

The president signed the Patient Protection and Affordable Care Act on March 23, 2010, and he signed the Health Care and Education Reconciliation Act on March 30, 2010. These two pieces of legislation are generally known as health care reform. For better or worse, now that the dust has settled we have health care reform. The law is massive and will impact almost everyone in America. Some of the provisions are effective now, some will become effective in 2014, and other provisions will become effective between now and 2018. Again, the main focus of this bi-monthly newsletter is to discuss current benefit issues. It is impossible to talk about health care reform in a single newsletter. Therefore, I will continue to talk about current events and will, every now and again, touch on an aspect of health care reform.

#### **Small Employer Tax Credit**

As I indicated, various aspects of health care reform become effective at different times. However, one provision has a retroactive effective date as of January 1, 2010. Certain small employers that provide health coverage to employees may be entitled to a tax credit! The Internal Revenue Service (IRS) issued guidance on the tax credit and, not surprisingly, the rules are complicated. The following are links to the IRS Web pages explaining the credit.

<http://www.irs.gov/newsroom/article/0,,id=220809,00.html?portlet=6>

<http://www.irs.gov/newsroom/article/0,,id=220839,00.html>

The following is a brief summary of the rules and how they apply for the 2010 calendar year. To be eligible for the credit the employer (1) must be small (i.e., 25 or fewer full-time employees) (2) whose employees' average annual salary is less than \$50,000 and (3) the employer must pay at least 50 percent of the cost of single coverage. The maximum credit is 35 percent of the amount of premiums the employer paid. The tax credit is reduced if the employer has more than 10 full-time employees and/or their annual average salary exceeds \$25,000.

As I indicated, a small employer is defined as an employer with 25 or fewer full-time employees. The rules require members of a control group to be treated as a single employer. If the employer has part-time employees the employer must convert them to full-time employees when determining the number of full-time employees. To do this the employer adds up the total hours worked by all employees and divides that number by 2080. This number is then rounded down to the next lowest number. Note that seasonal employees (i.e., those working less 120 days a year) and any hours in excess of 2080 per employee are excluded from the calculation. In addition, sole proprietors, partners, 2 percent shareholders in an "S" Corporation, and 5 percent or more owners of other businesses and the family members of these individuals are excluded when determining the number of employees. These people are also excluded when calculating the credit.

#### **Full-Time Employee Determination**

The following example shows the two-step process employers must use to determine the number of full-time employees.

Example: For the 2010 tax year, an employer pays five employees wages for 2,080 hours each, three employees wages for 1,040 hours each, and one employee wages for 2,300 hours. The employer's full-time employees for purposes of the tax credit are calculated as follows: First, add up the total hours worked by all the employees, excluding hours over 2080 worked by any one employee.

### Step One

Total hours not exceeding 2,080 per employee is the sum of:

- a. 10,400 hours for the five employees paid for 2,080 hours each (5 x 2,080)
- b. 3,120 hours for the three employees paid for 1,040 hours each (3 x 1,040)
- c. 2,080 hours for the one employee paid for 2,300 hours (lesser of 2,300 and 2,080)

These add up to 15,600 hours

### Step Two

Second, divide the total hours (i.e., 15,600) by 2080. This equals 7.5 but employers round down. Therefore, this employer has seven full-time employees.

Note that the "control group" rules apply, so related employers are treated as a single employer when calculating the number of full-time employees.

### Average Annual Wage Calculation

Once the employer has determined the number of full-time employees, the employer must next calculate their average wages. This is relatively simple. The employer simply adds the total wages paid to the employees for last year and divides that number by the number of full-time employees for last year. That number is then rounded down to the nearest \$1,000.

For example, assume the employer paid all the employees \$224,000 in total wages and there were 10 full-time employees. The average annual wage is \$22,400. The employer then rounds this down to \$22,000 for the average annual wage for purposes of calculating the credit.

### Tax Credit Calculation

If the employer has less than 10 full-time employees and the average annual wage is less than \$25,000, the credit is 35 percent of the amount the employer paid in premiums. However, if the employer has more than 10 full-time employees and/or the average annual salary is greater than \$25,000, the credit is reduced proportionally. The following example shows how this reduction works.

If the number of full-time employees exceeds 10, the reduction is determined by multiplying the otherwise applicable credit amount by a fraction, the numerator of which is the number of full-time employees in excess of 10 and the denominator of which is 15. If average annual wages exceed \$25,000, the reduction is determined by multiplying the

otherwise applicable credit amount by a fraction; the numerator of which is the amount by which average annual wages exceed \$25,000 and the denominator of which is \$25,000. In both cases, the result of the calculation is subtracted from the otherwise applicable credit to determine the credit to which the employer is entitled. For an employer with both (more than 10 full-time employees and average annual wages exceeding \$25,000) the reduction is the sum of the amount of the two reductions. This sum may reduce the credit to zero for some employers with fewer than 25 full-time employees and average annual wages of less than \$50,000.

