

## SMALL BUSINESS TAX CREDITS IN THE PATIENT PROTECTION AND AFFORDABLE CARE ACT

Under the Patient Protection and Affordable Care Act (PPACA; P.L. 111-148) small businesses that choose to provide health insurance could be eligible for a credit toward their cost of health insurance. Though certain businesses may be exempt from any employer responsibility to provide health insurance or any penalties for non-compliance, the new law would offer an incentive to small businesses by helping pay for their employees' coverage through a tax credit toward the purchase of health insurance.

### Eligibility

The new small business tax credit is effective for amounts paid or incurred after December 31, 2009, and applies for the determination of AMT credits after that date and their carryback. It is not restricted to those with a tax liability. Small businesses that currently provide health care for their workers could receive immediate help with their premium costs, and additional firms that initiate coverage this year could receive the tax assistance.

To be eligible, small employers would have to contribute at least 50% of the cost of premiums towards a qualified health plan (or 50% of a benchmark premium). Small businesses with 10 or fewer full-time employees and with average taxable wages of \$25,000 or less could claim the full credit amount. *§1421(a): IRC §45R(a) and (d) as amended by §10105.*

- In addition to business size (full credit for 10 or fewer employees/ tiered credit for 11-25 employees), the credit is also linked to the average wage of employees. A small business must pay their workers \$25,000 or less in order to qualify for the full credit. The amount of the credit is tiered for those with workers making up to \$50,000. An employer paying average taxable wages above \$50,000 is not eligible for the tax credit.

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Employers will not be eligible to use the credit for certain employees, including defined "seasonal workers," self-employed individuals, 2 percent shareholders of an S corporation (as defined by section 1372(b), 5 percent owners of a small business (as defined by section 416(i)(1)(B)(i)), and dependents or other household members. However, leased employees are eligible employees for the credit. *§1421(a): IRC §45R(e).* The self-employed are eligible for the individual premium assistance available in 2014 if they meet the income requirements (individual making below \$43,320 or family of four with income below \$88,200.)

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Non-profit organizations would be eligible. The credit amount would be the lesser of (1) a 25% credit (2010–2013) and a 35% credit (beginning in 2014), or (2) the amount of employer-paid payroll taxes (including the Medicare contribution) for the relevant calendar year. *§1421(a): IRC §45R(f) and (g) as amended by §10105*

Employers receiving credits will be denied any deduction for health insurance costs equal to the credit amount.

#### **Credit Amount & Duration**

A 35% credit (in years 2010-2013) and 50% credit (beginning in 2014 for no more than two consecutive taxable years) is offered for employer costs for the lesser of (1) the employer premium contribution toward plans offered by the employer through an exchange, or (2) the contribution the employer would have made if each of those same employees had enrolled in a qualified health plan with a premium equal to the average (determined by the HHS Secretary) for the small group market in the rating area in which the employee enrolls for coverage. To avoid an incentive to choose a high-cost plan, an employer's eligible contribution is limited to the average cost of health insurance in that state. (For 2010-2013, "average" would be determined by the Secretary based on the average premium for the small group market in the state, or area in the state, in which the employer offers health insurance). *§1421(a): IRC §45R(b) and (g) as amended by §10105*

The tax credit phases out as average employee compensation increases from \$25,000 to \$50,000 and as the number of full-time employees increases from 10 to 25. Full-time employees would be calculated by dividing the total hours worked by all employees during the tax year by 2,080 (with a maximum of 2,080 hours for any one employee). Seasonal workers would be exempt from this calculation. Average annual wages would be determined by dividing the aggregate amount of wages paid by the employer by the number of full-time-equivalent employees, for the taxable year. *§1421(a): IRC §45R(c) and (d) as amended by §10105* The average wage threshold for determining the phase-out of credits will be adjusted for inflation after 2013.

Firms can claim the credit for 2010 through 2013 and for any two years after that.

To continue receiving a tax credit in 2014, a small employer must drop their existing coverage and purchase group coverage in the newly created Exchanges.



## Small Business Health Care Tax Credit for Small Employers



The Small Business Health Care Tax Credit helps small businesses and small tax-exempt organizations afford the cost of covering their employees.

