Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515–0515

To: Members, Subcommittee on Economic Growth, Tax, and Capital Access, Committee on Small Business
From: Committee Staff
Date: March 18, 2016
Re: Subcommittee Hearing: "Lip Service but Little Else: Failure of the Small Business Health Insurance Tax Credit"

On Tuesday, March 22, 2016, at 10:00 a.m., in Room 2360 of the Rayburn House Office Building, the Subcommittee on Economic Growth, Tax and Capital Access of the Committee on Small Business will meet to examine the efficacy of the small business health insurance tax credit. The credit was enacted as part of the Patient Protection and Affordable Care Act of 2010 (PPACA)[1] to provide an incentive for small employers to provide health insurance and to make insurance more affordable. The credit was available for tax years beginning after December 31, 2009. In response to a letter from the Committee,[2] the United States Government Accountability Office (GAO) conducted an investigation and in May 2012 released a report examining the credit and its utility in promoting employer-provided health insurance coverage in small businesses.[3] In March 2015, GAO released a subsequent study, as mandated by the PPACA,[4] that updated some of the relevant data.[5] It is appropriate that on the eve of the 6th anniversary of PPACA this hearing will examine whether the credit was effective and analyze the factors that contributed to its ultimate performance.

I. Introduction

Historically, most Americans covered by health insurance were covered through their employers. These employers were generally larger private or government entities. On March 23, 2010, the PPACA ("Obamacare") was enacted, requiring health insurance coverage for almost every individual regardless of employment status (the "individual mandate").[6] Similarly, an "employer mandate" requires that entities that employ more than 50 full-time equivalent (FTE) employees offer affordable health insurance to those workers.[7] An entity employing 49 or fewer FTEs is not subject to the employer mandate. The small business health insurance tax credit was

[1] Pub. L. No. 111-148, §§ 1421, 10105, 124 Stat. at 119 (Mar. 23, 2010), (codified at 26 U.S.C. § 45R).
[2] Letter from Sam Graves, Ranking Member, U.S. House of Representatives Committee on Small Business, to Gene L. Dodaro, Acting Comptroller General of the United States, Government Accountability Office (Oct. 25, 2010).
[3] GAO, SMALL EMPLOYER HEALTH TAX CREDIT: FACTORS CONTRIBUTING TO LOW USE AND COMPLEXITY (GAO-12-549) (2012), *available at* http://www.gao.gov/products/GAO-12-549 [hereinafter GAO's 2012 Report].
[4] Pub. L. No. 111-148, § 1401(c), 124 Stat. 119, 220 (2010).
[5] GAO, PRIVATE HEALTH INSURANCE: EARLY EVIDENCE FINDS PREMIUM TAX CREDIT LIKELY CONTRIBUTED TO EXPANDED COVERAGE, BUT SOME LACK ACCESS TO AFFORDABLE PLANS (GAO-15-312) (2015), *available at* http://www.gao.gov/products/GAO-15-312 [hereinafter GAO's 2015 Report].
[6] 26 U.S.C. § 5000A.
[7] 26 U.S.C. § 4980H.

included in the law to provide an incentive for employers with fewer than 25 FTEs to offer and subsidize health insurance for their workers.

II. Background

Among companies that primarily employ low wage individuals (low-wage employers or LWEs), the number of employees directly correlates to the likelihood of offering health insurance.[8] In 2014, only about 12.5 percent of LWE with fewer than 10 employees offered health insurance, while 22 percent of those with fewer than 25 employees did. By contrast, around 84 percent of LWEs with between 100 and 999 employees offered health insurance at that time.[9]

Small LWEs generally do not offer health insurance as a result of a combination of factors. First of all, health insurance increases the total compensation costs for employees. Since smaller companies generally operate on much tighter margins than their larger counterparts, any overhead cost increases are a much bigger deal. Second, very low-wage employees generally prefer additional pay rather than insurance benefits.[10] Finally, due to their small employee pool and lack of bargaining power, premiums and out-of-pocket expenses are likely to be higher than those of their larger counterparts.[11]

III. Eligibility

The PPACA included a tax credit to provide an incentive for small businesses to offer health insurance for their employees and to help make insurance more affordable. Government agency and small business advocacy groups' estimates of the eligible pool ranged from 1.4 million to 4 million employers.[12] Whether a business qualifies for the credit depends on a number of different factors, discussed below.

a. Size

To be eligible, an employer must be a small business or tax-exempt employer in the United States and paying premiums for employee health insurance coverage issued in the United States. It also must employ fewer than 25 FTEs[13] in the tax year, excluding business owners, family

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[8] "Low-wage" in this context means that 50 percent or more of their employees earn $11.50 per hour or less. GAO's 2012 Report, *supra* note 2, at 1.

