# Affordable Care Tax Credit
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# Affordable Care Tax Credit

## I. Affordable Care Small-Employer Tax Credit

This course examines health care legislation designed to incentivize purchase of insurance coverage for employees by small employers. As part of the health care reform legislation under the Affordable Care Act (ACA), small businesses were given some relief from the cost of employee health care coverage in the form of the Small Business Health Care Tax Credit ("SBHCTC"), effective on January 1, 2010.[1] This credit allows small business employers that provide health insurance for their employees to receive immediate help with their premium costs. Both small for-profit businesses and small non-profit organizations are eligible. The term 'eligible small employer' is defined in the Internal Revenue Code to include employers with 'no more than' 25 full-time employees.

### Benefits of the Small Business Health Care Tax Credit

For tax years 2010 through 2013, the maximum credit was 35% of premiums paid for by small business employers and 25% of premiums paid for by small tax-exempt employers, such as charities and other non-profit organizations. Beginning in 2014, instead of a maximum tax credit of 35% of premiums paid, small business employers were able to claim a tax credit for up to 50% to offset the costs of providing health insurance coverage to employees. Likewise, small non-profit organizations can claim a tax credit of up to 35%, rather than the previous 25%. In addition, a new eligibility requirement applies: a small employer must pay premiums on behalf of employees enrolled in a qualified health plan offered through a Small Business Health Options Program (SHOP) Marketplace.

### Claiming the Credit

Particulars on claiming the credit are as follows. To be eligible, the taxpayer must cover at least 50 percent of the cost of single (not family) health care coverage for each employee. The company must also have fewer than 25 full-time equivalent employees (FTEs). Those employees must have average wages of less than $50,000 (as adjusted for inflation beginning in 2014) per year. Insurance must be purchased through the SHOP Marketplace to be eligible for the credit for tax years 2014 and beyond.
**Average annual wages-** Suppose a company pays total wages of $200,000 and has 10 FTEs. To figure average annual wages divide $200,000 by 10 — the number of FTEs — and the result is the average annual wage. The average annual wage would be $20,000. The amount of the credit received works on a sliding scale. The smaller the business or charity is, the bigger the credit will be. Thus if a company has more than 10 FTEs or if the average wage is more than $25,000 (as adjusted for inflation beginning in 2014), the amount of the credit received will be less.

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[1] The terms "small employer" and "small business" are used interchangeably here; the IRS uses the former.

Use IRS Form 8941, Credit for Small Employer Health Insurance Premiums, to calculate the credit. A small business includes the amount as part of the general business credit on their income tax return. A tax-exempt organization includes the amount on line 44f of the Form 990-T, Exempt Organization Business Income Tax Return. The Form 990-T must be filed in order to claim the credit, even if the company does not ordinarily do so. It is important to remember that a small business employer may be able to carry the credit back or forward and tax-exempt employers may be eligible for a refundable credit. There follows a report on the implementation of this program.

# II. Health Insurance and Small Employers

Many small employers do not offer health insurance to their employees. This is particularly true for small employers paying low wages. According to data from the Medical Expenditure Panel Survey (MEPS), about 17 percent of employers with less than 10 employees who earn low wages (50 percent or more of their employees earn $11.50 per hour or less) offered health insurance to their employees in 2010, while about 90 percent of employers with 100 to 999 employees who earn low wages did. MEPS is a set of large-scale surveys. MEPS is administered by the Agency for Healthcare Research and Quality in the Department of Health and Human Services. The 2010 Insurance Component survey had a response rate of about 83 percent for private establishments, and 38,409 respondents, including for-profit, and nonprofit employers; government units are excluded from these statistics. [2]

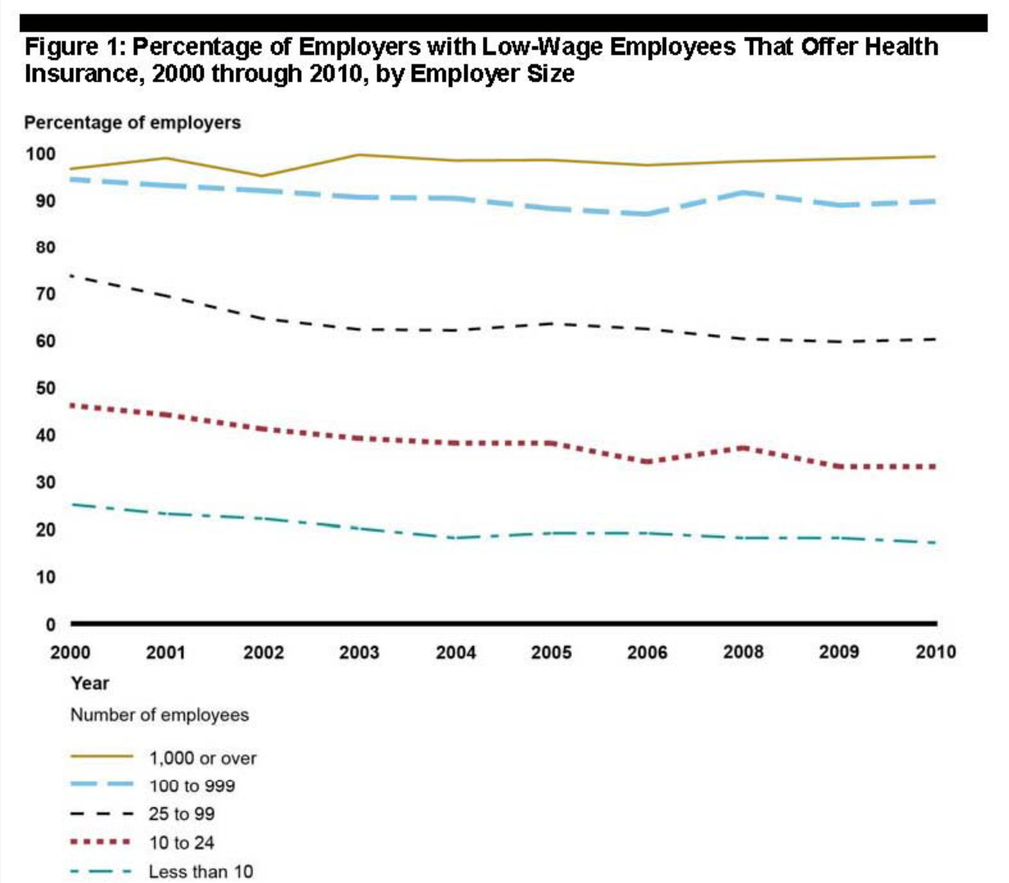
To provide an incentive for small employers to provide health insurance, and to make insurance more affordable, Congress included the Small-Employer Health Insurance Tax Credit (referred to in this report as the credit) in the Patient Protection and Affordable Care Act (PPACA) (Pub. L. No. 111-148, §§ 1421, 10105, 124 Stat. 119 (Mar. 23, 2010), (codified at 26 U.S.C. § 45R)). The credit is available for tax years beginning after December 31, 2009 to certain employers with employees earning low wages— small business and tax-exempt entities—that pay at least half of their employees' health insurance premiums. The Congressional Budget Office (CBO) and the Joint Committee on Taxation (JCT) jointly estimated that the credit would cost $2 billion in fiscal year 2010 and $40 billion from fiscal years 2010 to 2019 (Congressional Budget Office, letter to the House Speaker Pelosi (Washington, D.C.: Mar. 18, 2010)).

## Small-Employer Health Insurance Market

Small employers with low-wage employees do not commonly offer health insurance, compared with large employers with low-wage employees, as shown in Figure 1

[2] Section II information abridged from General Accountability Office Report "Small Employer Health Tax Credit" GAO 12-549, May 2012

**Figure 1 Low-Wage Employees**




Notes: Figure includes for-profit and nonprofit (tax-exempt) entities but not government entities. A low-wage employer is defined as an employer that has 50 percent or more of its employees earning a low wage (earning $11.50 per hour or less, which is an annual salary of, at most, about $23,920). Data were not collected for the MEPS Insurance Component for 2007.

## Why Health Insurance is not Offered

A combination of factors explains why small, low-wage employers tend not to offer health insurance;

- For very low-wage employees, such as minimum wage employees, health insurance drives up total compensation costs for employees. In general, the federal minimum wage is $7.25 per hour. Many states also have minimum wage laws and minimum wages vary from state to state.
- Low-wage employees working for small employers generally prefer to receive wages over insurance benefits as part of total compensation. On one hand, while employees pay both income and employment tax on wages, employees do not have to pay income or employment taxes on premiums paid by their employers for health insurance. However, for low-wage employees, the income tax exclusion is worth less relative to cash wages than for higher-income employees because low-wage employees may be in a lower income tax bracket (Quantria Strategies/Small Business Administration, *Health Insurance in the Small Business Market: Availability, Coverage, and the Effect of Tax Incentives* (Cheverly, Md.: September 2011)).

- Insurers of small employers face higher per-employee fixed costs for billing and marketing. CBO estimated that for firms with 25 or fewer employees, 26 percent of premiums goes toward insurers' administration costs, compared with 7 percent for firms with at least 1,000 employees (See CBO, *Key Issues in Analyzing Major Health Insurance Proposals* (Washington, D.C.: December 2008)).
- Small groups are less able to pool risk across large numbers of employees. Risk pooling spreads risk across a group; a larger pool stabilizes the average insurance costs. Smaller risk pools raise costs because insurers run the risk of insuring those with relatively high health care needs. As a result, insurers may increase premiums to better ensure that they can cover unexpectedly large health care costs.
- Plans offered to small employers are likely to have higher premiums or have less coverage and higher out-of-pocket costs than plans offered to large employers. The average deductible in 2010 per employee enrolled in a single (employee only) health insurance plan was $1,421 for employers with fewer than 10 employees; $1,420 for employers with 10 to 24 employees, $1,513 for employers with 25 to 99 employees, $1,155 for employers with 100 to 999 employees, and $738 for employers with 1,000 or more employees, according to MEPS. A deductible is the amount of expenses that must be paid out-of-pocket before an insurer will pay any expenses.

