

# Small Employer

## Tax Credit Under the Affordable Care Act

This document provides general information only. It is not intended to provide legal or tax advice. If you have questions about how to comply with this legislation, please consult with your attorney.



On May 17, 2010, the Internal Revenue Service released detailed guidance in the form of Notice 2010-44 (the Notice) explaining the new small employer tax credit under the Patient Protection and Affordable Care Act (the Affordable Care Act). The information is meant to help small employers determine if they qualify for the new tax credit and estimate the amount of the credit they will receive. The Notice refers to the credit by the section of the tax code in which it will be codified—Section 45R.

The IRS said in an accompanying news release that the Section 45R credit is designed to encourage small employers to offer health coverage for the first time or to maintain coverage they already provide. The Section 45R credit covers up to 35 percent (25 percent for tax-exempt employers) of the premiums that eligible small businesses pay on behalf of their employees. The maximum credits are available for eligible small employers with 10 or fewer full-time equivalent employees (FTEs) with average annual wages under \$25,000, and gradually phase out as the number of FTEs and the amount of average annual wages increases.

### Determining Eligibility

In order for an employer to qualify for the credit:

- it must have fewer than 25 FTEs for the taxable year;
- the average annual wages of its employees for the year must be less than \$50,000 per FTE; and
- it must maintain a “qualifying arrangement” under which the employer pays a uniform percentage of at least 50 percent of the premium cost of the health coverage for each employee covered under the employer-provided insurance.

The Notice provides the following steps for determining whether an employer is eligible for a credit under Section 45R:

1. Determine the employees who are taken into account for purposes of the credit.
2. Determine the number of hours of service performed by those employees.
3. Calculate the number of the employer’s FTEs.
4. Determine the average annual wages paid per FTE.
5. Determine the premiums paid by the employer that are taken into account for purposes of the credit. Specifically, the premiums must be paid by an employer under a qualifying arrangement and must be paid for health insurance that meets the requirements of section 45R.

The Notice provides details for each of these steps. For example, in determining what employees are taken into account for purposes of the credit, the notice specifies that sole proprietors, partners in a partnership, shareholders owning more than two percent of an S corporation, and any owners of more than five percent of other businesses are not taken into account as employees for purposes of the credit. Neither are family members of these owners and partners. The wages of these owners and partners and their family members are disregarded in determining FTEs and average annual wages, and the premiums paid on their behalf are not counted in determining the amount of the credit.

The wages of seasonal workers are also disregarded unless they work for the employer on more than 120 days during the taxable year, though premiums paid on their behalf may be counted in determining the amount of the credit.

Employers may use any of the following methods to calculate the total number of hours of service that must be taken into account for an employee for the year:

- determine actual hours of service from records of hours worked and hours for which payment is made or due, including such payment for illness, vacation, holiday, and other applicable leave of absence time;
- use a “days-worked equivalency” through which the employee is credited with eight hours of service for each day for which he or she would be required to be credited with at least one hour of service; or

## Employer Qualification

- 1 ) Fewer than 25 FTEs
- 2 ) Average wages less than \$50k/FTE
- 3 ) Pay at least 50% of premium cost



- use a “weeks-worked equivalency” through which the employee is credited with 40 hours of service for each week for which he or she would be required to be credited with at least one hour of service.

The Notice also provides guidance on how to determine the number of an employer’s FTEs (divide the total hours of service credited to employees that may be counted up to a maximum of 2080/employee by 2,080; for example, an employer with 46 half-time employees has 23 FTEs), and how to determine the employer’s average annual wages for the taxable year.

### Qualifying Arrangement

The Notice defines a “qualifying arrangement” as “an arrangement under which the employer pays premiums for each employee enrolled in health insurance coverage offered by the employer in an amount equal to a uniform percentage (not less than 50 percent) of the premium cost of the coverage.”

Qualifying health insurance coverage consists of benefits for medical care provided through insurance or reimbursement under any hospital or medical service policy, certificate or contract, including limited scope dental or vision coverage, long-term care, nursing home care, home health care, coverage for a specified disease or illness, hospital indemnity insurance and Medicare supplemental health insurance.

Different types of coverage are not aggregated for purposes of meeting the qualifying arrangement requirement, so if an employer offers a medical insurance plan and a stand-alone vision plan, for example, each type of coverage must separately satisfy the requirements for a qualifying arrangement.

**Important limitation:** The amount of an employer’s premium payments that are taken into account in calculating the credit is limited to the premium payments the employer would have made under the same arrangement if the average premium for the small group market in the State (or area within the State) in which the employer offers coverage were substituted for the actual premium. For example, if an employer pays 80 percent of the premiums for the coverage it provides to its employees, the premiums that are taken into account for purposes of the credit are the lesser of 80 percent of the actual premiums paid or 80 percent of the premiums that would have been paid for the average small group in the employer’s State (or area within the State).

### Transition Relief for Tax Years Beginning in 2010

The Notice provides transition relief for tax years that begin in 2010 with respect to the requirement that the employer pay a uniform percentage (not less than 50

percent) of the premium cost. For 2010 tax years, this “uniformity requirement” will be deemed to be satisfied as long as the employer pays for each employee an amount equal to at least 50 percent of the premium for single (employee-only) coverage, even if the employer does not pay the same percentage of the premium for each such employee, i.e., because its contribution for family coverage isn’t a uniform percentage.

### Coordination with State Tax Credits

Small businesses receiving state health care tax credits may still qualify for the full federal credit, and goes into details on how the two subsidies would interact. In this situation, for purposes of determining whether the employer has satisfied the “qualifying arrangement” requirement to pay an amount equal to a uniform percentage (not less than 50%) of the premium cost, the premium payment made by the employer is not reduced by the state credit or subsidy.

### Claiming the Credit

Eligible employers will claim the credit on their annual income tax returns, as part of the general business credit. An unused credit amount may be carried back one year or forward 20 years. However, because the unused credit amount cannot be carried back to years prior to the enactment of the credit, for 2010 tax years unused credit amounts can only be carried forward. The credit can be reflected in estimated tax payments and can offset an employer’s alternative minimum tax liability for the year (subject to certain limitations). An employer cannot take a deduction under IRC § 162 for that portion of the health insurance premiums paid that is equal to the amount of the section 45R credit.

### More Guidance Coming

The IRS stated it will provide tax-exempt employers with further information on how to claim the credit, and requested that taxpayers submit comments on issues that should be addressed in future guidance that it plans to issue on additional issues under Section 45R, such as the application of the uniformity requirement and the 50 percent requirement for taxable years beginning after 2010.

A copy of the full Notice is available [here](#).

