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Congress of the United States

U.S. House of Representatives

Committee on Small Business

2361 Rayburn House Office Building
Washington, DC 20515–6515

Memorandum

To: Members, Small Business Committee
From: Committee Staff
Date: March 4, 2013
Re: Hearing: "The Health Care Law: Implementation and Small Businesses"

On Wednesday, March 6, 2013 at 1:00 p.m. in Room 2360 of the Rayburn Building, Washington, DC, the Small Business Committee will hold a hearing for the purpose of receiving testimony from witnesses on the impact of the Patient Protection and Affordable Care Act[1] on small businesses.

I. Background

The Patient Protection and Affordable Care Act[2] was signed into law on March 23, 2010, and the reconciliation legislation containing amendments to the Act[3] was signed into law on March 30, 2010. Although many people agreed that our health care system needed reform, the debate that resulted in the comprehensive health care law was a contentious one, culminating in a decision by the United States Supreme Court that largely upheld the law.[4]

The law requires individuals to purchase and maintain at least minimum essential health insurance coverage or, with certain exceptions, pay a penalty for not doing so, and establishes health insurance exchanges where individuals will be able to purchase health insurance. Certain individuals may be eligible for subsidies to help defray the cost of insurance. The law mandates that employers with the equivalent of 50 full-time workers offer minimum essential coverage that is affordable or pay a penalty. The law has remained controversial, raising questions about the access, affordability, and delivery of health care.[5] These issues can be particularly important for small businesses, because they are often disproportionately affected by changes to laws and regulations and expend more resources to comply.[6]

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[1] The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (2011).
[2] Hereinafter "the health care law" or "the law."
[3] The Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (2011).
[4] Nat'l Fed. of Indep. Bus., et al. v. Sebelius, et al., 567 U.S. ___, slip op. (2012), *available at* http://www.supremecourt.gov/opinions/11pdf/11-393c3a2.pdf.
[5] KAISER FAMILY FOUNDATION, HEALTH TRACKING POLL, February, 2011, *available at* http://www.kff.org/kaiserpolls/8156.cfm.
[6] NICOLE V. CRAIN AND W. MARK CRAIN, THE IMPACT OF REGULATORY COSTS ON SMALL FIRMS, OFFICE OF ADVOCACY, U.S. SMALL BUSINESS ADMINISTRATION iv (September 2010), *available at* http://www.sba.gov/advocacy/853/2016.

This hearing will provide an opportunity for Members to hear from small businesses and others about the implementation of the law and how it is affecting small businesses, our nation's best job creators.[7]

II. Health Insurance and Small Businesses

During the 111th and 112th Congresses, the Committee held several hearings on topics related to health care and small businesses. Many witnesses agreed that the health care system needed reform, because the cost of health care continues to escalate and entrepreneurs found health insurance difficult to obtain in the individual or small group markets. Some small company owners said that although they had traditionally offered health care to their employees, and wanted to continue to do so, the concentration of health insurers gave them few options for purchasing coverage, and those options were extremely expensive.

After the health care law passed in 2010, small business owners became concerned about steps they might have to take to comply with the new law. A July 2010 Fidelity Investments survey[8] found that 22% of small employers were seriously considering eliminating health care coverage, compared with 14% of larger employers.[9]

III. Keeping Existing Coverage

Richard S. Foster, the Chief Medicare Actuary for the Centers for Medicare and Medicaid Services, projected that following the passage of the health care law, "some smaller employers would be inclined to terminate their existing coverage and companies with low average salaries might find it to their -- and their employees' – advantage to end their plans, thereby allowing their workers to qualify for heavily subsidized coverage through the Exchanges."[10]

The health care law contains provisions[11] that allow health insurance plans that were in effect on March 23, 2010[12] to be "grandfathered," or exempt from certain requirements of the law. But under the law, even grandfathered plans must meet certain requirements that may make the plans more expensive.[13] The Interim Final Rule published on June 17, 2010[14] by the Departments of Health and Human Services, Department of the Treasury and Department of Labor outlined several changes to health insurance that could cause the loss of grandfathered status.[15]

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[7] From mid-2009 to 2011, U.S. small businesses created 67% of net new jobs, according to the Small Business Administration Office of Advocacy. http://www.sba.gov/sites/default/files/FINAL%20FAQ%202012%20Sept%202012%20web.pdf.