## IRS Requirements for Calculating and Claiming the Credit

IRS's Small Business and Self-Employed Division (SB/SE) and Tax Exempt and Government Entities Division (TEGE) are primarily responsible for implementing the credit. IRS works with the Department of Health and Human Services (HHS) and the Small Business Administration (SBA) on implementation tasks, such as outreach and communication. To be eligible, an employer must:

- Be a small business or tax-exempt employer located in or having trade or business income in the United States and pay premiums for employee health insurance coverage issued in the United States. For purposes of this credit, a business includes those that are corporations in a controlled group of corporations, or members of an affiliated service group, as well as partnerships, sole proprietorships, cooperatives and trusts. A sole proprietor is an individual who owns an unincorporated business but may employ others. The credit is available to tax-exempt employers described in 26 U.S.C. § 501(c) and exempt from tax under 26 U.S.C. § 501 (a).
- Employ fewer than 25 full-time-equivalent (FTE) employees in the tax year (excluding certain employees, such as business owners and their family members). To calculate FTEs, the total hours of service must be determined for all individuals considered employees. There are a number of methods that can be used to determine the hours worked, but the hours are limited to 2,080 per employee. The total number of hours of service is divided by 2,080 to arrive at the FTE number. Other exclusions are seasonal employees, unless they work for the employer on more than 120 days in the tax year, and ministers who are deemed to be self-employed. Leased employees are included in FTE calculations.
- Pay average annual wages of less than $50,000 per FTE in the tax year. Wages for the employees included in the FTE calculations are included in average wage

calculations except for minister's wages which are not subject to Social Security or Medicare tax.
- Offer health insurance and pay at least 50 percent of the health insurance premium under a "qualifying arrangement." This means that the employer uniformly pays at least 50 percent of the cost of premiums for enrolled employees, although IRS did develop relaxed criteria for meeting this requirement for tax year 2010.IRS offered a transition rule on the "qualifying arrangement" criteria for tax year 2010 and for satisfying the uniformity requirement. IRS Notice 2010-44.

The amount of the credit that employers can claim depends on several factors. Through 2013, small businesses could receive up to 35 percent and tax-exempt entities can receive up to 25 percent of their base payments for employee health insurance premiums; these portions increased to 50 percent and 35 percent, respectively, starting in 2014. Employers could receive the full credit percentage if they have 10 or fewer FTEs and pay an average of $25,000 or less in annual wages; employers with 11 to 25 FTEs and average wages exceeding $25,000 up to $50,000 are eligible for a partial credit that "phases" out to zero percent of premium payments as the FTE and wage amounts rise. Figure 2 shows the phase-out of the credit for small businesses; the phaseout for tax-exempt entities follows a similar pattern, up to 25 percent of health insurance premiums.

**Figure 2: Phase-out**
**Phase-out of the Credit for Small Businesses as a Percentage of Employer Contributions to Premiums, for 2010 to 2013**

| | Average wage | | | | | |
|---|---|---|---|---|---|---|
| Number of FTEs | $25,000 and less | $30,000 | $35,000 | $40,000 | $45,000 | $50,000 |
| 10 and fewer | 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% |

## Process for Claiming the Credit

Employers are to calculate the credit amount on IRS Form 8941, “Credit for Small Employer Health Insurance Premiums.” Small businesses are to claim the credit as part of the general business tax credit (on Form 3800), and use it to offset actual tax liability. If they do not have a federal tax liability, they cannot receive the credit as a refund but may carry the credit forward or back to offset tax liabilities for other years. The unused credit for small businesses may be carried back 1 year or forward up to 20 years. Credits cannot be carried back to a year prior to the effective date of the credit; any unused credit amounts for 2010 can only be carried forward (See IRS Notice 2010-44).

Credit amounts claimed by partnerships and S corporations are to be passed through to their partners and shareholders, respectively, who may claim their portions of the credit on their individual income tax returns. Owners of S corporations are referred to as shareholders. S corporations are corporations that “pass through” gains and losses to shareholders’ individual tax returns without generally paying taxes at the entity level. Similarly, partners receive pass through income and losses from a partnership. For partners and shareholders, the credit is to be entered on the Schedule K-1 to be filed with an income tax return.

Employers that claim the credit can also deduct health insurance expenses on their tax returns but must subtract the amount of the credit from the deduction. Employers can claim the credit for up to six years—the initial four years from 2010 through 2013 and any two consecutive years after 2013 if they buy insurance through the Small Business Health Option Programs, which are part of the insurance exchanges to be established under PPACA. Tax-exempt entities are to claim the credit on Form 990-T, “Exempt Organization Business Income Tax Return,” and receive the credit as a refund even though the employer has no taxable income. PPACA required the establishment of exchanges in each state by January 1, 2014, which help eligible individuals and small employers compare and select insurance coverage from among participating health plans (See Pub. L. No. 111-148, § 1311(b), 124 Stat. 119, 173 (Mar. 23, 2010)).

## Fewer Claim Credit

Fewer Small Employers Claimed the Credit Than Were Thought to Be Eligible Because of Factors Such as Credit Size and Complexity
Actual Credit Claims Were Much Lower Than Initial Rough Eligibility Estimates

Fewer small employers claimed the credit for tax year 2010 than were thought to be eligible based on rough estimates of eligible employers made by government agencies and small business groups. IRS data on total claimants, adjusted to account for claims by partners and shareholders, show that about 170,300 small employers made claims for the credit in 2010. The number of employees who had their premiums paid by employers that claimed the credit was about 770,000. The average credit amount claimed was about $2,700. Limited information is available on the distribution of claim amounts for business entities because IRS focuses its data collection on the taxpayers filing credit claims, who may be partners or shareholders claiming their portions of a business entity's credit.

Selected estimates, made by government agencies and small business groups, of employers eligible for the credit range from around 1.4 million to 4 million. However, data limitations mean that these estimates are necessarily rough. Based on the review of available data sources on the three basic eligibility rules for the credit—involving wages, FTEs, and health insurance—it is not possible to combine data from various sources to closely match these rules. Though statistical modeling corrects for imperfect data to match these rules, models are not precise. While acknowledging the data limitations, several entities produced estimates of the number of employers potentially eligible for the credit. The Council of Economic Advisors estimated 4 million and SBA estimated 2.6 million. The Council of Economic Advisors is an agency within the Executive Office of the President charged with offering objective advice on the formulation of domestic and international economic policy, and SBA is a government agency that offers a variety of programs and support services to help small businesses.

Other groups making estimates included small business groups such as the Small Business Majority (SBM) and the National Federation of Independent Businesses (NFIB). Their estimates were 4 million and 1.4 million, respectively. The estimate for SBM and SBA included nonprofits. The estimate for NFIB was only for small businesses; it is not known whether the estimate for the Council of Economic Advisors included nonprofits in addition to businesses. A similar pattern is seen when the dollar value of credits actually claimed is compared to initial estimates. The dollar value of claims made in 2010 was $468 million compared to initial cost estimates of $2 billion for 2010 (a CBO and JCT joint estimate). CBO and JCT reduced their original estimates of the future costs of the credit to a cost of $1 billion in 2012 and a cost of $21 billion from 2012 to 2021. These estimates were previously $5 billion in 2012 and $40 billion from 2012 to 2021.

## Phase-out Rules and State Average Premiums

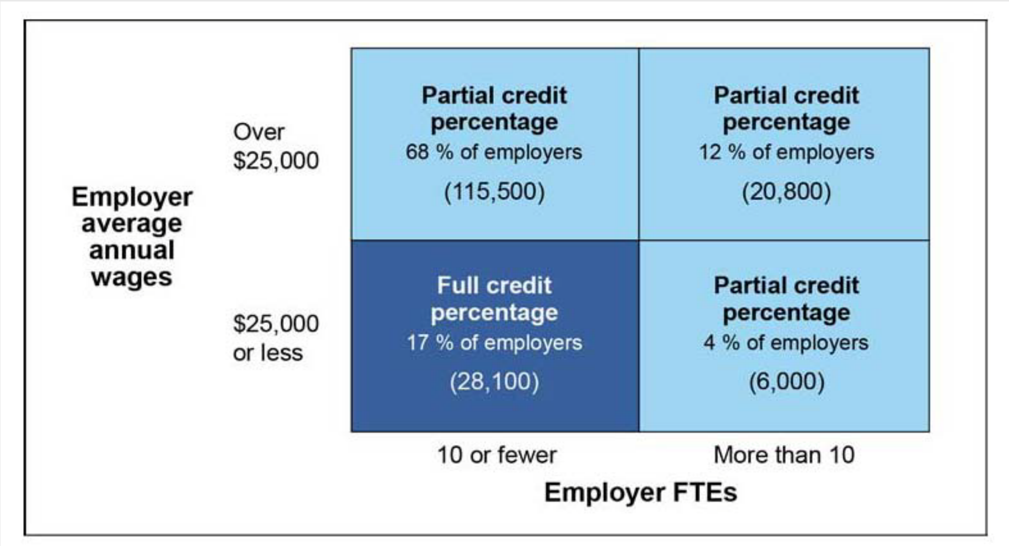
Most Small Employer Claims Were Reduced Because of the Phaseout Rules and Some Were Reduced by the State Average Premiums

Most of the claims were for less than the full credit percentage. Of the approximately 170,300 small employers making claims for tax year 2010, 142,200- 83 percent- could not use the full credit percentage. Usually employers could not meet the average wage requirement to claim the full percentage, as about 68 percent did not qualify based on wages but did meet the FTE requirement. (See fig. 3.)

