TAX AND BUSINESS Alert™

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Health Insurance Tax Credit

The Patient Protection and Affordable Care Act (Health Care Act) provides a new beneficial tax credit for small employers. For tax years beginning in 2010 through 2013, this legislation provides the small employer health insurance credit for *qualified small employers* that purchase health insurance for their employees. A *qualified small employer* is generally one that (a) employs no more than 25 Full-time Equivalent (FTE) employees during its tax year, (b) pays annual FTE wages that average no more than $50,000, and (c) has a qualified health insurance plan (or arrangement) that requires it to pay at least 50% of the premiums (on a uniform basis) on behalf of all of its employees who enroll in the plan.

Self-employed individuals, including partners and sole proprietors, 2% (or greater) shareholders of an S corporation, and 5% (or greater) owners of the employer, are not treated as employees for purposes of this credit.

For 2010, the credit generally equals 35% (25% for tax-exempt employers) of the lesser of (a) the amount of contributions the employer made during the tax year to its qualified health arrangement to purchase qualifying health coverage for its employees or (b) the amount of contributions that the employer would have made during the tax year to its qualified health arrangement if each employee had enrolled in coverage with a small business benchmark premium. The small business benchmark premium will be determined by the Secretary of Health and Human Services each year on a state-by-state basis. Benchmark premium information will then be provided by the IRS.

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However, the full amount of the credit is available only to an employer with 10 or fewer FTE employees who have average annual FTE wages of less than $25,000. The credit will phase out when those thresholds are exceeded. Also, only nonelective employer contributions qualify. Basically, this means that employee elective contributions to the plan that are used by the employer to pay for the employee's coverage don't qualify for the credit.

For tax years beginning in 2014 and later, eligible small employers who purchase coverage

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Tax Aspects of Purchasing a Life Insurance Contract

Generally, proceeds of life insurance policies paid because of death of the insured are not subject to income tax. However, some life insurance transactions can have an income tax effect on the parties involved. One of these potentially taxable transactions involves the purchase of life insurance contracts as an investment. This phenomenon has not escaped the attention of the IRS, which has issued guidance on the tax aspects of this type of investment.


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This IRS guidance indicates that taxpayers purchasing life insurance contracts, other than modified endowment contracts, must include in income (a) any non-annuity amount received under the life insurance contract before the annuity starting date and (b) amounts received under a life insurance contract on the complete surrender, redemption, or maturity of the contract, but only to the extent it exceeds investment in the contract. Essentially, start with what you received at the insured's death and subtract what you paid for the contract plus any premiums you paid. The difference is taxable income, as shown in the following example.

Example: Tax aspects of purchasing a life insurance contract.

Alex and Britney are resident U.S. citizens. In June 2009, Britney purchased a $100,000 life insurance contract on the life of Alex from him for $20,000. The contract was issued by First State Insurance, a domestic corporation, to Alex in January 2002. The contract was a level premium 15-year term life insurance contract without cash surrender value. At the time of purchase, the remaining term of the contract was approximately seven years and six months. The monthly premium for the contract was $500, due and payable on the first day of each month. As owner of the contract, Britney named herself as beneficiary immediately after acquiring the contract. Britney had no insurable interest in Alex's life. She had no relationship with Alex and would suffer no economic loss upon his death. Britney purchased the contract with a view to profit.

In December 2010, Alex died, and First State Insurance paid $100,000 under the life insurance contract to Britney by reason of Alex's death. Through that date, Britney had paid monthly premiums totaling $9,000 to keep the contract in force. Britney must recognize $71,000 [$100,000 – ($20,000 + $9,000)] of ordinary income on the receipt of death benefits with respect to the life insurance contract.

The bottom line is that there is no free lunch when it comes to paying taxes on most types of income. So, please contact us to discuss this or any other tax planning or compliance issue.

Health Insurance Tax Credit

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through a state-run Insurance Exchange will be eligible for a tax credit for two additional years of up to 50% (35% for tax-exempt employers) of their contribution. So, a *qualified small employer* could potentially qualify for the credit for six years—four years under the first phase (2010 through 2013) and two years under the second phase beginning in 2014. Also, the wage limits will be indexed for inflation beginning in 2014.

The credit presumably applies regardless of the type of entity in which an employer conducts business. Thus, a qualified employer can be a C or an S corporation, partnership, limited liability company (LLC), or sole proprietorship.

This is a brief overview of the Small Employer Health Insurance Credit. Please contact us for an in-depth discussion of this credit and to assess its impact on your business. Keep in mind this is a credit, not a deduction, so it will offset your tax bill on a dollar-for-dollar basis.

HIRE Act Employment Incentives

The Hiring Incentives to Restore Employment Act (HIRE Act) recently passed by Congress includes three meaningful business tax breaks intended to boost hiring and lower the level of unemployment.

