

Small Employer Tax Credits For Health Care Expenses



Washington State's Chamber of Commerce

***Do you have fewer than 25 FTE employees?
Do your employees earn less than \$50,000 in average annual salaries?
Do you pay at least 50% of monthly health care premiums for your employees or are willing to do so?***

If you answered yes to each of the above questions, you may be eligible for a refundable tax credit from the IRS.

Certain small employers who currently provide or who choose to begin providing health care coverage for their employees may be eligible for a federal tax credit authorized under the new Patient Protection and Affordable Care Act. The credit is offered in two phases and applies differently based on tax-exempt status. The value of the credit is based on the size of the employer and average annual wages paid.

Phase I – Tax Years 2010-2013

In general, the credit is available to small employers with 25 or fewer FTE employees who pay less than \$50,000 per year in annual salaries. The maximum credit available is 35 percent of the eligible small employer's premium expenses not exceeding the average small employer premium rate of the state. Those employers with 10 or fewer FTE employees with average annual wages of less than \$25,000 receive the maximum credit of 35 percent. As both the number of employees and the average annual wage increases, the credit phases out. Thus not all employers with 25 or fewer employees will be eligible for the credit and the credit amount will vary by employer. The credit is refundable and is claimed as part of the employer's annual federal tax filing.

Tax-exempt small employers may also qualify for the tax credit under the same criteria described above. However, the maximum tax credit available to tax-exempt employers is 25 percent. The process for determining the value of the credit is the same as other eligible small employers.

Phase II – Tax Years 2014 and Beyond

The tax credit increases to 50 percent. All other criteria still apply, except that the annual wage thresholds will be adjusted through a future cost-of-living adjustment.

Tax-exempt small employers purchasing health care coverage through one of the new state-based health insurance exchanges (or national exchange) will be eligible for a maximum 35 percent credit. The process for determining the value of the credit is the same as other eligible small employers.

Determining Employer Size/Number of FTEs

Employer size for the tax credit is based on the number of full-time equivalents or FTEs, not full-time employees. To determine whether you qualify for the tax credit based on your employer "size", divide the total number of hours you paid wages to employees during the year (but not more than 2,080 hours for any employee) by 2,080 (do not include seasonal employees in the calculation).

Example

Employer has 33 employees but only 11 are full-time:
11 employees worked 2,080hrs = 11(2080) = 22,880hrs
15 employees worked 1,040hrs = 15(1040) = 15,600hrs
7 employees worked 700hrs = 7(700) = 4,900hrs

Total hours = 22,880 + 15,600 + 4,900 = 43,380hrs

Total FTEs = 43,380/2080 = 20 FTEs

Determining Average Annual Wages

To determine the average annual wage paid divide the total wages (as defined for FICA purposes) you paid to employees during the tax year by the number of FTEs calculated for the year (round down to the nearest \$1,000) (excluding wages paid to seasonal employees).

Example

Employer paid annual wages of \$332,000 and had 9 FTEs for the year:

Avg Annual Wages = 332,000/9 = \$36,888 or \$36,000

In the above example, the employer qualifies for the credit but even though they employ fewer than 10 FTEs, they are ineligible for the maximum credit because average annual wages exceed \$25,000. The value of the credit will be reduced based on the higher wage rate.

Calculating the Approximate Tax Credit

It is not possible at this time to calculate the exact tax credit any eligible small employer may receive. In addition to employer size and average annual wage base, the value of the health plan you purchase will also be included in the calculation of the final credit. When determining the credit, the IRS will determine whether you paid more for your health plan than the average cost of a small employer plan in your state. Any amount you pay for your health plan that exceeds the average value of the cost of a small group plan in your state will be subtracted from the amount you paid in benefits before further adjustments due to employer size and average wages are made.

The IRS will be posting the average small group market premiums in each state within the next few months. For more information, please check their website at www.IRS.gov

What More Should I Know?

If you currently employ a large number of part-time employees, your overall FTE count may make you ineligible for the credit or could reduce the level of credit you could receive even though these employees may be ineligible for coverage.

If you currently provide a relatively rich benefit package to your employees, even though you may meet all other requirements, you still may not qualify for the full 35 percent credit.

If you currently provide health care coverage and are happy with the plan you have, you may be required to change coverage in the future in order to continue receiving the tax credit.

If you currently provide health care coverage and take the tax deduction for health insurance premiums, the amount of this tax credit will reduce the allowed amount of your tax deduction.