State average premiums also reduced some credit amounts by reducing the amount of the premium base against which the credit percentage is applied. This premium base may be reduced when it exceeds the state average premiums for small group plans, as determined by HHS (A small-group plan is a health coverage plan sponsored by small employers for the employees). If so, small employers are to use the state average amount, which in essence caps the premium amount used to calculate their credit.

According to IRS data, this cap reduced the credit for around 30 percent of employer claims. For example, a nonprofit representative stated that their credit dropped from $7,900 to $3,070 because of the cap in its state.

**Figure 3: Percentage Claiming**
**The Number of Small Employers Claiming the Full and Partial Credit Percentages, by FTE and Wage Requirements for the Credit, Tax Year 2010**




Source: GAO analysis of IRS data on Form 8941
Notes: This information is based on the approximately 170,300 small employer claims. Numbers are rounded to the nearest hundred. Numbers and percentages do not add to totals because of rounding.

## Requirement Hurdle

Most Small Employers Could Not Meet the Health Insurance Requirement for the Credit and the Credit Was Not Seen as an Incentive to Start Offering Insurance

As already discussed, small employers do not commonly offer health insurance. MEPS estimates that 83 percent of employers who may otherwise be eligible for the full credit did not offer health insurance in 2010 and that 67 percent of employers who could be eligible for the partial credit did not offer insurance. This was confirmed by researcher's discussion groups and other interviewees (in this context, researchers are authors or contributors to the GAO report), with comments and examples of small, low-wage employers not offering health insurance to employees. The MEPS statistic is based on;
**Employers with fewer than 10 employees** (both profit and non-profit) that pay annual wages of $24,000 or less to over half of their employees
**Employers with 10 to 25 employees** (both profit and non-profit) that pay annual wages of $24,000 or less to over half of their employees. Because the employers eligible for the partial credit can pay up to $50,000 in wages, this is a less precise estimate than using MEPS to estimate insurance offerings for the full credit.

Furthermore, the small employers do not likely view the credit as a big enough incentive to begin offering health insurance and to make a credit claim, according to employer representatives, tax preparers, and insurance brokers with whom researchers met. While some small employers could be eligible for the credit if they began to offer health insurance, small business group representatives and discussion group participants maintained that the credit may not offset costs enough to justify a new outlay for health insurance premiums. Related to this concern, the credit being available for six years overall and just two consecutive years after 2014 further detracted from any potential incentive to small employers to start offering health insurance in order to claim the credit.

## Complex Eligibility Determination

Complexity Deterred Small Employer Claims, According to Discussion Groups

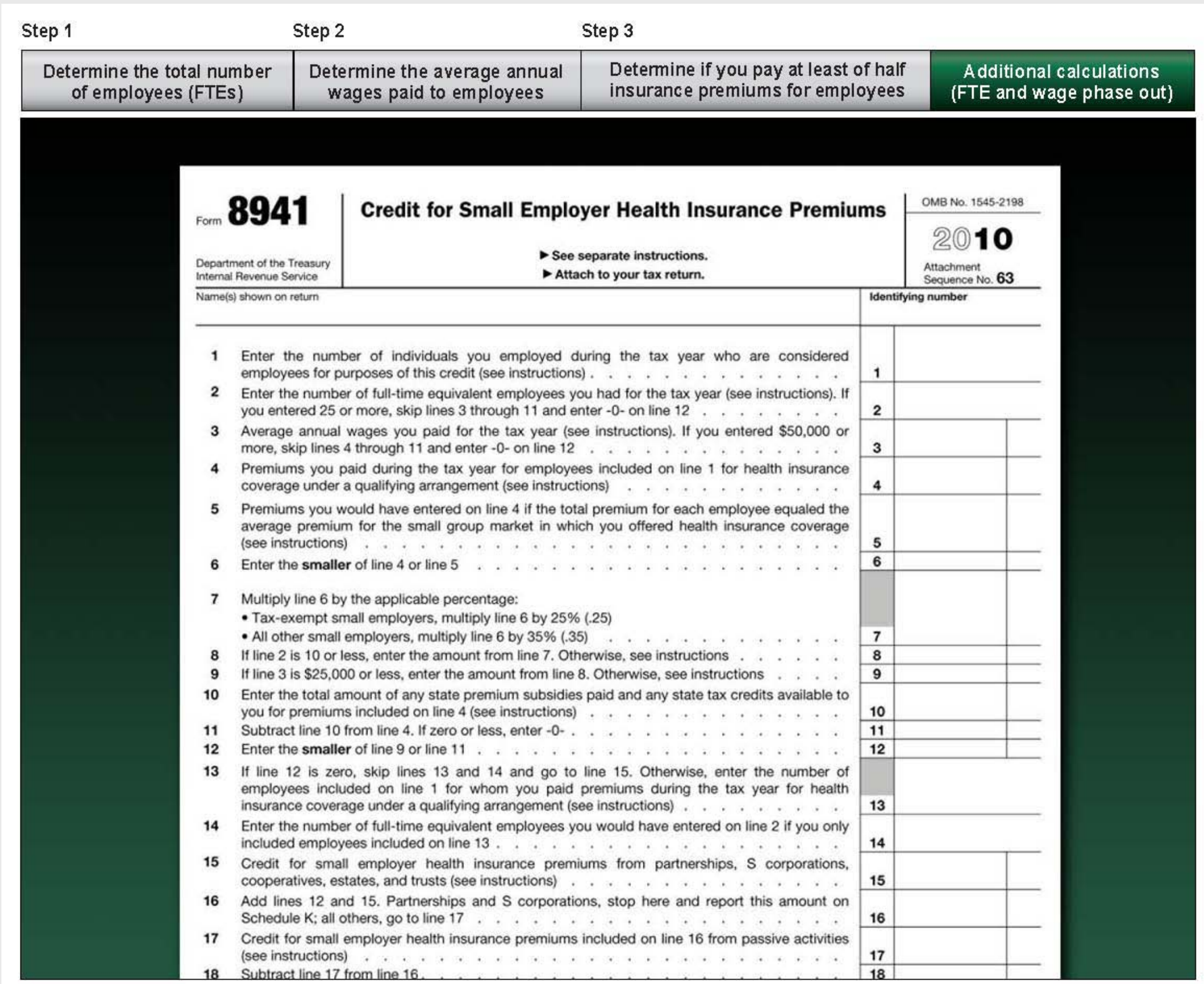
Most discussion group participants and groups interviewed for this report found the tax credit to be complicated, deterring small employers from claiming it. The complexity arises from the various eligibility requirements, the various data that must be recorded and collected, and number of worksheets to be completed. A major complaint from those providing input centered on gathering information for and calculating FTEs and the health insurance premiums associated with those FTEs. Eligible employers reportedly did not have the number of hours worked for each employee readily available to calculate FTEs and their associated average annual wages nor did they have the required health insurance information for each employee readily available.

Exclusions from the definition of “employee” and other rules make the calculations complex. For example, seasonal employees are excluded from FTE counts but insurance premiums paid on their behalf count toward the employer’s credit. Incorporating the phase-out also complicates the credit calculation. In discussion groups with tax preparers, researchers heard that small business owners generally do not want to spend the time or money to gather the necessary information to calculate the credit, given that the credit will likely be insubstantial. Tax preparers stated that it could take their clients from 2 to 8 hours or possibly longer to gather the necessary information to calculate the credit and that the tax preparers spent, in general, 3 to 5 hours calculating the credit. The National Society of Accountants conducted a survey in 2008 that estimated the hourly tax preparer fee to be $122 an hour. Tax preparers may not necessarily charge for the credit, according to some discussion group participants.

## Three Simple Steps

Tax preparers interviewed for the report said that IRS did the best it could with the Form 8941 given the credit’s complexity. IRS officials said they did not receive criticism about Form 8941 itself but did hear that the instructions and its seven worksheets were too long and cumbersome for some claimants and tax preparers. On its website, IRS tried to reduce the burden on taxpayers by offering “3 Simple Steps” as a screening tool to help taxpayers determine whether they might be eligible for the credit. However, to calculate the actual dollars that can be claimed, the three steps become 15 calculations, 11 of which are based on seven worksheets, some of which request multiple columns of information. Figure 4 aligns IRS's "3 Simple Steps," with the seven worksheets used for computing the credit in the next section and the lines on Form 8941.

**Figure 4: Form 8941 and Credit Calculations**
**Worksheets Related to IRS's "3 Simple Steps" for Determining Potential Eligibility**
(See *Specific Instructions* section later)



| Step 1 | Step 2 | Step 3 | |
|---|---|---|---|
| Determine the total number of employees (FTEs) | Determine the average annual wages paid to employees | Determine if you pay at least of half insurance premiums for employees | Additional calculations (FTE and wage phase out) |

Form **8941** — Department of the Treasury, Internal Revenue Service

**Credit for Small Employer Health Insurance Premiums**

► See separate instructions.
► Attach to your tax return.