[9] MEPS is a set of large-scale surveys. MEPS is administered by the Agency for Healthcare Research and Quality in the Department of Health and Human Services. The 2014 Insurance Component survey had a response rate of about 70 percent for private establishments, and 39,002 respondents, including for-profit and nonprofit employers. Agency for Healthcare Research and Quality, Center for Financing, Access and Cost Trends. 2014 Medical Expenditure Panel Survey-Insurance Component, *available at* http://meps.ahrq.gov/mepsweb/data_stats/summ_tables/insr/national/series_1/2014/tia2.htm.

[10] GAO's 2012 Report, *supra* note 3, at 4.

[11] GAO's 2012 Report, *supra* note 3, at 4-5.

[12] *Id.* at 9-10.

[13] 26 U.S.C. § 45R(d)(1)(A). To calculate FTEs, the total hours of service must be determined for all individuals considered employees. The hours are limited to 2,080 per employee. The total number of hours of service is divided by 2,080 to determine the FTE number. *Id.* at § 45R(d)(1)(B).

members, and certain other employees.[14] As discussed in more detail later, only businesses with fewer than 10 employees are eligible to receive the full credit.[15]

b. Wage Cap

The PPACA provides that the employer must pay annual wages of less than $50,000 (indexed for inflation beginning in 2014) per FTE in the tax year to receive even a partial credit.[16] However, as discussed later, the credit itself begins to phase out when average annual wages exceed $25,000.[17]

c. Provision of Health Insurance

The employer must offer health insurance to its employees and pay at least 50 percent of the health insurance premium under a "qualifying arrangement."[18] This means that the employer must make a contribution on behalf of each employee in an amount equal to a uniform percentage (not less than 50 percent) of the premium cost for enrolled employees.[19]

d. SHOP Exchange

Beginning in 2014, the credit is generally available only to otherwise-qualified employers that purchase employee coverage through a Small Business Health Options Program (SHOP) exchange.[20] SHOP exchanges were established under the PPACA as marketplaces where private health insurance issuers sell health insurance plans to small employers.[21] PPACA required the establishment of SHOPs in each state by January 1, 2014.[22] As of January 2014, there were 19 state-based marketplaces.[23]

IV. Availability of the Credit

The credit is available for tax years beginning after December 31, 2009.[24] However, as of 2014, the credit is available for only two consecutive tax years, beginning with the first year a qualified employer obtains coverage through a SHOP exchange.[25] Consequently, employers may claim the credit for a maximum of up to 6 years. The Congressional Budget Office (CBO) and the

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[14] Seasonal employees are excluded unless they work for the employer more than 120 days in the tax year. Ministers are deemed self-employed. 26 U.S.C. § 45R(d)(5). Leased employees are included. *Id.* at § 45R(e)(1)(B).
[15] 26 U.S.C. § 45R(c)(1).
[16] 26 U.S.C. § 45R(d)(3).
[17] 26 U.S.C. § 45R(c)(2).
[18] The IRS developed relaxed criteria for meeting this requirement for tax year 2010. *See* IRS Notice 2010-44.
[19] GAO's 2012 Report, *supra* note 3, at 6.
[20] 26 U.S.C. § 45R(d)(4).
[21] Pub. L. No. 111-148, § 1311(b)(1)(B), 124 Stat. at 173.
[22] *Id.*
[23] https://www.cms.gov/CCIIO/Resources/Fact-Sheets-and-FAQs/state-marketplaces.html.
[24] 26 U.S.C. § 45R(g).
[25] 26 U.S.C. § 45R(e)(2).

