

Legislative Brief

Health Care Reform: IRS Guidance on the Small Employer Health Care Tax Credit



EXECUTIVE SUMMARY

The Patient Protection and Affordable Care Act (PPACA), as amended by the Health Care and Education Reconciliation Act (the Reconciliation Act), provides a tax credit to certain small employers that provide health care coverage to their employees, effective with **tax years beginning in 2010**.

On May 17, 2010, the Internal Revenue Service (IRS) issued Notice 2010-44 (the Notice), which provides guidance on the credit applicable to tax years beginning before January 1, 2014. Specifically, the Notice explains how to:

- Determine whether an employer is eligible for the credit;
 - Calculate the credit; and
 - Claim the credit.
- The Notice also provides transition relief for certain employers for qualifying for the credit.

This The Barnett Group Legislative Brief discusses the guidance contained in IRS Notice 2010-44. Please read below for further information. For a copy of Notice 2010-44, see www.irs.gov/pub/irs-drop/n-10-44.pdf. For a tax credit calculator, please see www.smallbusinessmajority.org/tax-credit-calculator/ or www.nfib.com/issues-elections/healthcare/credit-calculator. We will continue to monitor legislative and regulatory developments related to these rules and health care reform in general.

EXPLANATION OF IRS NOTICE 2010-44

Section 1421 of PPACA added Section 45R to the Internal Revenue Code (IRC). Section 45R offers a tax credit to certain small employers that provide health insurance to their employees. It is effective for taxable years beginning in 2010. Both taxable and tax-exempt employers that may be eligible for the section 45R credit. In most cases, employers that are agencies or instrumentalities of the federal government, or of a state, local or Indian tribal government, will not be eligible for the credit.

Eligible Small Employers

The IRS refers to employers that satisfy the requirements for the credit as "eligible small employers." The Notice specifies that the following requirements must be met in order for an employer to be considered an eligible small employer:

- The 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 be less than \$50,000 per FTE; and
- The employer must maintain a "qualifying arrangement."

According to the Notice, a qualifying arrangement is one under which the employer pays premiums for each employee enrolled in the employer's health insurance coverage, in a uniform percentage that is at least 50 percent of the premium cost of the coverage. However, as discussed below, the Notice also provides transition relief with respect to the requirements for a qualifying arrangement.

The Notice sets out specific steps for determining whether an employer is **eligible** for the tax credit.

Legislative Brief

Health Care Reform: IRS Guidance on the Small Employer Health Care Tax Credit

Step 1: Determine the employees who are taken into account for purposes of the credit.

In general, employees who perform services for the employer during the taxable year are taken into account in determining the employer's FTEs, average wages and premiums paid, with certain individuals excluded and with employees of certain related employers included.

Partners in a business and certain owners are not taken into account as employees for purposes of the credit. Specifically, this group includes sole proprietors, partners in a partnership, shareholders owning more than 2 percent of an S corporation, and any owners of more than 5 percent of other businesses, along with their family members and other members of their households who qualify as tax dependents.

A family member is defined as a child (or descendant of a child), a sibling or step-sibling, a parent (or ancestor of a parent), a step-parent, a niece or nephew, an aunt or uncle, or a son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law or sister-in-law. Any other members of the household of these owners and partners who qualify as a tax dependent are also not taken into account as employees.

Accordingly, the wages and hours of these business owners and partners, and of their family members and dependent members of their household, are disregarded in determining FTEs and average annual wages, and the premiums paid on their behalf are not counted in determining the amount of the section 45R credit.

Seasonal workers are also disregarded in determining FTEs and average annual wages unless the seasonal worker works for the employer on more than 120 days during the taxable year. However, premiums paid on their behalf may be counted in determining the amount of the section 45R credit.

All employers treated as a single employer under IRC section 414(b), (c), (m) or (o) are treated as a single employer for purposes of the credit. Thus, all employees of a controlled group or affiliated service group (except employees not taken into account as described above), along with their wages and premiums, are taken into account in determining whether the employer is an eligible small employer.

Step 2: Determine the number of hours of service performed by those employees.

