IRS Publishes Guidance on Business Health Care Tax Credit - small businesses get up to 35% back

According to the SBA, half of the small businesses between three and 10 people don't provide health care, but would like to offer it. According to the US Treasury, the Affordable Care Act contains provisions that would allow up to a 35% tax credit for qualifying businesses, who may receive both state and federal tax credits. Fortunately, determining whether your business qualifies for those credits just became much easier.

As always, you should consult your attorney or tax advisor for advice tailored to your situation. However, the government has made it easier to determine where your business falls thanks to new guidance issued by the IRS and the US Treasury Department. On May 17, 2010, the Treasury issued release TG-698, which outlines some common scenarios. The IRS has issued a more in-depth publication via IRS Notice 2010-44 (pdf). Here are some of the highlights:

Getting Money For Health Care: Combined Credits up to 75%
If you're a business in Texas, the 35% credit is a welcome step, allowing for federal credits where no direct credits were previously available. In other states that do provide direct assistance, the combined federal-state credits can cover *up to 75% of an employer's premium costs*.

Federal Tax Credits
A common adage is that "the devil is in the details," and that's often true with the transition between legislative action and implementation. However, based upon the recent guidance, the new Act's provisions look like they'll be implemented generously. Beginning immediately in 2010, businesses may be able to claim up to a 35% tax credit for health care premiums. Starting in 2014, that number increases to a 50% federal credit.

"Health Insurance Coverage" is defined broadly. In addition to the traditional medical insurance, the Section 45(R) credit includes dental, vision, and other limited-scope coverage. There is an explicit allowance in the IRS Notice for longterm care, home nursing care, disease-specific riders like cancer coverage, "or any combination thereof". There are some restrictions, such as requiring a minimum 50% employer contribution, and each must be a stand-alone qualifying arrangement, but your tax advisor, insurance agent, or legal counsel should be able to help you determine whether your current offering qualifies and what changes or tweaks may be needed to ensure compliance.

State Tax Incentives
The new Act does not reduce federal credits based on state benefits, unless the combination would exceed the employer's contribution. State tax incentives are monetary incentives usually provided by tax credits or deductions that reduce your businesses' tax bill. The National Conference of State Legislatures (NCSL) provides a summary of Employer Health Coverage Tax Incentives for businesses in Alabama, Arizona, Colorado, Georgia, Idaho, Indiana, Kansas, Kentucky, Maine, Montana, Michigan, Missouri, North Carolina, Oklahoma, South Carolina, Utah, and Wisconsin.

State Premium Assistance
Premium assistance is money available for direct or indirect payment or reduction of premiums. Unlike tax-driven incentives, premium assistance can be un-bundled from the tax system and potentially provides another avenue to defray costs for tax-disadvantaged businesses. The NCSL maintains a list of premium assistance programs for businesses in Arkansas, Idaho, Kentucky, Maine, Maryland, Massachusetts, Montana, New Mexico, Oklahoma, Washington, and Tennessee.

Health Savings Accounts (HSAs) allow for tax-free accounts that are usually coupled with high-deductible insurance that provide an alternative to traditional premium-only insurance. The NCSL also provides a list of health savings account (HSA) programs that interested businesses should review.

Employer and Plan Eligibility Requirements
The tax credits are often referred to as "Small Business Health Care Credits". But who is a small business? Fortunately, the IRS guidance allows for some flexibility in this definition. In order to be an eligible small employer, "(1) the employer must have fewer than 25 full-time equivalent employees (FTEs) for the

taxable year; (2) the average annual wages of its employees for the year must be less than $50,000 per FTE; and (3) the employer must maintain a “qualifying arrangement.” --IRS Notice, SII(A)

A "qualifying arrangement" is one where the employer pays at least 50% of the per-employee premium on a uniform percentage. There are some caveats for 2010 due to the implementation phase-in, so if you plan to claim a 2010 credit, be sure to ask your advisor about the 2010 rules.

Under the IRS guidance, employers can elect for the most favorable method of determining FTE hours (full time equivalent). This is important for eligibility because the tax credit is highest for employers with 10 or fewer FTE employees. Benefits extend up to 25 FTE employees, and the employer is able to choose whether to look to actual hours of service, or can use estimated hours based on total days or weeks of service.

The calculation is basically a five-step approach:

1. Determine the employees who are taken into account
2. Determine the number of hours of service performed by those employees
3. Calculate the number of the employer’s FTEs.
4. Determine the average annual wages paid per FTE.
5. Determine the premiums paid by the employer for a qualifying arrangement under section 45(R)

The full IRS Notice 2010-44 contains all of the details, as well as example scenarios for common business situations.

Some Cautionary Notes

As with any law, the actual legislation isn't without caveats. For example, while the tax credit is scheduled to increase to 50% in 2014, the credit is only available for six years total, unless amended. Businesses can claim the credit in tax years 2010 to 2013, and for two additional years thereafter. Based on these numbers, the plan is expected to save small businesses up to $40 billion through 2019. The flip side of that is that the government will lose the same amount in tax revenue, if not made up by other sources. Also, lawmakers were also worried about so-called "Cadillac Plans" and therefore, the eligible contribution iscapped based on the average cost of health insurance in your state.

As I've mentioned, the typical disclaimers apply: This post is provided as general information, and is not intended as legal advice. The applicability of this information will vary based upon countless variables unique to your business, and the legality and applicability of this information will vary depending upon your jurisdiction. You should always consult a professional, such as your attorney, accountant, or tax advisor before making decisions. IRS CIRCULAR 230 DISCLOSURE: While this information is not considered legal advice, any tax-related information contained in this communication (including any attachments or links) is not intended or written to be used, and cannot be used, by any taxpayer for the purpose of (1) avoiding tax-related penalties under the U.S. Internal Revenue Code or (2) promoting, marketing or recommending to another party any tax-related matters addressed herein.