



## **Small Business Health Care Tax Credit Frequently Asked Questions**

### 1. Which employers are eligible for the small employer health care tax credit?

Small employers that provide health care coverage to their employees may be eligible for a Federal income tax credit for the health insurance premiums paid for employees. In order to qualify, employers must have fewer than 25 full-time equivalent employees (FTE), pay less than \$50,000 in average annual wages to each FTE, and pay premiums through a qualifying agreement (see question 2 for details).

### 2. What expenses are counted in calculating the credit?

Only premiums *paid by the employer* are counted in calculating the credit. In a qualifying agreement, the employer pays premiums for each employee enrolled in health care coverage offered by the employer. Only premiums less than or equal to the State average (yet to be determined) will qualify. The employer must *uniformly* cover at least 50% of the cost of a single-coverage premium for the employee. If the employer is covering less than 50% of a family or self-plus-one plan, but is paying at least 50% of an equivalent single-coverage premium, the employer satisfies the 50% coverage requirement.

If the employer does not cover a uniform percentage of premiums for all employees but meets all other requirements, relief is temporarily available to allow the employer to qualify for the credit.

### 3. What is the maximum credit for a qualified employer?

For tax years beginning in 2010 through 2013, the maximum credit is 35% of the employer's qualifying premium expenses.

Example: An employer has 9 FTEs with average annual wages of \$23,000 per FTE. The employer pays \$72,000 in health care premiums for those employees and the premiums do not exceed the State average. The credit for 2010 equals \$25,200 (35% of \$72,000).

4. How is the credit reduced if the number of FTEs exceeds 10 or the average annual wages exceed \$25,000?

The credit may be reduced by either or both of the above situations. If the number of FTEs exceeds 10, the reduction is determined by multiplying the otherwise available credit by the number of FTEs in excess of 10 and dividing by 15. If the average annual wages exceed \$25,000, multiply the otherwise available credit by the average annual wages in excess of \$25,000 and divide by \$25,000. The actual credit will be the otherwise available credit less either or both the reductions. Depending on the amount of the reductions, the credit may be fully eliminated for some qualifying employers.

Example: For the 2010 tax year, a qualified employer has 12 FTEs and average annual wages of \$30,000. The employer pays \$96,000 in health care premiums for these employees and the premiums do not exceed the state average.

A - Initially available credit:	(35% x \$96,000)	\$33,600
B - Credit reduction for excess FTEs:	(\$33,600 x 2/15)	(\$ 4,480)
C - Credit reduction for excess wages:		
	(\$33,600 x \$5,000/\$25,000)	<u>(\$ 6,720)</u>
D - Total 2010 Tax Credit		\$22,400)

5. How is the number of FTEs determined for the credit?

The number of an employer's FTEs is determined by dividing the total hours for which the employer pays wages to employees during the year (limited to 2,080 per employee) by 2,080. The result is rounded down to the next lowest whole number.

Example: For the 2010 tax year, an employer pays 5 employees for 2,080 hours, 3 employees for 1,040 hours, and 1 employee for 2,300 hours. The number of FTEs would be calculated as follows:

A - 5 employees x 2,080 hours	10,400
B - 3 employees x 1,040 hours	3,120
C - 1 employee x 2,300 (limited to 2,080)	<u>2,080</u>
Total Hours	15,600

Number of FTEs: 15,600 total hours / 2,080 = 7.5 Rounded to: 7 FTEs

Because the credit is based on the number of FTEs, an employer with more than 25 employees may qualify for the credit.

6. How is the amount of average annual wages determined?

The amount of average annual wages is determined by dividing the total wages paid to employees during the employer's tax year by the number of FTEs for the year. The result is rounded down to the nearest \$1,000. For the credit, wages are wages as defined for FICA purposes without regard to the Social Security wage base limitation.

Example: For the 2010 tax year, an employer pays \$224,000 in wages and has 10 FTEs.

Average annual wages:  $\$224,000 / 10 \text{ FTEs} = \$22,400$ , rounded to \$22,000

7. Do seasonal workers, business owners, or family members who work for the business count in determining the credit?

Generally, none of these workers count in determining the number of FTEs and any premiums paid on their behalf do not qualify for the credit. A sole proprietor, a partner in a partnership, a shareholder owning more than two percent of an S corporation, and any other owner of more than five percent of other businesses are not considered employees for purposes of the credit. Seasonal workers are disregarded, unless they work for the employer on more than 120 days, and family members are not considered employees for the purposes of the credit.

8. How is the credit claimed and what are limitations to the credit?

The credit is claimed on the employer's income tax return. The credit is limited to taxable income (it cannot create a loss), but may be carried back one year or carried forward for 20 years. Unused credits from 2010, however, may only be carried forward.

9. Does taking the credit affect an employer's deduction for health insurance premiums?

Yes. The amount of premiums that may be deducted on the employer's income tax return must be reduced by the amount of the credit.

Special rules apply to calculating the credit for tax-exempt employers. If you have any questions about the Small Business Health Care Tax Credit, please contact our office at (717) 392-8200 to speak with Erin Bensing or another member of our Tax Department.