General Board of Pension and Health Benefits
of The United Methodist Church

**Caring For Those Who Serve**

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## Small Business Tax Credit

A number of local churches have received postcards from the Internal Revenue Service (IRS) containing information about the Small Business Tax Credit ("Tax Credit") for health insurance coverage that is a provision of the new health care reform laws. In addition, it appears that many local churches are inquiring with conference offices about the Tax Credit's applicability to them as small employers.

The General Board has been closely monitoring the regulatory guidance being issued by the federal agencies under the health care reform laws. The General Board has been posting analyses of the statute and regulations on its Web site under "**Health Care Reform**."

The statutory language in the Tax Credit provision of the health care reform laws presents concerns for small employers, including local churches, in church health plans. In addition, on its Web site, the IRS sets forth requirements for the Tax Credit that may make it more difficult for small church employers to qualify.

On May 18, 2010 the IRS released Notice 2010-44 (**http://www.irs.gov/pub/irs-drop/n-10-44.pdf**), which provided some clearer guidance about the qualifications for and the mechanics of the Tax Credit. However, barriers to the Tax Credit remain for many local churches.

The health care reform law and Notice 2010-44 tie the Tax Credit to "health insurance" coverage as defined in §9832 of the Internal Revenue Code ("Code"). That section appears to require that the health insurance provided by the small employer comes from a health insurance issuer licensed by a state. Self-funded church plans, such as HealthFlex and many United Methodist annual conference plans, do not meet that definition. Local churches that obtain insured coverage on the small group market or through a fully-insured annual conference plan might benefit from this credit (though there are other hurdles for church employers, which are explained below).

There is some minor ambiguity in the language of the statute and Notice. However, without clear regulatory guidance to the contrary, the common-sense reading of the language leads to the conclusion that the coverage must be from a state-regulated health insurance company. The General Board, with other church benefit boards, is discussing this concern with the Department of Health and Human Services and the IRS in order to obtain some relief in future Tax Credit guidance. The drafters of the statute probably did not think that any small business, otherwise eligible for the Tax Credit, would have a self-funded plan. Church employers are fairly unique in this respect. There is hope that the IRS may accommodate small employers in self-funded church plans in future notices or regulations.

For small churches with fully-insured plans (or churches in self-funded church plans if the IRS provides the sought relief), there remain a few other concerns in qualifying for the Tax Credit.

1. The employer seeking the Tax Credit must provide uniform coverage through a contribution arrangement under which it pays at least 50% of the cost of single coverage for all employees (clergy and lay) covered in the church employer's plan. The level of contribution must be uniform for all employees. However, there is a transition exception for 2010 only for employers that contribute different amounts for employees as long as all amounts are at least 50%.

2. Clergy, while considered employed for income tax and health benefits purposes, are self-employed for payroll tax purposes. The requirements for qualifying for the Tax Credit involve calculating average wages among the small business' employees. The calculations are based on wages subject to FICA (Social Security) tax. Clergy earnings are subject to SECA (self-employment) tax—not FICA tax; therefore, it is unclear how their earnings would figure into the average wage calculations, if at all.

3. Because nonprofit (tax-exempt) employers do not pay income tax, the Tax Credit for tax-exempt employers is structured as a credit or offset against the payroll and income tax withholding from employee pay and the small employer's Medicare tax obligations. The concern for small church employers is that a large percentage of the church's aggregate payroll may not be subject to mandatory income tax withholding, FICA or Medicare taxes because clergy pay SECA taxes. There is a limited self-help remedy available to the church employer if the clergyperson involved voluntarily elects to have income taxes withheld from his or her pay. Nonetheless, some churches may have too little in payroll tax obligations to fully benefit from the Tax Credit.

The General Board will provide more information about the Tax Credit as the IRS issues additional guidance.

If you have questions about the Tax Credit or other health care reform provisions, please e-mail us at **healthcarereform@gbophb.org**.

IRS Resources: http://www.irs.gov/newsroom/article/0,,id=220809,00.html?portlet=6