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Small Employer Tax Subsidies

As part of the Patient Protection and Affordable Care Act of 2010 and the Health Care and Education Reconciliation Act of 2010 (collectively, the "PPACA"), many small businesses and certain tax-exempt organizations that provide health insurance coverage to their employees now qualify for a special tax credit. The credit was designed to encourage small employers to offer health insurance coverage for the first time or maintain coverage they already have. In this Client Alert, we explain who qualifies for the tax credit and how to calculate the amount of the credit.

Who Is Eligible for the Credit?

In general, the credit is available to small employers: (i) who have no more than 25 full-time equivalent employees; (ii) whose employees' average annual wages do not exceed \$50,000; and (iii) who pay at least half the cost of single coverage for their employees.

- **Full-time Equivalent Employees.** Full-time equivalent employees is calculated by determining the total hours for which the employer pays wages to employees during the year (excluding overtime), and then dividing that number by 2,080. If some employees work part-time, an employer with more than 25 employees may qualify for the credit depending on the number of hours worked by all employees.
- **Average Annual Wages.** The average annual wages are calculated by determining the total wages paid by the employer to employees during the employer's tax year, and then dividing that number by the employer's full-time equivalent employees for the year.
- **Coverage Requirement.** The employer must contribute at least half the cost of single coverage for each employee who enrolls in a "qualifying health plan" offered by the employer to its employees. Between now and the end of 2013, a qualifying health plan is generally major medical coverage.

How Does the Credit Work?

Calculating the Credit. The maximum credit is generally 35% of premiums paid by the employer during the taxable year, but it is only 25% for tax-exempt employers. The credit is equal to the lesser of the following two amounts, multiplied by 35% or 25%, whichever is applicable:

- (i) the amount of contributions the employer made on behalf of its employees during the year; or
- (ii) the amount of contributions the employer would have made if each employee had enrolled in coverage with a *small business benchmark premium*. This is the average premium for the small group market applicable to the employer. These benchmarks are determined by the Department of Health and Human Services ("HHS") and published by the IRS; the first set of benchmarks was published earlier this month.

Essentially, this calculation prevents an employer from claiming the credit on the portion of employer-paid premiums for coverage that is more expensive than the average coverage in that small group market. Once the total credit is calculated, that amount is reduced pro rata based upon the size of the employer and the average wages paid to employees. The end result is that the maximum credit goes to smaller employers—those with 10 or fewer FTEs—paying annual average wages of \$25,000 or less.

Claiming the Credit. Eligible employers may claim the credit on their 2010 federal income tax returns and may continue to do so in the same fashion until 2013. For tax-exempt employers, the IRS will provide further information on how to claim the credit.

Changes in 2014. Beginning in 2014, qualification for the credit changes and the terms of the credit also change. Specifically: (i) a “qualifying health plan” will mean health insurance coverage purchased by an employer through a state exchange; (ii) the maximum credit increases to 50% of premiums for for-profit employers, 35% for tax-exempt employers; and (iii) the credit will only be available for two consecutive tax years beginning with the first year in which the employer first offers a plan to its employees through a state exchange. (The two-year limitation does not take into account years before 2014, so an employer could potentially qualify for this credit in six different tax years.

Additional Information

This alert is part of an ongoing Kutak Rock LLP series discussing the impact and implications of the health care reforms. For questions regarding the changes we will see over the next several months, please see our previous alert, “[Health Care Reform: What Changes Will We See This Year?](#)” For questions regarding other issues, please visit our [Web site](#) for news and other alerts in this series.

If you wish to visit with us about the latest health care reforms, please contact your Kutak Rock LLP attorney or a member of our Employee Benefits Practice Group listed below. For more information on our Employee Benefits practice and for recent Employee Benefits news and alerts, please visit us at www.kutakrock.com.

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