HEARING BEFORE THE
COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON OVERSIGHT
U.S. HOUSE OF REPRESENTATIVES

“Implementation and Effectiveness of the Small Business Health Care Tax Credit”

November 15, 2011

Washington, DC

Statement of
The Honorable J. Russell George
Treasury Inspector General for Tax Administration
Chairman Boustany, Ranking Member Lewis, and Members of the Subcommittee, I thank you for the opportunity to testify on the Small Business Health Care Tax Credit (Credit). My comments will focus on the Treasury Inspector General for Tax Administration’s (TIGTA) oversight of the Internal Revenue Service’s (IRS) efforts to implement the Credit and on recommendations we have made to improve the implementation.

Background on the Small Business Health Care Tax Credit

The Patient Protection and Affordable Care Act\(^1\) amended the Internal Revenue Code to provide the Credit. This is a new business credit for employee health insurance expenses of small businesses and certain tax-exempt organizations. It is effective for tax years beginning after December 31, 2009. The Congressional Budget Office estimated the Credit would cost $37 billion over 10 years.

In general, the Credit is available only to small employers who pay at least one-half the cost of health insurance coverage for their employees. Similar to other small employers, small tax-exempt organizations described in Internal Revenue Code section 501(c) and exempt from tax under section 501(a) may also qualify for the Credit. When claimed on individual or business returns, the Credit is nonrefundable (\textit{i.e.}, only available to offset actual tax liability). The Credit is refundable to tax-exempt organizations, but only to the extent it does not exceed the total amount of income tax and Medicare tax withholding from employees’ wages and the employer share of Medicare tax. Employers will continue to be able to deduct the costs in excess of the Credit amount as an ordinary expense for employee compensation. A credit is normally preferred to a deduction because it reduces tax due dollar-for-dollar, as opposed to a deduction, which decreases taxable income.

The law concerning which taxpayers qualify for the Credit and how to calculate the Credit amount is complex. To address this, the Internal Revenue Service issued Notice 2010-44 and Notice 2010-82, which set forth detailed guidance on claiming the Credit. The IRS notices contain the following information:

To qualify for the Credit, an employer must have the following characteristics:

- Have fewer than 25 full-time equivalents (FTE)\(^2\) for the taxable year.
- Have average annual wages for its employees for the year less than $50,000 per FTE.
- Maintain a “qualifying arrangement.”\(^3\)
- Not be an agency or instrumentality of Federal, State, local, or Indian Tribal Governments.
- If a tax-exempt organization, be described in Internal Revenue Code section 501(c) and be exempt from tax under section 501(a). Tax-exempt entities do not qualify if these sections do not apply.

In brief, an employer must follow these steps to determine eligibility for the Credit:

- Determine the employees who are taken into account for purposes of the Credit.
- Determine the number of hours of service performed by those employees.
- Calculate the number of the employer's FTEs.
- Determine the average annual wages paid per FTE.
- Determine the premiums paid by the employer that are taken into account for purposes of the Credit. The premiums must be paid by an employer under a qualifying arrangement and must be paid for health insurance that meets requirements related to the Credit.

There are multiple steps to calculate the Credit, and seven worksheets must be completed in association with claiming the Credit.\(^4\) These worksheets are required to determine the correct amounts to enter on 8 of the 25 lines on

\(^2\) FTEs, as defined by the legislation, means a number of employees equal to the number determined by dividing the total number of hours of service for which wages were paid by the employer to employees during the taxable year by 2,080. Additional guidance on FTEs is also provided in the legislation and in IRS Notice 2010-44.

\(^3\) An arrangement under which the employer pays premiums for each employee enrolled in health insurance 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.

\(^4\) The worksheets are contained in the instructions for Credit for Small Employer Health Insurance Premiums (Form 8941). See Appendix I for a copy of the Form 8941 showing the steps that must be reported. Appendix III contains a more detailed summary of factors that must be considered in determining eligibility for the Credit.
Form 8941. For example: the number of employees, the number of FTEs, the average annual wages paid, the premiums paid, and the calculation of the reduced Credit amount for businesses with over 10 FTEs and average annual wages over $25,000. In general, the steps include:

- Calculate the maximum amount of the Credit.
- Reduce the maximum Credit in step one in accordance with the phase-out rule, if necessary.\(^5\)
- For employers receiving a State credit or subsidy for health insurance, determine the employer’s actual premium payment.