[8] FIDELITY INVESTMENTS SURVEY, July 2010, *available at* http://www.fidelity.com/inside-fidelity/employer-services/fidelity-survey-finds-majority-of-employers-rethinking-health-care-strategy-post-health-care-reform.

[9] *Id.*

[10] Memorandum from Richard S. Foster, Chief Actuary, Centers for Medicare and Medicaid Services (April 22, 2010), *available at* https://www.cms.gov/ActuarialStudies/Downloads/PPACA_2010-04-22.pdf, on the estimated financial effects of the Patient Protection and Affordable Care Act.

[11] 124 U.S.C. § 1251 (2011).

[12] The date that the Patient Protection and Affordable Care Act was signed into law.

[13] These include: 1) a prohibition on annual or lifetime limits; 2) insurance company Medical Loss Ratio reporting (must spend 80 percent of their premium income on medical claims for the individual and small group markets, and 85 percent in the large group market); 3) uniform explanation of coverage documents; 4) prohibition on rescissions; 5) dependent coverage for children under 26 years of age; 6) prohibition on excessive waiting periods; and 7) coverage for preexisting conditions.

[14] 75 Fed. Reg. at 34,541 (June 17, 2010), *available at* http://www.gpo.gov/fdsys/pkg/FR-2010-06-17/pdf/2010-14488.pdf.

[15] The changes include: 1) a plan that did not have continuous enrollment (does not need to be the same enrollee); and 2) termination of an existing collective bargaining agreement under which the grandfathered health insurance was provided. Finally, the rule includes transitional rules that allow flexibility in changes made to the terms of health insurance that do not cause the loss of grandfathered status. The Interim Final Rule was effective on June 14, 2010.

In its June 17, 2010 Interim Final Rule, the Departments of Health and Human Services, Treasury and Labor estimated that by 2013, about 50 percent of employer-sponsored plans will no longer qualify as grandfathered. For larger employer (with 100 or more employees) plans, about 45 percent would lose grandfathered status by 2013. For smaller employer (3-99 employees) plans, about 66% would no longer qualify.[16] An amendment to the Interim Final Rule allowed plans to switch insurance carriers and remain grandfathered, so the Departments predicted a small increase in the number of plans that will retain grandfathered status.[17]

The law does not address the point at which changes to a health insurance coverage in which an individual was enrolled on March 23, 2010 are significant enough to cause the plan or coverage to cease to be grandfathered. The Departments said in the June 17, 2010 Interim Final Rule that it was an attempt to "ease the transition of the healthcare industry into the reforms established by the Affordable Care Act by allowing for gradual implementation of reforms through a reasonable grandfathering rule."[18] Some small firms have expressed concern that they may not be able to offer their current health insurance.[19]

IV. The Employer Mandate

Beginning in 2014, the health care law requires any employer with more than 50 full-time equivalent employees[20] during the preceding calendar year to provide health insurance to their employees. If the employer fails to do so, and at least one full-time employee receives a premium subsidy to purchase health insurance through the new health insurance exchanges, a penalty of $2,000 per employee will be assessed (after the first 30). Employers with more than 50 employees who offer coverage but have at least one full-time employee receiving a premium tax credit will pay the lesser of $3,000 for each employee receiving a premium credit or $2,000 per full-time employee (after the first 30), whichever is less. In addition, the employer must offer a minimum set of benefits, defined as "minimum essential coverage,"[21] or a penalty may be assessed. If any full-time employee receives a premium credit toward purchasing coverage through a health insurance exchange, the employer will be subject to a penalty.[22] Determining who is a full-time employee is not simple. The proposed rule provides various methods to help employers calculate the number of full-time workers in their business.[23]

Also beginning in 2014, employers will have additional reporting requirements related to health insurance. Under the law, large employers and employers who offer minimum essential coverage will be required to file a return with the Internal Revenue Service (IRS).[24] The IRS form must include the name, address, and tax identification number of the insured employee and others covered under the policy; whether the coverage is provided through a health exchange,

