

## Shortcut tables to calculating new small business health insurance tax credit

### CRS Summary of Small Business Health Insurance Tax Credit Under PPACA (P.L. 111-148)

In a new publication, the Congressional Research Service (CRS) simplifies some of the difficult aspects of calculating the Code Sec. 45R small employer health insurance credit created by the Patient Protection and Affordable Care Act (PPACA, P.L. 111-148). The credit percentage that can be claimed varies with the number of employees and average wages. Taxpayers and their advisers who want an idea of the credit percentage available in a particular instance can use one of three tables in the study to get a quick read.

**Background.** For tax years beginning after Dec. 31, 2009, the PPACA provides a tax credit for an eligible small employer (ESE) for nonelective contributions to purchase health insurance for its employees. (Code Sec. 45R) An eligible small employer (ESE) generally is an employer with no more than 25 full-time equivalent employees (FTEs) employed during its tax year, and whose employees have annual full-time equivalent wages that average no more than \$50,000. (Code Sec. 45R(d)) However, the full amount of the credit is available only to an employer with 10 or fewer FTEs and whose employees have average annual full-time equivalent wages from the employer of less than \$25,000. (Code Sec. 45R(c))

The credit is a general business credit, and can be carried back for one year and carried forward for 20 years. (Code Sec. 38(b), Code Sec. 39(a)) The credit is available for tax liability under the alternative minimum tax. (Code Sec. 38(c)(4)(B)(vi))

**Year the credit is available.** The credit is initially available for any tax year beginning in 2010, 2011, 2012, or 2013. Qualifying health insurance for claiming the credit for this first phase of the credit is health insurance coverage within the meaning of Code Sec. 9832(b)(1). (Code Sec. 45R(g)(2)) This is generally health insurance coverage purchased from an insurance company licensed under State law.

For tax years beginning in years after 2013, the credit is only available to an eligible small employer that purchases health insurance coverage for its employees through a State exchange and is only available for a maximum coverage period of two consecutive tax years beginning with the first year in which the employer or any predecessor first offers one or more qualified plans to its employees through an exchange. (Code Sec. 45R(d)(4))

**Calculation of credit amount.** The credit is equal to the lesser of the following two amounts multiplied by an applicable tax credit percentage: (1) the amount of contributions the ESE made on behalf of the employees during the tax year for the qualifying health coverage and (2) the amount of contributions that the employer would have made during the tax year if each employee had enrolled in coverage with a small business benchmark premium. (Code Sec. 45R(b)) To calculate the contributions under the second of these two amounts, the benchmark premium is multiplied by the number of employees enrolled in coverage and then multiplied by the uniform percentage that applies for calculating the level of coverage selected by the employer. (Committee Report)

The applicable percentage is 35% for tax years beginning after 2009 and before 2014. It is 50% for tax years beginning after 2013. (Code Sec. 45R(b))

Tax-exempt 501(c) organizations are allowed the credit in a lesser amount (25% for 2010 through 2013 and 35% thereafter) against certain payroll taxes. (Code Sec. 45R(f)) For exemptions, the credit takes the form of a reduction in income and Medicare tax the employer must withhold from employees' wages and the employer share of Medicare tax on employees' wages (with the credit thus limited by these amounts).

The credit reduces the employer's deduction under Code Sec. 162 for contributions. (Code Sec. 45R(e)(5))

Aggregation rules apply in determining the employer. (Code Sec. 45R(b))

Self-employed individuals, including partners and sole proprietors, 2% shareholders of an S Corporation, and 5% owners of the employer (within the meaning of Code Sec. 416(i)(1)(B)(i) ) are not treated as employees for purposes of this credit. The credit is not available for a domestic employee of a sole proprietor of a business, and there's a special rule to prevent sole proprietorships from receiving the credit for the owner and their family members. (Code Sec. 45R(e)(1); Committee Report)

**Figuring the number of FTEs.** The number of an employer's FTEs is determined by dividing (1) the total hours for which the employer pays wages to employees during the year (but not more than 2,080 hours for any employee) by (2) 2,080. (Code Sec. 45R(d)(2)) The result, if not a whole number, is then rounded to the next lowest whole number.

**Calculating average annual wages.** The amount of average annual wages is determined by first dividing (1) the total wages paid by the employer to employees during the employer's tax year by (2) the number of the employer's FTEs for the year. The result is then rounded down to the nearest \$1,000 (if not otherwise a multiple of \$1,000). Code Sec. 45R(d)(3)(A)) For this purpose, wages means wages as defined for FICA purposes (without regard to the wage base limitation). (Code Sec. 45R(e))

**Credit phaseout.** If the number of FTEs exceeds 10 or if average annual wages exceed \$25,000, the amount of the credit is reduced as follows (but not below zero).