After eligibility is established and Form 8941 is completed to determine the Credit amount, the amount is transferred to another form or forms. In the case of most businesses and individuals, the Credit is reported as part of the General Business Credit (Form 3800) and then transferred again (to the extent allowed) to the U.S. Corporation Income Tax Return (Form 1120) or U.S. Individual Income Tax Return (Form 1040). Partnerships and S corporations\(^6\) report the Credit as part of Schedule K on the U.S. Return of Partnership Income (Form 1065) or the U.S. Income Tax Return for an S Corporation (Form 1120S). Estates and trusts report the Credit as part of Schedule K on the U.S. Income Tax Return for Estates and Trusts (Form 1041). Tax-exempt organizations report the Credit on the Exempt Organization Business Income Tax Return (Form 990-T).

**Extensive Efforts Were Made to Implement the Credit**

The IRS completed extensive efforts to implement the Credit and other Affordable Care Act provisions. Shortly after the legislation was passed, the IRS began assessing what it would need to do to implement the Credit and tracked these efforts as they were completed. According to the IRS, it has completed more than 1,000 outreach and educational actions, including communication efforts to inform taxpayers and tax professionals about the Credit. The IRS mailed approximately 4.4 million postcards at a reported cost of approximately $1 million, with basic information on the Credit to businesses that could be affected. The IRS also used several means to inform tax professionals about the Credit including press releases, presentations, an internet page to provide information on the Credit, electronic messages such as alerts and news articles, and a telephone line for taxpayer and practitioner questions related to the Affordable Care Act.

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\(^5\) Employers with more than 10 but less than 25 FTEs or average wages of more than $25,000 but less than $50,000 will not be eligible for the full amount of the Credit but may qualify for a reduced amount.

\(^6\) An S corporation is a corporation that elects to be taxed under Subchapter S of Chapter 1 of the Internal Revenue Code.
Guidance on Applying State Subsidy Rules is Being Developed

While the IRS has issued guidance to taxpayers on how to account for State subsidies when calculating the Credit, little information was available from the IRS on which States offer such subsidies. The IRS also did not issue guidance to its revenue agents on which States offer this benefit for consideration when auditing taxpayers. When we brought this to the IRS’s attention, the IRS acknowledged that it should do more in these areas and plans to obtain tax practitioners’ thoughts on how to improve. As of the date of our report, the IRS was in the process of developing a job aid for revenue agents to use during exams.

Potential Compliance Issues Exist

There is a risk of errors or irregularities occurring when the Credit is claimed or processed. The Credit is new, and both taxpayers and IRS employees will need to acquaint themselves with the rules. The rules themselves are complex, making it difficult for taxpayers to follow. The IRS also had to complete new programming to accommodate the new Form 8941 and identify potential compliance risks.

Even though the Credit is specifically targeted to small employers, certain taxpayers may claim it even when they have not filed required employment tax returns. A lack of employment tax returns could indicate an erroneous claim and that the taxpayer is not even an employer, but could also be the result of the taxpayer using the services of a Professional Employer Organization (PEO).

Professional Employer Organizations began operating in the early 1980s and assume some employment-related responsibilities for client companies, including hiring some or all of the client companies’ employees whose services are then leased back to the client companies. The PEOs pay wages and file employment tax returns on employees’ wages that would otherwise be handled by their client companies. An industry organization, the National Association of Professional Employer Organizations, describes this relationship as “co-employment.”

The PEO, acting as the employer of the leased employees, files employment tax returns under its own Employer Identification Number, and the client businesses where the employees work claim other employment-related expenses and the related deductions and credits (as long as these were paid by the client business) under their (different) Employer Identification Numbers. This presents a challenge to the IRS to determine whether a company, which does not file employment tax returns, qualifies for the Credit without corresponding with or auditing the company.

7 An employee in the Examination function who conducts face-to-face examinations of more complex tax returns such as businesses, partnerships, corporations, and specialty taxes (e.g., excise tax returns).
While some businesses, such as companies that only process payroll and file tax returns on behalf of other businesses, disclose similar arrangements to the IRS, this is generally not the case for the PEOs. Other arrangements, where one business acts as an agent for another business, are disclosed on the forms for Employer/Payer Appointment of Agent (Form 2678) and the Allocation Schedule for Aggregate Form 941 Filers (Schedule R (Form 941)). However, the PEO business model is premised on the PEO’s view that it is a legal employer, not the agent of the client business.

