

## **Does the Federal Government Owe You Tens of Thousands of Dollars? Claiming the Small Business Health Care Tax Credit**

### **Introduction**

On June 28, 2012, the Patient Protection Affordable Care Act ("ACA"), often referred to as "Obamacare," was declared constitutional by the United States Supreme Court. While most of the coverage of the ACA has focused on its mandates to purchase insurance and provide coverage for contraceptives, abortifacients and surgical sterilizations, many small tax exempt organizations (including churches) may be losing out on tens of thousands of dollars of savings per year by not taking advantage of a tax credit that was also included in the ACA. The small business health care tax credit (Tax Credit) is an incentive for small employers to provide health insurance coverage to their employees.

Effective for taxable years beginning in 2010, "qualified small employers," including tax-exempt organizations, may be eligible for the Tax Credit if they contribute a uniform percentage of at least 50% toward the cost of their employees' health insurance.<sup>1</sup> For tax-exempt organizations, the Tax Credit can be up to 25% of premiums paid and will take the form of a refundable credit against the amounts the employer is required to withhold from its employees' wages for federal income taxes and Medicare tax, plus the employer share of Medicare taxes. The credit is also limited by these amounts.

### **Employer's Eligibility for the Tax Credit**

To be eligible, an employer must: (1) be a small business or tax-exempt employer located in or having trade or business income in the United States that pays premiums for employee health insurance coverage issued in the United States; (2) employ fewer than 25 full-time-equivalent (FTE) employees in the tax year (excluding certain employees, such as business owners and their family members); (3) pay average annual wages of less than \$50,000 per FTE in the tax year; and, (4) offer health insurance and pay at least 50 percent of the health insurance premium under a "qualifying arrangement."

**Determining the Total Number of Employees:** An employer calculates its number of employees by adding (1) the number of full-time employees (the number of employees who work at least 40 hours per week) and (2) the number of FTE employees (calculate the number of FTEs by dividing the total annual hours of part time employees by 2,080). If the total number of employees is fewer than 25, the employer may be eligible for the tax credit. Employers may round down to the nearest whole number (not less than 1) of FTE employees, so 6.99, for example, becomes 6. For this purpose, the maximum number of hours that are counted for any single employee is 2,080. Notice 2010-82 and the IRS FAQs state that employers may apply different methods of calculating employees' hours of service for different classifications of

---

<sup>1</sup> Employer contributions to health reimbursement arrangements (HRAs), health savings accounts (HSAs), and health flexible spending accounts (FSAs) are not eligible premiums for purposes of computing the Tax Credit (see IRS Notice 2010-82, III, D).

employees (e.g., counting actual hours, using a days-worked or a weeks-worked equivalency) as long as the classifications are reasonable and consistently applied.

**Calculating the Average Annual Wages of Employees:** To calculate the average annual wages of employees, take the total annual wages paid to employees and divide it by the number of employees from the previous step. If the result is less than \$50,000, the employer may be eligible for the tax credit.

**Employer Pays At Least 50 Percent Under a “Qualifying Arrangement”:** An employer’s premium payments are not taken into account for purposes of the tax credit unless they are paid for health insurance coverage under a qualifying arrangement. A qualifying arrangement is an arrangement under which the employer pays premiums for each employee enrolled in health insurance coverage offered by the employer in an amount equal to a uniform percentage (not less than 50 percent) of the premium.

### Special Considerations for Ministers and Churches

Whether a church may include a minister in its calculation when determining eligibility for the Tax Credit depends on whether, under the common law test for determining worker status, the minister is considered an employee of the church or self-employed.<sup>2</sup> If the minister is an employee, he or she is taken into account in determining an employer’s FTE employees for purposes of the Tax Credit. Health insurance premiums paid by the employer for the coverage of a minister who is an employee may be taken into account in computing the Tax Credit, subject to limitations on the credit. If the minister is self-employed, he or she is not taken into account in determining an employer’s FTEs or premiums paid.

Note that compensation paid to ministers who qualify as common law employees for duties performed in the exercise of their ministry are not subject to FICA taxes. Thus, the wages of a minister who is a common law employee are not taken into account when computing average annual wages for purposes of determining eligibility for the Tax Credit, making it easier for the minister’s employer to meet the average annual wage limitation.

### Limits on the Credit Amount

The amount of the credit that employers can claim depends on several factors. Through 2013, small businesses can receive up to 35 percent and tax-exempt entities can receive up to 25 percent of their base payments for employee health insurance premiums; these portions rise to 50 percent and 35 percent, respectively, starting in 2014. Employers can receive the full credit percentage if they have 10 or fewer FTEs and pay an average of \$25,000 or less in annual wages; employers with 11 to 25 FTEs and average wages exceeding \$25,000 up to \$50,000 are eligible for a partial credit that phases out to zero percent of premium payments as the FTE and wage amounts rise.

---

<sup>2</sup> To determine whether an individual is an employee or an independent contractor under the common law, the relationship of the worker and the business must be examined. See IRS Publication 15-A for more details or contact Gammon & Grange.

Also, the amount of the credit is limited if the premiums paid by an employer are more than the average premiums determined by HHS for the small group market in the state in which the employer offers insurance. The credit percentage is multiplied by the allowable premium to calculate the dollar amount of the credit claimed.

### **How to Claim the Tax Credit**

Employers are to calculate the amount of the credit on IRS Form 8941. Tax-exempt entities are to claim the credit on Form 990-T, "Exempt Organization Business Income Tax Return," and receive the credit as a refund even though the employer has no taxable income. Employers may claim the credit for up to 6 years—the initial four years from 2010 through 2013 and any 2 consecutive years after 2013 if they buy insurance through the Small Business Health Option Programs, which are part of the insurance exchanges to be established under ACA.<sup>3</sup>

Tax exempt organizations that have already filed a Form 990-T for tax years 2010 and 2011 may still claim the Tax Credit for those tax years by filing amended returns. Organizations that were not required to file Form 990-T may still do so to claim the Tax Credit. There is no penalty for late filing because any potential penalty is based on tax liability. If there is no tax liability, there is no late fee.

**If you would like to speak with a Gammon & Grange attorney about whether or not your church or organization qualifies for the tax credit and how to claim it, contact [Patrick Purtill](#) or [Steve King](#) at (703) 761-5000.**

© 2012 Gammon & Grange, P.C. For more information, contact Gammon & Grange, P.C. (GGAlert@gg-law.com; 703-761-5000), a law firm serving nonprofit organizations and businesses throughout the United States and abroad. Readers may freely copy and distribute this Alert **in full without modification**.

**Disclaimer:** This memo is provided for general information purposes only and is not a substitute for legal advice. The transmission of this memo does not create an attorney/client relationship. No recipients of this memo should act or refrain from acting on the basis of this memo without seeking professional legal counsel. Gammon & Grange, P.C. expressly disclaims all liability relating to actions taken or not taken based on the content of this memo.

---

<sup>3</sup> ACA requires the establishment of exchanges in each state by January 1, 2014 which are to help eligible individuals and small employers compare and select insurance coverage from among participating health plans. See Pub. L. No. 111-148, § 1311(b), 124 Stat. 119, 173 (Mar. 23, 2010).