OMB No. 1545-2198
2010
Attachment Sequence No. 63

Name(s) shown on return | Identifying number

| | | |
|---|---|---|
| 1 | Enter the number of individuals you employed during the tax year who are considered employees for purposes of this credit (see instructions) | 1 |
| 2 | Enter the number of full-time equivalent employees you had for the tax year (see instructions). If you entered 25 or more, skip lines 3 through 11 and enter -0- on line 12 | 2 |
| 3 | Average annual wages you paid for the tax year (see instructions). If you entered $50,000 or more, skip lines 4 through 11 and enter -0- on line 12 | 3 |
| 4 | Premiums you paid during the tax year for employees included on line 1 for health insurance coverage under a qualifying arrangement (see instructions) | 4 |
| 5 | Premiums you would have entered on line 4 if the total premium for each employee equaled the average premium for the small group market in which you offered health insurance coverage (see instructions) | 5 |
| 6 | Enter the **smaller** of line 4 or line 5 | 6 |
| 7 | Multiply line 6 by the applicable percentage: • Tax-exempt small employers, multiply line 6 by 25% (.25) • All other small employers, multiply line 6 by 35% (.35) | 7 |
| 8 | If line 2 is 10 or less, enter the amount from line 7. Otherwise, see instructions | 8 |
| 9 | If line 3 is $25,000 or less, enter the amount from line 8. Otherwise, see instructions | 9 |
| 10 | Enter the total amount of any state premium subsidies paid and any state tax credits available to you for premiums included on line 4 (see instructions) | 10 |
| 11 | Subtract line 10 from line 4. If zero or less, enter -0- | 11 |
| 12 | Enter the **smaller** of line 9 or line 11 | 12 |
| 13 | If line 12 is zero, skip lines 13 and 14 and go to line 15. Otherwise, enter the number of employees included on line 1 for whom you paid premiums during the tax year for health insurance coverage under a qualifying arrangement (see instructions) | 13 |
| 14 | Enter the number of full-time equivalent employees you would have entered on line 2 if you only included employees included on line 13 | 14 |
| 15 | Credit for small employer health insurance premiums from partnerships, S corporations, cooperatives, estates, and trusts (see instructions) | 15 |
| 16 | Add lines 12 and 15. Partnerships and S corporations, stop here and report this amount on Schedule K; all others, go to line 17 | 16 |
| 17 | Credit for small employer health insurance premiums included on line 16 from passive activities (see instructions) | 17 |
| 18 | Subtract line 17 from line 16 | 18 |

Given the effort involved to make a claim and the uncertainty about the credit amounts, a few discussion group participants said it would be helpful to be able to quickly estimate employers' eligibility for the credit and the amount they might receive; this would help them to decide whether the credit would be worth the effort, although this would not reduce the complication of filing out Form 8941 because, to fill out the form, full documentation would need to be reviewed. IRS's Taxpayer Advocate Service is developing a calculator for IRS's website to quickly estimate an employer's eligibility, but this will still require gathering information such as wages, FTEs, and insurance plans. The Taxpayer Advocate Service is an independent organization within the IRS that helps taxpayers who are experiencing economic harm; are seeking help in resolving problems with IRS; and believe an IRS system or procedure is not working as it should. Concerns were also voiced that a calculator could cause confusion for clients who find they are eligible when quickly estimating the credit but then turn out to be ineligible or find they are eligible for a smaller credit when their accountant fills out Form 8941.

## Aware of the Credit

The Extent to Which Lack of Awareness Is a Factor Limiting More Claims Is Unknown, Although IRS Did Significant Outreach

Many small businesses reported that they were unaware of the credit. The NFIB Research Foundation and the Kaiser Family Foundation both estimated that approximately 50 percent of small businesses were aware of the credit, as of May 2011, or more than 1 year after Congress authorized this credit. NFIB conducted this survey in April and May 2011 of 750 small employers of firms with 50 or fewer employees. The Kaiser Family Foundation conducted its survey from January through May 2011 of 3,184 public and private firms with 3 or more employees and its questions about the credit were directed to employers with 50 or fewer employees.

The extent to which being unaware prevented eligible employers from claiming the credit for tax year 2010 is not known. Some discussion group participants raised concerns about unawareness, but they also cited other factors limiting credit claims for tax year 2010. If 50 percent of small businesses knew about the credit, then the approximately 170,300 claims is a relatively small proportion of those that were knowledgeable. This indicates that other factors contributed to employers not claiming the credit. Further, it is hard to interpret the impact of awareness on claims because these surveys included an unknown number of small business employers that would not be eligible for the credit regardless of their awareness. For those employers that were unaware, the surveys did not account for their accountants or tax preparers that may have known about the credit but did not tell their clients about it because they did not believe their clients would qualify or because the credit amount would be very small. In addition, the surveys did not cover tax-exempt entities.

To raise awareness of the credit, IRS did significant outreach. IRS developed a communication and outreach plan, written materials on the credit, a video, and a website. IRS officials also reached out to interest groups about the credit and developed a list of target audiences and presentation topics. IRS officials began speaking at events in April 2010 to discuss the credit and attended over 1,500 in-person or web-based events from April 2010 to February 2012. Discussion of the credit at the events varied from being a portion of a presentation covering many topics to some events that focused on the credit with a dedicated discussion period.

IRS does not know whether its outreach efforts actually increased awareness of the credit or were otherwise cost-effective. It would be challenging to estimate the impact of IRS's outreach efforts on awareness with a rigorous methodology; however, based on ongoing feedback they received from interest groups, IRS officials stated that they believe their efforts have been worthwhile. IRS used some feedback from focus groups of tax preparers and from other sources to revise its outreach efforts. Each focus group in 2011 consisted of 12 tax preparers. IRS issued a report on the focus groups' results on October 14, 2011. For example, IRS modified its outreach from initially focusing on tax preparers and small employers to including insurance brokers.

## Expanding Credit and Design Changes

Addressing Factors and Expanding Credit Use May Require Substantive Design Changes

Given that most small employers do not offer insurance and the input about the size of the credit not being big enough to incentivize offering health insurance, it may not be possible to significantly expand credit use without changing the credit's eligibility. Most claims were for partial credits and many people viewed the credit amount as too small and temporary to justify providing health insurance when none is currently provided. Given the previously discussed lack of knowledge or awareness, it is not clear that increasing outreach would increase credit usage.

In addition, given that IRS has conducted extensive outreach about the credit, it is not likely that more outreach would significantly increase the number of businesses claiming the credit. Amending the eligibility requirements or increasing the amount of the credit may allow more businesses to take advantage of the credit, but these changes would increase its cost to the Federal government. Options include the following:

- Increasing the amount of the full credit, the partial credit, or both. But these changes would increase its cost to the Federal government.
- Increasing the amount of the credit for some by eliminating state premium averages.
- Expanding eligibility requirements by increasing the number of FTEs and wage limit allowable for employers to claim the partial credit, the full credit, or both. This expansion would not, however, likely affect the smallest employers which do not offer health insurance.
- Simplifying the calculation of the credit in the following ways:
- Using the number of employees and wage information already reported on the employer's tax return. This could reduce the amount of data gathering as well as credit calculations because eligibility would be based on the number of employees and not FTEs. A trade-off with this option would be less precise in targeting the full and partial credit amount to specific small employer subgroups. Using the number of employees instead of FTEs would require an increase in the number of eligible employees in order to reach the same population of small employers. For example, two part-time employees working 20 hours per week count as one FTE, making the employer appear larger than if FTEs were counted.
- Offering a flat credit amount per FTE (or number of employees) rather than a percentage, which would reduce the precision in targeting the credit.

In general, an employer considers all employees who perform services for the small employer during the tax year when determining the number of your full-time equivalent employees, as well as average annual wages and premiums paid.

However, in the FTE calculation, one does not include the wages and hours worked of the certain types of employees mentioned below. Also excluded are the premiums paid on behalf of these employees to determine the amount of health care tax credit:

- Owner of a sole proprietorship
- Partner in a partnership
- Shareholder of S Corporation owning more than 2 percent
- Owner of more than 5 percent of the business or other businesses
- Family members of the above

## III. Computing the Small-Employer Premium Credit

The maximum credit is a percentage of premiums the employer paid during the tax year for certain health insurance coverage the employer provided to certain employees. But the credit may be reduced by limitations based on the employer's full-time equivalent employees, average annual wages, state average premiums, and state premium subsidies and tax credits.

For **tax-exempt small employers**, the credit is generally 25% of premiums paid, is also limited to the amount of certain payroll taxes paid, and is claimed as a refundable credit on IRS Form 990-T, Exempt Organization Business Income Tax Return. A tax-exempt small employer is an eligible small employer described in section 501(c) that is exempt from taxation under section 501(a). A tax-exempt employer not described in section 501(c) is generally not eligible to claim this credit. However, a tax-exempt farmers' cooperative subject to tax under Section 1381 may be able to claim the credit as a general business credit as discussed next.

For **all other small employers**, the credit is generally 35% of premiums paid, can be taken against both regular and alternative minimum tax, and is claimed as part of the general business credit on IRS Form 3800. Taxpayers other than partnerships, S corporations, cooperatives, estates, and trusts, whose only source of this credit is from those pass-through entities, are not required to complete or file this form. Instead, they can report this credit directly on Form 3800.

