

Health Insurance Tax Credit for Churches

The health insurance reform package included an immediate tax break for small businesses: the small business health insurance tax credit. Qualified small employers, including nonprofit employers, may reduce the cost of providing health insurance to their employees this year. However, the credit is complex and there are important limitations, especially when calculating the number of employees and other provisions. Don't let the complexity of the credit discourage you from exploring its benefits. This letter provides a description of the credit; please contact our office so we can explain in detail how the credit may help cut your health insurance costs.

Small employers. To be eligible, your ministry must meet *all three* of the following requirements:

1. You must have fewer than 25 full-time equivalent employees (FTEs). (*see how to determine the number below*)
2. Your average employee wages must be less than \$50,000. (*see how to determine below*)
3. You must pay a uniform percentage for all employees receiving coverage, and this percentage must be at least 50% of the total premium cost of single (employee-only) coverage.

How long it's available. The Tax Credit became available beginning in 2010, and is only available for a limited time.

- From 2010 to 2013: The Tax Credit can equal up to 25% of allowed employer healthcare costs.
- From 2014 to 2016: The maximum tax credit will increase to 35% of premiums paid by eligible tax-exempt organizations – but only for coverage obtained through the yet-to-be-created health insurance exchanges.

The Tax Credit is a reimbursement.

The Tax Credit is a reimbursement against certain payroll tax obligations. Because of this, the total amount of the Tax Credit cannot exceed the total amount of:

- Federal income tax and Medicare tax withheld from employee wages, and
- The ministry's share of Medicare tax on employees' wages for the year.

Employees. To determine eligibility for the credit, employers have to calculate their number of FTEs. The number of an employer's FTEs is determined by dividing the total hours for which the employer pays wages to employees during the year (but not more than 2,080 hours for any employee) by 2,080. The result, if not a whole number, is rounded to the next lowest whole number. Lawmakers selected 2,080 hours because 2,080 hours comprise the number of hours in a 52-week assuming a 40-hour work week. Any hours beyond 2,080, such as overtime hours, are not taken into account when calculating FTEs. (*see attached example for calculation*)

Average annual wages. Employers also need to calculate average annual wages. The amount of average annual wages is determined by first dividing the total wages paid by the employer to employees during the employer's tax year by 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).

Special Rules for Clergy. Clergy are generally considered self-employed for Social Security (FICA) and Medicare tax purposes. Depending on the facts and circumstances, clergy may be considered employees for purposes of the Tax Credit. Churches need to determine whether the clergyperson serving the church in question satisfies the requirements of the common law test for determining worker status. This is the same test that a church employer follows to determine whether the clergyperson is an employee subject to *Form W-2* reporting or an independent contractor subject to *Form 1099* tax reporting.



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If the church employer is reporting the clergyperson's wages on a *Form W-2*, the clergyperson is most likely an employee for purposes of the Tax Credit.

If, under the common law test, the clergyperson is considered self-employed, he or she is not taken into account for the Tax Credit. If, under the common law test, he or she is considered an employee, then the clergyperson is counted in the employer's employee count and the premiums paid for coverage of the clergyperson are counted toward the Tax Credit.

In addition, even when counted as an employee for the purposes of the Tax Credit, a clergyperson's compensation is not included, i.e., it is excluded, from the employer's calculation of average wages, because it is not subject to FICA. This exclusion may actually benefit some churches by resulting in a lower overall average wage, because clergy wages are excluded from the calculation but clergy are included in the calculation of the number of FTEEs.

Claiming the Credit. Eligible tax-exempt organizations will first use *Form 8941* to calculate their refundable Tax Credit, and then will claim the Tax Credit on Line 44f of *Form 990-T*. Many churches do not typically file a *Form 990-T* because that form is primarily filed by organizations liable for the tax on unrelated business income. However, *Form 990-T* must now be used by any eligible tax-exempt organization to claim the Tax Credit, regardless of whether the organization is subject to the tax on unrelated business income. Employers wishing to claim the Tax Credit for 2010 generally should submit a *Form 990-T* by the 15th day of the 5th month after their year-end, May 15th for calendar year organizations.

Please contact our office if you have any questions about the new small employer health insurance tax credit at 865-769-0660.

Sincerely yours,

Pugh & Company, P.C.



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An Example

A local church has one clergy person. Let's assume the clergy person is considered an employee under the common law test, i.e., she receives a *Form W-2* from the church. The church also has 2 full-time lay employees and 2 part-time lay employees. The clergy person is paid \$60,000. Employee 1 is paid \$35,000, employee 2 is paid \$25,000, and employee 3 and 4 are each paid \$12,500. The church has enrolled its clergy person and 2 full-time employees in its denominational church health plan. The church pays 75% of the single employee-only premium, which is \$8,000 per employee, on behalf of each employee. The church pays \$18,000 for the coverage (\$6,000 per employee). The church is located in Tennessee.

Calculate the FTEEs for the church

Hours Worked: Employee 1 (2,080); Employee 2 (2,080), Employee 3, (1,040), Employee 4 (1,040), Clergy person 1 (2,080). Total hours: 8,300.

FTEEs: 4 (8,300 hours ÷ 2,080 hours)

Calculate average wages

Wages: \$35,000 + \$25,000 + \$12,500 + \$12,500 = \$85,000 aggregate wages. The clergy person's wages are not counted.

Average Wages: \$85,000 ÷ 4 = \$21,250 per FTEE, rounded down to \$21,000. The clergy person is counted as an employee in the denominator, even though his or her wages are not included. According to the table in the Appendix, the church is eligible for a credit of 25%.

Calculate premiums paid and Tax Credit

Employer Health Care Costs: \$18,000 (\$6,000 x 3). Premiums paid to cover the clergy person are counted.

Average Tennessee Premium: \$4,611, single coverage (\$10,369 for family coverage). This limits the amount of premiums paid that can be counted toward the Tax Credit. The church can only claim 75% of \$4,611 (what it would have paid if the coverage were average Tennessee coverage) per employee. \$4,611 x 75% = \$3,458.25 x 3 = \$10,374.75 maximum premium limit.

2010 Tax Credit: **\$2,593.69** (25% x \$10,374.75). This amount is refundable as a credit as long as the church has withheld at least that much from employee wages combined with what the church has paid in employer Medicare taxes.



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