- If the number of FTEs exceeds 10, the reduction is determined by multiplying the otherwise applicable credit amount by a fraction having as the numerator the number of FTEs in excess of 10, and having 15 as the denominator.
- If average annual wages exceed \$25,000, the reduction is determined by multiplying the otherwise applicable credit amount by a fraction having as the numerator the amount by which average annual wages exceed \$25,000, and having \$25,000 as the denominator. (Code Sec. 45R(c))

In both cases, the result of the calculation is subtracted from the otherwise applicable credit to determine the credit to which the employer is entitled. In guidance posted on its website, IRS has said that for an employer with both more than 10 FTEs and average annual wages exceeding \$25,000, the reduction is the sum of the amount of the two reductions. This sum may reduce the credit to zero for some employers with fewer than 25 FTEs and average annual wages of less than \$50,000 (see Federal Taxes Weekly Alert 04/08/2010).

**Finding the credit percentage under the phaseout rules.** In three tables, the CRS summary of the new small business health insurance tax credit shows how the Code Sec. 45R credit is phased out as the number of FTEs increases from 10 to 25 and as average compensation increases from \$25,000 to \$50,000. Note that the \$25,000 and \$50,000 figures will be indexed for inflation beginning in 2014; the report uses these figures throughout for simplicity's sake.

Table 1. Small Business Tax Credit as a Percent (Maximum of 35%) of Employer Contribution to Premiums, For-Profit Firms in 2010-2013 and Nonprofit Firms in

2014+

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Average wage

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Firm size	Up to \$25,000	\$30,000	\$35,000	\$40,000	\$45,000	\$50,000
Up to 10	35%	28%	21%	14%	7%	0%
11	33%	26%	19%	12%	5%	0%
12	30%	23%	16%	9%	2%	0%
13	28%	21%	14%	7%	0%	0%
14	26%	19%	12%	5%	0%	0%
15	23%	16%	9%	2%	0%	0%
16	21%	14%	7%	0%	0%	0%
17	19%	12%	5%	0%	0%	0%
18	16%	9%	2%	0%	0%	0%
19	14%	7%	0%	0%	0%	0%
20	12%	5%	0%	0%	0%	0%
21	9%	2%	0%	0%	0%	0%

22	7%	0%	0%	0%	0%	0%
23	5%	0%	0%	0%	0%	0%
24	2%	0%	0%	0%	0%	0%
25	0%	0%	0%	0%	0%	0%

Table 2. Small Business Tax Credit as a Percent (Maximum of 50%) of Employer Contribution to Premiums, For-Profit Firms in 2014+

Average wage						
Firm size	Up to \$25,000	\$30,000	\$35,000	\$40,000	\$45,000	\$50,000
Up to 10	50%	40%	30%	20%	10%	0%
11	47%	37%	27%	17%	7%	0%
12	43%	33%	23%	13%	3%	0%
13	40%	30%	20%	10%	0%	0%
14	37%	27%	17%	7%	0%	0%
15	33%	23%	13%	3%	0%	0%
16	30%	20%	10%	0%	0%	0%
17	27%	17%	7%	0%	0%	0%
18	23%	13%	3%	0%	0%	0%
19	20%	10%	0%	0%	0%	0%
20	17%	7%	0%	0%	0%	0%
21	13%	3%	0%	0%	0%	0%
22	10%	0%	0%	0%	0%	0%
23	7%	0%	0%	0%	0%	0%
24	3%	0%	0%	0%	0%	0%



**RIA observation:** Although Code Sec. 45R(d) says an ESE generally is an employer with no more than 25 full-time equivalent employees (FTEs) employed during its tax year, and whose employees have annual full-time equivalent wages that average no more than \$50,000, the charts, which reflect the statutory reduction computation in Code Sec. 45R(c) , make it clear that there's no small business credit if the average wage is \$50,000.

**RIA caution:** The tables, which use rounded percentages, are a valuable way to get a quick read on the amount of credit percentage available in a particular instance. However, note that IRS has yet to indicate whether it will employ similar tables in administering the Code Sec. 45R credit.

[Note: The full CRS report can be viewed on the Web on this site:  
<http://www.ncsl.org/documents/health/SBtaxCredits.pdf> .]