We identified the issue related to tracking the relationships between the PEOs and client companies in a previous report. In that report, TIGTA recommended that the IRS work with the Department of the Treasury to explore all options, including use of the revised Form 2678, to establish accurate links between the PEOs and their clients. The IRS agreed to establish links between PEOs and their clients; however, it did not accomplish this.

The IRS has a high-priority compliance program aimed at identifying and auditing employers who have not paid employment taxes. Businesses using the PEOs may unnecessarily fall into this compliance program, resulting in a waste of IRS resources and an increased burden on the affected taxpayers.

To administer employment tax laws and to effectively use scarce compliance resources, the IRS needs to be able to identify businesses that begin using the services of a PEO, as well as when businesses terminate the use of those services. Without this ability, the IRS may not take appropriate actions against the businesses that do not pay employment taxes or improperly claim credits.

We recommended that the IRS track PEO relationships by inputting cross-referenced Employer Identification Numbers on the client business tax accounts. IRS management agreed with this recommendation and indicated that it will revise impacted form instructions to require reporting that will closely track relationships between businesses and PEOs and Professional Leasing Organizations filing payroll returns. We plan a follow-up audit to ensure this issue has been corrected.

The Credit is refundable to tax-exempt taxpayers, which is a high-risk factor for erroneous refunds. The IRS advised that, as of September 30, 2011, compliance personnel from its Tax Exempt and Government Entities Division had initiated examinations on 769 returns from tax-exempt organizations claiming the Credit. The IRS also advised that through mid-October 2011, 9,697 tax-exempt organizations (taxpayers filing Form 990-T) claimed Small Business Health Care

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9 TIGTA, Ref. No. 2011-40-103, Affordable Care Act: Efforts to Implement the Small Business Health Care Tax Credit Were Mostly Successful, but Some Improvements Are Needed (September 2011).
Credits, totaling $36.4 million.

The Tax Exempt and Government Entities Division implemented a two-step process for verifying the Credit claimed by tax-exempt organizations on Form 990-T. First, the IRS developed computer programs to detect potential errors on Forms 990-T claiming the Credit. This validation process occurs before funds have been released to the organizations. When errors are detected, the IRS will freeze any associated refund and notify the organization through a notice. Tax Exempt and Government Entities Division personnel will review the Form 990-T to determine if an examination is warranted.

The second step is an examination of the documentation supporting the Credit claimed on Forms 990-T identified by the IRS with potential errors. Examinations can be performed either before the refund is issued or after. If IRS resources are available before the refund is issued, an examination will be initiated to determine if the Credit is valid and whether a refund should be issued. If a determination is made that sufficient resources are not available to perform an examination, the refund will be released within 45 days. For these returns, the IRS will provide a listing of cases to its compliance personnel for potential review during its regular post-refund examination process. At that time, the IRS can perform an audit of the taxpayer’s records by a correspondence audit, office audit, or field examination. During these audits, taxpayers will be asked to provide the documentation necessary to verify the Credit claimed on Form 990-T.

The Volume of Credit Claims Has Been Lower Than Expected

Despite IRS efforts to inform 4.4 million taxpayers who could potentially qualify for the Credit, the volume of claims for the Credit has been low. The Credit was designed to encourage small employers to offer health care insurance. However, through mid-October 2011, the IRS reported that 309,000 taxpayers (including the tax-exempt taxpayers previously referred to) had claimed the Credit for a total amount of $416 million.\(^{10}\) This is substantially lower than the Congressional Budget Office estimate that taxpayers would claim up to $2 billion of Credit for Tax Year 2010. (Appendix II provides the volumes and amounts of Credits filed on each type of tax return.)

Although the IRS sent postcards to businesses that might potentially qualify for the Credit to make sure they were aware of it, the IRS did not have ready access to data that would allow it to determine which of these businesses actually offer health care insurance to their employees or otherwise qualify for the Credit. Many small businesses do not offer health insurance and would not qualify for the Credit. Other factors, such as family members working as employees or the business failing to offer an appropriate health care plan, might also cause businesses to be ineligible.

\(^{10}\) Internal Revenue Service statistics on credits claimed under I.R.C. § 45R.
The IRS spoke with industry groups and professional organizations to try to determine why businesses were not claiming the Credit. Some reasons given were: small businesses may take a wait and see approach with the Credit; the Credit is not worth the time and effort to claim it; taxpayers are unclear on the specifics of the Credit and rely on tax professionals to claim it; and business-related information needed to claim the Credit is not readily available.

