

Small Business Tax Considerations Under the Health Reform and HIRE Acts

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Federal Health Care Reform

- Small Employer Health Insurance Credit.

What It Gives You

- A Federal Income Tax Credit for Qualified Small Business Employers who make Non Elective Contributions to purchase Health Insurance for their Employees.

Who Qualifies?

A Qualified Small Business Employer:

- Must have 25 or fewer full time equivalent employees (FTEs) during the taxable year.
- Excludes sole proprietors, partners, 2% S corporation shareholders, 5% C corporation shareholders, family members and dependents of owners, domestic employees, seasonal workers.

Determining FTEs

- Limit each employee to 2080 hours
- Determine total hours worked by all qualifying employees.
- Exclude hours greater than 2080 by employee.
- Divide result by 2080.

Average Compensation Limit

- Must pay FTEs average wages of \$50,000 or less (future years indexed for inflation).
- Use FICA taxable wages.
- Calculate total wages paid to qualifying employees as done with the FTE computation.
- Exclude excess wages and divide by number of FTEs.

Aggregation Rules Apply

- Groups of businesses under common control are treated as a single employer.

Non Elective Contributions

- Must be made through an arrangement that requires the employer to make a “non elective” contribution for each employee.
- Must be a uniform percentage of premium cost.
- Must be at least 50%.
- Health insurance must be “qualified.”
 - Through 2013, purchased from any insurance company licensed under State law.
 - After 2013, only purchased through a State exchange.

How to Claim the Credit

- Claimed on employer's income tax return.
- May only offset actual income tax liability.
- Passes through to owners for Pass Through Entities (S Corporations, Partnerships).
- Treated as a General Business Credit.
- Can be carried back one year and forward for twenty years.
- May offset alternative minimum tax liability.

Credit Availability

- Available for any tax year from 2010-2013.
- After 2013, maximum of two consecutive tax years for which the credit may be claimed.

Credit Calculation

- Lesser of:
 - Amount of contributions by the employer during the taxable year for health insurance for the benefit of the employees or
 - Amount of contributions the employer would have made during the taxable year if each employee had enrolled in coverage with a small business benchmark premium.

Small Business Benchmark Premium

- Determined by the Secretary of Health and Human Services.
- Equal to the average premium for the small group market rating in which the employee enrolls for coverage.
- Rating area is a state or smaller area.
- Premium assigned by coverage type – Single, Adult with child, Family, Two adults.

Credit Percentage

- 35% for small business employers from 2010 to 2013 (25% for non-profits).
- 50% (35% non-profits) from 2014 through 2016 (but only if insurance purchased through the state insurance exchange).
- %'s decline for excess employees and wages.

Percentage Reductions

- Employers with more than ten FTEs must reduce the credit based on the number of FTEs.
- For each FTE more than ten, the credit is reduced by 6.67%.
- No credit available for employers with more than 25 FTEs.

Percentage Reductions, cont.

- Employers with average wages greater than \$25,000 must also reduce the credit.
- For each \$1,000 of average wages greater than \$25,000, reduce the credit by 4%.
- No credit available for employers with average wages of \$50,000 or more.

Percentage Reductions, cont.

- For employers with more than ten FTEs and average wages greater than \$25,000, reduce the credit based on the sum of the amounts of the two reductions.
- Calculate each reduction separately and then reduce the credit by each.
- Do not reduce the credit below zero.

Examples of Credits

| | | | | |
|------------------|----------|----------|----------|----------|
| Premiums | \$50,000 | \$50,000 | \$50,000 | \$50,000 |
| FTEs | 5 | 13 | 5 | 13 |
| Average Wages | \$24,000 | \$24,000 | \$33,000 | \$33,000 |
| Applicable % | 35% | 35% | 35% | 35% |
| Initial Credit | \$17,500 | \$17,500 | \$17,500 | \$17,500 |
| FTE Reduction | 0% | 20% | 0% | 20% |
| Wage Reduction | 0% | 0% | 32% | 32% |
| Credit Reduction | \$0 | \$3,500 | \$5,600 | \$9,100 |
| Credit | \$17,500 | \$14,000 | \$11,900 | \$8,400 |

Reduction of Tax Deduction

- Employers are generally allowed a tax deduction for payment of employee health insurance.
- This deduction must be reduced by the amount of the credit.
- For example, if an employer pays \$50,000 of premiums but receives a \$17,500 credit, tax deduction will be \$32,500.