In calculating how many hours of service the employees have performed, the following hours are considered:

- Each hour for which an employee is paid, or entitled to payment, for the performance of duties for the employer during the employer's taxable year; and
- Each hour for which an employee is paid, or entitled to payment, by the employer on account of a period of time during which no duties are performed due to vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence (except that no more than 160 hours of service are required to be counted for an employee on account of any single continuous period during which the employee performs no duties).

In calculating the total number of hours of service, the employer may use any of the following methods:

- Determine actual hours of service from records of hours worked and hours for which payment is made or due (payment is made or due for vacation, holiday, illness, incapacity, etc.);
- Use a days-worked equivalency whereby the employee is credited with 8 hours of service for each day for which the employee would be required to be credited with at least one hour of service because he or she is paid or entitled to payment; or
- Use a weeks-worked equivalency whereby the employee is credited with 40 hours of service for each week for which the employee would be required to be credited with at least one hour of service because he or she is paid or entitled to payment.

The Notice provides examples illustrating methods for calculating hours worked. In all of the examples in the Notice, none of the employees is an owner, partner in a business or otherwise excluded from being taken into account for purposes of the credit.

Legislative Brief

Health Care Reform: IRS Guidance on the Small Employer Health Care Tax Credit

Example 1 – Counting hours of service by hours actually worked or for which payment is made or due.

For the 2010 taxable year, an employer's payroll records indicate that Employee A worked 2,000 hours and was paid for an additional 80 hours on account of vacation, holiday and illness. The employer counts hours actually worked. Under this method of counting hours, Employee A must be credited with 2,080 hours of service (2,000 hours worked and 80 hours for which payment was made or due).

Example 2 – Counting hours of service under weeks-worked equivalency. For the 2010 taxable year, Employee B worked 49 weeks, took 2 weeks of vacation with pay, and took 1 week of leave without pay. The employer uses the weeks-worked equivalency. Under this method of counting hours, Employee B must be credited with 2,040 hours of service (51 weeks multiplied by 40 hours per week).

Step 3: Calculate the number of the employer's FTEs.

The Notice explains that the number of an employer's FTEs is determined by dividing (1) the total hours of service credited during the year to employees taken into account for purposes of the credit (but not more than 2,080 hours for any employee) by (2) 2,080 and rounding the result to the next lowest whole number.

In some circumstances, an employer with 25 or more employees may qualify for the credit if some of its employees work part time. For example, an employer with 46 half-time employees (meaning they are paid wages for 1,040 hours) has 23 FTEs and, therefore, may qualify for the credit.

The Notice includes the following examples for calculating the number of FTEs.

Example 3 – Determining the number of FTEs. For the 2010 taxable year, an employer pays 5 employees wages for 2,080 hours each, 3 employees wages for 1,040 hours each, and 1 employee wages for 2,300 hours. The employer does not use an equivalency method to determine hours of service for any of these employees.

To calculate the number of FTEs, first add the total hours of service (not exceeding 2,080 per employee) for all the employees. The sum of 10,400 hours of service for the 5 employees paid for 2,080 hours each (5 x 2,080), 3,120 hours of service for the 3 employees paid for 1,040 hours each (3 x 1,040), and 2,080 hours of service for the 1 employee paid for 2,300 hours (lesser of 2,300 and 2,080) is equal to 15,600 total hours of service.

Next, divide the total hours of service by 2,080. 15,600 total hours of service divided by 2,080 is 7.5, which must be rounded to the next lowest whole number. Therefore, this employer has 7 FTEs.

Example 4 – Determining the number of FTEs. For the 2010 taxable year, an employer has 26 FTEs with average annual wages of \$23,000 per FTE. Only 20 of the employer's employees are enrolled in the employer's health insurance plan. The hours of service and wages of all employees are taken into consideration in determining whether the employer is an eligible small employer for purposes of the credit. Because the employer does not have fewer than 25 FTEs for the taxable year, the employer is not an eligible small employer for purposes of the credit.

Step 4: Determine the average annual wages paid per FTE.

