



OFFICE OF  
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224  
August 3, 2000

Number: **200050003**  
Release Date: 12/15/2000  
TL-N-73-00/CC:TEGE:EB:HW  
UILC: 45A.00-00

INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR: District Counsel, North-South Carolina District, Greensboro

FROM: Assistant Chief Counsel Employee Benefits

SUBJECT: Indian Employment Credit

This Field Service Advice responds to your memorandum dated January 20, 2000. You ask for our assistance in determining the proper methodology for computing the Indian Employment Credit under section 45A of the Internal Revenue Code.

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LEGEND

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Taxpayer =

### ISSUES

In calculating the Indian Employment Credit under section 45A of the Code for an employer's taxable year:

- (1) How is the \$20,000 limitation on qualified wages and qualified employee health insurance costs applied?
- (2) How are individuals who were qualified employees in the 1993 base year but not in the taxable year treated?

### CONCLUSIONS

- (1) The \$20,000 limitation is applied separately to each qualified employee's qualified wages plus qualified employee health insurance costs in the base year (1993). In the taxable year for which the credit is being determined, the limitation is again applied separately to each qualified employee's qualified wages plus qualified employee health insurance costs.
- (2) If an individual was a qualified employee in the 1993 base year, that individual's qualified wages plus qualified employee health insurance costs for 1993, limited to \$20,000, are included in the total of qualified wages plus qualified employee health insurance costs paid or incurred by the employer for 1993. Once the 1993 total is established, it does not decrease on account of individuals who are not qualified employees in subsequent years.

### FACTS

During the years at issue, Taxpayer claimed the Indian Employment Credit under section 45A of the Internal Revenue Code with respect to certain of its Indian employees. Taxpayer computed the credit as 20 percent of the amount determined as follows:

Step 1: For each qualified employee, determine the actual wages plus health insurance costs paid or incurred during the taxable year (not limited to \$20,000).

Step 2: For each qualified employee, determine the actual wages plus health insurance costs paid or incurred during the 1993 base year (not limited to \$20,000).

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Step 3: For each qualified employee, (A) determine the excess (if any) of the Step 1 amount over the Step 2 amount; (B) if the result exceeds \$20,000, reduce it to \$20,000.

Step 4: Total the Step 3 amounts for all qualified employees.

## LAW AND ANALYSIS

Section 45A(a) of the Code provides that the amount of the Indian employment credit with respect to any employer for any taxable year is an amount equal to 20 percent of the excess (if any) of (1) the sum of (A) the qualified wages paid or incurred during that taxable year and (B) qualified employee health insurance costs paid or incurred during that taxable year, over (2) the sum of the qualified wages and qualified employee health insurance costs (determined as if section 45A were in effect) that were paid or incurred by the employer (or any predecessor) during calendar year 1993.

The term “qualified wages” generally means any wages paid or incurred by an employer for services performed by an employee while the employee is a qualified employee. Section 45A(b)(1)(A) of the Code. The term “qualified employee health insurance costs” generally means any amount paid or incurred by an employer for health insurance to the extent the amount is attributable to coverage provided to any employee while the employee is a qualified employee. Section 45A(b)(2)(A).

Section 45A(b)(3) of the Code provides that the aggregate amount of qualified wages and qualified employee health insurance costs taken into account with respect to any employee for any taxable year (and for the base period under section 45A(a)(2), i.e., calendar year 1993) shall not exceed \$20,000.

Section 45A(c)(1) of the Code provides in part that the term “qualified employee” generally means any employee of an employer if the employee is an enrolled member of an Indian tribe or the spouse of such an enrolled member. Additional requirements in section 45A(c)(1) pertain to where the employee’s services are performed and the location of the employee’s abode.

Section 45A(c)(2) of the Code provides that an employee shall not be treated as a qualified employee for any taxable year of the employer if the total amount of the wages paid or incurred by the employer to the employee during that taxable year (whether or not for services within an Indian reservation) exceeds the amount determined at an annual rate of \$30,000. Section 45A(c)(3) provides for annual inflation adjustments of the \$30,000 amount for years beginning after 1994.

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Taxpayer's method of computing the credit, as described above, does not correctly apply the \$20,000 limitation. For example, assume that Taxpayer had a single qualified employee throughout 1993 and 1994 with qualified wages of \$15,000 in 1993, qualified wages of \$22,000 in 1994, and no qualified employee health insurance costs in either year. Under Taxpayer's method, because \$22,000 minus \$15,000 is \$7,000, which is less than \$20,000, the limitation is not triggered and the credit is computed as 20 percent of \$7,000, or \$1,400. In describing the \$20,000 limitation, however, section 45A(b)(3) of the Code refers to "any taxable year" and refers separately to the base period. It is clear from the plain language of the Code that the limitation is applied separately to the taxable year for which the credit is being computed and to the base year. Thus, in this example, the \$22,000 for 1994 is limited to \$20,000, the \$15,000 for 1993 is subtracted, leaving \$5,000, and the correct credit is 20 percent of that, or \$1,000.

Taxpayer's computation method also does not correctly account for individuals who were qualified employees in 1993 but were not qualified employees in the taxable year for which the credit is being determined. For example, assume that in 1993 Taxpayer had three qualified employees, each with qualified wages of \$15,000; one of them terminated employment at the end of 1993, and in 1994 the remaining two each had qualified wages of \$19,000. Assume further that there were no other qualified employees, and no qualified employee health insurance costs in either year. Under Taxpayer's method, the terminated employee is disregarded, the \$4,000 wage increases of each remaining employee are added, and the credit is computed as 20 percent of \$8,000, or \$1,600. In describing the credit, however, section 45A(a) of the Code refers to 20 percent of the excess of (1) the sum of qualified wages and qualified employee health insurance costs for the taxable year over (2) the corresponding sum for 1993. There is no basis in the statutory language for determining the excess of the first sum over the second sum separately with respect to each individual who is a qualified employee for the taxable year. The sum for each year is an aggregate with respect to all qualified employees for that year. Thus, in this example, the sum for 1994 is \$38,000 (\$19,000 + \$19,000), while the sum for 1993 is \$45,000 (\$15,000 + \$15,000 + \$15,000). Because \$38,000 does not exceed \$45,000, the credit for 1994 is zero.

In summary, the credit for a taxable year is correctly computed as 20 percent of the amount determined as follows:

Step 1: For each qualified employee in 1993, determine the qualified wages plus qualified health insurance costs paid or incurred during that year; if the sum exceeds \$20,000, reduce it to \$20,000.

Step 2: Total the amounts from Step 1 for all qualified employees in 1993.

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Step 3: For each qualified employee in the taxable year for which the credit is being determined, determine the qualified wages plus qualified employee health insurance costs paid or incurred during that taxable year; if the sum exceeds \$20,000, reduce it to \$20,000.

Step 4: Total the amounts from Step 3 for all qualified employees in the taxable year.

Step 5: Compute the excess (if any) of the taxable year total (Step 4) over the 1993 total (Step 2).

We hope you find this helpful. If you have any further questions, please call (202) 622-6060.

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(Employee Benefits)

By: \_\_\_\_\_  
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