### Eligible Small Employers

A small employer is eligible for the tax year if the entity meets the following three requirements;

**1. Premiums were paid for employee health insurance coverage under a qualifying arrangement.** A qualifying arrangement is generally an arrangement that requires the employer to pay a uniform percentage (not less than 50%) of the premium cost for each enrolled employee's health insurance coverage (defined later). However, an arrangement that requires the employer to pay a uniform premium for each enrolled employee (composite billing) and offers different tiers of coverage (for example, self-only, self plus one, and family coverage) can be a qualifying arrangement even if it requires payment of a uniform percentage that is less than 50% of the premium cost for employees not enrolled in self-only coverage. In addition, an arrangement that requires employers to pay a separate premium for each employee based on age or other factors (list billing) can be a qualifying arrangement even if it requires the employer to pay a uniform percentage that is less than 50% of the premium cost for some employees.

**2. The company had fewer than 25 full-time equivalent employees (FTEs) for the tax year.** This requirement may be met in certain cases even if the entity had 25 or more employees. For details, see *Individuals Considered Employees* and *Full-Time Equivalent Employee (FTE) Limitation,* later.

**3. The average annual wage for the tax year was less than $53,000 per FTE.** For details, see *Individuals Considered Employees* and *Average Annual Wage Limitation,* later. If there were more than 10 FTEs **and** average annual wages of more than $26,000, the FTE and average annual wage limitations (discussed later) will separately reduce the credit. This may reduce the credit to zero even if the company had fewer than 25 FTEs and average annual wages of less than $53,000.

## Employers treated as a single employer

The following employers are treated as a single employer to figure the credit:

- Employers who are corporations in a controlled group of corporations.
- Employers who are members of an affiliated service group.
- Employers who are partnerships, proprietorships, etc., under common control (See Regulations sections 1.414(c)-2, 1.414(c)-3, and 1.414(c)-4 for details)
- Tax-exempt employers under common control (See Regulations section 1.414(c)-5)

No more than one Form 8941 can be filed with a tax return, unless the exception described in Example 2 below applies

***Example 1.*** Employer is a sole proprietor with two separate businesses and files a separate Schedule C (Form 1040) for each business. The employer must treat both businesses as a single employer to figure the credit. This entity will file one Form 8941 for both businesses.

***Example 2.*** An individual and his/her spouse are both sole proprietors and file a separate Schedule C (Form 1040) for each of their separate businesses. Neither spouse was an employee of the other spouse or participated in the management of the other spouse's business at any time during the tax year. No more than 50% of the gross income of either business was derived from royalties, rents, dividends, interest, and annuities and the entity otherwise meets the requirements listed in Regulations section 1.414(c)-4(b)(5)(ii). Do not treat both businesses as a single employer to figure the credit. If an individual and his/her spouse are both eligible small employers, he or she can file two Forms 8941 with a jointly filed Form 1040.

## Individuals Considered Employees

In general, all employees who perform services for the employer during the tax year are taken into account in determining the FTEs, average annual wages, and premiums paid. Rules that apply to certain types of employees are discussed below.

### Excluded employees

The following individuals are not considered employees when figuring this credit. Hours and wages of these employees and premiums paid for them are not counted when an employer figures the credit:

- The owner of a sole proprietorship.
- A partner in a partnership.
- A shareholder who owns (after applying the section 318 constructive ownership rules) more than 2% of an S corporation.
- A shareholder who owns (after applying the section 318 constructive ownership rules) more than 5% of the outstanding stock or stock possessing more than 5% of the total combined voting power of all stock of a corporation that is not an S corporation.
- A person who owns more than 5% of the capital or profits interest in any other business that is not a corporation.
- Family members or a member of the household who is not a family member but qualifies as a dependent on the individual income tax return of a person listed above. Family members include a child (or descendant of a child), a sibling or step sibling, a parent (or ancestor of a parent), a step-parent, a niece or nephew, an aunt or uncle, or a son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law. A spouse is also considered a family member for this purpose.

### Leased employees

Premiums paid by the leasing organization are not used to figure the credit. Also, a leased employee who is not a common law employee is considered an employee for credit purposes if he or she does all the following:

- Provides services under agreement between employer and a leasing organization.
- Has performed services for the employer (or for the employer and a related person) substantially full time for at least 1 year.
- Performs services under the employer's primary direction or control.

But do not use hours, wages, or premiums paid with respect to the initial year of service on which leased employee status is based.

### Seasonal employees

Seasonal employees who work 120 or fewer days during the tax year are not considered employees in determining FTEs and average annual wages. But premiums paid on their behalf are counted in determining the amount of the credit. Seasonal workers include retail workers employed exclusively during holiday seasons. Seasonal workers also include workers employed exclusively during the summer.

### Household and other non-business employees

Household employees and other employees who are not performing services in the employer's trade or business are considered employees if they otherwise qualify as discussed above. A sole proprietor must include both business and nonbusiness employees to determine FTEs, average annual wages, and premiums paid.

### Ministers

A minister performing services in the exercise of his or her ministry is treated as self-employed for social security and Medicare purposes. However, for credit purposes, whether a minister is an employee or self-employed is determined under the common law test for determining worker status. Self-employed ministers are not considered employees.

## Full-Time Equivalent Employee (FTE) Limitation

Credit is reduced if the employer had more than 10 FTEs for the tax year. If there were 25 or more FTEs for the tax year, the credit is reduced to zero. However, one can still receive a credit from a partnership, S corporation, cooperative, estate, or trust.

**How to figure FTEs** To figure the number of FTEs the employer had for the tax year, do the following:

1. Figure the total hours of service (discussed below) for the tax year of all individuals considered employees.
2. Divide the total hours of service by 2,080.
3. If the result is not a whole number (0, 1, 2, etc.), generally round the result down to the next lowest whole number. For example, 10.99 is rounded down to 10. However, if the result is less than one, round up to 1.

### Employee hours of service

An employee’s hours of service for a year include the following:

- Each hour for which the employee is paid, or entitled to payment, for the performance of duties for the employer during the employer’s tax year.
- Each hour for which an employee is paid, or entitled to payment, by the employer on account of a period of time during the employer's tax year during which no duties are performed due to vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty, or leave of absence (except that no more than 160 hours of service are required to be counted for an employee on account of any single continuous period during which the employee performs no duties).

Do not include hours of service of any seasonal employee who worked 120 or fewer days during the tax year. Also, do not include more than 2,080 hours of service from any employee.

To figure the total number of hours of service that must be taken into account for an employee for the year, any of the following methods can be used:

- ***Actual hours worked method.*** Determine actual hours of service from records of hours worked and hours for which payment is made or due (payment is made or due for vacation, holiday, illness, incapacity, etc., as described above).
- ***Days-worked equivalency method.*** Use a days-worked equivalency whereby the employee is credited with 8 hours of service for each day for which the employee would be required to be credited with at least one hour of service under the rules described above.
- ***Weeks-worked equivalency method.*** Use a weeks-worked equivalency whereby the employee is credited with 40 hours of service for each week for which the employee would be required to be credited with at least one hour of service under the rules described above.

### Average Annual Wage Limitation

The credit is reduced if the employer paid average annual wages of more than $26,000 for the tax year. If average annual wages of $53,000 or more were paid for the tax year, credit is reduced to zero. However, one can still receive a credit from a partnership, S corporation, cooperative, estate, or trust.

**Computing average annual wages** To figure the average annual wages paid for the tax year, the following must be done:

1. Figure the total wages paid (discussed below) for the tax year to all individuals considered employees.
2. Divide the total wages paid by the number of FTEs the employer had for the tax year (discussed earlier).
3. If the result is not a multiple of $1,000 ($1,000, $2,000, $3,000, etc.), round the result down to the next lowest multiple of $1,000. For example, $25,999 is rounded down to $25,000.

**Employee wages paid** Wages, for this purpose, mean wages subject to social security and Medicare tax withholding determined without considering any wage base limit. But do not include wages paid to any seasonal employees who worked 120 or fewer days during the tax year.

## Employer Premiums Paid

Only premiums paid for health insurance coverage under a qualifying arrangement (discussed later) for individuals considered employees are counted when figuring the credit. For this purpose, if the employer is entitled to a state tax credit or a state premium subsidy paid directly for premiums paid, do not reduce the amount paid by the credit or subsidy amount. Also, if a state pays a premium subsidy directly to the employer's insurance provider, treat the subsidy amount as an amount paid for employee health insurance coverage. If an employer pays only a portion of the premiums and the employees pay the rest, only the portion paid by the employer is taken into account. For this purpose, any premium paid through a salary reduction arrangement under a Section 125 Cafeteria Plan is not treated as an employer paid premium.

***Example 3.*** You offer health insurance coverage to employees under a qualifying arrangement that requires you to pay 60% of the premium cost for single (employee-only) coverage for each employee enrolled in any health insurance coverage you provide to employees. The total premium for each employee enrolled in single (employee-only) coverage is $5,200 per year or $100 ($5,200 ÷ 52) for each weekly payday. The total premium for each employee enrolled in family coverage is $13,000 per year or $250 ($13,000) for each weekly payday.
Each payday you contribute $60 (60% of $100) toward the premium cost of each employee enrolled in single (employee-only) coverage and withhold the remaining $40 from the employee's paycheck to obtain the $100 total weekly premium. Each payday you contribute $60 (the same amount you pay toward the premiums of employees enrolled in single coverage) toward the premium cost of each employee enrolled in family coverage and withhold the remaining $190 from the employee's paycheck to obtain the $250 total weekly premium.
To determine the premiums you paid during the tax year, multiply the number of pay periods during which the employee was enrolled in the health insurance coverage by $60. For example, you would have paid $3,120 ($60 × 52) for an employee who was enrolled for the entire tax year. You would have paid $600 ($60 × 10) for an employee who was only enrolled for 10 pay periods. You will need an additional set of calculations if the premium amounts changed during the tax year.