According to the Notice, the average annual wages paid by an employer for a taxable year is determined by dividing (1) the total wages paid by the employer during the employer's taxable year to employees taken into account for purposes of the credit by (2) the number of the employer's FTEs for the year. The result is then rounded down to the nearest \$1,000.

For purposes of determining the employer's average annual wages for the taxable year, only wages that are paid for hours of service are taken into account. Wages for this purpose means wages as defined for purposes of the Federal Insurance Contributions Act (FICA), determined without regard to the wage base limitation.

Legislative Brief

Health Care Reform: IRS Guidance on the Small Employer Health Care Tax Credit

Example 5 – Determining the amount of average annual wages. For the 2010 taxable year, an employer pays \$224,000 in wages and has 10 FTEs. The employer's average annual wages is: \$22,000 (\$224,000 divided by 10 = \$22,400, rounded down to the nearest \$1,000).

Step 5: Determine the premiums paid by the employer that are taken into account for purposes of the credit.

The Notice specifies that premiums must be paid by an employer under a qualifying arrangement and must be paid for health insurance that meets the requirements of IRC section 45R. If an employer pays only a portion of the premiums (with employees paying the rest), only the portion paid by the employer is taken into account. For example, if an employer pays 80 percent of the premiums for employees' coverage (with employees paying the other 20 percent), the 80 percent paid by the employer is taken into account in calculating the credit.

Any premium paid pursuant to a salary reduction arrangement under a section 125 cafeteria plan may not be counted as paid by the employer. However, when calculating the credit for a taxable year beginning in 2010, an employer may count all premiums it paid in the 2010 tax year, including premiums paid before PPACA was enacted.

As noted above, premiums must be paid for health insurance coverage under a qualifying arrangement. A qualifying arrangement is one where the employer pays premiums for each employee enrolled in the employer's health insurance coverage, in a uniform percentage that is at least 50 percent of the premium cost of the coverage. However, as discussed below, the Notice also provides transition relief with respect to the requirements for a qualifying arrangement.

For years prior to 2014, health insurance coverage for purposes of the credit means benefits consisting of medical care (provided directly, through insurance or reimbursement, or otherwise) under any hospital or medical service policy or certificate, hospital or medical service plan contract, or health maintenance organization contract offered by a health insurance issuer. It also includes:

- Limited scope dental or vision plans;
- Plans providing long-term care, nursing home care, home health care, community-based care or any combination thereof;
- Coverage only for a specified disease or illness;
- Hospital indemnity or other fixed indemnity insurance; and
- Medicare supplemental health insurance, certain other supplemental coverage and similar supplemental coverage provided to coverage under a group health plan.

However, health insurance coverage does not include certain excepted benefits, such as:

- Coverage only for accident, or disability income insurance, or a combination of the two;
- Coverage issued as a supplement to liability insurance;
- Liability insurance, including general liability insurance and automobile liability insurance;
- Workers' compensation or similar insurance;
- Automobile medical payment insurance;
- Credit-only insurance;
- Coverage for on-site medical clinics; or
- Other similar insurance coverage, specified in regulations, under which benefits for medical care are secondary or incidental to other insurance benefits.

Different types of health insurance plans are not aggregated for purposes of meeting the qualifying arrangement. For example, if an employer offers a major medical insurance plan and a stand-alone vision plan, the employer must separately satisfy the requirements for a qualifying arrangement with respect to each type of coverage.

There is a cap on the amount of an employer's premium payments that can be taken into account for calculating the credit. The amount is limited to the premium payments the employer would have made, if it had paid the average premium for the small group market in the state (or an area within the state) in which it offers coverage.

Legislative Brief

Health Care Reform: IRS Guidance on the Small Employer Health Care Tax Credit

For example, if an eligible small employer pays 80 percent of the premiums for coverage provided to employees (and employees pay the other 20 percent), the premiums taken into account for purposes of the credit are the lesser of:

- 80 percent of the total actual premiums paid, or
- 80 percent of the premiums that would have been paid for the coverage, using the average premium for the small group market in that state (or an area within the state).¹

The average premium for the small group market in the state does not apply separately to each type of coverage provided, but rather provides an overall cap for all health insurance coverage provided by an eligible small employer.

