Health Reform's Impact on Small Businesses

Congressman Mike Rogers (MI)

"The Senate bill would impose job-killing mandates and penalties on businesses, increase taxes and burdens on small businesses."

- U.S. Chamber of Commerce, 3/19/2010

"For small businesses, healthcare reform has always been about costs – reducing them. But the only thing this bill does is drive costs even higher. It will raise, not lower, insurance costs and it will increase both taxes and the cost of doing business for the very people they said they wanted to help – small business.

- National Federation of Independent Businesses, 3/21/2010

Poorly-structured tax credit with limited value

The law's credit for small businesses will do little to nothing to help small employers afford insurance. In fact, the Congressional Budget Office (CBO) has estimated that only 12% of the nation's small businesses would qualify for the credit.

This is because the credit is very restrictive and puts small business owners through a series of complicated tests to determine the actual amount of the credit. Here's how it works:

- Only firms with less than 10 employees will receive the full credit (up to 50% of health coverage expenses)
- For firms with 11-25 employees, the credit is reduced per employee
- Firms with more than 25 employees get no credit
- In addition, only firms who pay their workers $25,000 or less are eligible for the full credit. The credit is reduced as the average wage goes up, stopping at $50,000
- The credit begins in 2010 for existing coverage expenses, but only lasts until 2016

Beginning in 2014 (when the Exchanges are up and running), businesses that are eligible for the credit would be required to offer highly comprehensive plans and pay the vast majority of the employees' premiums – and after two or three years, the credit would vanish entirely, leading to an immediate spike in a small businesses' cost. These factors make it highly unlikely that most small businesses would, or would be able to, take advantage of this credit.

Costly, complex new employer health insurance mandate

Beginning in 2014, the new health care law contains a costly, complex employer mandate requiring some firms to provide insurance, pay penalties or both. The penalties are based on 3 things:

- The number of full-time equivalent employees (defined as employees working on average at least 30 hours per week)
- Whether or not the firm offers coverage

- Whether or not employees qualify for government subsidies toward the purchase of health insurance in an Exchange. (An employee qualifies for a subsidy if his or her household income is below 400% of the federal poverty line, $88,000 for an individual today).

Here's how this would work in the real world:

- *If your business*: Has more than 50 FTE employees. Does not offer insurance. Has one or more employees receiving premium subsidies in an Exchange. Penalty = $2,000 per employee.
- *If your business*: Has more than 50 FTE employees. Offers insurance. Has one or more employees receiving premium subsidies in an Exchange. Fine = lesser of $3,000 per subsidized employee or $2,000 per employee.
- *If your business*: Has more than 50 FTE employees. Offers insurance. Has no employees receiving premium subsidies in an Exchange. No penalty.
- *If your business*: Has 50 or fewer FTE employees. No penalty.
- *Note*: Once a business reaches the 50 FTE threshold and is subject to a penalty, the first 30 FTEs are exempted from the penalty

To add insult to injury, even if an employer is already providing coverage, they will be subject to the penalty if the government "deems" their plan to be "unaffordable."

This mandate constitutes a massive incentive for small businesses not to grow or hire new workers, and many businesses will be hesitant to hire low-income, low-skill workers, who would be likely to trigger the new tax. CBO says at least 9 million Americans will lose work-based insurance because companies will decide to pay the penalty and drop coverage for workers. CBO also estimated this new mandate will cost employers over $56 billion in direct penalties over the next 10 years. The NFIB estimates that this employer mandate alone will cost our fragile economy 1.6 million jobs.

Individual insurance mandate

Starting in 2014, all U.S. citizens and legal residents must have "qualified" health coverage or pay penalties. The federal government will determine what qualified coverage looks like and what benefits it must cover. For an individual, the penalty begins in 2014 at the greater of $95 or 1% of household income. In 2015, it grows to $325 or 2.0%. In 2016, it reaches $695 or 2.5%. (For families, the figure will be $2,250). After 2016, the amount will rise by a cost-of-living adjustment.

Drives health costs higher for small businesses

New mandates on health benefits. Beginning in 2014, the federal government will define what health plans must look like through an "essential benefits package." Starting that year, all policies must comply with these new mandates. The federal government will determine what benefits businesses must offer, how much they can charge in co-pays or cost-sharing, and how much of their employees' premiums they must cover.

Every health plan will be required to meet these new, expensive standards set by the federal government, except for "grandfathered plans," which the reconciliation bill essentially eliminates. The end result of these new requirements, according to CBO, is that health insurance premiums will be 10-13% more expensive because of this new law.

1099 reporting. Beginning in 2012, businesses will have to complete 1099 forms for every business-to-business transaction of $600 or more – a tremendous new paperwork burden for small business.