## Health Insurance Coverage

For credit purposes, health insurance coverage means benefits consisting of medical care (provided directly, through insurance or reimbursement, or otherwise) under any hospital or medical service policy or certificate, hospital or medical service plan contract, or health maintenance organization contract offered by a health insurance provider. A health insurance provider is either an insurance company or another entity licensed under state law to provide health insurance coverage:

- Health insurance coverage also includes coverage under the following plans.
- Limited scope dental or vision plans.
- Long-term care plans.
- Nursing home care plans.
- Home health care plans.
- Community-based care plans.
- Any combination of the above.

In addition, health insurance coverage includes the following.

- Coverage only for a specified disease or illness.
- Hospital indemnity or other fixed indemnity insurance.
- Medicare supplemental health insurance.
- Certain other supplemental coverage.
- Similar supplemental coverage provided to coverage under a group health plan.

Health insurance coverage **does not** include the following benefits:

- Coverage only for accident, or disability income insurance, or any combination thereof.
- Coverage issued as a supplement to liability insurance.
- Liability insurance, including general liability insurance and automobile liability insurance.
- Workers' compensation or similar insurance.
- Automobile medical payment insurance.
- Credit-only insurance.
- Coverage for on-site medical clinics.
- Other similar insurance coverage, specified in regulations, under which benefits for medical care are secondary or incidental to other insurance benefits.

Also, because the coverage must be offered by a health insurance provider as discussed above, health insurance coverage does not include benefits provided by the following:

- Health reimbursement arrangements (HRAs).
- Flexible spending arrangements (health FSAs).
- Coverage under other self-insured plans.
- Health savings accounts (HSAs).
- However, health insurance coverage may include coverage under the following plans.
- Church welfare benefit plans.
- Multiemployer health and welfare plans that provide coverage through a health insurance provider. For details, see Notice 2010-82 as discussed under *More Information,* later.

## Qualifying Arrangement

A qualifying arrangement is generally an arrangement that requires the employer to pay a uniform percentage (not less than 50%) of the premium cost for each enrolled employee's health insurance coverage (defined earlier). An arrangement that offers different tiers of coverage (for example, self-only, self-plus one, and family coverage) is generally a qualifying arrangement if it requires the payment of a uniform percentage (not less than 50%) separately for each tier of coverage offered. However, an arrangement can be a qualifying arrangement even if it requires the employer to pay a uniform percentage that is less than 50% of the premium cost for some employees. Although total premiums are utilized when determining whether an employer has paid a qualifying percentage of premiums, only premiums actually paid by the employer are used to calculate the credit.

**Arrangements with composite billing.** An arrangement that requires payment of a uniform premium for each enrolled employee (composite billing) and offers different tiers of coverage can be a qualifying arrangement even if it requires payment of a uniform percentage that is less than 50% of the premium cost for employees not enrolled in self-only coverage. It is a qualifying arrangement (assuming self-only coverage is the least expensive tier of coverage) if it requires the payment of the following amounts:

- A uniform percentage (not less than 50%) of the premium cost for each employee (if any) enrolled in self-only coverage,
- A uniform amount that is no less than the amount that would have been paid toward self-only coverage for each employee (if any) enrolled in self plus one coverage.
- A uniform amount that is no less than the amount that would have been paid toward self-only coverage for each employee (if any) enrolled in family coverage.
- A uniform amount that is no less than the amount that would have been paid toward self-only coverage for each employee (if any) enrolled in any other tier of coverage (figured separately for each tier).

## List Billing and Tiers

List billing is the process that allows a health insurance company to send employers a single bill for several employees' individual health insurance policies, if the employer and employee agree to payroll-deduct employee premiums. After obtaining an agreement from the employer, the agent offers any interested employees the opportunity to apply for the health insurance plan of their choice. Once accepted by the insurer, the employees agree to have the premiums deducted from their paychecks. The insurer, in turn, sends a single bill, listing each employee's premium- hence, "list bill"- to the employer.

**Arrangements with list billing and only self-only coverage** Under a list bill arrangement, the payment of a separate premium is required for each employee based on age or other factors (list billing) that only provides self-only coverage can be a qualifying arrangement even if it requires the employer to pay a uniform percentage that is less than 50% of the premium cost for some employees. It is a qualifying arrangement if it requires the employer to pay either of the following amounts:

- A uniform percentage (not less than 50%) of the premium charged for each employee enrolled in the self-only coverage, or
- A uniform percentage (not less than 50%) of the employer-computed composite rate (defined later) for self-only coverage for each employee enrolled in the self-only coverage.

**Arrangements with list billing and other tiers of coverage** An arrangement that requires payment of a separate premium for each employee based on age or other factors (list billing) that provides other tiers of coverage can be a qualifying arrangement even if it requires the employer to pay a uniform percentage that is less than 50% of the premium cost for some employees. It is a qualifying arrangement (assuming self-only coverage is the least expensive tier of coverage) if it requires payment of the following amounts:

- A uniform percentage (not less than 50%) for each employee enrolled in self-only coverage as discussed under *Arrangements with list billing and only self-only coverage* above.

- A uniform amount that is either equal to the amount that would have been paid toward self-only coverage (as discussed above), a uniform percentage (not less than 50%) of the premium charged, or a uniform percentage (not less than 50%) of the employer-computed composite rate (defined below) for self plus one coverage, for each employee (if any) enrolled in self plus one coverage.
- A uniform amount that is either equal to the amount that would have been paid toward self-only coverage (as discussed above), a uniform percentage (not less than 50%) of the premium charged, or a uniform percentage (not less than 50%) of the employer-computed composite rate (defined below) for family coverage, for each employee (if any) enrolled in family coverage.
- A uniform amount that is either equal to the amount that would have been paid toward self-only coverage (as discussed above), a uniform percentage (not less than 50%) of the premium charged, or a uniform percentage (not less than 50%) of the employer-computed composite rate (defined below) for any other tier of coverage, for each employee (if any) enrolled in any other tier of coverage (figured separately for each tier).

**Employer-computed composite rate** The employer-computed composite rate for a tier of coverage is the average rate determined by adding the premiums for that tier of coverage for all employees eligible to participate in the health insurance plan (whether or not they actually receive coverage under the plan or under that tier of coverage) and dividing by the total number of such eligible employees.

**More than one plan** Different types of health insurance plans are generally not aggregated for purposes of meeting the qualifying arrangement requirement. For example, if the employer offers a major medical insurance plan and a stand-alone vision plan, the employer generally must separately satisfy the requirements for a qualifying arrangement with respect to each type of coverage. For exceptions, see Notice 2010-82 as discussed under *More Information,* later.

**State subsidies and credits** For this purpose, if the employer is entitled to a state tax credit or a state premium subsidy paid directly for premiums paid, do not reduce the amount paid by the credit or subsidy amount. Also, if a state pays a premium subsidy directly to the employer's insurance provider, treat the subsidy amount as an amount paid for employee health insurance coverage.

**Multiemployer health and welfare plans** For a special rule that applies to multiemployer health and welfare plans, see Notice 2010-82 as discussed under *More Information,* later.

## State Average Premium Limitation

The credit is reduced if the employer premiums paid are more than the employer premiums that would have been paid if individuals considered employees enrolled in a plan with a premium equal to the average premium for the small group market in the state and county in which the employee works (See Table A).

***Example 4*** Assume the same facts that were used in *Example 3.* The $60 you contribute each payday toward employee health insurance coverage is 60% ($60 ÷ $100) of the weekly premium for each employee enrolled in single (employee-only) coverage and 24% ($60 ÷ $250) of the weekly premium for each employee enrolled in family coverage.
In this situation, the total average premium limitation amounts that apply are 60% of the applicable amounts shown in the single coverage column of Table A for each employee enrolled in single coverage and 24% of the applicable amounts shown in the family coverage column of Table A for each employee enrolled in family coverage.
You have an employee enrolled in single (employee-only) coverage who works for you in Baltimore County, Maryland. The single coverage amount shown in Table A for that location is $6,283 or $120.83 ($6,283 ÷ 52) for each weekly payday. The amount you are considered to have paid toward this employee's health insurance coverage based on the average premiums in Table A is $72.50 (60% of $120.83) each payday.
To determine the premiums you would have paid for this employee during the tax year if the employee had enrolled in a state-average-premium plan, multiply the number of pay periods during which your employee was enrolled in the health insurance coverage by $72.50. For example, you would have paid $3,770 ($72.50 × 52) if the employee was enrolled for the entire tax year. You would have paid $725.00 ($72.50 × 10) if the employee was only enrolled for 10 pay periods. You will need an additional set of calculations if the premium amounts changed during the tax year.

## State Premium Subsidy and Tax Credit Limitation

The credit may be reduced if the employer is entitled to a state tax credit or a state premium subsidy for the cost of health insurance coverage provided under a qualifying arrangement to individuals considered employees. The state tax credit may be refundable or nonrefundable and the state premium subsidy may be paid to the employer or directly to the insurance provider.
Although a state tax credit or premium subsidy paid directly to the employer does not reduce the amount of employer premiums paid, and although a state premium subsidy paid directly to an insurance provider is treated as an employer premium paid, the credit amount cannot be more than the net premium payments.
Net premium payments are employer premiums paid (discussed earlier) minus the amount of any state tax credits received or to be received and any state premium subsides paid either to the employer or directly to the insurance provider for premiums for health insurance coverage provided by the employer under a qualifying arrangement to individuals considered employees.

