

**Small is Good:
More Perks for Small Businesses in Health Care Reform**

Health care reform contains a new income tax credit that is available now, and available *only* to small businesses (those with fewer than 25 full-time equivalent employees or “FTEs”).

Employers are eligible to claim the credit if they have group health insurance for employees and pay at least 50% of the cost of coverage (that’s determined based on the premium cost of employee-only coverage for 2010, and does not include salary reduction contributions through a cafeteria plan as employer contributions). Employers who qualify for this credit also must have an annual average wage of less than \$50,000 per FTE.

The number of FTEs is computed based on the total hours for which the employer pays wages (limited to 2,080 hours for any single employee) divided by 2,080, which is the number of hours of work in a year for an employee working 40 hours per week. So, an employer who has 46 half-time employees (those paid for 1,040 hours per year) has only 23 FTEs and still may qualify for the credit. The credit, which is limited to 35% of the employer’s premium expense, applies for the tax year beginning in 2010. Thus, for calendar year taxpayers, it is effective retroactive to January 1, 2010. It may also be limited based on the “average premium for the small group market” in the state, which is determined by a government survey and is supposed to be posted on the IRS website in the near future. An example from the recently released IRS *Frequently Asked Questions* (live link: <http://www.irs.gov/newsroom/article/0,,id=220839,00.html>) illustrates how the credit works:

For the 2010 tax year, a qualified employer has 9 FTEs with average annual wages of \$23,000 per FTE. The employer pays \$72,000 in health care 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% of \$72,000).

The full credit is available for employers with no more than ten FTEs and an average wage of \$25,000 per FTE (phase-outs apply for employers with between 10 and 24 FTEs and those with average wages between \$25,000 and \$50,000). For this purpose, the business owner (sole proprietor, partner, a two percent S corporation shareholder or five percent owner of other businesses) and family members are disregarded.

Now, for the fine print: Seasonal employees are also excluded. Household employers cannot qualify for the credit, but tax-exempt organizations can. The credit can be refunded in cash to tax-exempts with no income tax liability, but is not refundable to taxable employers (any unused 2010 credit can be carried forward, but cannot be applied to prior tax years). However, in determining an employer’s deduction for health insurance premiums, the amount of premiums

that can be deducted is reduced by the amount of the credit (that's OK – a tax credit is generally worth more than a tax deduction of the same amount).

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