Example 6 – Determining amount of premium payments for purposes of the credit. For the 2010 taxable year, an eligible small employer offers a health insurance plan with single and family coverage. Employer has 9 FTEs with average annual wages of \$23,000 per FTE. Four employees are enrolled in single coverage and 5 are enrolled in family coverage.

The employer pays 50 percent of the premiums for all employees enrolled in single coverage and 50 percent of the premiums for all employees enrolled in family coverage (and the employee is responsible for the remainder in each case). The premiums are \$4,000 a year for single coverage and \$10,000 a year for family coverage. The average premium for the small group market in employer's state is \$5,000 for single coverage and \$12,000 for family coverage.

The employer's premium payments for each FTE (\$2,000 for single coverage and \$5,000 for family coverage) do not exceed 50 percent of the average premium for the small group market in employer's state (\$2,500 for single coverage and \$6,000 for family coverage). Thus, the amount of premiums paid by the employer for purposes of computing the credit equals \$33,000 ((4 x \$2,000) plus (5 x \$5,000)).

Example 7 – Premium payments exceeding average premium for small group market. Same facts as Example 6, except that the premiums are \$6,000 for single coverage and \$14,000 for family coverage.

The employer's premium payments for each employee (\$3,000 for single coverage and \$7,000 for family coverage) exceed 50 percent of the average premium for the small group market in the employer's state (\$2,500 for single coverage and \$6,000 for family coverage). Thus, the amount of premiums paid by the employer for purposes of computing the credit equals \$40,000 ((4 x \$2,500) plus (5 x \$6,000)).

Example 8 – Offering health insurance plan and dental plan. For the 2010 taxable year, an eligible small employer offers a major medical plan and a dental plan. The employer pays 50 percent of the premium cost for single coverage for all employees enrolled in the major medical plan and 50 percent of the premium cost for single coverage for all employees enrolled in the dental plan.

For purposes of calculating the credit, the employer can take into consideration the premiums paid by the employer for both the major medical plan and the dental plan, but only up to 50 percent of the amount of the average premium for single coverage for the small group market in the employer's state.

Example 9 – Meeting qualifying arrangement requirement. Same facts as Example 8, except that the employer pays 40 percent of the premium cost for single coverage for all employees enrolled in the dental plan. For purposes of calculating the credit, the employer can take into consideration only the premiums paid by the employer for the major medical plan, and only up to 50 percent of the amount of the average premium for single coverage for the small group market in the employer's state. The employer cannot take into consideration premiums paid for the dental plan.

Calculating the Credit

Notice 2010-44 contains the following specific steps illustrating how to calculate the amount of the tax credit.

¹ See [Rev. Rul. 2010-13](#) for the average premium for the small group market in a state for the 2010 taxable year.

Legislative Brief

Health Care Reform: IRS Guidance on the Small Employer Health Care Tax Credit

Step 1: Calculate the maximum amount of the credit.

For taxable years beginning in 2010 through 2013, the maximum credit for a taxable eligible small employer is 35 percent of the premium payments taken into account. For a tax-exempt eligible small employer for those years, the maximum credit is 25 percent those premium payments.

However, for a tax-exempt employer, there is an additional cap on the amount of the credit. It cannot exceed the total amount of income tax and Medicare tax that the employer is required to withhold from employees' wages for the year and the employer's share of Medicare tax employees' wages for the year.

Both small businesses and tax-exempt organizations will use the form 8941 to calculate the credit.

Step 2: Reduce the maximum credit according to the phaseout rule.

Although the credit is available to small employers with fewer than 25 full-time equivalent employees (FTEs) and average annual wages of less than \$50,000 per FTE, the credit is gradually phased out for eligible small employers with more than 10 FTEs and average annual wages in excess of \$25,000.

If the number of FTEs exceeds 10, the reduction is determined by multiplying the otherwise applicable credit amount by a fraction. The numerator of the fraction is the number of FTEs in excess of 10 and the denominator is 15.

