

**WRITTEN TESTIMONY OF
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TAX-EXEMPT AND GOVERNMENT ENTITIES OPERATING DIVISION
INTERNAL REVENUE SERVICE
BEFORE
THE COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON OVERSIGHT
ON THE SMALL EMPLOYER HEALTH CARE TAX CREDIT
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Introduction and Summary

Chairman Boustany, Ranking Member Lewis and Members of the Subcommittee on Oversight, my name is Sarah Hall Ingram and I am Commissioner of the Tax-Exempt and Government Entities Operating Division at the Internal Revenue Service. I also serve as the executive lead on the IRS's operational planning and implementation of the small employer tax credit and other tax law provisions of the Affordable Care Act. I appreciate the opportunity to testify on the Small Business Health Care Tax Credit, which was enacted as part of the Patient Protection and Affordable Care Act of 2010.

My purpose here this morning is to explain how the credit works, what the eligibility requirements are, how to claim the credit, and what actions the IRS has taken to help ensure small businesses that may be eligible for the credit are aware of it.

The credit is designed to help small businesses and tax-exempt organizations afford the cost of providing health coverage to their employees. In general, the credit is available to small employers that primarily employ low- and moderate-income workers, and pay at least half the cost of single coverage for their employees.

For tax years 2010 to 2013, the maximum credit is 35 percent of premiums paid by eligible small businesses and 25 percent of premiums paid by eligible employers that are tax-exempt organizations. For tax-exempt organizations, the credit cannot exceed the total amount of income and Medicare tax withheld from employees' wages for the year and the employer share of Medicare tax for the year. After 2013, eligible employers will be able to take the credit for two additional years. Beginning in 2014, the maximum credit will increase to 50 percent of premiums paid by eligible small business employers and 35 percent of premiums paid by eligible tax-exempt organizations.

The maximum credit goes to smaller employers – those with 10 or fewer full-time equivalent (FTE) employees – paying annual average wages of \$25,000 or less. The credit is completely phased out for employers that have 25 FTEs or more or pay average wages of \$50,000 per year or more. Because the eligibility rules are based in

part on the number of FTEs, not the number of employees, businesses that use part-time help may qualify even if they employ more than 25 individuals

Qualifying Arrangements

By law, only premiums paid by the employer under an arrangement meeting certain requirements are counted in calculating the credit. Arrangements that meet these requirements are considered to be “qualifying arrangements.” 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. However, a qualifying arrangement can also be one under which the employer pays at least 50 percent of the premium cost for employee-only, or single, coverage for each employee enrolled in any health insurance coverage offered by the employer.

The IRS issued guidance last year clarifying that the credit is available to a broad range of employers, including religious institutions that provide self-insured coverage through denominational organizations, small employers that cover their workers through insured multiemployer health and welfare plans, and employers that subsidize their employees’ health care costs through a broad range of contribution arrangements.

Determining FTEs and Average Annual Wages

To determine whether an employer with a qualifying arrangement is eligible to claim the credit, the employer must first calculate the number of FTEs for the year. This is done by dividing the total hours of service for which the employer pays wages to employees during the year by 2,080.

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 40 half-time employees – those who are paid wages for 1,040 hours for the year – is deemed to have 20 FTEs and therefore may qualify to claim the credit.

For purposes of computing the number of FTEs, the law generally does not require employers to count seasonal workers. In addition, business owners such as sole proprietors and partners in a partnership are not counted as employees for purposes of the credit and are not counted toward the number of FTEs, even though these individuals may provide services to the business. A similar exclusion applies to a business owner’s family members who work for the business.

In determining eligibility, the employer must also calculate the amount of average annual wages paid to employees. To calculate the amount of average annual wages, an employer must divide the total wages paid during the tax year to employees by the number of the employer’s FTEs for the year. The result is then rounded down to the

nearest \$1,000. As with FTEs, the average wage computation does not include seasonal workers, generally, and does not include business owners or their family members working in the business.

How Employers Claim the Credit

To claim the credit, a small business uses Form 8941 to calculate the credit amount, and then includes that amount as part of the general business credit that it takes on its income tax return. A tax-exempt organization, which generally by definition has no income tax liability, uses Form 8941 to calculate its refundable credit amount, and then claims the credit on Line 44f of Form 990-T. Though the Form 990-T is filed primarily by those organizations liable for the tax on unrelated business income, it can also be used by any eligible tax-exempt organization claiming the credit, regardless of whether they are subject to unrelated business income tax.

The credit can be used to offset an employer's alternative minimum tax (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 credit. Also, under the general business credit rules, as amended by section 2012 of the Small Business Jobs Act of 2010, the unused 45R credit determined in taxable years beginning after Dec. 31, 2009 and before January 1, 2011, may be carried back five years or forward up to 20 years.

IRS Education and Outreach

Because the credit was enacted mid-year in 2010 and was effective immediately upon enactment, the IRS launched a significant outreach campaign to small businesses in the months following enactment. Actions taken as part of this campaign included the following:

- In April of 2010, to increase awareness, the IRS mailed postcards to more than 4 million small businesses and tax-exempt organizations that were identified as potentially eligible for the credit based on limited payroll data maintained by the IRS which gives a general indication of number of employees and wages (without knowledge of whether they otherwise qualify);
- In May of 2010, the IRS issued detailed guidelines, illustrated by more than a dozen examples, to help small employers determine whether they qualify for the credit and assist them in estimating the amount of credit they could receive;
- During 2010, the IRS posted videos in English, Spanish, and American Sign Language (ASL) to its YouTube channel describing the basics of the credit and how to claim it;
- Since enactment, the IRS has held or attended more than 1,500 outreach events, (ranging from large conferences and webinars to workshops and focus groups) targeted at small businesses and the tax practitioners business professionals who serve them; and

- On a regular basis, the IRS has added materials and tools to a dedicated page on irs.gov (frequently-asked-questions, tax tips, teaching materials, etc.), reached out to a wide range of stakeholders through E-news lists and newsletters, and provided partners with materials and links to use in their own channels and programs.
- IRS collaborated with HHS and SBA on outreach and useful materials to maximize effective education of the small business community, including SBA webinar and HHS e-news.

The IRS is now developing a new outreach campaign, to ensure that small employers that are eligible for the credit in 2011 will claim it on their 2012 returns. This campaign will focus on working with our partners, including:

- The tax software industry, to improve access to educational information and to help alert small employers and practitioners when taxpayers may be eligible for the credit;
- Insurance agents and brokers who work with small businesses, to help ensure that participants in the health insurance marketplace understand the features and benefits of the credit. The Department of Health and Human Services recently sent an email to 2,000 agents and brokers alerting them to the credit for their small business clients; and
- The small business and practitioner community, to provide additional materials and educational opportunities regarding the credit, including webinars and toolkits.

The goal of our outreach and education has been to inform eligible small businesses and tax-exempt organizations how they can claim the Small Business Health Care Tax Credit to reduce their taxes. To do this, we highlighted the advantages of claiming the credit to both eligible small businesses and practitioners.

We continue to seek input to further deliver our messages to a number of key audiences: small business owners, tax-exempt organizations, tax preparers, insurance agents and brokers. The IRS will continue to communicate through social media and other venues, including IRS YouTube videos and Twitter feeds. We plan on continuing and expanding our relationships with external stakeholders as we collaboratively find new and innovative ways to market this valuable tax credit.

Conclusion

Mr. Chairman, this concludes my testimony. I appreciate the opportunity to testify about the Small Business Health Care Tax Credit. I will now be happy to answer any questions that you may have.