The IRS conducted focus groups with tax practitioners in conjunction with its Nationwide Tax Forums to identify knowledge gaps on the part of taxpayers and tax practitioners, determine barriers to taxpayers claiming the Credit, and determine better ways to communicate with stakeholders. In general, the focus group participants were aware of the Credit, but many could not explain the specific eligibility requirements and indicated they would not feel confident calculating the Credit themselves. Few participants had completed Form 8941 for their own business or for their clients. They indicated that the Credit is not easy to calculate and the payroll information needed to calculate accurately the Credit amount was not readily available to them. They also stated that the instructions for calculating the FTEs were not clear causing clients who may have been eligible for the Credit not to claim it. In addition, many of the practitioners’ clients had not claimed the Credit because they did not offer insurance or did not meet the eligibility criteria. Practitioners indicated that given the current economic environment, the Credit was not enough to encourage their clients to start offering insurance.

Some of the taxpayer errors and omissions were not identified by the IRS

There was insufficient information on the Form 8941 and other forms filed with taxpayer returns to identify all errors made when claiming the Credit; however, based on the information that was available, we concluded that some claims contained errors or were incomplete.

We reviewed a judgmentally selected sample of different return types as they were being processed at the Austin, Texas, and Ogden, Utah, IRS campuses. We chose the returns based primarily on how many forms of a particular type were available during our visit and whether we noticed any anomalies during our review. Our review included 257 returns for individuals, businesses, and tax-exempt organizations. The results of the judgmental sample cannot be used to estimate the extent of actual errors. The purpose of the sample was to identify the types of errors that were occurring, but was not intended to project the frequency of those errors. Additionally, we analyzed computerized data that were available prior to the end of the filing season for possible issues. The types of problems we identified through either the case review or data analysis included:

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11 The Form 8941 does not contain all of the data and calculations needed to verify each step of Credit eligibility and calculation. It is necessary to complete worksheets in the Instructions for the Form 8941 in order to correctly claim the Credit. The worksheets are not filed with the return.
• Obvious errors in calculating FTEs. The number of FTEs claimed exceeded the number of employees reported.

• Incorrect use of the applicable percentage. Taxpayers either used the wrong percentage to calculate the Credit or left that portion of the form blank. Tax-exempt small employers should use 25 percent and all other small employers should use 35 percent.

• Incorrect calculations of phase-out rules. Taxpayers who had over 10 FTEs or who paid average annual wages of over $25,000 incorrectly calculated the reduced Credit amount.

• Premiums paid that exceeded the maximum premium allowed based on the IRS’s State Average Premium for Small Group Markets.

• Taxpayers reported that no employees for whom they paid premiums were covered under qualifying arrangements (i.e., the health insurance coverage provided to the employees did not meet the specifications in the law).

• Missing Form 3800 or missing required information on Form 3800 related to a credit received from a pass-through entity (such as a partnership, trust, or Subchapter S corporation). Credits from pass-through entities are reported on Form 8941. Any remaining pass-through Credit after adjustments for all but Form 990-T is reported on Form 3800, which is attached to Form 1040, Form 1065, or Form 1041.

• Claims made with no evidence of employment-tax returns having been filed to show that the Form 1120 business had employees and was entitled to the Credit.

**The lack of targeted math error authority could hamper IRS compliance efforts**

Some of the errors that taxpayers made could have been addressed during processing because they were straightforward arithmetic errors, which the IRS has authority to correct. We recommended, and the IRS agreed, to capture more data from the Form 8941 to facilitate addressing these types of errors.

Math error authority allows the IRS to correct certain errors during processing, including calculation errors and entries that are inconsistent or exceed statutory limits, without having to issue the taxpayer a statutory notice of deficiency. This is especially important with respect to refundable credits because such credits are targets for fraud. In our report regarding the Small Business Health Care Tax Credit,\(^\text{12}\) we provided examples of specific errors taxpayers were making when claiming the Credit which are beyond the IRS’s

\(^{12}\) TIGTA, Ref. No. 2011-40-103, *Affordable Care Act: Efforts to Implement the Small Business Health Care Tax Credit Were Mostly Successful, but Some Improvements Are Needed* (September 2011).
current authority to correct through math error processes, but which could be addressed through legislation providing targeted math error authority. Math error authority would allow the IRS to improve compliance and avoid burdensome audits by correcting certain errors or contacting the taxpayer during processing, but prior to allowing the Credit or paying refunds on potentially erroneous returns.