**Table A. 2017 State Average Premiums for Small Group Markets**

| Maryland | | |
|---|---|---|
| County | Employee-Only | Dependent, Family, etc |
| Allegany | 5,979 | 15,272 |
| Anne Arundel | 6,283 | 17,167 |
| Baltimore | 6,283 | 17,167 |
| Baltimore City | 6,283 | 17,167 |
| Calvert | 6,172 | 15,613 |
| Caroline | 6,172 | 15,613 |
| Carroll | 5,979 | 15,272 |
| Cecil | 6,172 | 15,613 |
| Charles | 6,172 | 15,613 |
| Dorchester | 6,172 | 15,613 |
| Frederick | 5,979 | 15,272 |
| Garrett | 5,979 | 15,272 |
| Harford | 6,283 | 17,167 |
| Howard | 6,283 | 17,167 |
| Kent | 6,172 | 15,613 |
| Montgomery | 6,615 | 18,377 |
| Prince George's | 6,615 | 18,377 |
| Queen Anne’s | 6,172 | 15,613 |
| Somerset | 6,172 | 15,613 |
| St. Marys | 6,172 | 15,613 |
| Talbot | 6,172 | 15,613 |
| Washington | 5,979 | 15,272 |
| Wicomico | 6,172 | 15,613 |
| Worcester | 6,172 | 15,613 |

Note: Only Maryland Counties shown in this example. Form 8941 Instructions provide comprehensive list.

## Payroll Tax Limitation for Tax-Exempt Small Employers

The maximum credit for tax-exempt small employers is 35% of premiums paid cannot exceed the amount of certain payroll taxes. The credit is claimed as a refundable credit on Form 990-T, ‘Exempt Organization Business Tax Return.’ A tax-exempt eligible small employer is an eligible small employer described in Section 501(c) that is exempt from taxation under 501(a). A tax-exempt employer not described in Section 501(c) is generally not eligible to claim this credit. However, a tax-exempt farmers’ cooperative subject to tax under Section 1381 may be able to claim the credit as a general business credit.

## Premium Deduction Reduced

The deduction for the cost of providing health insurance coverage to employees must be reduced by the amount of any credit for small employer health insurance premiums allowed with respect to the coverage.

## More Information

For more information about this credit, see the following;

Notice 2010-44, 2010-22 I.R.B. 717, available at *www.irs.gov/irb/2010-22_IRB/ar12.html.*

Notice 2010-82, 2010-51 I.R.B. 857, available at *www.irs.gov/irb/2010-51_IRB/ar09.html.*

# IV. Form 8941

Readers will now turn their attention to completing the IRS tax form for claiming the health insurance premium credit. A copy of the form can be found at the end of this book. If the only source for this credit is a partnership, S corporation, cooperative, estate, or trust, skip lines 1 through 14 of the form and report the credit received from these sources on:

- Line 15 if the employer is one of these entities, or
- Form 3800, line 4h, if not one of these entities.

Worksheets 1 through 7 can help in figuring the amounts to report on various lines of Form 8941:

- Use Worksheets 1, 2, and 3 to figure the amounts to report on lines 1a, 2, and 3 of Form 8941.
- Use Worksheet 4 to figure the amounts to report on lines 4 and 5 of Form 8941.
- Use Worksheets 5, 6, and 7 to figure amounts to report on lines 8, 9, and 14 of Form 8941.

**Line 1a** Enter the total number of individuals considered employees shown in column (a) of Worksheet 1. For details, see *Individuals Considered Employees,* earlier.

## Instructions for Worksheet 1

**Column (a).** Enter the name or other identifying information for all individuals considered employees for purposes of this credit. For details, see *Individuals Considered Employees,* earlier.

**Column (b).** Enter the total hours of service for the tax year for each employee listed in column (a). Do not enter more than 2,080 hours for any employee. But enter -0- for seasonal employees who worked 120 or fewer days during the tax year. The information in this column is used to figure the number of full-time equivalent employees on Worksheet 2. For details, see *Full-Time Equivalent Employee (FTE) Limitation,* earlier.

*Complete Worksheet 2 before completing column (c) of Worksheet 1.* ***Do not*** *complete column (c) if Worksheet 2, line 3, is 25 or more.*

**Column (c).** Enter the total wages paid for the tax year for each employee listed in column (a). But enter -0- for seasonal employees who worked 120 or fewer days during the tax year. The information in this column is used to figure the average annual wages on Worksheet 3. For details, see *Average Annual Wage Limitation,* earlier.

**Line 1b** If the employer identification number (EIN) used on employment tax returns filed to report employment taxes for individuals included on line 1a is different from the identifying number used on Form 8941, enter the EIN on line 1b. This EIN may be different from the identifying number used on Form 8941 because the employer designated a third party as its agent on Form 2678, Employer/Payer Appointment of Agent.

**Worksheet 1 Information Needed**
**To Complete Line 1a and Worksheets 2 and 3**

| **a. Individuals Considered Employees** | **b. Employee Hours of Service** | **c. Employee Wages Paid** |
|---|---|---|
| 1. | | |
| 2. | | |
| 3. | | |
| 4. | | |
| 5. | | |
| 6. | | |
| 7. | | |

**Line 2** Enter the number of full-time equivalent employees shown on line 3 of Worksheet 2. For details, see *Full-Time Equivalent Employee (FTE) Limitation,* earlier.

**Worksheet 2 Full-Time Equivalent Employees (FTEs)**

| | |
|---|---|
| 1. Enter the total employee hours of service from Worksheet 1, column (b) | 1. ________ |
| 2. Hours of service per FTE | 2. ________ |
| 3. Full-time Equivalent Employees Divide line 1 by line 2. If the result is not a whole number, generally round the result down to the next lowest whole number. However, if the result is less than one, enter 1. Report this amount on Form 8941, line 2. ………… | 3. ________ |

**Line 3** Enter the average annual wages shown on line 3 of Worksheet 3. For details, see *Average Annual Wage Limitation*, earlier.
**Line 4** Enter the total employer premiums paid shown in column (b) of Worksheet 4. For details, see *Instructions for Worksheet 4* below.
**Line 5** Enter the total employer-state-average premiums shown in column (c) of Worksheet 4. For details, see *Instructions for Worksheet 4* below.

**Worksheet 3  Average Annual Wages**

| | |
|---|---|
| 1. Enter the total employee wages paid from Worksheet 1, column (c) ……… | 1. ________ |
| 2. Enter the FTEs from Worksheet 2, line 3 …….. | 2. ________ |
| 3. **Average Annual Wages**. Divide line 1 by line 2. If the result is not a multiple of $1,000 ($1,000, $2,000, $3,000, etc.), round the result down to the next lowest multiple of $1,000. Report this amount on Form 8941, line 3 | 3. ________ |

## Instructions for Worksheet 4

**Column (a).** Enter the name or other identifying information for each individual listed in column (a) of Worksheet 1 who was enrolled in health insurance coverage provided to employees during the tax year under a qualifying arrangement. For details, see *Health Insurance Coverage* and *Qualifying Arrangement,* earlier.
**Column (b).** Enter the total employer premiums paid for the tax year for each employee listed in column (a). For details, see *Employer Premiums Paid,* earlier.

**Worksheet 4. Summary of Information**
**Needed To Complete Lines 4 and 5 and Worksheet 7**

| (a) Enrolled Individuals Considered Employees | (b) Employer Premiums Paid | (c) Employer State Average Premiums | (d) Enrolled Employee Hours of Service |
|---|---|---|---|
| 1. | | | |
| 2. | | | |
| 3. | | | |
| 4. | | | |
| 5. | | | |
| 6. | | | |
| 7. | | | |

**Column (c).** Enter, for each employee listed in column (a), the premiums that would have been paid if the employee had enrolled in a plan or plans with a total premium equal to the average premium for the small group market in the state in which the employee works. For details, see *State Average Premium Limitation,* earlier.
***Do not** complete column (d) if Form 8941, line 12, is zero.*

**Column (d).** Enter the amount from column (b) of Worksheet 1 for each employee listed in column (a) of Worksheet 4.

If more rows are needed, use a separate sheet and include the additional amounts in the totals below.

**Line 8** If the number of FTEs reported on line 2 is 10 or less, credit is not reduced by the FTE limitation. Enter on line 8 the amount from line 7. If line 2 is more than 10, enter on line 8 the reduced credit amount shown on Worksheet 5, line 6.

**Worksheet 5  FTE Limitation**

| | | |
|---|---|---|
| 1. Enter the amount from Form 8941, line 7 | | 1. ________ |
| 2. Enter the amount from Form 8941, line 2 | 2. ________ | |
| 3. Subtract 10 from line 2 | 3. ________ | |
| 4. Divide line 3 by 15. Enter the result as a decimal (rounded to at least three places) | 4. ________ | |
| 5. Multiply line 1 by line 4 | | 5. ________ |
| 6. Subtract line 5 from line 1. Report this amount on Form 8941, line 8 | | 6. ________ |

If the average annual wages reported on line 3 are $25,000 or less, credit is not reduced by the average annual wage limitation. Enter on line 9 the amount from line 8. If line 3 is more than $25,000, enter on line 9 the reduced credit amount shown on Worksheet 6, line 7.

**Line 10** Enter the total amount of any state premium subsidies paid and any state tax credits available for premiums included on line 4. For details, see *State Premium Subsidy and Tax Credit Limitation,* earlier.