The HIRE Act extends by one year the generous $250,000 maximum for the so-called Section 179 deduction allowance, through tax years beginning in 2010. This deduction, named after the Internal Revenue Code section, allows business owners to expense equipment immediately rather than depreciate it over a period of years. The new law also extends the $800,000 equipment purchase threshold for the Section 179 deduction phase-out rule. Specifically, for tax years beginning in 2010, the maximum Section 179 deduction generally remains at $250,000 (versus only $134,000 before the new law). For tax years beginning in 2011, the maximum Section 179 deduction will fall all the way back to $25,000 unless Congress takes further action. Likewise, the phase-out threshold for the Section 179 deduction generally remains at $800,000 (versus only $530,000 before the new law). For tax years beginning in 2011, the phase-out threshold will fall all the way back to $200,000 unless Congress takes further action. Bottom line, the HIRE Act extends the Section 179 amounts that applied in 2009 through 2010.

Next, thanks to the HIRE Act, wages paid by a *qualified employer* to a *qualified new employee* with respect to employment between March 19, 2010, and December 31, 2010, are exempt from the 6.2% employer's portion of the social security tax. There is no exemption for the employee's 6.2% portion of the tax or the Medicare tax portion of the FICA tax. Individuals who pay self-employment tax are not affected.

Qualified employers basically include private-sector companies, tax-exempt not-for-profit organizations, and eligible public higher-education institutions. *Qualified new employees* are full-time or part-time workers who: (a) start work after February 3, 2010, and by no later than December 31, 2010, and (b) certify on Form W-11 that they were not employed more than 40 hours during the 60-day period ending on the start date. Although a qualified employee who begins work after February 3, 2010, can be eligible for the payroll tax holiday, the employer's portion of the social security tax will only be forgiven for wages paid after March 18, 2010. Also, the new worker cannot replace another worker unless that person quit voluntarily or was discharged for cause.

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Finally, above and beyond the temporary social security tax exemption explained above, employers can also claim a temporary new tax credit of up to $1,000 for wages paid to each qualified new employee, using the same definition as for the social security tax exemption. The new qualified employee credit is implemented via an increase to the employer's general business credit.

There are some additional requirements for this credit. The worker must be kept on the payroll for at least 52 consecutive weeks, and wages during the last half of the 52-week period must equal at least 80% of wages paid during the first half of that period.

The new qualified employee credit equals the lesser of: (a) 6.2% of wages paid to the worker during the 52-consecutive-week period beginning on the date of hire or (b) $1,000. Therefore, to claim the maximum $1,000 credit, the worker must be paid at least $16,130 during the 52-week period. The credit can only be claimed for the tax year during which the 52-week requirement is first met for the worker. So, it's a one-time deal for each eligible worker, based on wages paid to that worker during the 52-week period that starts with his or her employment date.

Please contact us if you have questions about or require more information on these new hiring incentives.

Improved Adoption Credit

Taxpayers can claim a tax credit for certain eligible adoption expenses and exclude from income benefits received from an employer that maintains an adoption assistance program. The credit and exclusion are subject to dollar limitations and phaseout for taxpayers whose income exceeds certain thresholds.

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The Patient Protection and Affordable Care Act (Health Care Act) increased the adoption credit by $1,000 to $13,170 in 2010. The $13,170 is not an annual limitation; it applies to the adoption of each child and is cumulative (for that child) over all tax years. The limitation is the same for both married and unmarried taxpayers, but married couples must file a joint return to claim the credit.

The credit for an adoption involving a child with special needs that becomes final in the tax year is automatically $13,170, regardless of the actual amount (even if less than $13,170) of qualifying adoption expenses that were incurred.

Beginning in 2010, the adoption credit is refundable. So, taxpayers can receive a refund of the amount that the credit exceeds their tax liability, as shown in the following example.

Example: Refundable adoption credit.

In 2010, Fred and Abby Worth file a joint return and have a federal tax liability of $12,000 after considering all tax credits other than the adoption credit. The Worths are entitled to the maximum credit for qualified adoption expenses of $13,170 in 2010. The $13,170 adoption credit will wipe out their $12,000 tax liability and, in addition, the Worths may claim a refund of $1,170.

For purposes of the adoption credit, an employee's gross income does not include amounts paid or expenses incurred by his or her employer under an adoption assistance program for qualified adoption expenses in connection with the employee's adoption of a child. Under pre-Health Care Act law, the aggregate amount of qualified adoption expenses that could be taken into account under the exclusion for all tax years with respect to an adoption of a child was limited to $12,170. The 2010 Health Care Act increased the amount of employer-provided adoption assistance that may be excluded in 2010 to $13,170.

Please contact us to discuss adoption benefits, or any other tax planning or compliance issue impacting you or your business.