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[16] 75 Fed. Reg. 70,114.
[17] *Id.*
[18] 75 Fed. Reg. at 70,115.
[19] Avery Johnson, *Firms Find Changing Insurance is Trickier*, WALL ST. J., June 23, 2010, *available at* http://online.wsj.com/article/SB10001424052748703513604575311013340405940.html.
[20] In determining whether a company is a large employer, both full-time and part-time employees are included in the calculation. Full-time employees are those working 30 or more hours per week. The hours worked by part-time workers are included on a monthly basis by determining their number of hours worked and dividing by 120. Seasonal workers are excluded if they work less than 120 days per year.
[21] 26 U.S.C. § 5000A (2010).
[22] According to the Congressional Research Service, in 2014, the monthly penalty assessed will be equal to the number of full-time employees minus 30 multiplied by one-twelfth of $2,000 for any applicable month. After 2014, the penalty would be indexed by a premium percentage adjustment for that calendar year.
[23] 78 Fed. Reg. 218.
[24] I.R.C. § 6051 (a)(14).

and if so, the cost-sharing or tax credit provided; the length of coverage provided; and if the coverage is provided by the employer's group plan, the premium or portion of premium provided by the employer.

Beginning with taxable years after 2010, employers will be required to provide on an employee's W-2[25] the cost of employer-sponsored health insurance coverage, and indicate the share paid by the employer and by the employee. This amount will not be included in the employee's taxable income. The Internal Revenue Service issued its proposed rule on January 2, 2013, and the deadline for comments is March 18, 2013. Some small business trade association executives have said small companies may alter their workforce or forgo expansion to stay under the full-time employee threshold.[26]

V. Health Exchanges

The health care law requires states to establish exchanges, participate in regional exchanges with other states, or to utilize an exchange established by the U.S. Department of Health and Human Services (HHS).[27] Supporters of the health care law believe that making insurance products available for purchase on the exchanges will result in a competitive marketplace where the small group market will have increased negotiating power, so that affordable coverage would be available to small business owners and their employees.[28] In addition to the broader exchanges, separate Small Business Health Option Program (SHOPs) exchanges will be established where small businesses with up to 100 employees can obtain coverage for their employees.[29]

The health insurance exchanges must be ready for open enrollment by participants by October 2013, and are required to be operational by January 1, 2014. Because so few states have decided to operate exchanges, the federal government is facing the possibility that it may be responsible for establishing exchanges in a very high number of states. As of January 15, 2013, a total of 12 states and the District of Columbia had notified HHS that they wish to run their own exchanges.[30] A total of 17 states have declared they will not establish their own exchange,[31] and six states have indicated they will opt for partnership exchanges.[32]

VI. Health Insurance Tax Credit for Small Employers

The health care law offers a limited, temporary health care tax credit for certain small business owners who purchase health insurance. In 2010, the law provided a 35% tax credit for an employer's health insurance costs if they met the criteria outlined below. The tax credit is effective from 2010 through 2013. Beginning in 2014, the law provides a 50% credit for an employer's health insurance costs. The credit is available for two additional years, and only if the employer purchases health insurance through one of the exchanges.

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[25] 42 U.S.C. § 9002 (2011).
[26] Dan Danner, Op-ed, *Opposing View: Businesses Face Wrenching Choice*, USA TODAY, December 9, 2012, *available at* http://www.usatoday.com/story/opinion/2012/12/09/employer-mandate-dan-danner/1757269/.
[27] §§ 1311(b) and 1321(c).
[28] THE AFFORDABLE CARE ACT INCREASES CHOICE AND SAVING MONEY FOR SMALL BUSINESSES 2, THE WHITE HOUSE, *available at* http://www.whitehouse.gov/files/documents/health_reform_for_small_businesses.pdf.
[29] 42 U.S.C. § 18031 (2011).
[30] The states that have declared they will run their own exchanges are: NY, VT, CT, MA, MD, DC, KY, MS, CO, UT, NM, ID, NV, CA, OR and WA.
[31] States that have declared they will not establish a state exchange include ME, NH, NJ, PA, VA, OH, IN, SC, GA, FL, AL, TN, LA, TX, OK, MO, KS, NE, SD, WI, SD, ND, WY, MT and AZ.
[32] States opting for partnership exchanges are: WV, NC, MI, IL, IA and AR.