### Received a Postcard from the IRS?

Millions of small employers will receive [postcards](#) from the IRS beginning the week of April 19 that alert them to the new Small Business Health Care Tax Credit and encourage them to check their eligibility. Even if you don't receive a postcard, your business still may be eligible. Read [more](#) about this effort.

### Eligibility Rules

- **Providing health care coverage.** A qualifying employer must cover at least 50 percent of the cost of health care coverage for some of its workers based on the single rate.
- **Firm size.** A qualifying employer must have less than the equivalent of 25 full-time workers (for example, an employer with fewer than 50 half-time workers may be eligible).
- **Average annual wage.** A qualifying employer must pay average annual wages below \$50,000.
- **Both taxable (for profit) and tax-exempt firms qualify.**

### Amount of Credit

- **Maximum Amount.** The credit is worth up to 35 percent of a small business' premium costs in 2010. On Jan. 1, 2014, this rate increases to 50 percent (35 percent for tax-exempt employers).
- **Phase-out.** The credit phases out gradually for firms with average wages between \$25,000 and \$50,000 and for firms with the equivalent of between 10 and 25 full-time workers.

### Three Simple Steps for Employers to Qualify

To determine if your small business or tax exempt organization qualifies for the Small Business Health Care Tax Credit, follow the three simple steps on our [fact sheet](#).

### Examples

Scenarios illustrate [how the credit applies](#) to employers in different circumstances.

### Questions and Answers

Need more detailed information? We have [answers](#).

### YouTube Primer on Health Care Credit

This new [video](#) explains the who, what, why and how of the Small Business Health Care Tax Credit.

### For More Information

New [guidance](#) makes it easier for small businesses to determine whether they're eligible for the new health care tax credit under the Affordable Care Act and how large a credit they'll receive.

### Related Items:

- [Fiver](#) on the Small Business Health Care Tax Credit for small employers
- [Affordable Care Act of 2010: News Releases, Multimedia and Legal Guidance](#)
- [Affordable Care Act Tax Provisions](#)

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# 3 SIMPLE STEPS

If you are a small employer (business or tax-exempt) that provides health insurance coverage to your employees, determine if you may qualify for the **Small Business Health Care Tax Credit** by following these three simple steps:

**1**

**Determine the total number of your employees (not counting owners or family members):**

Full-time employees: \_\_\_\_\_  
(enter the number of employees who work at least 40 hours per week)

+

Full-time equivalent of part-time employees: \_\_\_\_\_  
(Calculate the number of full-time equivalents by dividing the total annual hours of part-time employees by 2080.)

=  total employees

If the total number of employees is fewer than 25 **GO TO STEP 2**

**2**

**Calculate the average annual wages of employees (not counting owners or family members):**

Take the total annual wages paid to employees: \_\_\_\_\_

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Divide it by the number of employees from STEP 1: \_\_\_\_\_  
(total wages ÷ number of employees)

=  average wages

If the result is less than \$50,000, **AND**

**3**

You pay at least half of the insurance premiums for your employees at the single (employee-only) coverage rate, then



you may be able to claim the **Small Business Health Care Tax Credit**.  
Find out more information at [IRS.gov](http://IRS.gov)



## Small Business Health Care Tax Credit Scenarios

### Examples of Employers Receiving the Credit

#### Example 1: Auto Repair Shop with 10 Employees Gets \$24,500 Credit for 2010

**Main Street Mechanic:**

- **Employees:** 10
- **Wages:** \$250,000 total, or \$25,000 per worker
- **Employee Health Care Costs:** \$70,000

2010 Tax Credit: \$24,500 (35% credit)

2014 Tax Credit: \$35,000 (50% credit)

#### Example 2: Restaurant with 40 Part-Time Employees Gets \$28,000 Credit for 2010

**Downtown Diner:**

- **Employees:** 40 half-time employees (the equivalent of 20 full-time workers)
- **Wages:** \$500,000 total, or \$25,000 per full-time equivalent worker
- **Employee Health Care Costs:** \$240,000

2010 Tax Credit: \$28,000 (35% credit with phase-out)

2014 Tax Credit: \$40,000 (50% credit with phase-out)

#### Example 3: Foster Care Non-Profit with 9 Employees Gets \$18,000 Credit for 2010

**First Street Family Services.org:**

- **Employees:** 9
- **Wages:** \$198,000 total, or \$22,000 per worker
- **Employee Health Care Costs:** \$72,000

2010 Tax Credit: \$18,000 (25% credit)

2014 Tax Credit: \$25,200 (35% credit)



## Small Business Health Care Tax Credit: Frequently Asked Questions

The new health reform law gives a tax credit to certain small employers that provide health care coverage to their employees, effective with tax years beginning in 2010. The following questions and answers provide information on the credit as it applies for 2010-2013, including information on transition relief for 2010. Additional guidance on the credit is available in [Notice 2010-44](#).

