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Legal Alert: Small Nonprofits May Be Eligible For Tax Credit Under Healthcare Reform Law

On March 23, 2010, President Obama signed into law the Patient Protection and Affordable Care Act (the “Act”). One week later he signed into law the Health Care and Education Reconciliation Act of 2010 (the “Reconciliation Act”), which makes certain modifications to the Act. As used in this alert, the Act and the Reconciliation Act are collectively referred to as “PPACA.” Congress enacted PPACA to expand health insurance coverage in the United States.

Under PPACA, certain small nonprofit organizations will be eligible for a tax credit for taxable years starting in 2010. “Eligible small employers” may receive a small employer health insurance credit for amounts expended for health insurance coverage for employees.

An “eligible small employer” is one that meets all of the following conditions:

1. The employer employs fewer than 25 full-time equivalent employees for the taxable year. Full-time equivalence is generally determined by dividing the total number of hours of service for which wages were paid by 2,080.¹ Seasonal employees working fewer than 120 hours during the taxable year are not considered full-time employees.
2. The average annual wages paid by the employer during the taxable year (determined by dividing the aggregate amount of wages paid by the employer to employees during the taxable year by the number of full-time equivalent employees for the taxable year) is less than \$50,000 (indexed for cost of living adjustments after 2013).
3. The employer has an arrangement in effect that requires the employer to make a non-elective contribution on behalf of each employee in an amount equal to a uniform percentage (not less than 50%) of the premium cost of the “qualified health plan.”² (In other words, the employer must pay at least half the premium cost.) These rules are applied on a control group basis.

The tax credit has two phases. For Phase I (tax years 2010 through 2013), the amount of the credit for tax-exempt “eligible small employers” is 25% of the lesser of: (1) the aggregate amount of non-elective contributions (*i.e.*, employer contributions other than salary reduction contributions) the employer made during the taxable year for “qualified health plan” coverage (including coverage obtained through a state insurance exchange); and (2) the aggregate amount of non-elective contributions that the employer would have made if each employee taken into account

¹ Note: Employer size is determined on a control group basis; if you are a small employer but part of a larger control group or an affiliated service group, you may not be able to claim the credit. It is possible that certain fiscal sponsorship relationships may be considered a control group?]

² “Qualified health plan” is health insurance offered by a insurance company that provides essential health benefits and meets certain certification requirements established by the Secretary of HHS and the Exchange in the state in which such insurance is offered.

under (1) had enrolled in a plan that had premiums equal to the average premiums in the small group market in the rating area in which the employee enrolls for coverage. The amount of the credit cannot exceed the total amount of income and Medicare tax the employer is required to withhold from employees' wages for the year and the employer share of Medicare tax on employees' wages. The credit phases out based on the number of employees and average annual wages of the employer—if the number of full-time employees exceeds 10 or if average annual wages exceed \$25,000, the amount of the credit is reduced.³

During Phase II (starting in tax year 2014 and lasting for the first two years in which the employer offers coverage through a state exchange), eligible tax-exempt employers will be able to claim a tax credit of up to 35% of the employer's contribution for health coverage purchased through new exchanges, or insurance marketplaces that states must set up for small businesses.

The IRS has issued guidance on the new tax credit in the form of FAQs. In this guidance, the IRS has announced that the credit is available for premiums paid in 2010, including those paid before the date of enactment of PPACA.

The IRS will be issuing further guidance on the mechanics of how eligible tax-exempt organizations will be able to claim the tax credit.

This alert is meant to provide general information only, not legal advice. Please contact Judith Moldover at Lawyers Alliance for New York at (212) 219-1800 x 250 or visit our website www.lawyersalliance.org for further information.

³ More information on how this reduction is calculated can be found on the IRS website at <http://www.irs.gov/newsroom/article/0,,id=220839,00html>.