

## ADMINISTRATION RELEASES NEW GUIDANCE ON SMALL BUSINESS HEALTH CARE TAX CREDIT

May 17, 2010

### *Small Businesses May Receive Both State and Federal Tax Credits, Dental and Vision Coverage Eligible for Credit*

#### **Key Facts about New Guidance on the Small Business Health Care Tax Credit:**

- *Provides detailed information to make it easier for small businesses to determine whether they are eligible and how large a credit they will receive.*
- *Resolves a number of key implementation issues in ways that allow employers to receive the maximum credit available under the law.*
- *Clarifies that a business's credit will not be reduced because the business also receives a health care tax credit or subsidy from a state.*
- *Allows small businesses to receive the credit not only for regular health insurance but also for add-on dental, vision, and other limited-scope health insurance coverage.*

#### **Key Elements:**

- **Detailed Guidance.** To help small businesses make employee benefit decisions with full knowledge and to provide a clear incentive to offer health insurance coverage, new IRS Notice 2010-44 released today lays out detailed guidance on how a business can determine whether it is eligible and how large a credit it will receive.
- **No Reduction Due to State Credits.** Responding to a number of taxpayer questions about the interaction of the credit with state-level health care tax credits and subsidies, the guidance announces that the new tax credit will not be reduced by a state health care tax credit or subsidy (except in limited circumstances to prevent abuse of the credit). In particular, an employer that receives such a state tax credit or subsidy will also receive the full federal credit based on its entire contribution so long as the federal credit does not exceed the employer's net contribution. According to lists compiled by the National Conference of State Legislatures, about 20 states offer these benefits.<sup>1</sup>
- **Dental and Vision Coverage Qualify.** The guidance clarifies that small businesses can receive the credit not only for traditional health insurance coverage but also for add-on dental, vision, and other limited-scope coverage. The employer must meet the requirements for limited-scope coverage that are similar to those that apply for single coverage: the employer must offer to pay at least 50% of the premium.
- **Employers Can Choose Most Favorable Method of Determining Hours Worked.** Because the tax credit's matching rate is highest for employers with 10 or fewer full-time equivalent employees (FTEs), the number of hours worked is an important factor in calculating the credit. The new guidance allows

<sup>1</sup> See <http://www.ncsl.org/?tabid=14526> and <http://www.ncsl.org/?tabid=13956>

employers to choose among 3 different methods of determining hours to minimize their bookkeeping duties while receiving the maximum tax credit for which they are eligible. Employers can look at actual hours of service, or can use simple rules of convenience to estimate hours based on total days or weeks of service.

- **Transition Relief for 2010 Formalized**. Because the tax credit is effective for 2010 but was not enacted until March 23, some small businesses that are providing health insurance in 2010 may not meet all the requirements for a qualifying health insurance offer. To ensure that these businesses benefit from the credit, the Administration is providing special transition relief for tax year 2010. The transition rules simplify the requirements for what constitutes a qualifying health insurance offer while maintaining the core requirement that an employer make a significant contribution to the employee's coverage. The transition relief was first mentioned in FAQs released on the IRS website on April 1, and has now been formalized in the new notice.

### **Example of Interaction with State Credit**

#### **Auto Repair Shop Receiving 40% State Credit Also Receives Full Federal Credit – Together Covering 75% of Employer's Health Insurance Costs**

##### **Main Street Mechanic:**

- ***Employees:*** 10
- ***Average Annual Wage:*** \$24,000
- ***Employer Contribution to Health Insurance (before any credits):*** \$100,000, or \$10,000 per worker
- ***State Small Business Health Care Tax Credit:*** \$40,000

**Net Employer Contribution: \$60,000** (\$100,000 minus \$40,000)

**Employer Contribution Qualifying for Federal Tax Credit: \$100,000**

**Federal Tax Credit: \$35,000** (35% of \$100,000)

**Combined Federal and State Credits: \$75,000** (\$40,000 plus \$35,000)

### **Example of Benefit for Offering Limited-Scope Coverage**

#### **Manufacturing Firm with 10 Employees Gets \$3,500 More for Offering Vision and Dental Coverage**

##### **Acme Air Conditioning, LLC:**

- ***Employees:*** 10
- ***Average Annual Wage:*** \$25,000
- ***Employer Cost for Regular Health Insurance:*** \$60,000, or \$6,000 per worker
- ***Employer Cost for Add-On Vision and Dental Plan:*** \$10,000, or \$1,000 per worker

**Tax Credit for Regular Health Insurance: \$21,000** (35% of \$60,000)

**Additional Tax Credit for Vision and Dental Plan: \$3,500** (35% of \$10,000)

**Total Tax Credit: \$24,500** (35% of \$70,000)

## **ADDITIONAL BACKGROUND ON THE SMALL BUSINESS HEALTH CARE TAX CREDIT**

*Health reform legislation signed by President Obama includes a Small Business Health Care Tax Credit to help small businesses afford the cost of covering their workers.*

### **Key Facts about the Small Business Health Care Tax Credit**

- *The tax credit, which is effective immediately, can cover up to 35 percent of the premiums a small business pays to cover its workers. In 2014, the rate will increase to 50 percent.*
- *The Congressional Budget Office estimates that the tax credit will save small businesses \$40 billion by 2019.*
- *Last month, the IRS sent out over 4 million postcards to employers that may qualify to ensure that they know about the credit and how to claim it.*

