, holiday and illness
  - Using actual hours of service method, employee must be credited with 2,080 hours
- Employee worked 49 weeks, took 2 weeks vacation and 1 week leave without pay
  - Using weeks worked equivalency, employee must be credited 2,040 hours (51 weeks X 40 hours/wk)
- Employer pays 5 employees wages for 2,080 hours each, 3 employees for 1,040 hours each and 1 employee for 2,300 hours
  - Employer uses actual hours worked to calculate

    10,400 hours for 5 employees paid 2,080 each

    3,120 hours for 3 employees paid 1,040 hours each

    2,080 hours for 1 employee paid 2,300 hours

    Total hours not exceeding 2,080 per employee = 15,600

    Employer has 7 FTEs (15,600/2,080 = 7.5 rounded down)
- Employer has 26 FTEs with AAW of $23K per FTE. Only 20 employees enrolled in plan
  - Not a qualified employer b/c more than 25 FTEs

How to Determine Average Annual Wages

- Total wages/number of FTEs
- Round down to nearest $1,000 (if not otherwise multiple of $1,000)
  - Ex. $224,000 paid for 10 FTEs

    $224,000/10 = $22,400 round down to $22,000

What is a Qualifying Arrangement for Tax Years 2010-2013?

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- Must pay premium for each employee enrolled in insurance in amount equal to a uniform percentage (not less than 50%) of premium cost of coverage
- Premium must be for "health insurance coverage" – includes
  - Medical care (hospital, HMO)
  - Limited scope dental or vision
  - Long-term care
  - Nursing home care
  - Home health care
  - Community-based care
  - Coverage for specified disease or illness
  - Hospital indemnity or other fixed indemnity insurance
  - Medicare supplemental and certain other supplemental coverage
  - Does NOT include self-insured plan
- Cannot aggregate plans to meet qualifying arrangement requirement

Uniformity

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- Composite vs. List Billing
  - Composite: charge uniform premium for each employee or bill single aggregate premium for group and employer splits up
  - List: separate premium amount listed for each employee based on employee’s age or other factors
- One tier vs. multiple tiers
- One plan vs. multiple plans

Uniformity – Employers Offering One Plan

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(a)self-only coverage—composite billing. Pay same amount toward premium for each employee
receiving self-only coverage under the plan – must be at least 50% of the self-only premium

(**b)other tiers of coverage—composite billing.** (i) Pay same amount for all employees in tier (no less than amount would have contributed toward self-only coverage for that employee); or (ii) meet basic uniformity rule (uniform amt of at least 50% of premium) for each tier

(c) self-only coverage – list billing. (i) Pay uniform percentage (not less than 50%) of the premium
charged for each employee; or (ii) convert individual premiums for self-only coverage into composite
rate -- if employee contribution is required, each employee who receives coverage under the plan
must pay uniform amount toward self-only premium that is no more than 50% of the employer-
computed composite rate.

(d) other tiers of coverage—list billing. (i) Pay amount equal to amount would have contributed for that employee for self-only coverage (calculated on actual premium or composite rate for single coverage); or (ii) meet basic uniformity rule for each tier by substituting composite rate for that tier for composite rate for self-only

Uniformity – Employers Offering Multiple Plans

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2 ways to satisfy

- Plan- by-Plan Method: satisfy uniformity on a plan-by-plan basis
  - Amounts/% don't have to be identical as long as satisfy uniformity requirement for each of the plans; or
- Reference Plan Method
  - Satisfy anti-abuse rule: self-only composite rate for reference plan must be at least 66% of self-only composite rate for each non-reference plan with respect to which the employer claims the credit
  - Designate reference plan and make contributions as follows:
    - determine level of contributions for each employee that would satisfy uniformity if each eligible employee enrolled in the reference plan
    - allow each employee to apply that amount either toward the reference plan or toward the cost of coverage under any of the other health insurance plans the employer makes available

Transition Relief for 2010

Don't have to pay uniform % of premium for each employee as long as minimum premium paid is 50%