Tax Exempt Organizations

- Credit is calculated in same manner as for profit entities, however:
 - Different credit rates.
 - Utilized vs. certain payroll taxes rather than income taxes.

Beware – Many New Taxes!

- Starting in 2013, an additional .9% Medicare tax for individuals earning more than \$200,000 (\$250,000 for married couples).
- Starting in 2013, an additional 3.8% Medicare tax on net investment income for individuals with adjusted gross income greater than \$200,000 (\$250,000 for married couples).

New Taxes – cont.

- Starting in 2014, penalty taxes for employers with 50 or more employees who do not provide minimum levels of health insurance.
- Starting in 2014, penalty taxes for individuals who fail to obtain health insurance.

New Taxes – cont.

- Starting in 2013, the floor for itemized medical expenses is raised from 7.5% to 10.0% of adjusted gross income for most taxpayers.
- Starting in 2011, over the counter medications will no longer be eligible for reimbursement by Section 125 plans.
- Starting in 2013, deferrals to Section 125 plans limited to \$2,500 annually for medical expenses.
- And many more!!!

HIRE Act

- Hiring Incentives to Restore Employment Act.
- Payroll tax exemptions and credits.

Payroll Tax Exemption

- Employer exempt from paying FICA taxes on wages of qualified new employees hired after February 3, 2010.
- Applies to wages paid from March 19, 2010 through December 31, 2010.
- Maximum savings is \$6,621 per employee (6.2% of 2010 FICA wage limit of \$106,800).
- All employers except governmental agencies eligible.

Qualified Hires

- Qualifying employee must be unemployed or employed for no more than 40 hours during 60 days preceding hire date.
- Employee must submit an affidavit – recommend use of new form W-11.
- Employee must be an addition to the workforce or replacement for an employee who left voluntarily or was fired for cause.
- Cannot fire to hire the same employee.

Qualified Hires, cont.

- Cannot be related to the employer.
- An employee is related to you if he or she:
 - Is your dependent or
 - Is related to, or is a dependent of, anyone who owns more than 50% of your outstanding stock and/or interest in profits.

How to Claim

- Form 941 will be modified beginning with second quarter 2010.
- Exemption generated for period March 19, 2010 to March 31, 2010 will be calculated on second quarter 2010 form 941 along with the exemption actually generated during the quarter.

Employee Impact

- Employees still subject to full 6.2% withholding.
- No impact on earnings recorded for individual's social security records.
- A new code will be included on 2010 forms W-2 to identify qualified wages.

Retention Credit

- For 2011, a General Business Credit will be available for retaining newly hired workers.

Qualified Employees

- Employees who qualified for the payroll tax exemption in 2010 who:
 - Are employed by the employer on any day during the taxable year,
 - Continue to be employed for 52 consecutive weeks, and
 - Receive wages during the last 26 weeks of the 52 consecutive weeks that are at least 80% of the wages earned during the first 26 weeks

Credit Amount

- Maximum credit of \$1,000 per employee.
- Credit cannot exceed 6.2% of wages.

Credit Calculation

- No provision to start credit before March 18, 2010.
- Credit must be claimed for period starting March 19, 2010.
- Credit must not be claimed until the tax year in which the employee reaches 52 weeks worked.

Reduction of Tax Deduction

- Like health insurance, employers are generally allowed a tax deduction for payment of payroll taxes.
- This deduction must be reduced by the amount of the credit.

Questions?

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