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To: Clients, Friends & Associates of Pro@ctive CPA
From: Mark Wyssbrod, Managing Member
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Re: Health Insurance Credit Update

The Health Insurance Credit for Small Employer Update

Once again the complexity of the Health Care Act of 2919 (HCA) is causing confusion with both employer responsibility and employee wants. Many employers believe all small businesses qualify for a tax credit for providing health insurance to their employees. At the same time employees believe their health insurance must be 100% paid by the employer. Neither is fully true. Below we will review the general characteristics of the rules and the phase-outs to the Health Insurance Credit.

General Characteristics of the Credit

First, to be eligible for the credit small business owners must contribute 50% of the health insurance premium for all qualified employees (Section 45R (d)(4)). Further costs on the employer is the health insurance contributions from the employer <u>**cannot**</u> be the result of a salary reduction agreement (Sec 45R (e)(3)). Generally speaking, the credit is 35% (25% for non-profits) of the employer paid portion.

<u>For example</u>, Joe, the employee, earns $30,000 and his health insurance premiums are $4,000 a year. The employer arranges with Joe to reduce his wages to $28,000 and pay the full amount of insurance. The health insurance premiums would not qualify for health care credit. In other words, the employer has to increase costs (i.e. potentially reduce profit and cash flow as well as take on additional risk) in order to qualify for the credit.

If the business did not attain profitability in 2010 you should still take time to calculate the credit. Although the tax credit is not refundable (it can only be used to offset tax), the tax credit can be carried forward 20 years. In tax year 2010 you will be able to carry back the tax credit to 2009.

Phase-outs

Well, if every small business qualified for the credit it would be too straight forward! Congress added some additional rules to ensure only selected small businesses (the ones they deemed needing help) to receive the tax credit. When Congress targeted a select set of small businesses to receive the tax credit it added complexities to the tax credit by inserting phase-outs.

The first phase-out is for employer with more than 10 full time employees (25 full time employees is the maximum) and the second phase-out is for employers who pay employees more than $25,000 per employee.

The phase-out for 10 and 25 full time employees include part-time employees. The 10 full time employees are worded as full-time equivalent (FTE). An employer might have 20 part-time employees which could be the equivalent to 10 FTEs. Seasonal employees do not count as FTE unless they worked more than 120 days. This rule is to encourage employers to hire full time employees instead of part-time employees. An employer with more than 25 FTEs does not qualify for the credit. The business owner and related parties do not count towards the credit.

The hours for each employee are limited for the calculation to 2,080 per employee. These hours are used to calculate the total # of FTEs.

The Calculations

Initial Tax Credit = 35% of qualified employer paid health care premiums

Phase-out for employers between 10 and 25 FTEs = Initial credit x [(number of FTEs -10)/15]

Phase-out for employee wages = Initial credit x [(average annual wage - $25,000)/$25,000]

Health Insurance Credit = Initial credit – Phase-out for FTEs – Phase-out for employee wages

The employer cannot claim the full health insurance expense and receive the health insurance credit. Instead the employer can claim the health insurance expense less the tax credit amount received and the health insurance credit.

In Conclusion

It seems in life that nothing is easy! The health insurance example is one of these items. A small business may receive a benefit, but it will have to jump through a lot of hoops and face increased tax preparation and advisory fees. An employer must also be aware that not providing health insurance in the future may be subject to costly penalties.

Citing

"The Health Insurance Credit For Small Employers" Wayne M. Schell, CPA, Ph.D., The Tax Adviser, October 2010.