Some small business owners and small business groups believe the tax cut may be too narrowly tailored to help more than a few entrepreneurs.[33] To be eligible for the full credit, a small business owner must: 1) have fewer than 10 full time equivalent employees, but at least one employee; 2) pay those employees an average annual wage of $25,000 or less; and 3) offer health insurance to them and pay at least 50% of the premium.[34] To be eligible for a partial tax credit, the small business owner must: 1) have 11 to 25 full time employees; 2) pay an average wage of $25,000 to $50,000; and 3) offer health insurance to those employees and pay at least 50% of the premium.[35] The self-employed, although they represent 78% of all small businesses in the U.S., are excluded from the credit.[36]

In May, 2012, a Government Accountability Office study[37] found the small employer tax credit to be complex and under-utilized. For example, although government agencies and small business organizations estimated 1.4 to 4 million small businesses would be eligible for the credit, only 170,300 actually claimed it. Just 28,100 claimed the full credit.[38] Small employers cited the credit's complexity as one reason they didn't claim it.[39]

VII. Economics of Implementation in the Long Term

It is uncertain how the health care law will affect small businesses in the long term. Many of the new law's provisions have not yet become effective. However, the law will impose new regulations, mandates, taxes and indirect costs on a number of small and medium-sized businesses.

In January, 2013, the U.S. Chamber of Commerce released its quarterly study of small businesses.[40] It found that 71% believe implementation of the health care law will make it harder for them to hire more employees.[41] More than half (53%) of small firms have not hired in the past year, and 64% don't expect to add employees in 2013.[42] In addition, 75% expect the law will increase costs for their businesses.[43] In a similar study of 600 small business owners with 100 employees or less by the Job Creator's Alliance, six out of ten business owners believe the health care law will negatively impact their business in 2013.[44] Those surveyed cited the health care law as the second most important issue facing them (taxes was first).[45]

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[33] NATIONAL FEDERATION OF INDEPENDENT BUSINESS, *Will the Small Business Healthcare Tax Credit Help Small Business Owners? available at* http://www.nfib.com/issues-elections/issues-elections-item?cmsid=52260.

[34] Pub. L. No. 111-138, 124 Stat. 238 (2010).

[35] INTERNAL REVENUE SERVICE, SMALL BUSINESS HEALTH CARE TAX CREDIT: FREQUENTLY ASKED QUESTIONS, December 3, 2010, *available at* http://www.irs.gov/newsroom/article/0,,id=220839,00.html.

[36] U.S. CHAMBER OF COMMERCE MAGAZINE, *Health Care Reform and Your Business,* May 1, 2010, *available at* http://www.uschambermagazine.com/article/health-care-reform-and-your-business.

[37] GAO, SMALL EMPLOYER HEALTH TAX CREDIT: FACTORS CONTRIBUTING TO LOW USE AND COMPLEXITY (2012) (GAO-12-549), *available at* http://www.gao.gov/products/GAO-12-549.

[38] *Id.*

[39] *Id.* at 12.

[40] U.S. CHAMBER OF COMMERCE, QUARTERLY SURVEY OF SMALL BUSINESS EXECUTIVES (January 14, 2013), *available at* http://www.uschambersmallbusinessnation.com/community/q4-2012-small-business-outlook-survey.

[41] *Id.* at 1.

[42] *Id.*

[43] *Id.*

[44] Job CREATOR'S ALLIANCE, SMALL BUSINESS OWNERS: WASHINGTON HOSTILE TO JOB CREATION, FREE ENTERPRISE (January 15, 2013), *available at* http://jobcreatorsalliance.org/blog/comments/small_business_owners_washington_policies_hostile_to_job_creation_free_ente.

[45] JOB CREATOR'S ALLIANCE, SMALL BUSINESS OWNERS: WASHINGTON HOSTILE TO JOB CREATION, FREE ENTERPRISE (January 15, 2013), *available at* http://jobcreatorsalliance.org/blog/comments/small_business_owners_washington_policies_hostile_to_job_creation_free_ente.

There are many facets of the law that may affect the ability of small firms to create jobs, invest and promote economic growth, including the employer and individual mandates, the cost of insurance premiums, whether a business qualifies for the small business health care tax credit, the new Medicare surtax and tax increase on unearned income, and increased paperwork, regulatory and other compliance costs.

VIII. Conclusion

This hearing will provide Committee Members with the opportunity to hear about the effect of the health care law's implementation on small businesses.