



# Health Care Reform

## LEGISLATIVE BRIEF

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## Small Employer Health Care Tax Credit: Changes for 2014

The Affordable Care Act (ACA) amended the Internal Revenue Code (Code) to create a tax credit for certain small employers that provide health insurance coverage to their employees. The ACA's small employer health care tax credit, which is contained in Code section 45R, became effective with the 2010 taxable year.

The health care tax credit will continue to be available in 2014 and later taxable years. However, a few key aspects of the tax credit will change beginning in 2014. These changes include an increase to the maximum amount of the credit, a requirement that employers obtain group coverage through an Exchange and a new two-year limit on taking the credit.

On Aug. 25, 2013, the IRS issued a [proposed rule](#) to provide guidance on the availability of the health care tax credit for 2014 and later taxable years. Employers may rely on the proposed rule for taxable years beginning after Dec. 31, 2013 and before Dec. 31, 2014. If future guidance on the health care tax credit is more restrictive, it will not be applied retroactively and employers will be provided with time to comply with the final guidance. In any case, employers will not be required to comply with any final guidance for taxable years beginning prior to Jan. 1, 2015.

This Legislative Brief provides an overview of the changes to the small employer health care tax credit that will take effect for 2014.

### ELIGIBLE SMALL EMPLOYERS

To be eligible for the health care tax credit, an employer must:

- Have fewer than 25 full-time equivalent employees (FTEs);
- Pay average annual wages of less than \$50,000 per FTE; and
- Maintain a "qualifying arrangement."

In general, for the 2010 through 2013 taxable years, a qualifying arrangement is one where the employer pays premiums for each employee enrolled in its health insurance coverage in an amount equal to a uniform percentage of not less than 50 percent of the premium cost of the coverage.

For tax years beginning with 2014, the dollar amount of average annual wages is subject to a cost-of-living adjustment. On Oct. 31, 2013, the IRS [announced](#) that, for 2014, an employer must pay average annual wages of **\$50,800 or less** per FTE to be eligible for the health care tax credit.

**Beginning with the 2014 taxable year, employers must purchase health insurance coverage for their employees under the Exchange's Small Business Health Options Program (SHOP) to be eligible for the health care tax credit.**

The proposed rule provides that, beginning with the 2014 taxable year, a qualifying arrangement is one where the employer is required to pay a uniform percentage (not less than 50 percent) of the premium cost of a qualified health plan (QHP) offered by the employer to its employees through a SHOP Exchange.

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As described below, the proposed rule provides transition relief for 2014 for employers with different plan years and taxable years. Also, although online enrollment through the federally-facilitated SHOP (FF-SHOP) has been delayed until November 2014, the health care tax credit is available to eligible employers that enroll through the direct enrollment process.

## UNIFORM PERCENTAGE REQUIREMENT

As explained above, to be eligible for the health care tax credit, an employer must pay a uniform percentage (at least 50 percent) of employees' health insurance premiums. This rule is known as the "uniform percentage requirement." The proposed rule outlines how the uniform percentage requirement is met when an employer offers more than one QHP to its employees through a SHOP Exchange. In this situation, the uniform percentage requirement may be satisfied in one of the following two ways:

- **Plan-by-plan basis**—The employer's premium payments for each plan must individually satisfy the uniform percentage requirements. The amounts or percentages of premiums paid toward each QHP do not have to be the same, but they must each satisfy the uniform percentage requirement if each QHP is tested separately.
- **Reference plan method**—The employer designates one of its QHPs as a reference plan. Then, the employer either:
  - Determines a level of employer contributions for each employee so that, if all eligible employees enrolled in the reference plan, the contributions would satisfy the uniform percentage requirement as applied to that reference plan; or
  - Allows each employee to apply the minimum amount of employer contribution determined necessary to meet the uniform percentage requirement toward the reference plan or toward coverage under any other available QHP.

State or local laws may require employers to contribute certain amounts toward employees' premium costs. The proposed rule provides that an employer will be treated as meeting the uniform percentage requirement if the failure to satisfy the requirement is attributable to additional employer contributions made to certain employees solely to comply with an applicable state or local law.

## MAXIMUM AMOUNT OF CREDIT

The amount of the health care tax credit is calculated as a percentage of the nonelective contributions that the eligible small employer makes towards employees' health insurance coverage. The maximum tax credit is only available to employers with 10 or fewer FTEs and average annual wages of \$25,000 or less for tax years 2010-2014 (the dollar amount is \$25,400 for 2014). Eligible small employers that exceed these thresholds receive a reduced tax credit.

