

SMALL BUSINESS HEALTH CARE TAX CREDIT

March 24, 2010

Health reform legislation signed by President Obama includes a Small Business Health Care Tax Credit to help small businesses afford the cost of covering their workers.

Key Facts about the Small Business Health Care Tax Credit

- *The tax credit, which is effective immediately, can cover up to 35 percent of the premiums a small business pays to cover its workers. In 2014, the rate will increase to 50 percent.*
- *The Congressional Budget Office estimates that the tax credit will save small businesses \$40 billion by 2019.*
- *Both small for-profit businesses and small not-for-profit organizations are eligible.*

Key Elements

- **Available Immediately.** The credit is effective January 1, 2010. As a result, small businesses that provide health care for their workers will receive immediate help with their premium costs, and additional firms that initiate coverage this year will get a tax cut as well.
- **Broad Eligibility.** The Council of Economic Advisors estimates that 4 million small businesses are eligible for the credit if they provide health care to their workers. Qualifying firms must have less than the equivalent of 25 full-time workers (e.g., a firm with fewer than 50 half-time workers would be eligible), pay average annual wages below \$50,000, and cover at least 50 percent of the cost of health care coverage for their workers.
- **Substantial Benefit.** The credit is worth up to 35 percent of a small business's premium costs in 2010. On January 1, 2014, this rate increases to 50 percent.
- **Firms Can Claim Credit for Up to 6 Years.** Firms can claim the credit for 2010 through 2013 and for any two years after that.
- **Non-Profits Eligible.** Tax-exempt organizations are eligible for a 25 percent refundable tax credit in 2010. In 2014, this rate increases to 35 percent.¹
- **Gradual Phase-Outs.** 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.
- **Premium Cost Eligibility.** 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.

¹ The credit rates are lower for non-profits to ensure that the value of the credit is approximately equal to that provided to for-profit firms that cannot claim a tax deduction for the amount of the credit claimed.

Benefit from Small Business Health Care Tax Credit: *Three Cases*

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 \$19,000 Credit for 2010

First Street Family Services.org:

- **Employees:** 9
- **Wages:** \$198,000 total, or \$22,000 per worker
- **Employee Health Care Costs:** \$76,000

2010 Tax Credit: \$19,000 (25% credit)

2014 Tax Credit: \$26,600 (35% credit)

Why Do Small Businesses Need Help? Small businesses want to provide health coverage for their workers, but they face extraordinary challenges in doing so:

- **Higher Premiums.** On average, small businesses pay 18 percent more for the same coverage than larger firms because they have less bargaining power and are penalized by market inefficiencies.
- **Higher Administrative Costs.** They also face higher brokers' fees and administrative costs to set up and maintain a health plan.
- **Greater Uncertainty.** Because small firms have smaller risk pools, they face sudden and extreme price increases when just one or two of their workers get sick.

How Else Does Health Reform Help Small Businesses? In addition to immediate help from the Small Business Health Care Tax Credit, the health reform bill signed by President Obama includes a number of additional benefits for small businesses over the next few years:

- **Health Care Exchange.** Firms with 100 workers or fewer can pool their buying power and reduce administrative costs by purchasing insurance through an exchange.
- **Ends Price Discrimination.** "Community rating" rules prohibit insurers from charging more to cover firms with sicker workers or raising rates when someone gets sick.
- **Covers the Uninsured to Reduce Premiums for Everyone.** Right now, the cost of treating the uninsured adds a "hidden tax" of over \$1,000 to every health care premium. Covering 32 million additional Americans will significantly reduce this tax.
- **Slows the Growth of Health Care Costs.** According to CBO, health reform will reduce the cost of a given plan in the small group market by 1% to 4% by 2016.