### **Key Elements:**

- **Available Immediately.** The credit is effective January 1, 2010. As a result, small businesses that provide health care for their workers will receive immediate help with their premium costs, and additional firms that initiate coverage this year will get a tax cut as well.
- **Broad Eligibility.** The Council of Economic Advisors estimates that 4 million small businesses are eligible for the credit if they provide health care to their workers. Qualifying firms must have less than the equivalent of 25 full-time workers (e.g., a firm with fewer than 50 half-time workers would be eligible), pay average annual wages below \$50,000, and cover at least 50 percent of the cost of health care coverage for their workers.
- **Substantial Benefit.** The credit is worth up to 35 percent of a small business's premium costs in 2010. On January 1, 2014, this rate increases to 50 percent.
- **Firms Can Claim Credit for Up to 6 Years.** Firms can claim the credit for 2010 through 2013 and for any two years after that.
- **Non-Profits Eligible.** Tax-exempt organizations are eligible for a 25 percent tax credit in 2010. In 2014, this rate increases to 35 percent.<sup>2</sup>
- **Gradual Phase-Outs.** The credit phases out gradually for firms with average wages between \$25,000 and \$50,000 and for firms with the equivalent of between 10 and 25 full-time workers.
- **Premium Cost Eligibility.** To avoid an incentive to choose a high-cost plan, an employer's eligible contribution is limited to the average cost of health insurance for small businesses in that state.
- **Extensive Outreach.** The Administration has initiated a nationwide educational campaign to ensure small businesses and tax preparers are informed about the credit. Last month the IRS sent out over 4 million postcards to employers that may qualify, and it is also spreading the word at over 1,000 tax workshops and small business forums, and through its email list of 175,000 tax professionals.

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<sup>2</sup> The credit rates are lower for non-profits to ensure that the value of the credit is approximately equal to that provided to for-profit firms that cannot claim a tax deduction for the amount of the credit claimed.

## **FIVE ADDITIONAL WAYS HEALTH REFORM HELPS SMALL BUSINESSES**

Small businesses want to provide health coverage for their workers, but they face extraordinary challenges in doing so, including premiums that are 18 percent higher on average than large businesses pay for the same coverage. Health reform legislation signed by the President includes a number of important benefits to help make coverage more affordable:

### **1. Creates Health Insurance Exchanges to Increase Bargaining Power and Reduce Administrative Costs.**

- **Status Quo: Small Businesses Have Little Bargaining Power, Face High Administrative Costs.** Currently, small businesses face not only premiums that are 18 percent higher than large businesses pay, but also face higher administrative costs to set up and maintain a health plan. The premiums they pay have 3 to 4 times as much administrative cost built into them as plans in the large group market. They are also at a disadvantage in negotiating with insurance companies because they lack bargaining power.
- **Solution: Health Insurance Exchanges will Provide More Choice, Lower Prices, and Greater Bargaining Power for Firms with up to 100 Employees:** Health reform will change this dynamic. Starting by 2014, firms with 100 or fewer workers will be able to pool their buying power and reduce administrative costs by purchasing insurance through a health insurance exchange. According to the Congressional Budget Office, coverage that small businesses purchased through an exchange “would have lower administrative costs, on average, than the policies those firms would buy under current law, particularly for very small firms.”

### **2. Ends Price Discrimination against Small Businesses with Sick Workers.**

- **Status Quo: Small Businesses with Sick Workers Face Higher Prices, Sudden Price Increases.** Currently, small businesses with just one sick worker can face significantly higher premiums, and having a worker fall ill can lead to a precipitous price increase – raising premiums just when insurance is needed most.
- **Solution: Ending Price Discrimination Based on Illness:** Health reform will end this price discrimination. Starting in 2014, “community rating” rules will prohibit insurers from charging more to cover small businesses with sicker workers or raising rates when someone gets sick.

### **3. Increases Health Care Security to Unlock Entrepreneurship.**

- **Status Quo: Health Insurance Insecurity Creates “Job Lock,” which Inhibits Entrepreneurship.** Our current health care system inhibits entrepreneurship and small business formation by locking workers — especially those with families or with any sort of health problem — into jobs at large firms that offer family coverage and have a big enough risk pool to absorb the cost of covering pre-existing conditions. This “job lock” causes many workers to stay at large firms even if they would be more productive working at a small business or starting their own business.
- **Solution: Health Security Empowers Entrepreneurship:** By providing health security for every American and eliminating exclusions for pre-existing conditions and price discrimination

against those who are sick, health reform will make it easier for small businesses to attract the best workers and easier for entrepreneurs to strike out on their own.

4. **Reduces the Hidden Tax on Small Business Employees with Health Insurance.**

- **Status Quo: Hidden Tax Adds \$1,000 to Every Premium:** Currently, the cost of treating the uninsured adds a “hidden tax” of over \$1,000 to every health care premium.
- **Solution: Reduce Hidden Tax by Dramatically Expanding Coverage:** Health reform will significantly reduce this tax by covering an additional 32 million Americans by 2019.

5. **Reduces Premiums in the Small Group Market.**

- **Status Quo: Higher Premiums Mean Coverage Is Unaffordable for Small Businesses.** In a recent national survey, nearly three quarters of small businesses that did not offer benefits cited high premiums as the reason.
- **Health Reform Will Lower Costs, Making Coverage More Affordable:** Taken together, the measures described above will significantly reduce premiums for small businesses. According to the Congressional Budget Office, health reform will reduce the cost of a given plan in the small group market by 1-4 percent by 2016.