- Example: 9 FTEs with AAW of $23K per FTE. 6 employees have single coverage ($8,000), 3 have family ($14K). Employer pays 50% of premium for single coverage for each employee in single or family coverage (50% X $8,000 = $4K for each employee). Employer pays $4K for each of 6 employees on single and $4,000 for each of 3 on family.
  - Deemed to satisfy uniformity requirement for qualifying arrangement under transition rule

- Example: same as above except employer pays 50% premium for employees on single coverage ($4K for 6 employees) but pays no premium for employees on family coverage
  - Employer does not satisfy uniformity requirement for qualifying arrangement

Qualifying Arrangement – After 2014

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- Employer must make non-elective contributions for each employee enrolled in qualified health plan through an exchange in an amount equal to a uniform percentage (not less than 50%) of premium cost of qualified health plan

Amount of Employer’s Premium Payments Taken into Account in Calculating Credit

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- Limited to average premium for small group market in state employer offers coverage
  - Rev. Rul. 2010-13
- Count only premium paid by employer
- Don’t count premiums paid per pre-tax salary reduction
- Don’t include premium for excludable individuals
- Don’t count employer contributions to health FSA, HRA or HSA premiums
- Can include premiums paid in 2010 tax year before PPACA enacted
- Contributions by employer to multiemployer plan used to pay premiums for health coverage are treated as payment of health insurance premiums by employer

Examples –Determining Premium

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- Eligible small employer offers plan with single and family coverage. 9 FTEs with AAW of $23,000 per FTE. 4 employees in single coverage, 5 in family coverage. Employer pays 50% single and 50% family. Total single $4,000, total family $10,000. Average SGM $5,000 single, $12,000 family.
  - Employer's premium payments for each FTE ($2K, $5K) do not exceed 50% of average premium SGM ($2,500, $6K)
  - Amt of premium paid by employer for purposes of calculating credit is $33K (4 X $2K) + (5 X $5K)
- Same facts as above except single premiums $6K, family $14K
  - Now employer's premium payments for each FTE ($3K, $7K) exceed 50% of average premium SGM ($2,500, $6K)
  - Amt of premium paid by employer is $40K (4 X $2,500) + (5 X $6K)

Examples – Determining Premium

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- Eligible small employer offers major medical and dental plans. Pays 50% of premium cost for single for all employees in major med and 50% premium cost for single coverage for all employees in dental
  - Employer can take into consideration premiums paid for both major medical and dental, but only up to 50% of amount of average SGM
- Same facts as above except employer pays 40% of premium cost for single coverage for all employees enrolled in dental
  - Employer can only take into consideration premiums paid for major medical, up to 50% of amt of average SGM, and not any premiums paid for dental plan

How do you Calculate Credit prior to 2014?

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- Calculate maximum amount of credit
  - Maximum 35% available if 10 or less FTEs and average annual wages $25K or less
  - Tax-exempt maximum 25% -- can't exceed total amount of income tax and Medicare tax
- Reduce maximum credit in accordance with phase-out, if necessary
  - >10 FTEs: numerator is # FTEs in excess of 10, denominator is 15
  - >$25K: numerator is amt annual wages exceeds $25K, denominator is $25K
  - Both: add together (may reduce credit to 0)
- Determine actual premium payment if receiving state subsidy/credit
  - If paid directly to employer, premium payment by employer not reduced to satisfy qualifying arrangement
  - If paid directly to insurance company, state is treated as making payments on behalf of employer to satisfy qualifying arrangement and treated as employer contribution to calculate credit
  - Amt of credit can't exceed amt of employer's net premium payments
  - If state administered program (ex. Medicaid) makes payments that aren't contingent on maintenance of plan, don't take into account to determine credit

Examples of Calculating Credit

- A taxable eligible small employer has 9 FTEs with AAW of $23,000 per FTE. Employer pays $72K in premiums.
  - Credit is $25K (35% X $72K)
- Tax-exempt eligible small employer has 10 FTEs with AAW of $21K per FTE. Employer pays $80K in premiums. Total amount of employer's income tax and Medicare tax withholding, plus share of Medicare tax is $30K.
  - Initial amount of credit before reduction (25% X $80K) = $20K
  - Employer's withholding and Medicare taxes: $30K
  - Total credit = $20K (lesser of $20K and $30K)