An enhanced version of the credit will be effective beginning in 2014. The new law, the Patient Protection and Affordable Care Act, was passed by Congress and was signed by President Obama on March 23, 2010.

### Employers Eligible for the Credit

#### 1. Which employers are eligible for the small employer health care tax credit?

A. Small employers that provide health care coverage to their employees and that meet certain requirements ("qualified employers") generally are eligible for a federal income tax credit for health insurance premiums they pay for certain employees. In order to be a qualified employer, (1) the employer must have fewer than 25 full-time equivalent employees ("FTEs") for the tax year, (2) the average annual wages of its employees for the year must be less than \$50,000 per FTE, and (3) the employer must pay the premiums under a "qualifying arrangement" described in Q/A-3. See Q/A-10 through 16 for further information on calculating FTEs and average annual wages and see Q/A-24 for information on transition relief for tax years beginning in 2010 with respect to the requirements for a qualifying arrangement.

#### 2. Can a tax-exempt organization be a qualified employer?

A. Yes. The same definition of qualified employer applies to an organization described in Code section 501(c) that is exempt from tax under Code section 501(a). However, special rules apply in calculating the credit for a tax-exempt qualified employer. An employer that is an agency or instrumentality of the federal government, or of a State, local or Indian tribal government, is not a qualified employer unless it is an organization described in Code section 501(c) that is exempt from tax under Code section 501(a). See Q/A-6.

### Calculation of the Credit

#### 3. What expenses are counted in calculating the credit?

A. Only premiums paid by the employer under an arrangement meeting certain requirements (a "qualifying arrangement") are counted in calculating the credit. Under a qualifying arrangement, the employer pays premiums for each employee enrolled in health care coverage offered by the employer in an amount equal to a uniform percentage (not less than 50 percent) of the premium cost of the coverage. See Q/A-24 for information on transition relief for tax years beginning in 2010 with respect to the requirements for a qualifying arrangement.

For years prior to 2014, only premiums paid to a health insurance issuer, such as an insurance company or HMO, for health care coverage are counted for purposes of the credit. Premiums for health care coverage that covers a wide variety of conditions, such as a major medical plan, are counted and premiums for certain coverage that is more limited in scope, such as limited scope dental or vision coverage, are also counted. However, if an employer offers more than one type of coverage, such as a major medical plan and a separate limited scope dental or vision plan, the employer must separately satisfy the requirements for a qualifying arrangement with respect to each type of coverage the employer offers (meaning the employer cannot aggregate these different plans for purposes of meeting the qualifying arrangement requirement). For a detailed description of the types of coverage that are counted for the credit, see section II.G of Notice 2010-44.

If an employer pays only a portion of the premiums for the coverage provided to employees under the arrangement, with employees paying the rest, the amount of premiums counted in calculating the credit is only the portion paid by the employer. For example, if an employer pays 80 percent of the premiums for employees' coverage, with employees paying the other 20 percent, the 80 percent premium amount paid by the employer counts in calculating the credit. For purposes of the credit, including the 50-percent requirement, any premium paid pursuant to a salary reduction arrangement under a section 125 cafeteria plan is not treated as paid by the employer.

In addition, the amount of an employer's premium payments that counts for purposes of the credit is capped by the premium payments the employer would have made under the same arrangement if the average premium for the small group market in the state (or an area within the state) in which the employer offers coverage were substituted for the actual premium. For example, if an employer pays 80 percent of the premiums for coverage provided to employees and the employees pay the other 20 percent, the premium amount that counts for purposes of the credit is the lesser of 80 percent of the total actual premiums paid or 80 percent of the premiums that would have been paid for the coverage if the average premium for the small group market in the state were substituted for the actual premium. The average premium for the small group market does not apply separately to each type of coverage the employer offers, but rather provides an overall cap for all health insurance coverage provided by a qualified employer. See Q/A-4 for information on the average premium for the small group market in a State (or an area within the State).