IRS management agreed that math error authority is an important compliance tool, and will explore with the Department of the Treasury whether math error authority is appropriate for this Credit. The IRS agreed that it is beneficial to address potential compliance issues as early in the process as possible and has developed procedures to examine questionable returns prior to the issuance of refunds.

Chairman Boustany, Ranking Member Lewis, and Members of the Subcommittee, thank you for the opportunity to provide TIGTA’s assessment of the IRS’s administration of the Small Business Health Care Credit. In closing, I would like to emphasize that TIGTA will continue to monitor the IRS’s implementation of significant provisions of the Affordable Care Act and will promptly alert you and the IRS of any problems or emerging issues. I would be pleased to answer any questions you may have at the appropriate time.
## Appendix I

### Form Used to Claim the Credit

**Form 8941**  
Credit for Small Employer Health Insurance Premiums  
OMB No. 1545-2198  
2010  
Attachment  
Filing status  
No. 63

<table>
<thead>
<tr>
<th>Step</th>
<th>Description</th>
<th>Identification Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Enter the number of individuals you employed during the tax year who are considered employees for purposes of this credit (see instructions).</td>
<td>1</td>
</tr>
<tr>
<td>2</td>
<td>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.</td>
<td>2</td>
</tr>
<tr>
<td>3</td>
<td>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.</td>
<td>3</td>
</tr>
<tr>
<td>4</td>
<td>Premiums you paid during the tax year for employees included on line 1 for health insurance coverage under a qualifying arrangement (see instructions).</td>
<td>4</td>
</tr>
<tr>
<td>5</td>
<td>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).</td>
<td>5</td>
</tr>
<tr>
<td>6</td>
<td>Enter the smaller of line 4 or line 5.</td>
<td>6</td>
</tr>
</tbody>
</table>
| 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 25% (.25) | 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. | 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                    |
| 19   | Credit for small employer health insurance premiums allowed for 2010 from a passive activity (see instructions). | 19                    |
| 20   | Carryback of the credit for small employer health insurance premiums from 2011.                 | 20                    |
| 21   | Add lines 18 through 20. Cooperatives, estates, and trusts, go to line 22. Tax-exempt small employers, skip lines 22 and 23 and go to line 24. All others, stop here and report this amount on Form 3800, line 29h. | 21                    |
| 22   | Amount allocated to patrons of the cooperative or beneficiaries of the estate or trust (see instructions). | 22                    |
| 23   | Cooperatives, estates, and trusts, subtract line 22 from line 21. Stop here and report this amount on Form 3800, line 29h. | 23                    |
| 24   | Enter the amount you paid in 2010 for taxes considered payroll taxes for purposes of this credit (see instructions). | 24                    |
| 25   | Tax-exempt small employers, enter the smaller of line 21 or line 24 here and on Form 990-T, line 44f. | 25                    |

*Source: IRS web site.*
## Volumes of Credits Claimed
### By Return Types

<table>
<thead>
<tr>
<th>Return Type</th>
<th>Number of Credits Claimed</th>
<th>Amounts of Credits Claimed</th>
<th>Average Credit Claimed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Form 1120</td>
<td>23,724</td>
<td>$91,458,588</td>
<td>$3,855</td>
</tr>
<tr>
<td>Form 1120-S</td>
<td>88,848</td>
<td>Not Applicable(^{13})</td>
<td></td>
</tr>
<tr>
<td>Form 1120-C</td>
<td>62</td>
<td>$5,959,005</td>
<td>$96,113</td>
</tr>
<tr>
<td>Form 1120-F</td>
<td>2</td>
<td>$5,113</td>
<td>$2,557</td>
</tr>
<tr>
<td>Form 1120-FSC</td>
<td>0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>Form 1120-H</td>
<td>111</td>
<td>$996,441</td>
<td>$8,977</td>
</tr>
<tr>
<td>Form 1120-L</td>
<td>0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>Form 1120-PC</td>
<td>73</td>
<td>$282,597</td>
<td>$3,871</td>
</tr>
<tr>
<td>Form 1120-POL</td>
<td>0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>Form 1120-REIT</td>
<td>0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>Form 1120-RIC</td>
<td>0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>Form 1065</td>
<td>15,550</td>
<td>Not Applicable(^*)</td>
<td></td>
</tr>
<tr>
<td>Form 1041</td>
<td>27</td>
<td>$87,106</td>
<td>$3,226</td>
</tr>
<tr>
<td>Form 990-T</td>
<td>9,697</td>
<td>$36,422,240</td>
<td>$3,756</td>
</tr>
<tr>
<td>Form 1040</td>
<td>171,129</td>
<td>$280,382,758</td>
<td>$1,638</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>309,223</strong></td>
<td><strong>$415,593,848</strong></td>
<td></td>
</tr>
</tbody>
</table>

