Now Available - Tax Credits for Small Business Healthcare Premium Costs

Legal Alert

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The recently enacted Health Care and Education Reconciliation Act of 2010 (the Act) has some key provisions for small business owners. One major item is a tax credit for nonelective contributions to purchase health insurance for employees. In contrast to the existing deduction that employers may take for healthcare premiums, the tax credit, which is a dollar-for-dollar reduction in tax, can offset an employer's regular tax or its alternative minimum tax (AMT) liability.

Eligibility

To qualify, a business must offer health insurance to its employees as part of their compensation and contribute at least half the total premium cost. In general, the business must have no more than 25 full-time equivalent employees (FTEs), and the employees must have annual full-time equivalent wages that average no more than $50,000. The credit is phased out as the number of FTEs reaches 25 and as the average wage amount approaches $50,000. For instance, the full amount of the credit is available only to an employer with 10 or fewer FTEs and whose employees have average annual full-time equivalent wages from the employer of not more than $25,000.

To determine the number of the employer's FTEs, the Act does not permit a simple head count, but rather provides a formula based on the number of hours worked by full and part time employees divided by 2,080 (40 hours per week at 52 weeks). Additionally, for purposes of eligibility for the credit in general and when counting the number of FTEs and calculating the average wage, certain employees and others are excluded. For example, **self-employed individuals, including partners and sole proprietors, two percent shareholders of an S corporation, and five percent owners of the employer are not treated as employees for purposes of this credit**. There is also a special rule to prevent sole proprietorships from receiving the credit for the owner and the owner's family members.

Applicable Tax Years for the Credit

The credit is initially available for any tax year beginning in 2010, 2011, 2012, or 2013. Qualifying health insurance for claiming the credit for this first phase of the credit is health insurance coverage purchased from an insurance company licensed under state law. For tax years beginning after 2013, the credit is only available to an eligible small employer that purchases health insurance coverage for its employees through a state exchange, and is only available for two years.

Claiming and Calculating the Credit

Eligible employers can claim the credit as part of the general business credit starting in tax year 2010. The Internal Revenue Service has also indicated that the credit can be reflected in determining estimated tax payments for the year to which the credit applies, in accordance with regular estimated tax rules. For tax years beginning in 2010, 2011, 2012 and 2013, the credit is generally 35 percent (50 percent for tax years beginning after 2013) of the employer's nonelective contributions toward the employees' health insurance premiums. As mentioned, the credit phases out as company size and average wages increase.

Moreover, the employer is entitled to an ordinary and necessary business expense deduction equal to the amount of the employer contribution in excess of the dollar amount of the credit. For example, if an employer pays 100 percent of the cost of its employees' health insurance coverage and the amount of the tax credit is 35 percent of that cost (i.e., in tax years 2010-2013), the employer can claim a deduction for the balance of the premium cost.

If you would like more information about the extensions discussed in this alert, please contact a member of the Taxation Practice Group at Flaster Greenberg PC.

ATTORNEYS MENTIONED

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