If average annual wages exceed \$25,000, the reduction is determined by multiplying the otherwise applicable credit amount by a fraction. The numerator of this fraction is the amount by which average annual wages exceed \$25,000 and the denominator is \$25,000.

In both cases, the result of the calculation is subtracted from the otherwise applicable credit to determine the employer's actual credit.

For an employer with both more than 10 FTEs and average annual wages exceeding \$25,000, the total reduction is the sum of the two reductions. This may reduce the credit to zero for some employers with fewer than 25 FTEs and average annual wages of less than \$50,000.

Example 10 – Calculating the maximum credit for a taxable eligible small employer. For the 2010 taxable year, a taxable eligible small employer has 9 FTEs with average annual wages of \$23,000 per FTE. The employer pays \$72,000 in health insurance premiums for those employees (which does not exceed the average premium for the small group market in the employer's state) and otherwise meets the requirements for the credit. The credit for 2010 equals \$25,200 ($35\% \times \$72,000$).

Example 11 – Calculating the maximum credit for a tax-exempt eligible small employer. For the 2010 taxable year, a tax-exempt eligible small employer has 10 FTEs with average annual wages of \$21,000 per FTE. The employer pays \$80,000 in health insurance premiums for its employees (which does not exceed the average premium for the small group market in the employer's state) and otherwise meets the requirements for the credit. The total amount of the employer's income tax and Medicare tax withholding plus the employer's share of the Medicare tax equals \$30,000 in 2010.

The initial amount of the credit determined before any reduction is \$20,000 ($25\% \times \$80,000$). The employer's withholding and Medicare taxes is equal to \$30,000. The total 2010 tax credit equals \$20,000 (the lesser of \$20,000 and \$30,000).

Example 12 – Calculating the credit phaseout if the number of FTEs exceeds 10 or average annual wages exceed \$25,000. For the 2010 taxable year, a taxable eligible small employer has 12 FTEs and average annual wages of \$30,000. The employer pays \$96,000 in health insurance premiums for its employees (which does not exceed the average premium for the small group market in the employer's state) and otherwise meets the requirements for the credit.

Legislative Brief

Health Care Reform: IRS Guidance on the Small Employer Health Care Tax Credit

The initial amount of the credit determined before any reduction is \$33,600 (35% x \$96,000). The credit reduction for FTEs in excess of 10 is equal to \$4,480 ($\$33,600 \times 2/15$). The credit reduction for average annual wages in excess of \$25,000 is equal to \$6,720 ($\$33,600 \times \$5,000/\$25,000$). The total credit reduction is equal to \$11,200 ($\$4,480 + \$6,720$). The total 2010 tax credit equals \$22,400 ($\$33,600 - \$11,200$).

Step 3: For employers receiving a state credit or subsidy for health insurance, determine the employer's actual premium payment.

Some states offer tax credits to certain small employers that provide health insurance to their employees. Some of these are refundable credits and others are nonrefundable credits. In addition, some states offer premium subsidy programs for certain small employers, where the state makes a payment equal to a portion of the employees' health insurance premiums under the employer-provided health insurance plan. Generally, the state pays this premium subsidy either directly to the employer or to the employer's insurance company (or another entity licensed under state law to engage in the business of insurance).

If the employer is entitled to a state tax credit (whether refundable or nonrefundable) or a premium subsidy that is paid directly to the employer, the premium payment made by the employer is not reduced by the credit or subsidy for purposes of determining whether the employer has satisfied the "qualifying arrangement" requirement to pay an amount equal to a uniform percentage (of at least 50 percent) of the premium cost. Also, except as described below, the maximum amount of the Code section 45R credit is not reduced because of a state tax credit (whether refundable or nonrefundable) or because of payments by a state directly to an employer.

Generally, if a state makes payments directly to an insurance company (or another entity) to pay a portion of the premium for an employee's coverage of an employee under employer-provided health insurance (state direct payments), the state is treated as making these payments on behalf of the employer for purposes of determining whether the employer has satisfied the "qualifying arrangement" requirement to pay an amount equal to a uniform percentage (of at least 50 percent) of the premium cost of coverage. Also, except as described below, these premium payments by the state are treated as an employer contribution under section 45R for purposes of calculating the credit.