For the 2010 through 2013 tax years, the maximum credit is 35 percent of premiums paid for taxable small employers and 25 percent of premiums paid for tax-exempt small employers. In addition, the amount of an employer's premium payments that counts for purposes of the credit is capped by the premium payment the employer would have made under the same arrangement if the average premium for the small group market in the employer's geographic location were substituted for the actual premium. **For 2014 and later taxable years, the maximum credit increases to 50 percent of premiums paid for taxable small employers and 35 percent of premiums paid for tax-exempt small employers.**

In addition, Code section 45R and the proposed rule provide that the amount of an employer's premium payments that counts for purposes of the credit is limited by the average premium in the small group market in the rating area in which the employee enrolls for coverage through a SHOP Exchange. Thus, the credit will be reduced by the excess of the credit calculated using the employer's premium payments over the credit calculated using the average premium. The proposed rule provides the following example:

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*Example:* An employer pays 50 percent of the \$7,000 premium for family coverage for its employees (\$3,500), but the average premium for family coverage in the small group market in the rating area in which the employees enrolls is \$6,000. For purposes of calculating the credit, the employer's premium payments are limited to 50 percent of \$6,000 (\$3,000).

## CREDIT PERIOD LIMIT

**Beginning in 2014, the health care tax credit is only available to an employer for two consecutive taxable years.** The proposed rule provides that the first year of the two-year credit period is the first year for which an employer files with the IRS to claim the credit. Code section 45R provides that the credit period cannot begin before the 2014 taxable year. Thus, even if an eligible small employer receives the health care tax credit for taxable years prior to 2014, the credit will be available to the employer for two consecutive taxable years beginning, during or after the 2014 taxable year.

Taxable small employers use IRS Form 8941 ("Credit for Small Employer Health Insurance Premiums") to claim the credit. Tax-exempt small employers use IRS Form 990-T ("Exempt Organization Business Income Tax Return") and attach Form 8941 to claim the credit.

The proposed rule provides that, even if the employer is only eligible to claim the credit for part of the first year, the filing of Form 8941 begins the first year of the two-year credit period.

In addition, to prevent the avoidance of the two-year limit through the use of successor entities, the proposed rule provides that a successor entity and a predecessor entity are treated as the same employer. For example, if an eligible small employer claims the credit for the 2014 and 2015 taxable years, the employer's credit period will have expired so that any successor employer to that eligible small employer will not be able to claim the credit for any subsequent taxable years.

To identify successor entities, the proposed rule applies the provisions for identifying successor employers for purposes of employment taxes. Accordingly, under the proposed rule, an entity that would be treated as a successor employer for employment tax purposes would also be treated as a successor employer for purposes of the two-year credit period.

## TRANSITION RULE

The proposed rule recognizes that, if an eligible small employer's plan year begins on a date other than the first day of its taxable year, it may not be possible or practical for the employer to offer insurance to its employees through a SHOP Exchange at the beginning of its first taxable year beginning in 2014. The proposed rule provides a transition rule for employers that:

- As of Aug. 26, 2013, offer coverage in a plan year that begins on a date other than the first day of its taxable year;
- Offer coverage during the period before the first day of the plan year beginning in 2014 that would have qualified the employer for the health care tax credit under the rules that apply to periods before Jan. 1, 2014; and
- Begin offering coverage through a SHOP Exchange as of the first day of the plan year that begins in 2014.

**Small employers that satisfy the criteria for the transition rule will be treated as offering coverage through a SHOP Exchange for their entire 2014 taxable year for purposes of determining eligibility for the health care tax credit and calculating the credit.** Thus, for an employer that qualifies for the transition relief, the credit will be calculated at the 50 percent rate (35 percent rate for tax-exempt eligible small employers) for the entire 2014 taxable year and the 2014 taxable year will be the start of the two-year credit period.

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## FF-SHOP ONLINE ENROLLMENT DELAY

On Nov. 27, 2013, the Department of Health and Human Services (HHS) [announced](#) that online enrollment in the FF-SHOP will not be available until November 2014. Employers that wish to enroll their employees in SHOP coverage for 2014 will do so through “direct enrollment” with an agent, broker or insurer offering a certified SHOP plan. The direct enrollment process applies in states with FF-SHOPs only. States that operate their own SHOPs will still be permitted to offer online enrollment.

**The health care tax credit is still available to eligible small employers that use the direct enrollment process for FF-SHOP coverage.** To be eligible for the tax credit for 2014, small employers must receive an eligibility determination from the SHOP by completing a paper application (available on [www.healthCare.gov](http://www.healthCare.gov)). The agent, broker or insurer can help employers complete this form. The SHOP will send the employer an eligibility determination after it receives a completed application. The SHOP will also send employee enrollment information to the IRS to ensure that, if otherwise eligible, the employer can claim the tax credit for tax year 2014. Employers must apply and be determined eligible prior to filing their taxes and seeking the health care tax credit.

More information on the direct enrollment process is available in a set of [Frequently Asked Questions](#) (FAQs) released by HHS.

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