Tax Credit Could Help Bottom Line of "Small" Employers

By Timothy M. Finnerty

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Tucked inside the massive healthcare legislation passed earlier this year is an immediate tax credit for certain employers that employ less than twenty-five (25) "full time equivalent" employees who are paid, on average, less than $50,000 per year. Although the credit will be limited to a small number of employers, it can be quite beneficial to those employers that are eligible. It is worth some number-crunching to determine your eligibility.

The credit amount is determined with reference to the insurance premiums paid by the employer for the health care insurance of its employees. The credit can be as much as 35% of these premiums paid by the employer; if the employer is a tax-exempt entity, the maximum amount of the credit is limited to 25% of the insurance premiums paid by the employer. This percentage is reduced as the average annual wage paid and number of full time equivalent increases.

The credit can be quite a benefit for a small business' bottom line, but not unlike many other tax credits, there are exclusions, limitations and other nuances that must be carefully reviewed to determine whether an employer is eligible for this credit and the credit amount. Some of these are discussed below:

- **Who should not be considered an Employee:** Sole proprietors, partners in a partnership, shareholders owning more than two percent of an S corporation and any owner of more than five percent of other business organizations are not taken into account as employees for purposes of the credit. In addition, family members of owners are also not counted as employees when determining the number of full time equivalents of an employer. The wages and hours of these individuals are also disregarded in determining average annual wages paid for purposes of the credit calculation.
- **Number of Employees.** Eligibility for the credit is dependent upon the number of full time equivalent employees employed by the employer. To determine the number of such employees, an employer must divide the total hours of service by employees by 2080. The result (rounded up) is the number of full time equivalents. As such, an employer could employ more than 25 individuals and still qualify for the credit.
- **"Employer":** Where there is common ownership, or an affiliated or controlled group of companies in place, all such "employers" will be considered a single employer for purposes of the credit. As such, organizations with overlapping or affiliated ownership must be mindful of this when determining whether they are eligible for the credit.
- **Average Annual Wages.** The average annual wages for employees is calculated by dividing the total wages paid by the employer to the employees (not otherwise excluded as explained in point 1 above) by the number of full time equivalents. The result is rounded up to the nearest $1,000.
- **Phase-out/Credit Reduction.** The credit begins to phase out when the number of full time equivalents exceeds ten (10) and when the average annual wage exceeds $25,000. Where the number of full time equivalents exceeds ten (10), the credit is reduced by 6.67% for each full time equivalent over ten (10). So, if an employer has eleven (11) full time equivalents, the credit would be reduced by 6.67% of the maximum credit amount. Where the average annual wages exceed $25,000, the credit is also reduced by approximately 4% for each $1,000 that the average annual wage exceeds $25,000. So, where the average annual wage is $30,000 (or $5,000 above the $25,000 amount), the maximum credit amount would be further reduced by 20% (5 x 4%). The combination of

both limitations could completely phase out the credit for employers with less than 25 full time equivalent employees and an average wage of less than $50,000, so it is important for employers to run the numbers.

As with most tax credits, the devil is in the details. The calculations are a bit cumbersome, and most employers will not qualify for the credit. However, if an employer is eligible for this tax credit, it can be quite a benefit to its bottom line. Feel free to contact an attorney from the Asset Planning and Federal Tax Group for further information concerning your eligibility for this tax credit.