Although state tax credits and payments to an employer generally do not reduce an employer's otherwise applicable credit under section 45R, and although state direct payments are generally treated as paid on behalf of an employer, the amount of the section 45R credit may not exceed the amount of the employer's net premium payments. In the case of a state tax credit for an employer or a state subsidy paid directly to an employer, the employer's net premium payments are calculated by subtracting the state tax credit or subsidy from the employer's actual premium payments.

In the case of a state payment directly to an insurance company (or another entity), the employer's net premium payments are the employer's actual premium payments.

If a state-administered program (such as Medicaid) makes payments that are not contingent on the maintenance of an employer-provided group health plan, those payments are not taken into account in determining the tax credit.

Example 13 - State premium subsidy paid directly to employer. Employer's state provides a health insurance premium subsidy of up to 40 percent of the health insurance premiums for each eligible employee. The state pays the subsidy directly to the employer. Employer has one employee, Employee D.

Employee D's health insurance premiums are \$100 per month and are paid as follows: \$80 by the employer and \$20 by Employee D through salary reductions to a cafeteria plan. The state pays Employer \$40 per month as a subsidy for Employer's payment of insurance premiums on behalf of Employee D. Employer is otherwise an eligible small employer that meets the requirements for the Code section 45R credit.

For purposes of the requirements for a qualifying arrangement, and for purposes of calculating the amount of the Code section 45R credit, the amount of premiums paid by the employer is \$80 per month (the premium payment by the Employer without regard to the subsidy from the state).

Legislative Brief

Health Care Reform: IRS Guidance on the Small Employer Health Care Tax Credit

Example 14 - State premium subsidy paid directly to employer's insurance company. Employer's state provides a health insurance premium subsidy of up to 50 percent for each eligible employee. The state pays the premium directly to the employer's health insurance provider. Employer has one employee, Employee E. Employee E is enrolled in single coverage under Employer's health insurance plan.

Employee E's health insurance premiums are \$100 per month and are paid as follows: \$30 by the employer; \$50 by the State and \$20 by the employee. The state pays the \$50 per month directly to the insurance company and the insurance company bills the employer for the employer and employee's share, which equal \$50 per month. Employer is otherwise an eligible small employer that meets the requirements for the Code section 45R credit.

For purposes of the requirements for a qualifying arrangement, and for purposes of calculating the amount of the Code section 45R credit, the amount of premiums paid by the employer is \$80 per month (the sum of the employer's payment and the state's payment).

Example 15 - Credit limited by employer's net premium payment. Employer's state provides a health insurance premium subsidy of up to 50 percent for each eligible employee. The state pays the premium directly to the employer's health insurance provider. Employer has one employee, Employee F. Employee F is enrolled in single coverage under Employer's health insurance plan.

Employee F's health insurance premiums are \$100 per month and are paid as follows: \$20 by the employer; \$50 by the state and \$30 by the employee. The state pays the \$50 per month directly to the insurance company and the insurance company bills the employer for the employer's and employee's shares, which total \$50 per month. Employer is otherwise an eligible small employer that meets the requirements for the Code section 45R credit.

The amount of premiums paid by the employer for purposes of determining whether the employer meets the qualifying arrangement requirement (the sum of the employer's payment and the state's payment) is \$70 per month, which is more than 50 percent of the \$100 monthly premium payment. The amount of the premium for calculating the maximum Code section 45R credit is also \$70 per month. The maximum credit is \$24.50 (\$70 x 35%).

The employer's net premium payment is \$20 (the amount actually paid by the employer excluding the state subsidy). After applying the limit for the employer's net premium payment, the Code section 45R credit is \$20 per month, (the lesser of \$24.50 or \$20).

Claiming the Credit

The Code section 45R credit is claimed on an eligible small employer's annual income tax return and offsets an employer's actual tax liability for the year. Tax-exempt organizations will claim the small business health care tax credit on a revised Form 990-T. The Form 990-T is currently used by tax-exempt organizations to report and pay the tax on unrelated business income. Form 990-T will be revised for the 2011 filing season to enable eligible tax-exempt organizations – even those that owe no tax on unrelated business income – also to claim the small business health care tax credit.

