

IRS ISSUES GUIDANCE ON SMALL BUSINESS HEALTH CARE TAX CREDIT

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On Monday, May 17, 2010, the IRS issued Notice 2010-44, providing guidance to small businesses that are eligible to claim a tax credit for employee health insurance coverage pursuant to new Section 45R of the Internal Revenue Code, part of the Patient Protection and Affordable Care Act (the new health care reform legislation).

Section 45R allows certain eligible small businesses to claim a tax credit if they offer health insurance to their employees. In 2010, small businesses—defined as businesses with 25 or fewer employees and average annual wages of less than \$50,000—are eligible for credits of up to 35% of nonelective contributions the businesses make on behalf of their employees for insurance premiums. Tax-exempt organizations get a 25% credit against payroll taxes. After 2013, the credit increases to 50% (and 35% for tax-exempt organizations). The credit does phase out gradually (but not below zero) for eligible employers if the number of employees exceeds 10 or if the average annual wages exceed \$25,000. The Notice describes this phaseout in detail.

The amount of the credit is based on a percentage of the lesser of: (1) the amount of nonelective contributions paid by the eligible small employer on behalf of employees under a “qualifying arrangement” during the tax year, and (2) the amount of nonelective contributions the

employer would have paid under the arrangement if each employee were enrolled in a plan that had a premium equal to the average premium for the small group market in the state (or in an area in the state) in which the employer is offering health insurance coverage.

To determine whether an employer is eligible for a credit under Section 45R, an employer is directed under the Notice to take the following steps:

1. Determine the employees who are taken into account for purposes of the credit.
2. Determine the number of hours of service performed by those employees.
3. Calculate the number of the employer’s FTEs [full-time equivalent employees].
4. Determine the average annual wages paid per FTE.

Determine the premiums paid by the employer that are taken into account for purposes of the credit. Specifically, the premiums must be paid by an employer under a qualifying arrangement and must be paid for health insurance that meets the requirements of Section 45R.

Notice 2010-44 defines a “qualifying arrangement” as “an arrangement under 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 percent) of the premium cost of the coverage.” Further, the Notice defines

(Continued on page 2)

(Continued from page 1)

what qualifies as health insurance coverage for purposes of the credit. The Notice specifies that different types of coverage are not aggregated for purposes of meeting the qualifying arrangement requirement. Thus, by example, if an employer offers a medical insurance plan and a stand-alone vision plan, each type of coverage must separately satisfy the requirements for a qualifying arrangement.

The Notice also addresses situations in which an employer is entitled to a state tax credit or a premium subsidy that is paid directly to the employer.

According to Notice 2010-44, eligible employers will claim the credit on their annual income tax returns, as part of the general business credit, and an unused credit amount may be carried back one year or forward 20 years. Because the unused credit amount cannot be carried back to years prior to the

enactment of the credit, for tax years beginning in 2010, unused credit amounts can only be carried forward.

The Notice provides that the credit can be reflected in estimated tax payments and can offset an employer's alternative minimum tax liability for the year (subject to limitations).

The Notice prohibits "double dipping" by employers: An employer cannot take a deduction under Section 162 of the Internal Revenue Code for that portion of the health insurance premiums paid that is equal to the amount of the Section 45R credit.

The notice includes transition rules for 2010 and numerous examples illustrating how the credit is intended to work.

For further information, please contact Neil Birkhoff or any of the Woods Rogers Tax Group attorneys .

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