Example 1. (i) For the 2010 tax year, a qualified employer offers a health insurance plan with single and family coverage. Employer has 9 FTEs with average annual wages of \$23,000 per FTE. Four employees are enrolled in single coverage and 5 are enrolled in family coverage.

(ii) The employer pays 50% of the premiums for all employees enrolled in single coverage and 50% of the premiums for all employees enrolled in family coverage and the employee is responsible for the remainder in each case. The premiums are \$4,000 a year for single coverage and \$10,000 a year for family coverage. The average premium for the small group market in the employer's State is \$5,000 for single coverage and \$12,000 for family coverage.

(iii) The employer's premium payments for each FTE (\$2,000 for single coverage and \$5,000 for family coverage) do not exceed 50% of the average premium for the small group market in the employer's State (\$2,500 for single coverage and \$6,000 for family coverage).

(iv) Thus, the amount of premiums paid by the employer for purposes of computing the credit equals \$33,000 ((4 x \$2,000) plus (5 x \$5,000)).

Example 2: (i) Same facts as in Example 1, except that the premiums are \$6,000 for single coverage and \$14,000 for family coverage.

(ii) The employer's premium payments for each employee (\$3,000 for single coverage and \$7,000 for family coverage) exceed 50% of the average premium for the small group market in the employer's State (\$2,500 for single coverage and \$6,000 for family coverage).

(iii) Thus, the amount of premiums paid by the employer for purposes of computing the credit equals \$40,000 ((4 x \$2,500) plus (5 x \$6,000)).

Example 3: (i) For the 2010 tax year, a qualified employer offers a major medical plan and a dental plan. The employer pays 50% of the premium cost for single coverage for all employees enrolled in the major medical plan and 50% of the premium cost for single coverage for all employees enrolled in the dental plan.

(ii) For purposes of calculating the credit, the employer can take into consideration the premiums paid by the employer for both the major medical plan and the dental plan, but only up to 50% of the amount of the average premium for single coverage for the small group market in the employer's State.

Example 4: (i) Same facts as in Example 3, except that the employer pays 40% of the premium cost for single coverage for all employees enrolled in the dental plan.

(ii) For purposes of calculating the credit, the employer can take into consideration only the premiums paid by the employer for the major medical plan, and only up to 50% of the amount of the average premium for single coverage for the small group market in the employer's State. The employer cannot take into consideration premiums paid for the dental plan.

#### 4. What is the average premium for the small group market in a state (or an area within the state)?

A. The average premium is determined by the Department of Health and Human Services (HHS). [Revenue Ruling 2010-13](#) sets forth the average premium for the small group market in each state for the 2010 tax year. For the 2010 tax year, HHS may provide additional average premium rates for the small group market for areas within some states (sub-state rates). These additional sub-state rates will be published by the IRS and will not be lower than the applicable rate for each state that is set forth in Revenue Ruling 2010-13.

#### 5. What is the maximum credit for a qualified employer (other than a tax-exempt employer)?

A. For tax years beginning in 2010 through 2013, the maximum credit is 35 percent of the employer's premium expenses that count towards the credit, as described in Q/A-3.

#### 6. What is the maximum credit for a tax-exempt qualified employer?

A. For tax years beginning in 2010 through 2013, the maximum credit for a tax-exempt qualified employer is 25 percent of the employer's premium expenses that count towards the credit, as described in Q/A-3. However, the amount of the credit cannot exceed the total amount of income and Medicare (i.e., hospital insurance) tax the employer is required to withhold from employees' wages for the year and the employer share of Medicare tax on employees' wages for the year.

#### 7. How is the credit reduced if the number of FTEs exceeds 10 or average annual wages exceed \$25,000?

A. If the number of FTEs exceeds 10 or if average annual wages exceed \$25,000, the amount of the credit is reduced as follows. If the number of FTEs exceeds 10, the reduction is determined by multiplying the otherwise applicable credit amount by a fraction, the numerator of which is the number of FTEs in excess of 10 and the denominator of which is 15. If average annual wages exceed \$25,000, the reduction is determined by multiplying the otherwise applicable credit amount by a fraction, the numerator of which is the amount by which average annual wages exceed \$25,000 and the denominator of which is \$25,000. In both cases, the result of the calculation is subtracted from the otherwise applicable credit to determine the credit to which the employer is entitled. For an employer with both more than 10 FTEs and average annual wages exceeding \$25,000, the reduction is the sum of the amount of the two reductions. This sum may reduce the credit to zero for some employers with fewer than 25 FTEs and average annual wages of less than \$50,000.