*Source: IRS, ACA Oversight and Non-Exchange Provisions*

Form 1120: U.S. Corporation Income Tax Return
Form 1120-S: U.S. Income Tax Return for an S Corporation
Form 1120-C: U.S. Income Tax Return for Cooperative Associations
Form 1120-F: U.S. Income Tax Return of a Foreign Corporation
Form 1120-FSC: U.S. Income Tax Return of a Foreign Sales Corporation
Form 1120-H: U.S. Income Tax Return for Homeowners Associations
Form 1120-L: U.S. Life Insurance Company Income Tax Return
Form 1120-PC: U.S. Property and Casualty Insurance Company Income Tax Return
Form 1120-POL: U.S. Income Tax Return for Certain Political Organizations
Form 1120-REIT: U.S. Income Tax Return for Real Estate Investment Trusts
Form 1120-RIC: U.S. Income Tax Return for Regulated Investment Companies
Form 1065: U.S. Return of Partnership Income
Form 1041: U.S. Income Tax Return for Estates and Trusts
Form 990-T: Exempt Organization Business Income Tax Return (and proxy tax under section 6033(e))
Form 1040: U.S. Individual Income Tax Return

\(^{13}\) Form 1120-S is a pass-through form. Therefore, all credit amounts should have been reported to individual shareholders.

\(^{14}\) Form 1065 is a pass-through form. Therefore, all credit amounts should have been reported to individual partners.
Summary of Considerations in Determining Eligibility

IRS Notice 2010-44 describes the following factors in determining eligibility for the Small Business Health Care Tax Credit (Credit):

- Determine the employees who are taken into account for purposes of the Credit.
  - Exclude any wages and premiums paid related to partners, most owners,\(^{15}\) or family members of these partners or owners.
  - Seasonal workers are disregarded in determining FTEs and average annual wages unless the seasonal worker works for the employer for more than 120 days during the taxable year, although premiums paid on their behalf may be counted in determining the amount of the Credit.
  - Employers who are part of a controlled group or affiliated service group\(^{16}\) are treated as a single employer.

- Determine the number of hours of service. Consider hours for which employees were paid or entitled to payment (including vacations, holidays, illness) and use any of three methods for calculations (actual, days-worked equivalency based on eight hours of service per day, or weeks-worked equivalency based on 40 hours of service per week).

- Determine the number of an employer’s FTEs.
  - Divide (1) the total hours of service (but not more than 2,080 for any employee) by (2) 2,080. The result, if not a whole number, is then rounded to the next lowest whole number. In some circumstances, an employer with 25 or more employees may qualify for the Credit if some of its employees work part-time.

- Determine the average annual wages paid. Divide (1) the total wages paid for employees taken into account by (2) the number of the employer’s FTEs for the year. The result is then rounded down to the nearest $1,000. Only wages that are paid for hours of service as determined under Credit-related rules are taken into account.

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\(^{15}\) Specifically, sole proprietors, partners in a partnership, shareholders owning more than two percent of an S corporation, and any owners of more than five percent of other businesses are not taken into account as employees for purposes of the Credit. For purposes of the Credit, a very comprehensive list of potential relatives and dependent members of their households are excluded from eligibility.

\(^{16}\) Groups covered under section 414(b), (c), (m), or (o) of the Internal Revenue Code.
Determine the premiums paid by the employer that are taken into account for purposes of the Credit. Only the portion paid by the employer is taken into account.

- Determine the premiums related to qualifying arrangements. Qualifying arrangements may cover a wide range of medical expenses (e.g., hospital or medical policies, certificates, or service plans; dental or vision; long-term care). However, certain specific types of plans do not qualify. Different types of plans are not aggregated for purposes of meeting the qualifying arrangement requirement. So if an employer pays for a health insurance plan and a separate vision plan, determinations must be made for each plan with respect to whether it is a qualifying arrangement.

- The amount of an employer’s premium payments that are taken into account is limited to 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 eligible small employer pays 80 percent of the premiums for coverage provided to employees, the premiums taken into account for purposes of the Credit are the lesser of the 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 were substituted for the actual premium.

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17 See I.R.C. § 9832(c)(1).