W-2 reporting. Beginning in 2011, all employers will be required to report employees' health benefits on W-2s.

New authority for the IRS

The Internal Revenue Service (IRS) will function as the government's enforcer for the health care law, monitoring both businesses and individuals to certify whether they have the insurance coverage the government requires. The Congressional Budget Office estimated that the IRS will need $10 billion in additional funds to fulfill this new authority. An estimated 16,500 new IRS agents and personnel would have to be hired to enforce the new mandates and collect the $520 billion in new taxes.

IRS agents will be required to verify if small businesses offer "acceptable" health care coverage to their employees. The IRS has the authority to fine you up to $2,250 or 2 percent of your income (whichever is greater) for failure to prove that you have purchased "minimum essential coverage." The IRS can confiscate your tax refund for non-compliance. IRS audits are likely to increase.

Small business health insurance tax

The health care law's annual fee on health insurance providers will be passed on to small businesses and their employees. This tax will fall on the vast majority of plans that small businesses purchase. The amounts are $8 billion for 2014, $11.3 billion for 2015 and 2016, $13.9 billion for 2017, and $14.3 billion for 2018. After 2018, the fee amount is indexed to the rate of growth in premiums.

Worse, the law exempts self-insured businesses and select not-for-profit insurers – corporations and labor unions. These exemptions are a devastating blow to small business, because they will be forced to bear the brunt of this tax in the form of significant premium increases in the fully-insured market.

Medicare payroll tax increase

Under the health care law, the Medicare payroll tax on income in excess of $200,000 ($250,000 joint) will increase from 1.45% to 2.35% beginning in 2013. This increase is not indexed to inflation, meaning lower-income earners will be hit over time. This tax will be paid by individuals.

This tax marks the first time that funds designated for Medicare will be diverted elsewhere – specifically to pay for the insurance policies of people under the Medicare age. This also establishes a dangerous precedent by treating the payroll tax as a revenue raiser for future non-Medicare spending.

Since the majority of small business owners pay their taxes at the individual level, this tax will hit the business income of many small business owners. The businesses most likely to see the tax increase are those that employ between 20 to 200 workers. These businesses account for more than one-quarter of the American workforce.

Tax increases on health-related businesses

The new law includes several large tax increases on health-related businesses. These new taxes will raise costs for businesses, make it harder for these industries to create jobs, and eventually be passed on to consumers in the form of higher health care prices. The tax increases include:

- $59 billion tax increase on health insurance providers
- $22 billion tax increase on drug manufacturers and importers
- $19 billion tax increase on medical device manufacturers and importers
- $2 billion tax increase on self-insured health plans

Example: The tax on medical devices does not exempt Class I devices (i.e. tongue depressors, bedpans, exam gloves, surgical instruments). For one medical device manufacturer in Michigan, this means an immediate $4 million tax increase.

New restrictions on HSAs and FSAs

Small businesses use Health Savings Accounts (HSAs) and Flexible Spending Accounts (FSAs) as low-cost options to help their employees with health care costs. It is estimated that about one in three workers across the country has access to an HSA or FSA. But the new law would severely limit the use of these innovative products.

Beginning in 2011, employees could no longer use HSAs and FSAs to purchase many items, including most over-the-counter medications prescribed by physicians. Contributions to FSAs would be limited to $2,500 per year, and the penalty for making non-health related purchases with HSAs will increase to 20%. What's worse – beginning in 2014, the law does not prevent the federal government from outlawing HSAs by deeming them "unacceptable coverage."

Eliminates retiree drug coverage subsidy

Beginning in 2013, the health care law eliminates the tax deductibility of subsidies provided to employers who offer prescription drug coverage to their retired workers. These subsidies were originally created to incentivize employers to continue offering drug coverage to retired workers in lieu of those retirees receiving coverage under Medicare Part D. This $4 billion tax increase will likely result in employers dropping their retiree health coverage—undermining President Obama's frequent promise that those who like their current coverage will be able to keep it.

New tax on investment income

Beginning in 2012, the health care law imposes an additional 3.8% tax on net investment income for filers making over $200,000 ($250,000 joint). Investment income is defined to be interest, dividends, annuities, royalties, rents, and taxable net capital gains. This tax is also applicable to income from estates and trusts. The active income from trade for self-employed and S-corporations would not be subject to the tax. For these entities, the tax would apply only to passive income and trade income related to commodity trading. There is also a special provision for the application of the tax to S-Corporations who sell their businesses.

This tax increase is expected to cost over $123 billion over the next 10 years, and could hit many small businesses owners who file independently.