Example 5: For the 2010 tax year, a qualified employer has 9 FTEs with average annual wages of \$23,000 per FTE. The employer pays \$72,000 in health care premiums for those employees, which does not exceed the average premium for the small group market in the employer's state, and otherwise meets the requirements for the credit. The credit for 2010 equals \$25,200 (35% x \$72,000).

**Example 6:** For the 2010 tax year, a qualified tax-exempt employer has 10 FTEs with average annual wages of \$21,000 per FTE. The employer pays \$80,000 in health care premiums for those employees, which does not exceed the average premium for the small group market in the employer's state, and otherwise meets the requirements for the credit. The total amount of the employer's income tax and Medicare tax withholding plus the employer's share of the Medicare tax equals \$30,000 in 2010.

The credit is calculated as follows:

- (1) Initial amount of credit determined before any reduction:  $(25\% \times \$80,000) = \$20,000$
- (2) Employer's withholding and Medicare taxes: \$30,000
- (3) Total 2010 tax credit is \$20,000 (the lesser of \$20,000 and \$30,000).

**Example 7:** For the 2010 tax year, a qualified employer has 12 FTEs and average annual wages of \$30,000. The employer pays \$96,000 in health care premiums for those employees, which does not exceed the average premium for the small group market in the employer's state, and otherwise meets the requirements for the credit.

The credit is calculated as follows:

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

**8. Can premiums paid by the employer in 2010, but before the new health reform legislation was enacted, be counted in calculating the credit?**

A. Yes. In computing the credit for a tax year beginning in 2010, employers may count all premiums described in Q/A-3 for that tax year.

**9. What effect do State credits and State subsidies for health insurance have on the amount of the Federal health care tax credit?**

A. Some States offer tax credits or a premium subsidy to certain small employers that provide health insurance to their employees. Generally, the premium subsidy is provided in the form of payments made either directly to the employer or to the employer's insurance company. If an employer is entitled to a State tax credit (whether refundable or nonrefundable) or a premium subsidy that is paid directly to the employer, the premium payment made by the employer is not reduced by the State credit or subsidy for purposes of determining whether the employer has satisfied the qualifying arrangement requirement to pay an amount equal to a uniform percentage (not less than 50 percent) of the premium cost. Also, except as described below in this Q/A-9, the maximum amount of the Federal health care tax credit is not reduced by reason of a State tax credit (whether refundable or nonrefundable) or by reason of payments by a State directly to an employer.

Generally, if a State makes payments directly to an insurance company to pay a portion of the premium for coverage of an employee under employer-provided health insurance (State direct payments), the State is treated as making these payments on behalf of the employer for purposes of determining whether the employer has satisfied the qualifying arrangement requirement to pay an amount equal to a uniform percentage (not less than 50 percent) of the premium cost of coverage. Also, except as described below in this Q/A-9, these premium payments by the State are treated as an employer contribution for purposes of calculating the Federal health care tax credit.

Although State tax credits and payments to an employer generally do not reduce an employer's otherwise applicable Federal health care tax credit, and although State direct payments are generally treated as paid on behalf of an employer, the Federal health care tax credit cannot exceed the amount of the employer's net premium payments. In the case of a State tax credit for an employer or a State subsidy paid directly to an employer, the employer's net premium payments are calculated by subtracting the State tax credit or subsidy from the employer's actual premium payments. In the case of a State direct payment, the employer's net premium payments are the employer's actual premium payments.

If a State-administered program (such as Medicaid or another program that makes payments directly to a health care provider or insurance company on behalf of individuals and their families who meet certain eligibility guidelines) makes payments that are not contingent on the maintenance of an employer-provided group health plan, those payments are not taken into account in determining the Federal health care tax credit.

**Example 8:** (i) Employer's State provides a health insurance premium subsidy of up to 40% of the health insurance premiums for each eligible employee. The State pays the subsidy directly to the employer.

