



Summary of Small Business Health Insurance Tax Credit Under PPACA (P.L. 111-148)

Chris L. Peterson

Specialist in Health Care Financing

Hinda Chaikind

Specialist in Health Care Financing

April 20, 2010

Congressional Research Service

7-5700

www.crs.gov

R41158

This report provides a description of the small business tax credit and illustrations of the phase-out for qualifying employers' contributions toward their workers' health insurance premiums, based on §1421 and §10105(e) of the Patient Protection and Affordable Care Act (PPACA, P.L. 111-148). This credit is available to for-profit and nonprofit employers with fewer than 25 full-time equivalent employees with average annual wages of less than \$50,000.

Type of Credit

Under PPACA, certain small employers will be eligible for a tax credit, provided they contribute a uniform percentage of at least 50% toward their employees' health insurance.¹ For nonprofit (tax-exempt) organizations, the credit will be in the form of a reduction in income and Medicare tax the employer is required to withhold from employees' wages and the employer share of Medicare tax on employees' wages (with the credit thus limited by these amounts). For all other qualifying employers, it will be in the form of a general business credit. This type of credit is not refundable, but is limited by the for-profit employer's actual tax liability. In other words, if a for-profit company had a year in which it ended up paying no taxes (i.e., it had no taxable income, after accounting for all its other deductions and credits), then the small business tax credit could not be used for that year; there would be no income tax for this credit to reduce. However, as a general business credit, an unused credit amount can generally be carried back for one year² and carried forward up to 20 years. For for-profit employers, "the credit can be reflected in determining estimated tax payments for the year to which the credit applies in accordance with regular estimated tax rules."³

Eligible Small Employers

Full Credit

In each of the four years 2010 through 2013, the full (or maximum) credit will cover up to 35% of a qualified for-profit employer's contributions⁴ to health insurance. For example, if an employer paid for 60% of premiums, the maximum small business tax credit through 2013 will be equivalent to 35% of the employer contribution (or 21% of the total premium in this example—

¹ The Internal Revenue Service (IRS) has begun mailing over 4 million postcards to small businesses and tax-exempt organizations informing them about this credit. For more information about the postcard, and state-by-state information on the number of mailings, see <http://www.irs.gov/newsroom/article/0,,id=221511,00.html>. Additionally, the IRS has released a fact sheet to help businesses determine whether they might be eligible for the credit, available at http://www.irs.gov/pub/irs-utl/3_simple_steps.pdf.

² For 2010 only, the credit cannot be carried back one year because it is first available for tax years after December 31, 2009. Beginning in 2011 and thereafter, it can be carried back one year, as part of the general business credit.

³ Internal Revenue Service, "Small Business Health Care Tax Credit: Frequently Asked Questions," 19, available at <http://www.irs.gov/newsroom/article/0,,id=220839,00.html>.

⁴ For 2010-2013, the "employer contribution" for the year will be calculated as the lesser of (1) the employer's actual premium contribution, or (2) the contribution the employer would have made if each of those same employees had enrolled in a plan with a premium equal to the average premium (determined by the Secretary of Health and Human Services (HHS)) for the small group market in the state, or area in the state, in which the employer offers health insurance. Any premium paid pursuant to a salary reduction arrangement under a section 125 cafeteria plan is not treated as paid by the employer.

i.e., 35% of 60%). In this case, assume the average total premium for this employer was \$7,500, and the employer's contribution was \$4,500 (60%) per full-time equivalent employee (FTE), the maximum tax credit would be \$1,575 per FTE (35% of \$4,500).⁵ For nonprofit employers, the maximum credit through 2013 is 25% (rather than 35%) of the employer's contribution.

Beginning in 2014, for for-profit employers, the maximum credit is 50% of the employer's contribution⁶ toward premiums, and 35% of employer contributions for nonprofit organizations. The small business tax credit that is available beginning in 2014 is only available to an employer for two consecutive tax years, beginning with the first year that the employer offers coverage through an exchange. Thus, the small business tax credit is potentially available for a total of six years—the initial credit availability from 2010 through 2013, plus the two-year credit period beginning as early as 2014.

Small employers can claim the *full* credit amount if they meet the following two criteria:

- *The employer has 10 or fewer FTEs.* FTEs are calculated by dividing the total hours worked by all "employees" (see description below) during the tax year by 2,080 (with a maximum of 2,080 hours for any one employee).
- *The employer's average taxable wages are \$25,000 or less.* This is calculated by dividing the aggregate amount of wages paid to the "employees" during the year by the number of FTEs (and then rounding to the nearest \$1,000).

For calculating the number of FTEs and their wages, the term "employees" excludes seasonal workers (working no more than 120 days during the year). In addition, the term "employees" excludes the following (as defined in the Internal Revenue Code): a self-employed individual, a 2% shareholder in an S-corporation, a 5% owner of an eligible small business, or someone who is a relation or dependent of these people. Thus, for example, the business will not receive a credit for small business owners or their family members.

