

Eye On Washington

IRS ISSUES FINAL GUIDANCE ON THE SMALL EMPLOYER TAX CREDIT

The health care tax credit is designed to encourage and assist small businesses and small tax-exempt organizations in offering health insurance coverage to their employees. The new guidance in **Notice 2010-82** provides clarification on employers eligible for the tax credit, determination of who are employees, what a “qualified arrangement” is, as well as several tools needed to claim the credit.



BACKGROUND

A health care tax credit is available to for-profit and nonprofit “qualified” small employers that provide health care coverage to their employees. In order to be a “qualified employer,” the following requirements must be met:

- The employer must have fewer than 25 full-time equivalent employees (FTEs) for the year
- Average annual wages for the employees for the year must be less than \$50,000 per FTE
- The employer must pay the premium under a “qualifying arrangement”

The credit is available for 2010 through 2013 and for any two years after 2014. During 2010-2013, an eligible small employer may claim a credit of up to 35% (25% for tax-exempt employers) of its credit-eligible health insurance premiums. As of January 1, 2014, an eligible small employer may claim a credit of up to 50% of its premium contributions under a qualified health plan offered through a state-based exchange for the first two years the employer offers an exchange-based plan.

The credits are completely phased out for employers that have 25 or more full-time equivalent employees or that pay average wages of \$50,000 or more per year. Thus, the maximum credit goes to smaller employers – those with 10 or fewer full-time equivalent employees – paying average annual wages of \$25,000 or less per year.

The IRS previously provided initial guidance in IRS Notice 2010-44, which generally addressed four issues:

- Employers eligible for the tax credit
- Calculation of the credit
- Claiming the credit
- Transitional relief for the 2010 taxable year

TOOLS TO CLAIM THE 2010 CREDIT

The tools that a small employer needs to claim the tax credit are included in the most recent guidance. First, there is the new Form 8941 “**Credit for Small Employers Health Insurance Premium**” and a revised Form 990-T. Also included are instructions for Form 8941. Form 8941 is to be used by eligible small businesses to determine the tax credit which is then included as part of its general business credit on its income tax return. Note that any health care tax credit received reduces the employer’s allowable deduction for health insurance premiums.

Form 8941 is also used by tax-exempt organizations to determine their refundable credits, which are then reported on Form 990-T. The refundable credit is limited to the total income tax withholding and Medicare tax liability of a tax-exempt employer. Thus, even if the employer has no taxable income, the employer may still receive a refund, as long as it does not exceed its federal income tax withholding and Medicare tax liability.

Frequently Asked Questions are also available on the [IRS website](#) for additional guidance.

A qualified employer should be sure to consult with its tax adviser to ensure proper application of the small employer tax credit.



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EMPLOYERS' ELIGIBILITY FOR THE CREDIT

The new guidance clarifies that a broad range of employers will meet the eligibility requirements for the health care tax credit. First, the Notice clarifies that in order for a tax-exempt organization to be eligible for the credit, the organization must be "described in Code section 501(c) and exempt from taxation under Code section 501(a)." Thus, an employer that is an agency or instrumentality of the federal government, or of any local, state or Indian tribal government is not a qualified employer unless it meets the Code section 501 requirements.

Next, it addresses the fact that an employer is not required to perform services in a trade or business in order to be a small employer and to be eligible for the credit. Therefore, a household employer, for example, that otherwise satisfies the requirements of a qualified small employer is eligible for the credit.

Furthermore, guidance on employers located outside the United States is provided. In order to be eligible for the tax credit, the health insurance coverage must be offered by a health insurance issuer who is subject to the insurance laws of one or more of the 50 states plus the District of Columbia. Therefore, a small employer located outside of the U.S. (including an employer located in a U.S. territory) may only claim the tax credit for the paid health insurance premiums of its employees if the coverage is issued in and regulated by one of the 50 states or the District of Columbia.

DETERMINING EMPLOYEES

Previously, guidance in Notice 2010-44 provided that for determining the number of employees, sole proprietors, partners in a partnership, shareholders owning more than 2% of the stock in an S corporation, and any owner of more than 5% of other businesses are not taken into account. Notice 2010-82 confirms the above exclusions and that these exclusions include spouses and family members. Thus, none of the mentioned individuals are counted for the purpose of determining an employer's number of employees, nor is the premium paid for health care coverage for these individuals eligible for the tax credit.

For determining an employer's number of full-time equivalent employees and in computing average annual wages, the guidance confirms that leased employees are included in the calculation. However, the premiums for health insurance coverage paid by the leasing organization (the lesser) is not taken into consideration by the service recipient (the lessee) when computing the health care tax credit.

Finally, the guidance addresses the question of whether a minister will be counted as an employee in determining an employer's number of employees. Whether a minister is counted as an employee is based on the common law test. If self-employed, the minister is not taken into account for FTE count and wage computation, whereas, if the minister is an employee, the minister is taken into account. As this appears to be a circular argument, and it is not the purpose of this Alert to determine an individual's employment status, further information on the IRS common law test for determining worker status can be found by [clicking here](#).

"QUALIFYING ARRANGEMENT" EXPLANATION

A "qualifying arrangement" is one in 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%) of premium cost of the coverage. Thus, the first requirement of a qualifying arrangement is that it must be coverage offered by a health insurance issuer. A health insurance issuer is an entity licensed to engage in the business of insurance and is subject to state law regulating insurance. Thus, self-insured plans are not health insurance coverage for purposes of the tax credit and, as such, any employer contributions to a self-insured plan are not deemed a qualifying arrangement. Self-insured plans would include Health Reimbursement Arrangements (HRAs) and health Flexible Spending Accounts (FSAs). Furthermore, Health Savings Accounts in and of themselves are not health insurance coverage and also are not considered "qualifying arrangements."

Notwithstanding the above, there is an exception to the self-insured plan as a qualifying arrangement. The guidance clarifies that a small employer church plan that self-insures its coverage can qualify for the tax credit, even though the coverage is not provided by a health insurance issuer. This exception is based on another federal law which provides that a church plan is subject to state enforcement as if the church plan were an insurer licensed by the state. However, this rule applies solely for the purpose of eligibility for the small business tax credit.

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