(ii) Employer has one employee, Employee D. Employee D's health insurance premiums are \$100 per month and are paid as follows: \$80 by the employer and \$20 by Employee D through salary reductions to a cafeteria plan. The State pays Employer \$40 per month as a subsidy for Employer's payment of insurance premiums on behalf of Employee D. Employer is otherwise a qualified employer that meets the requirements for the Federal health care tax credit.

(iii) For purposes of the requirements for a qualifying arrangement, and for purposes of calculating the amount of the Federal health care tax credit, the amount of premiums paid by the employer is \$80 per month (the premium payment by the Employer without regard to the subsidy from the State).

**Example 9:** (i) Employer's State provides a health insurance premium subsidy of up to 50% for each eligible employee. The State pays the premium directly to the employer's health insurance provider.

(ii) The employer has one employee. The employee is enrolled in single coverage under the employer's health insurance plan.

(iii) The employee's health insurance premiums are \$100 per month and are paid as follows: \$30 by the employer; \$50 by the State and \$20 by the employee. The State pays the \$50 per month directly to the insurance company and the insurance company bills the employer for the employer and employee's share, which equal \$50 per month. The employer is otherwise a qualified employer that meets the requirements for the Federal health care tax credit.

(iv) For purposes of the requirements for a qualifying arrangement, and for purposes of calculating the amount of the Federal health care tax credit, the amount of premiums paid by the employer is \$80 per month (the sum of the employer's payment and the State's payment).

Example 10: (i) Employer's State provides a health insurance premium subsidy of up to 50% for each eligible employee. The State pays the premium directly to the employer's health insurance provider. Employer has one employee. The employee is enrolled in single coverage under Employer's health insurance plan. The employee's health insurance premiums are \$100 per month and are paid as follows: \$20 by the employer; \$50 by the State and \$30 by the employee. The State pays the \$50 per month directly to the insurance company and the insurance company bills the employer for the employer's and employee's shares, which total \$50 per month. The employer is otherwise a qualified employer that meets the requirements for the Federal health care tax credit.

(ii) The amount of premiums paid by the employer for purposes of determining whether the employer meets the qualifying arrangement requirement (the sum of the employer's payment and the State's payment) is \$70 per month, which is more than 50% of the \$100 monthly premium payment. The amount of the premium for calculating the maximum Federal health care tax credit is also \$70 per month. The maximum credit is \$24.50 ( $\$70 \times 35\%$ ).

(iii) The employer's net premium payment is \$20 (the amount actually paid by the employer excluding the State subsidy). After applying the limit for the employer's net premium payment, the Federal health care tax credit is \$20 per month, (the lesser of \$24.50 or \$20).

#### Determining FTEs and Average Annual Wages

##### 10. How is the number of FTEs determined for purposes of the credit?

A. The number of an employer's FTEs is determined by dividing (1) the total hours of service for which the employer pays wages to employees during the year (but not more than 2,080 hours for any employee) by (2) 2,080. The result, if not a whole number, is then rounded to the next lowest whole number. See Q/A-13 through 15 for information on which employees are not counted for purposes of determining FTEs.

An employee's hours of service for a year include each hour for which an employee is paid, or entitled to payment, for the performance of duties for the employer during the employer's tax year and each hour of paid leave (except that no more than 160 hours of service are required to be counted for an employee on account of any single continuous period of paid leave). To calculate the total number of hours of service which must be taken into account for an employee for the year, the employer may use any of the following methods: (1) determine actual hours of service from records of hours worked and hours for which payment is made or due, including hours for paid leave; (2) 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 Method 1; or (3) 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 Method 1.

Example 11: (i) For the 2010 tax year, an employer's payroll records indicate that an employee worked 2,000 hours and was paid for an additional 80 hours on account of vacation, holiday and illness. The employer counts hours actually worked.

(ii) Under this method of counting hours, Employee A must be credited with 2,080 hours of service (2,000 hours worked and 80 hours for which payment was made or due).

Example 12: (i) For the 2010 tax year, an employee worked 49 weeks, took 2 weeks of vacation with pay, and took 1 week of leave without pay. The employer uses the weeks-worked equivalency.

(ii) Under this method of counting hours, Employee B must be credited with 2,040 hours of service (51 weeks multiplied by 40 hours per week).