**Worksheet 6 Average Annual Wage Limitation**

| | | |
|---|---|---|
| 1. Enter the amount from Form 8941, line 8 | | 1. ________ |
| 2. Enter the amount from Form 8941, line 7 | 2. ________ | |
| 3. Enter the amount from Form 8941, line 3 | 3. ________ | |
| 4. Subtract $25,000 from line 3 | 4. ________ | |
| 5. Divide line 4 by $25,000. Enter the result as a decimal (rounded to at least three places) | 5. ________ | |
| 6. Multiply line 2 by line 5 | | 6. ________ |
| 7. Subtract line 6 from line 1. Report this amount on Form 8041, line 9 | | 7. ________ |

**Line 13** Enter the total number of individuals shown in column (a) of Worksheet 4. These are individuals considered employees for whom premiums were paid during the tax year for health insurance coverage under a qualifying arrangement.

**Worksheet 7 FTEs Enrolled in Coverage**

| | |
|---|---|
| 1. Enter the total enrolled employee hours of service from Worksheet 4, column (d) | 1. ________ |
| 2. Hours of service per FTE | 2. __2,080_ |
| 3. Divide line 1 by line 2. If the result is not a whole number (0,1,2, etc.), generally round the result down to the next lowest whole number. However, if the result is less than one, enter 1. Report this amount on Form 8941, line 14 | 3. ________ |

**Line 14** Enter the number of full-time equivalent employees (FTEs) shown on line 3 of Worksheet 7. These are FTEs for whom premiums were paid for health insurance coverage under a qualifying arrangement during the tax year.

**Line 15** Enter any credit for small employer health insurance premiums from:
Schedule K-1 (Form 1065), box 15 (code P),

Schedule K-1 (Form 1120S), box 13 (code P),
Schedule K-1 (Form 1041), box 13 (code G), and
Any notice of credit allocation received from a cooperative.

*Taxpayers other than partnerships, S corporations, cooperatives, estates, and trusts, whose only source of this credit is from those pass-through entities, are not required to complete line 15. Instead, they can report this credit directly on Form 3800, line 4h.*

**Line 17 Cooperatives.** A cooperative described in section 1381(a) must allocate to its patrons the credit in excess of its tax liability. Therefore, to figure the unused amount of the credit allocated to patrons, the cooperative must first figure its tax liability. While any excess is allocated to patrons, any credit recapture applies as if the cooperative had claimed the entire credit.
If the cooperative is subject to the passive activity rules, include on line 15 any credit for small employer health insurance premiums from passive activities disallowed for prior years and carried forward to this year. Complete Form 8810, Corporate Passive Activity Loss and Credit Limitations, to determine the allowed credit that must be allocated to patrons. For details, see the Instructions for Form 8810.

**Estates and Trusts.** Allocate the credit on line 16 between the estate or trust and the beneficiaries in the same proportion as income was allocated and enter the beneficiaries' share on line 17.
If the estate or trust is subject to the passive activity rules, include on line 15 any credit for small employer health insurance premiums from passive activities disallowed for prior years and carried forward to this year. Complete Form 8582-CR, Passive Activity Credit Limitations, to determine the allowed credit that must be allocated between the estate or trust and the beneficiaries. For details, see the Instructions for Form 8582-CR.

**Line 19** Enter the total amount of certain payroll taxes. Payroll taxes, for this purpose, means only the following taxes;

- Federal income taxes the tax-exempt employer was required to withhold from employees' wages in calendar year 2017.
- Medicare taxes the tax-exempt employer was required to withhold from employees' wages in calendar year 2017.
- Medicare taxes the tax-exempt employer was required to pay for calendar year 2017.

## Credit Trade-Off

The Small Employer Health Insurance Tax Credit was intended to offer an incentive for small, low-wage employers to provide health insurance. However, utilization of the credit was lower than expected for the time period examined in Section II, with the available evidence suggesting that the design of the credit is a large part of the reason why. While the credit could be redesigned, such changes come with trade-offs. Changing the credit to expand eligibility or make it more generous would increase the revenue loss to the federal government.

Form **8941**

Department of the Treasury
Internal Revenue Service

# Credit for Small Employer Health Insurance Premiums

► Attach to your tax return.

► Go to *www.irs.gov/Form8941* for instructions and the latest information.

OMB No. 1545-2198

**2017**

Attachment Sequence No. **65**

| Name(s) shown on return | Identifying number |
|---|---|
| | |

**A** Did you pay premiums during your tax year for employee health insurance coverage you provided through a Small Business Health Options Program (SHOP) Marketplace (or do you qualify for an exception to this requirement)? See instructions.

- ☐ **Yes.** Enter Marketplace Identifier (if any): ______________
- ☐ **No.** Stop. Do not file Form 8941 (see instructions for an exception that may apply to a partnership, S corporation, cooperative, estate, trust, or tax-exempt entity)

**B** Enter the employer identification number (EIN) used to report employment taxes for individuals included on line 1 below if different from the identifying number listed above ______________

**C** Does a tax return you (or any predecessor) filed for a tax year beginning in 2014 or 2015 include a Form 8941 with line A checked "Yes" and line 12 showing a positive amount?

- ☐ **Yes.** Stop. Do not file Form 8941 (see instructions for an exception that may apply to a partnership, S corporation, cooperative, estate, trust, or tax-exempt entity) (also see instructions for information about the credit period limitation)
- ☐ **No.**

**Caution:** See the instructions and complete Worksheets 1 through 7 as needed.

| | | | |
|---|---|---|---|
| 1 | Enter the number of individuals you employed during the tax year who are considered employees for purposes of this credit (total from Worksheet 1, column (a)) . . . . . . . . | 1 | |
| 2 | Enter the number of full-time equivalent employees (FTEs) you had for the tax year (from Worksheet 2, line 3). If you entered 25 or more, skip lines 3 through 11 and enter -0- on line 12 | 2 | |
| 3 | Average annual wages you paid for the tax year (from Worksheet 3, line 3). This amount must be a multiple of $1,000. If you entered $53,000 or more, skip lines 4 through 11 and enter -0- on line 12 | 3 | |
| 4 | Premiums you paid during the tax year for employees included on line 1 for health insurance coverage under a qualifying arrangement (total from Worksheet 4, column (b)) . . . . . . | 4 | |
| 5 | Premiums you would have entered on line 4 if the total premium for each employee equaled the average premium for the small group market in which the employee enrolls in health insurance coverage (total from Worksheet 4, column (c)) . . . . . . . . . . . . . . . . . . | 5 | |
| 6 | Enter the **smaller** of line 4 or line 5 . . . . . . . . . . . . . . . . . . . . . . . | 6 | |
| 7 | Multiply line 6 by the applicable percentage:<br>• Tax-exempt small employers, multiply line 6 by 35% (0.35)<br>• All other small employers, multiply line 6 by 50% (0.50) . . . . . . . . . . . . . . | 7 | |
| 8 | If line 2 is 10 or less, enter the amount from line 7. Otherwise, enter the amount from Worksheet 5, line 6 | 8 | |
| 9 | If line 3 is $26,000 or less, enter the amount from line 8. Otherwise, enter the amount from Worksheet 6, line 7 . . . . . . . . . . . . . . . . . . . . . . . . . . | 9 | |
| 10 | Enter the total amount of any state premium subsidies paid and any state tax credits available to you for premiums included on line 4. See instructions . . . . . . . . . . . . . . . . | 10 | |
| 11 | Subtract line 10 from line 4. If zero or less, enter -0- . . . . . . . . . . . . . . . . . | 11 | |
| 12 | Enter the **smaller** of line 9 or line 11 . . . . . . . . . . . . . . . . . . . . . . . | 12 | |
| 13 | If line 12 is zero, skip lines 13 and 14 and go to line 15. Otherwise, enter the number of employees included on line 1 for whom you paid premiums during the tax year for health insurance coverage under a qualifying arrangement (total from Worksheet 4, column (a)) . . . . | 13 | |
| 14 | Enter the number of FTEs you would have entered on line 2 if you only included employees included on line 13 (from Worksheet 7, line 3) . . . . . . . . . . . . . . . . . . . | 14 | |
| 15 | Credit for small employer health insurance premiums from partnerships, S corporations, cooperatives, estates, and trusts (see instructions) . . . . . . . . . . . . . . . . . | 15 | |
| 16 | Add lines 12 and 15. Cooperatives, estates, and trusts, go to line 17. Tax-exempt small employers, skip lines 17 and 18 and go to line 19. Partnerships and S corporations, stop here and report this amount on Schedule K. All others, stop here and report this amount on Form 3800, Part III, line 4h . . . . . . . . . . . . . . . . . . . . . . . . . . . . | 16 | |
| 17 | Amount allocated to patrons of the cooperative or beneficiaries of the estate or trust (see instructions) | 17 | |
| 18 | Cooperatives, estates, and trusts, subtract line 17 from line 16. Stop here and report this amount on Form 3800, Part III, line 4h . . . . . . . . . . . . . . . . . . . . . . . . . | 18 | |
| 19 | Enter the amount you paid in 2017 for taxes considered payroll taxes for purposes of this credit. See instructions . . . . . . . . . . . . . . . . . . . . . . . . . . . . . | 19 | |
| 20 | Tax-exempt small employers, enter the **smaller** of line 16 or line 19 here and on Form 990-T, line 45f | 20 | |

**For Paperwork Reduction Act Notice, see separate instructions.** Cat. No. 37757S Form **8941** (2017)