Joint Committee on Taxation (JCT) jointly estimated that the credit would cost $2 billion in fiscal year 2010 and $40 billion from fiscal years 2010 to 2019.[26]

V. Description of the Credit

The base of the credit is premiums paid, subject to limitation. Through 2013, small businesses could claim up to 35 percent of their base, while tax-exempt entities could receive up to 25 percent.[27] These percentages rose to 50 percent and 35 percent, respectively, beginning in 2014.[28] These numbers are subject to a number of limitations:

a. Average Premium

The base of the credit is limited if the premiums paid by the employer are more than the average premiums determined by HHS for the small group market in the employer's state. The credit percentage is multiplied by the lesser of the actual premium paid or the allowable premium (state average).[29]

b. Type of Credit

The credit is available to small non-profit entities in the form of a reduction in payroll taxes owed by the employer. Therefore, the credit is limited by the amount owed in payroll taxes in a particular year.[30]

For-profit employers can claim the credit as a general business credit. The credit is not refundable, so it is limited by the employer's actual tax liability. However, any unused credit amount can generally be carried back one year and carried forward up to 20 years.[31]

c. Phaseout of the Credit

Only employers with 10 or fewer FTEs can claim the full credit percentage, and only if their wages average $25,000 or less annually. Employers with 11-25 FTEs and average wages over $25,000 and up to $50,000 are eligible for a partial credit that phases out to zero percent.[32] The phaseout operates similarly for both non-profit and for-profit entities.[33]

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[26] CONGRESSIONAL BUDGET OFFICE, ESTIMATE OF THE DIRECT SPENDING AND REVENUE EFFECTS OF AN AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R. 4872, THE RECONCILIATION ACT OF 2010, Mar. 2010, Table 4, at 2.
[27] 26 U.S.C. § 45R(g)(2)(A).
[28] 26 U.S.C. § 45R(b).
[29] 26 U.S.C. § 45R(b)(2).
[30] 26 U.S.C. § 45R(f)(B).
[31] ANNIE L. MACH, CONG. RESEARCH SERV., R41158, SUMMARY OF THE SMALL BUSINESS HEALTH INSURANCE TAX CREDIT UNDER ACA 2 (2014) [hereinafter CRS Report].
[32] The $25,000 and $50,000 figures were effective from 2010 through 2013. They are adjusted for inflation using the Consumer Price Index – Urban beginning in 2014, resulting in an increase to $25,400 and $50,800 for 2014. *Id*. and GAO's 2015 Report, *supra* note 5, at 12.
[33] GAO's 2012 Report, *supra* note 3, at 6.

Table 2. Small Business Tax Credit as a Percentage of Employer Contribution to Premiums, For-Profit Employers in 2014[34]

Firm size (number of full-time equivalent employees)	Average wage: $25,400 and less	$30,000	$35,000	$40,000	$45,000	$50,800
10 and fewer	50.0%	40.9%	31.1%	21.3%	11.4%	0.0%
11	46.7%	37.6%	27.8%	17.9%	8.1%	0.0%
12	43.3%	34.3%	24.4%	14.6%	4.8%	0.0%
13	40.0%	30.9%	21.1%	11.3%	1.4%	0.0%
14	36.7%	27.6%	17.8%	7.9%	0.0%	0.0%
15	33.3%	24.3%	14.4%	4.6%	0.0%	0.0%
16	30.0%	20.9%	11.1%	1.3%	0.0%	0.0%
17	26.7%	17.6%	7.8%	0.0%	0.0%	0.0%
18	23.3%	14.3%	4.4%	0.0%	0.0%	0.0%
19	20.0%	10.9%	1.1%	0.0%	0.0%	0.0%
20	16.7%	7.6%	0.0%	0.0%	0.0%	0.0%
21	13.3%	4.3%	0.0%	0.0%	0.0%	0.0%
22	10.0%	0.9%	0.0%	0.0%	0.0%	0.0%
23	6.7%	0.0%	0.0%	0.0%	0.0%	0.0%
24	3.3%	0.0%	0.0%	0.0%	0.0%	0.0%
25	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Source: CRS calculations based on ACA.

Notes: The maximum credit for for-profit employers is 50% in 2014.

d. Deduction Limitation

An employer who claims the credit can also deduct health insurance on its tax return, but the amount of the credit must be subtracted from the deduction.[35] In other words, if an employer spends $10,000 on deductible health insurance premiums and he receives a tax credit for $2,000, his allowable deduction is $8,000.