Example 13: (i) For the 2010 tax year, an employer pays 5 employees wages for 2,080 hours each, 3 employees wages for 1,040 hours each, and 1 employee wages for 2,300 hours. The employer counts hours actually worked.

(ii) The employer's FTEs would be calculated as follows:

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

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

These add up to 15,600 hours

(2) FTEs:  $7$  ( $15,600$  divided by  $2,080 = 7.5$ , rounded to the next lowest whole number)

Example 14: (i) For the 2010 tax year, an employer has 26 FTEs with average annual wages of \$23,000 per FTE. Only 20 of the employer's employees are enrolled in the employer's health insurance plan.

(ii) The hours of service and wages of all employees are taken into consideration in determining whether the employer is a qualified employer for purposes of the credit. Because the employer does not have fewer than 25 FTEs for the tax year, the employer is not a qualified employer for purposes of the credit.

**11. How is the amount of average annual wages determined?**

A. The amount of average annual wages is determined by first dividing (1) the total wages paid by the employer during the employer's tax year to employees taken into account in Q/A-10 by (2) the number of the employer's FTEs for the year. The result is then rounded down to the nearest \$1,000 (if not otherwise a multiple of \$1,000). Only wages that are paid for hours of service determined in accordance with Q/A-10 are taken into account. Wages for this purpose means wages as defined for FICA purposes (without regard to the wage base limitation). See Q/A-13 through 15 for information on which employees are not counted as employees for purposes of determining the amount of average annual wages.

Example: For the 2010 tax year, an employer pays \$224,000 in wages and has 10 FTEs.

The employer's average annual wages would be: \$22,000 (\$224,000 divided by 10 = \$22,400, rounded down to the nearest \$1,000)

**12. Can an employer with 25 or more employees qualify for the credit if some of its employees are part-time?**

A. Yes. Because the limitation on the number of employees is based on FTEs, an employer with 25 or more employees could qualify for the credit if some of its employees work part-time. For example, an employer with 46 half-time employees (meaning they are paid wages for 1,040 hours) has 23 FTEs and therefore may qualify for the credit.

**13. Are seasonal workers counted in determining the number of FTEs and the amount of average annual wages?**

A. Generally, no. Seasonal workers are disregarded in determining FTEs and average annual wages unless the seasonal worker works for the employer on more than 120 days during the tax year, although premiums paid on their behalf may be counted in determining the amount of credit.

**14. If an owner of a business also provides services to it, does the owner count as an employee?**

A. Generally, no. A sole proprietor, a partner in a partnership, a shareholder owning more than two percent of an S corporation, and any owner of more than five percent of other businesses are not considered employees for purposes of the credit. Thus, the wages or hours of these business owners and partners are not counted in determining either the number of FTEs or the amount of average annual wages, and premiums paid on their behalf are not counted in determining the amount of the credit.

**15. Do family members of a business owner who work for the business count as employees?**

A. Generally, no. A family member of any of the business owners or partners listed in Q/A-14, or a member of such a business owner's or partner's household, is not considered an employee for purposes of the credit. Thus, neither their wages nor their hours are counted in determining the number of FTEs or the amount of average annual wages, and premiums paid on their behalf are not counted in determining the amount of the credit. For this purpose, a family member is defined as 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.

**16. How is eligibility for the credit determined if the employer is a member of a controlled group or an affiliated service group?**

A. Members of a controlled group (e.g., businesses with the same owners) or an affiliated service group (e.g., related businesses of which one performs services for the other) are treated as a single employer for purposes of the credit. Thus, for example, all employees of the controlled group or affiliated service group, and all wages paid to employees by the controlled group or affiliated service group, are counted in determining whether any member of the controlled group or affiliated service group is a qualified employer. Rules for determining whether an employer is a member of a controlled group or an affiliated service group are provided under Code section 414(b), (c), (m), and (o).

**How to Claim the Credit**

**17. How does an employer claim the credit?**

A. The credit is claimed on the employer's annual income tax return. For a tax-exempt employer, the IRS will provide further information on how to claim the credit.

**18. May an employer use the credit to offset its alternative minimum tax (AMT) liability?**

A. Yes. The credit can be used to offset an employer's AMT liability for the year, subject to certain limitations based on the amount of an employer's regular tax liability, AMT liability and other allowable credits. See section 38(c)(1) of the Code, as modified by section 38(c)(4)(B)(vi).