Taking Advantage of the Small Business Health Care Tax Credit

Since 2010, the government has offered a tax break for certain small businesses that offer qualifying employer-sponsored health plans to assist employers with premium costs and contributions. The health reform law, known as the Patient Protection and Affordable Care Act (ACA) does not require small businesses to provide health insurance coverage for employees. However, for those small businesses that have chosen to provide, or are already looking into providing, coverage to employees through Covered California’s Small Business Health Options Program (SHOP) in 2014, the tax credit can help ease the overall costs.

The Basics of the Small Business Tax Credit

The small business tax credit is available for both for-profit and nonprofit businesses and is based on the cost of premiums paid by the employer. To be eligible for the credit, small businesses must have fewer than 25 full-time equivalent employees and pay average annual wages of $50,000 or less. The percentage of credit that each small business is eligible for is based on a sliding scale that takes the number of employees in the business and the average annual wage into account. Qualifying for-profit businesses are eligible for up to a 50 percent tax credit, while nonprofit organizations are eligible for up to a 35 percent tax credit.

Tax credits are currently available to small businesses that meet all of the following requirements:

1. Have fewer than 25 full time equivalent employees
2. Have average annual wages of $50,000
3. Uniformly pay at least half of the employee-only (single person) insurance premiums for employees enrolled in the health plan

If all three of these conditions are met, your business may be eligible for the small business tax credit.

Who’s Premiums Are Eligible for the Tax Credit?

The small business tax credit is calculated based on the costs of premiums the business pays towards employee health coverage. The cost of insurance premiums for the small business owner, any partners within the small business, or sole proprietors running their own business are not counted when calculating the tax credit. Premiums paid for family members of the small business owner, including immediate and extended family members, are also not eligible for the tax credit.

---

1 For easy steps for determining FTE and Average Annual Wage status, go to http://www.irs.gov/pub/irs-utl/3_simple_steps.pdf
Small businesses that want to take advantage of this credit cannot reduce the amount of employment payments or tax deposits made throughout the year in anticipation of receiving the small business tax credit. However, employers that currently offer a health plan can adjust the percentage of employer-contribution towards employee premiums to become eligible for the tax credit.

Determining the Amount of Your Small Business Tax Credit

The tax credit is based on a sliding scale and the amount of this credit will vary depending upon the number of full-time equivalent employees in the business and the average annual wage that they make. Essentially, the process boils down to three steps: 1) figuring out the number of full-time equivalent employees at the business, 2) calculating the average wage your workers earn, and 3) determining the percentage you pay as an employer towards the cost of health premiums for your workers.

Step 1: Calculating the Number of Your Full-Time Equivalent Employees

Full-time equivalent workers means that part-time and seasonal workers who work more than 120 days per year need to be included when counting how many staff work at your business – for example, two employees who work 20 hours per week at the organization would count as one full-time equivalent. A full-time employee is one who works 40 hours or more a week. To calculate full-time equivalent employees, add up the total hours worked (including hours for which the employees were entitled to payment but did not work, for example if the employees receive paid vacation) by all your employees who aren’t full-time (excluding hours worked by owners, family members, partners in the organization, and seasonal employees who worked less than 120 days) during the year and divide by 2080 hours. Add this number to the number of full-time employees who work at your organization. This is the number of full-time equivalent employees in the organization. If the number is less than 25, you may qualify for a credit.

Step 2 – Determine Your Average Annual Wages

Next, you’ll need to determine the annual average wages at your organization. To do this, add up the total wages paid to all employees for the year and divide this number by the number of full-time equivalent employees in your organization. For example, if the annual wages paid by your business amount to $400,000 and you have 10 full-time equivalent workers, your average wage would be $40,000 ($400,000 divided by 10). Remember to exclude those individuals who aren’t eligible for the tax credit (such as relatives of the owner, partners, etc.) from this calculation just like you did when calculating the number of full-time equivalents.

---

2 For information on determining the average FTE status of your workforce, see FTE calculator (live link here)
Step 3 – Looking at that Percentage of Contribution

Finally, you’ll need to look at what percentage of the premium your business currently pays for employee health insurance. If it’s at least 50 percent of the amount, you have fewer than 25 employees, and your average annual wage is $50,000 or less, you may be eligible for a tax credit. The Congressional Research Service has created a report on the small business tax credit with an easy-to-read table that shows the percentage of credit you can claim based on the number of full-time equivalent workers and the average annual salary at your business.\(^3\) Kaiser Permanente has also developed a user-friendly small business tax credit worksheet\(^4\) and calculator\(^5\) to help small businesses estimate the percentage of credits they may be eligible for and what that total savings would amount to.

Claiming Your Tax Credit

If you’ve met the criteria to qualify for a small business tax credit and are ready to claim your credit either for this year or for a previous year where you met the requirement, but didn’t claim your tax credit, you’ll need to use Form 8941, “Credit for Small Employer Health Insurance Premiums,” which can be found on the IRS website.\(^6\)

For non-tax-exempt small businesses, this credit is non-refundable but for tax year 2010, the unused credit may be carried back five years. For other years, the normal carry forward and carry back rules apply. For tax-exempt small businesses, the tax credit is a refundable credit that cannot exceed the business’s withholdings for income and Medicare taxes. Health insurance premiums claimed as deductions cannot include the costs that were saved through using the small business tax credit.

Though the forms available through the IRS website seem fairly straightforward at first glance, the actual calculations can prove a bit tricky. Small business owners may find it useful to consult with an accountant or other financial advisor to determine the exact amount of expenses they can claim through the small business tax credit.

2014 and Beyond

Keeping track of all health care related expenses and hours worked by employees throughout the year can help with making the process of claiming a refund easier come tax season. The Small Business Health Options Program (SHOP) provides even more significant savings for eligible employers by encouraging competition

\(^4\) Worksheet available here: http://info.kaiserpermanente.org/html/hcr_ca/sb_tax_credit_estimate.html
\(^5\) Calculator available here: https://smallbusiness.kaiserpermanente.org/tax-credit-calculator
between insurers, decreasing the administrative burden involved in purchasing a health plan, and fostering a culture of transparency and accountability among health plans. Combined with the enhanced small business tax credit, small businesses may be able to reap significant savings while helping their employees to gain and maintain health coverage.

**Important to note:** The information contain in this document is provided for informational purposes only and should not be construed as financial, legal or operational advice, or as establishing a privileged attorney-client relationship. You must consult and rely solely upon your own independent professional advisors regarding your particular situation and the concepts presented herein. Although we have attempted to present accurate information, Kaiser Permanente disclaims any express or implied warranty as to the accuracy of any material contained herein and any liability with respect to it, and any responsibility to update this material for subsequent developments. Pursuant to IRS regulations, we are required to notify you that any advice contained on this web page that concerns federal tax issues was not intended or written to be used, and cannot be used, to avoid tax-related penalties under the Internal Revenue Code, or to promote, market, or recommend to another party any matters addressed herein. Users should consult with their own attorney or tax professional before making tax-related decisions.

**This posting is designed to provide a general overview of portions of the Affordable Care Act and should not be relied upon as legal or tax advice. Federal and state laws and regulations are subject to change. Seek professional advice regarding how the new requirements will affect your particular circumstances from an independent tax advisor or legal counsel. Information may have changed since publication.**