Small Business Health Care Tax Credit

Certain small businesses and tax-exempt employers that pay at least half of the premiums for employee health insurance coverage may be eligible for the small businesses health care tax credit. For tax years 2010–2013, the maximum credit is 35% for small business employers and 25% for small tax-exempt employers. For tax years beginning in 2014 or later, the maximum credit increased to 50% of premiums paid for small businesses and 35% of premiums paid for small tax-exempt employers.

Special Update: Effect of Sequestration on Small Business Health Care Tax Credit

Part of the automatic cuts that took place as of March 1, 2013 reduce the refundable portion of the Small Business Health Care Tax Credit for certain small tax-exempt employers. The sequestration reduction rate will be applied unless and until a law is enacted that cancels or otherwise impacts the sequester, at which time the sequestration reduction rate is subject to change.

Employer Eligibility

In order to be an eligible small employer:

- An employer must have **fewer than 25 full-time equivalent employees**(FTEs) for the taxable year; The average annual wages of its employees for the year must not exceed **$50,000 ($50,800** for tax year 2014 and $51,600 for tax year 2015); and
- The employer must pay **at least 50% of the premium cost** for single health care coverage for each employee.

For tax years beginning in 2014 or later, the employer must contribute toward premiums on behalf of each employee enrolled in a qualified health plan offered by the eligible small employer through a Small Business Health Options Program (SHOP Marketplace) to qualify for the credit.

Calculating the Credit

For each year from 2010 through 2013, the maximum credit is 35% of premiums paid by eligible small businesses and 25% of premiums paid by eligible tax-exempt organizations. Beginning in 2014, **the maximum credit increased to 50% of premiums paid by eligible small businesses** and 35% of premiums paid by eligible tax-exempt organizations.

For tax year 2015, the maximum credit is phased out based on the employer's number of full-time equivalent employees in excess of 10 and the employer's average annual wages in excess of **$25,800** (up from $25,400 in 2014 and $25,000 for 2013).

What Expenses Count?

Only premiums paid by the employer under a qualifying arrangement count.

- For tax years 2010 through 2013, only premiums paid to a health insurance issuer, such as an insurance company or HMO, count for purposes of the credit. For tax years beginning in 2014 or later, only premiums paid for qualified health plans offered through a SHOP Exchange count for purposes of the credit.
- Employer contributions to health reimbursement arrangements (HRAs), health flexible spending arrangements (FSAs) and health savings accounts (HSAs) are not taken into account for purposes of the credit.

The employer must pay at least 50% of coverage. However, if the employer provides more than one type of coverage or if the employer's health insurance provider does not charge the same premium for all enrolled employees, the employer may qualify even if he or she paid less than 50% of the premium cost for some employees.

- If an employer pays only a portion of the premiums and employees pay the rest, the amount counted to calculate the credit is only the portion paid by the employer. For example, if an employer pays 80% of the premiums, and employees have the other 20% taken out of their pay, only the 80% paid by the employer counts.
- In addition, the amount of an employer's

Small Business Health Care Tax Credit

premium payments that are taken into account in calculating the credit is capped. The employer's premium payment may not be more than the average premium for the small group market in the state where the employer offers coverage. If an employer pays 80% of the premiums, what counts is the 80% paid by the employer or 80% of the small group market average—whichever is less.

Determining FTEs and Average Annual Wages

How to Calculate FTEs

The number of full-time equivalent employees (FTEs) is determined by dividing the total hours of service for which the employer pays wages to employees during the year (not more than 2,080 hours for any employee) by 2,080. If the result is not a whole number, it is rounded to the next lowest whole number.

An employee's hours of service include each hour for which he or she is paid, or entitled to payment, during the employer's tax year. Hours of service may be calculated using one of three methods:

1. Determine actual hours of service from records of hours worked and hours for which payment is made or due, including hours for paid leave;

2. Use a days-worked equivalency whereby the employee is credited with 8 hours of service for each day for which payment is, made or due including days of paid leave; or

3. Use a weeks-worked equivalency whereby the employee is credited with 40 hours of service for each week for which payment is made or due including weeks of paid leave.

How to Calculate Average Annual Wages

The amount of average annual wages is determined by dividing the total wages paid by the employer during the tax year by the number of FTEs for the year. The result is then rounded down to the nearest $1,000 (if not otherwise a multiple of $1,000). For this purpose, an employer should use wages as defined for FICA purposes (without regard to the wage base limitation).

How to Claim the Credit

An employer (other than a tax-exempt employer) claims the credit on the employer's annual income tax return, with an attached Form 8941 showing the calculation of the credit. Small business employers who did not owe tax during the year may be able to carry the credit back or forward to other tax years.

Tax-exempt organizations claim the credit by filing Form 990-T with an attached Form 8941 showing the calculation of the credit. The credit is refundable for tax-exempt employers, so the employer may receive a refund even if it has no taxable income. However, the amount of the credit cannot be more than the total amount of income and Medicare tax the employer is required to withhold from employees' wages for the year and the employer share of Medicare tax on employees' wages for the year. Starting in 2014, an employer may claim the credit for two-consecutive taxable years, beginning with the first taxable year in or after 2014 in which the eligible small employer attaches a Form 8941 to its income tax return, or in the case of a tax-exempt eligible small employer, attaches a Form 8941 to the Form 990-T. An eligible small employer may take the credit for tax years beginning in 2010 through 2013 without those years counting toward the two-consecutive taxable year period.