For taxable employers, the credit is a general business credit. Generally, this means that any unused credit amount can be carried back one year and carried forward 20 years. However, because an unused credit amount cannot be carried back to a year before the effective date of the credit, any unused credit amounts for taxable years beginning in 2010 can only be carried forward.

For a tax-exempt eligible small employer, the credit is a refundable credit, so that even if the employer has no taxable income, the employer may receive a refund, as long as it does not exceed the tax-exempt eligible small employer's total income tax withholding and Medicare tax liability for the year.

The credit can be reflected in determining estimated tax payments for the year in which the credit applies, in accordance with regular estimated tax rules. The credit can also be used to offset an employer's alternative minimum

Legislative Brief

Health Care Reform: IRS Guidance on the Small Employer Health Care Tax Credit

tax (AMT) liability for the year, subject to certain limitations. However, because the credit applies against income tax, an employer may not reduce employment tax deposits and payments during the year in anticipation of the credit. Finally, employers cannot deduct the portion of the health insurance premiums which is equal to the amount of the Code section 45R credit.

Transition Relief for Taxable Years Beginning in 2010

Generally, in order to be eligible for the tax credit, an employer must provide health coverage to employees through a "qualifying arrangement." However, employers that provide coverage that is not through a qualifying arrangement can still be eligible for the credit for the 2010 tax year, if it satisfies the requirements for transition relief spelled out in the Notice.

An employer that meets the conditions for the transition relief is considered to satisfy the requirement that the employer pay a uniform percentage (of at least 50 percent) of the premium cost of the health insurance coverage for each employee (the uniformity requirement). Specifically, for 2010 tax years, an employer that pays an amount equal to at least 50 percent of the premium for single (employee-only) coverage for each employee enrolled in coverage is deemed to satisfy the uniformity requirement for a qualifying arrangement, even if the employer does not pay the same percentage of the premium for each such employee.

This means that an employer will be deemed to satisfy the uniformity requirement for a qualifying arrangement:

- if it pays at least 50 percent of the premium for single coverage for each employee receiving single coverage; and
- if the employer offers coverage that is more expensive than single coverage (such as family or self-plus-one coverage), if it pays an amount for each employee receiving that more expensive coverage that is at least 50 percent of the premium for single coverage for that employee (even if it is less than 50 percent of the premium for the more expensive coverage the employee is actually receiving).

The transition relief is illustrated in the following examples:

Example 16 - Transition relief rule for a qualifying arrangement. For the 2010 taxable year, an eligible small employer has 9 FTEs with average annual wages of \$23,000 per FTE. Six employees are enrolled in single coverage and 3 employees are enrolled in family coverage. The premiums are \$8,000 for single coverage for the year and \$14,000 for family coverage for the year (which do not exceed the average premiums for the small group market in the employer's state). The employer pays 50 percent of the premium for single coverage for each employee enrolled in single or family coverage ($50\% \times \$8,000 = \$4,000$ for each employee).

Thus, the employer pays \$4,000 of the premium for each of the 6 employees enrolled in single coverage and \$4,000 of the premium for each of the 3 employees enrolled in family coverage. The employer is deemed to satisfy the uniformity requirement for a qualifying arrangement under the transition relief rule.

Example 17 – Arrangement that does not satisfy requirement for transition relief. Same facts as Example 16, except that the employer pays 50 percent of the premium for employees enrolled in single coverage (\$4,000 for each of those 6 employees), but pays none of the premium for employees enrolled in family coverage. The employer does not satisfy the uniformity requirement for a qualifying arrangement.

This The Barnett Group Legislative Brief is not intended to be exhaustive nor should any discussion or opinions be construed as legal advice. Readers should contact legal counsel for legal advice.

Content © 2010 Zywave, Inc. Images © 2000 Getty Images, Inc. All rights reserved.

ES 5/10, 10/10