Examples of Calculating Credit

- Taxable eligible small employer has 12 FTEs and AAW of $30K. Employer pays $96K in premiums.
  - Initial amount of credit before reduction: (35% X $96K) = $33,600
  - Credit reduction for FTEs in excess of 10: ($33,600 X 2/15) = $4,480
  - Credit reduction for AAW in excess of $25K: ($33,600 X $5K/$25K) = $6,720
  - Total credit reduction: ($4,480 + $6,720) = $11,200
  - Total credit = $22,400 ($33,600 - $11,200)

- Employer's state provides subsidy up to 40% of premiums for each eligible employee, paid directly to employer. Employer has 1 employee with premiums $100/mo ($80 by employer, $20 by employee through Section 125 plan). State pays employer $40/mo as subsidy.
  - Amount of premiums is $80/month (premiums paid by employer without regard to subsidy from state)

Examples of Calculating Credit

- Employer's state provides premium subsidy up to 50% each eligible employee, paid directly to employer's health insurance provider. Employer has 1 employee enrolled in single coverage whose premiums are $100/mo (employer pays $30, state pays $50, employee pays $20). State pays $50 directly to insurance company and insurance company bills employer $50/mo (employer and employee share).
  - Amount of premiums paid by employer is $80/mo (sum of employer's payment and state's payment)
- Same as above except premiums paid as follows: $20 by employer, $50 by state, $30 by employee.
  - Amount of premiums paid by employer is $70/mo, which is more than 50% of $100 monthly premium payment. Amount of premium to calculate maximum credit is $70/mo. Max credit is $24.50 ($70 X 35%)
  - Employer's net premium payment is $20 (actual amount paid by employer excluding state subsidy).
  - After applying limit for employer's net premium payment, credit is $20/mo (lesser of $24.50 or $20)

Calculating Credit in 2014 and After

- Credit increases to 50% (35% for tax-exempt)
- Requirements for qualifying arrangement different than those applicable to earlier years
  - Non-elective contributions for 2014 and later must be made on behalf of employee who enroll in a qualified health plan offered to employees by employer through an exchange
- Contributions to which % is applied are lesser of:
  - Aggregate non-elective contributions employer made on behalf of employees during tax year toward qualifying health plan premiums OR
  - Aggregate amount of non-elective contributions employer would have made if each employee for whom contributions were made had enrolled in qualified health plan which had a premium equal to average premium for the small group market in rating area employee enrolls
- Tax credit available beginning 2014 only available to employer for 2 consecutive years
  - 6 years total

How to Claim Credit – Taxable Employers

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- Claim credit on employer's annual income tax return with attached Form 8941: Credit for Small Employer Health Insurance Premiums
- Report amount calculated on Form 8941 as part of general business credit on Form 3800: General Business Credit and attach both forms to tax return
  - Unused credit carried back one year and forward 20 years
- Not payable in advance to employer
- Not refundable

How to Claim Credit – Tax-Exempt Employers

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- File Form 990-T (Exempt Organization Business Income Tax Return) with attached Form 8941 showing calculation of credit
- Can claim credit even if no taxable income for the year
- Credit is refundable – can still receive refund as long as doesn't exceed employer's income tax withholding and Medicare tax liability

Offsetting credit

- Can use to offset Alternative Minimum Tax (AMT) liability subject to certain limitations for the year
- Amount of premiums that can be deducted (in determining employer's allowable deduction for health insurance premiums) is reduced by amount of credit
- Credit does not apply against employment taxes (social security, Medicare, withheld income)

References

- IRS FAQs: www.irs.gov/newsroom/article/0,,id=220839,00.html
- IRS Notice 2010-44: www.irs.gov/pub/irs-drop/n-10-44.pdf
- IRS Notice 2010-82: www.irs.gov/pub/irs-drop/n-10-82.pdf
- IRS Revenue Ruling 2010-13: www.irs.gov/pub/irs-drop/rr-10-13.pdf

Questions? Contact your legal or tax advisor or your independent broker Total Benefit Solutions Inc.

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