VI. Credit Utilization

GAO's analysis of IRS data found that only 170,300 employers claimed the credit in 2010. Of those, 142,200, or 83 percent, were unable to avail themselves of the full credit. The average credit amount claimed was about $2,700.[36] According to IRS data for subsequent years, 174,561 employers claimed the credit in 2011 and 186,905 in 2012.[37] However, this participation rate is a far cry from the estimated 1.4 to 4 million estimated eligible employers.

[34] CRS Report, *supra* note 31, at 5.
[35] *Id*. at 8.
[36] *Id* at 9-10.
[37] CRS Report, *supra* note 31, at 6.

The dollar value of the credits actually claimed reveals a similar pattern. Calendar year 2010 claims totaled only $468 million.[38] Again, this contrasts sharply with the joint CBO/JCT cost estimate of $2 billion for 2010.[39]

VII. Efficacy of the Credit

Looking at the MEPS data, the percentage of small employers of low-wage earners who offered health insurance actually fell from 17 percent in 2010 to 12.5 percent in 2014.[40] The number one small business problem for more than 25 years has been the "cost of health insurance,"[41] yet health insurance costs have continued to far outpace wages and inflation. The Administration had touted the small business health insurance tax credit as a way to decrease costs and provide an incentive for small employers to offer employee health insurance. The GAO's 2012 report concluded that the credit's design embodied fundamental problems that caused it to fail in its objective. Those problems and the GAO's related findings are discussed below:

a. Insufficient Incentive

First of all, GAO found that the maximum amount of the credit is targeted to very small employers, and the credit's size is not large enough to provide an incentive to offer or maintain health insurance.[42] Additionally, most employers that would be interested in taking advantage of the credit find themselves subject to various limitations and are unable to claim the full benefit, further eroding any incentive value.

b. Limited Duration

Second, the credit can be claimed for a maximum of 6 years, including only 2 consecutive years after 2013. GAO's analysis revealed that employers are reluctant to commit to the costs associated with offering health insurance when the tax credit designed to offset those costs is extremely temporary in nature.[43] As the credit disappears and costs continue to rise, the employer will be left with three unattractive options: 1) absorb the cost; 2) require a greater contribution from the employee; or 3) discontinue employer-provided health insurance coverage.

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[38] GAO's 2012 Report, *supra* note 3, at 10.
[39] CBO and JCT later revised their original cost estimates to $1 billion in 2012 and $21 billion from 2012 to 2021. CONGRESSIONAL BUDGET OFFICE, CBO AND JCT'S ESTIMATES OF THE EFFECTS OF THE AFFORDABLE CARE ACT ON THE NUMBER OF PEOPLE OBTAINING EMPLOYMENT-BASED HEALTH INSURANCE, Mar. 2012, Table 3.
[40] The 2010 Insurance Component Survey had a response rate of about 83 percent for private establishments, and 38,409 respondents, including for-profit and nonprofit employers. Agency for Healthcare Research and Quality, Center for Financing, Access and Cost Trends. 2010 Medical Expenditure Panel Survey-Insurance Component, *available at* http://meps.ahrq.gov/mepsweb/data_stats/summ_tables/insr/national/series_1/2010/tia2.htm.
[41] Holly Wade, *Small Business Problems and Priorities*, NFIB Research Foundation, Aug. 2012.
[42] GAO's 2012 Report, *supra* note 3, at 12.
[43] *Id*.

c. Complexity

Finally, GAO found that the sheer complexity of the credit also serves as a deterrent to small employers claiming it. The complexity arises from the eligibility requirements and how they are implemented. The form used to claim the credit is 25 lines long and is supported by 7 worksheets. The data that is required to complete these documents is time-consuming to collect and often not readily available. Small business owners generally do not want to spend the time or the money to gather the necessary information, [44] particularly when the preparation costs may actually reduce or completely net out the amount of the credit.

VIII. Conclusion

The small business health insurance tax credit was highly touted as a provision that would lower the cost to small businesses of providing health insurance to low-wage workers. As of GAO's 2012 report, it appeared that the reality was falling well short of the hype. Four years later, the Subcommittee will hear an update from the GAO, as well as the perspectives and experiences of the private sector. These stakeholders will assess whether the credit's design was effective and whether it was helpful to the businesses it was created to help.

[44] *Id*. at 12-13.