Partial Credit: Phase-Out

The credit is phased out as the number of FTEs increases from 10 to 25 and as average employee compensation increases from \$25,000 to \$50,000.⁷

Table 1 shows the amount of the tax credit as a percentage (maximum of 35%) of the *employer contribution* toward workers' health insurance for *for-profit businesses from 2010 through 2013*. This table also applies as the maximum possible credit available to *nonprofit organizations beginning in 2014*.

⁵ An employer could claim a regular business deduction for the amount of the employer contribution *not* covered by the credit (i.e., the amount of the contribution minus the dollar amount of the credit).

⁶ Beginning in 2014, the employer contribution will be calculated as the lesser of (1) the employer premium contribution toward qualified health plans (QHPs) offered by the employer through an exchange, or (2) the contribution the employer would have made if each of those same employees had enrolled in a QHP with a premium equal to the average (determined by the HHS Secretary) for the small group market in the rating area in which the employee enrolls for coverage.

⁷ Beginning in 2014, these dollar amounts would be increased by the Consumer Price Index (CPI). However, for purposes of this report, \$25,000 and \$50,000 will simply be cited, even for 2014 and beyond.

Table 2 shows the amount of the tax credit as a percentage (maximum of 50%) of the *employer contribution* toward workers' health insurance for *for-profit businesses beginning in 2014*.

Table 3 shows the amount of the tax credit as a percentage (maximum of 25%) of the *employer contribution* toward workers' health insurance for *nonprofit organizations from 2010 through 2013*.

Table 1. Small Business Tax Credit as a Percent (Maximum of 35%) of Employer Contribution to Premiums, For-Profit Firms in 2010-2013 and Nonprofit Firms in 2014+

Firm size	Average wage					
	Up to \$25,000	\$30,000	\$35,000	\$40,000	\$45,000	\$50,000
Up to 10	35%	28%	21%	14%	7%	0%
11	33%	26%	19%	12%	5%	0%
12	30%	23%	16%	9%	2%	0%
13	28%	21%	14%	7%	0%	0%
14	26%	19%	12%	5%	0%	0%
15	23%	16%	9%	2%	0%	0%
16	21%	14%	7%	0%	0%	0%
17	19%	12%	5%	0%	0%	0%
18	16%	9%	2%	0%	0%	0%
19	14%	7%	0%	0%	0%	0%
20	12%	5%	0%	0%	0%	0%
21	9%	2%	0%	0%	0%	0%
22	7%	0%	0%	0%	0%	0%
23	5%	0%	0%	0%	0%	0%
24	2%	0%	0%	0%	0%	0%
25	0%	0%	0%	0%	0%	0%

Source: CRS analysis of PPACA (P.L. 111-148).

Table 2. Small Business Tax Credit as a Percent (Maximum of 50%) of Employer Contribution to Premiums, For-Profit Firms in 2014+

Firm size	Average wage					
	Up to \$25,000	\$30,000	\$35,000	\$40,000	\$45,000	\$50,000
Up to 10	50%	40%	30%	20%	10%	0%
11	47%	37%	27%	17%	7%	0%
12	43%	33%	23%	13%	3%	0%
13	40%	30%	20%	10%	0%	0%
14	37%	27%	17%	7%	0%	0%
15	33%	23%	13%	3%	0%	0%
16	30%	20%	10%	0%	0%	0%
17	27%	17%	7%	0%	0%	0%
18	23%	13%	3%	0%	0%	0%
19	20%	10%	0%	0%	0%	0%
20	17%	7%	0%	0%	0%	0%
21	13%	3%	0%	0%	0%	0%
22	10%	0%	0%	0%	0%	0%
23	7%	0%	0%	0%	0%	0%
24	3%	0%	0%	0%	0%	0%
25	0%	0%	0%	0%	0%	0%

Source: CRS analysis of PPACA (P.L. 111-148).

Table 3. Small Business Tax Credit as a Percent (Maximum of 25%) of Employer Contribution to Premiums, Nonprofit Firms in 2010-2013

Firm size	Average wage					
	Up to \$25,000	\$30,000	\$35,000	\$40,000	\$45,000	\$50,000
Up to 10	25%	20%	15%	10%	5%	0%
11	23%	18%	13%	8%	3%	0%
12	22%	17%	12%	7%	2%	0%
13	20%	15%	10%	5%	0%	0%
14	18%	13%	8%	3%	0%	0%
15	17%	12%	7%	2%	0%	0%
16	15%	10%	5%	0%	0%	0%
17	13%	8%	3%	0%	0%	0%
18	12%	7%	2%	0%	0%	0%
19	10%	5%	0%	0%	0%	0%
20	8%	3%	0%	0%	0%	0%
21	7%	2%	0%	0%	0%	0%
22	5%	0%	0%	0%	0%	0%
23	3%	0%	0%	0%	0%	0%
24	2%	0%	0%	0%	0%	0%
25	0%	0%	0%	0%	0%	0%

Source: CRS analysis of PPACA (P.L. 111-148).

Author Contact Information

Chris L. Peterson
Specialist in Health Care Financing
cpeterson@crs.loc.gov, 7-4681

Hinda Chaikind
Specialist in Health Care Financing
hchaikind@crs.loc.gov, 7-7569