Example: For the 2010 tax year, a qualified employer has 12 full-time employees and average annual wages of \$30,000. The employer pays \$96,000 in health care premiums for those employees and otherwise meets the requirements for the credit.

The credit is calculated as follows:

- (1) Initial amount of credit determined before any reduction:  $(35\% \times \$96,000) = \$33,600$
- (2) Credit reduction for full-time employees in excess of 10:  $(\$33,600 \times 2/15) = \$4,480$
- (3) Credit reduction for average annual wages in excess of \$25,000:  $(\$33,600 \times \$5,000/\$25,000) = \$6,720$
- (4) Total credit reduction:  $(\$4,480 + \$6,720) = \$11,200$
- (5) Total 2010 tax credit:  $(\$33,600 - \$11,200) = \$22,400.$

## Miscellaneous Provisions

One of the requirements for the credit in 2010 is that the employer pays a uniform percentage of the premiums of not less than 50 percent of the premiums. The credit is based on what the employer paid in premiums. The amount the employee paid (even pre-tax salary deferrals) for coverage is not eligible for the credit. So, for example, if the employer only paid 80 percent of the premiums, only that portion would be eligible for the credit.

Another limitation is that the maximum premiums that are eligible for determining the credit will be capped at the average premium for the small group market in the state. The Department of Health and Human Services will determine that amount and the IRS will publish it. For example, assume the premium for single coverage under the employer's group health plan is \$800 per month, but the average premium for single coverage under the small group market in the state is \$500. The employer must use the \$500 amount rather than the \$800 amount when calculating the credit.

The employer will claim the credit on its annual tax return. Unfortunately, the employer will not get the credit if the employer has no taxable income. However, the credit can be carried forward for up to 20 years. The credit can be used by the employer when making estimated payments. It is important to note that employers can not "double dip" when it comes to the credit and premiums. That is, the employer must reduce its tax deduction for the premiums paid by the credit. For example, if the employer's portion of the premiums for 2010 were \$95,000 and the employer received a \$25,000 tax credit, the

employer's deduction for health premiums would be \$70,000 (i.e., \$95,000 paid in premiums less the \$25,000 tax credit).

Special rules apply to tax exempt organizations because they have no taxable income. Therefore, tax exempt organizations can receive a refundable credit.

Finally, the rules governing the credit change in 2011. That is, the discussion above only applies to 2010.

#### **Ohio Smoking Law**

Talk about bucking the trend. There has been legislation introduced in Ohio that would preclude employers from discriminating against smokers! Yes, this law would protect those who smoke. Again, the bill has only been introduced and, therefore, is not law. The proposed law does allow employers to prohibit tobacco use during working hours. However, if enacted, employers could not base employment decisions on the fact the person smokes while not at work. See the attached article:

<http://tinyurl.com/y4wr5e4>

Again, it is important to note that this legislation is only proposed and has not yet been enacted into law. Also, it does not talk about what impact the changes would have on the employer's ability to charge smokers more for health coverage. Obviously these things would have to be addressed if the proposed legislation is, in fact, enacted.

## HIRE

Last edition I talked about the government's efforts to help reduce the unemployed ranks by passing legislation that provides a tax credit for employers to hire the unemployed. One requirement of the new law is that individuals complete an affidavit. The IRS has released the form. The following is a link to an article on HIRE plus a link to the actual form.

[http://www.seyfarth.com/dir\\_docs/news\\_item/90982afb-0f68-4e68-b5aa-3b85af9e892a\\_documentupload.pdf](http://www.seyfarth.com/dir_docs/news_item/90982afb-0f68-4e68-b5aa-3b85af9e892a_documentupload.pdf)

I have included this information because it may impact a large number of employers. However, HIRE is beyond the scope of this newsletter since it really is not an employee benefit issue.

## Nursing Mothers

The health care reform legislation is massive and people are still combing through it to determine what and how it changes the current rules. Tucked away in one of the provisions is a requirement that employers may be required to give women reasonable break time to gather milk for infants. See the attached article.

[http://www.morganlewis.com/pubs/WashGRPP\\_NursingMothers\\_LF\\_07apr10.pdf](http://www.morganlewis.com/pubs/WashGRPP_NursingMothers_LF_07apr10.pdf)

The rules apply to most employers but smaller employers (i.e. less than 50 employees) may, under certain circumstances, be exempt from the rules.

I try to cover a number of topics in these newsletters while keeping them short. However, I thought the tax credit for small employers was important and is effective now. Therefore, I devoted more space than usual to this single topic. As always, please contact me if you have any questions.

As always, if you have any questions or comments, please direct your questions back to your McGohan Brabender Account Team.