

CENTER FOR RURAL AFFAIRS  
RURAL BRIEF

VOLUME 6 , ISSUE 1      MAY 2010

## HEALTH CARE REFORM, WHAT'S IN IT? SMALL BUSINESS

Small businesses dominate the rural economy. In fact, small businesses dominate the American economy in terms of the number of business firms. For that reason it is important to know, understand and accurately portray the effects of the “Patient and Affordable Care Act” (Public Law 111-148), the newly adopted health care reform law, on small businesses. This report will examine some important provisions of the new law and how they affect small businesses while dispelling some of the common myths about health care reform and small businesses.

It is important to understand what the new law means by “small business.” In many respects, “small employer” is a more accurate term. In fact, section 1421 (Credit for Employee Health Insurance Expenses of Small Businesses) uses that term. Self-employed sole proprietors who are not employers (non-employers in statistical parlance) and their immediate family members do not qualify for the small business tax credit benefits described below. They will qualify for the individual credits and premium assistance beginning in 2014 and the more immediate health insurance reforms.

### **MYTH NO. 1: SMALL BUSINESSES HAVE TO PROVIDE HEALTH INSURANCE TO THEIR EMPLOYEES OR FACE PENALTIES.**

Not true. There is a general employer mandate in The Patient and Affordable Care Act. But the law specifically exempts from this employer responsibility any business with 50 or fewer employees (Section 1513). The result is that nearly all businesses in the nation, including those in rural areas, are exempt from any requirements or mandates to provide health insurance to employees and are free from any penalties for not doing so. According to the U.S. Census Bureau’s County Business Patterns, 95 percent of all business establishments in the nation have fewer than 50 employees.<sup>1</sup> The House of Representatives Small Business Committee further estimates that when considering this exemption and the number of businesses that already provide health insurance to employees the employer mandate will apply to less than two percent of businesses.

### **MYTH NO. 2: SMALL BUSINESS CANNOT AFFORD THE HEALTH INSURANCE THEY ARE REQUIRED TO PROVIDE.**

In many respects the health insurance reform law is all gain and no pain for small businesses, particularly initially. As discussed above, the law exempts all businesses with 50 or fewer employees from providing health insurance for their employees and frees them from any penalty for not doing so. Section 1421 of the law establishes a Small Business Tax Credit for those businesses who do provide health insurance for their employees in order to make health insurance more affordable and to provide an incentive for employer-provided insurance in small businesses. The initial credit exists for tax years 2010 through 2013. It is a sliding scale credit for businesses with fewer than 25 full-time equivalent employees and average wages of less than \$50,000 who provide health insurance for their employees. A second credit exists for any two years beginning in 2014 when the health insurance Exchanges begin. The following outlines the basics of both tax credits. It is estimated that over 3.6 million small businesses across the nation will be potentially eligible for the premium tax credits.<sup>3</sup>

<b>Eligibility</b>	<b>2010-2013 Credit Amount</b>	<b>2014 and Beyond</b>
<ul style="list-style-type: none"><li>• Fewer than 25 full-time equivalent employees</li><li>• Average annual wages less than \$50,000</li><li>• Purchase health insurance for employees</li><li>• Must contribute at least 50% of the cost of premium</li></ul>	<ul style="list-style-type: none"><li>• Equal up to 35% of premium contributions</li><li>• Full credit to businesses with 10 or fewer full-time equivalent employees and average annual wage of less than \$25,000</li><li>• Credit lower as number of employees and average wages increase</li><li>• Tax exempt small businesses meeting requirement eligible for credit up to 25% of premium contribution</li></ul>	<ul style="list-style-type: none"><li>• Same eligibility</li><li>• Purchase insurance through state exchange</li><li>• Credit equal up to 50% of premium contribution</li><li>• Tax exempt small businesses eligible for credit up to 35% of premium contribution</li><li>• Credit lasts for any two years</li></ul>

Examples of how the credit works for hypothetical small businesses are below.<sup>2</sup>

	<b>Main Street Mechanic</b>	<b>Downtown Diner</b>	<b>First Street Family Services.org (nonprofit child care)</b>
<b>Employees</b>	10 full-time employees	40 part-time employees or 20 FTEs	9 full-time employees
<b>Wages</b>	\$250,000 or \$25,000 per employee	\$500,000 or \$25,000 per FTE	\$198,000 or \$22,000 per employee
<b>Employee Health Care Costs</b>	\$70,000	\$240,000	\$72,000
<b>2010 Credit</b>	\$24,500 (35% credit)	\$28,000 (35% credit with phase out due to number of employees)	\$18,000 (25% credit)
<b>2014 Credit</b>	\$35,000 (50% credit)	\$40,000 (50% credit with phase out due to number of employees)	\$25,200 (35% credit)

Note: tax exempt entities that meet the eligibility requirements receive an amount called a “tax credit” even though they do not file federal income taxes like individuals and businesses do.

The Small Business Tax Credit provides both immediate and longer term health insurance premium assistance for small businesses, especially the smallest businesses that dominate rural economies. The immediate tax credit beginning in 2010, and lasting through four tax years, acts as a bridge to the Health Insurance Exchange system that begins in 2014. The exchange system acts as large insurance pool for the nation’s small businesses (more on that below), enabling more affordable insurance as a result of the combination of lowered administrative costs and spreading insurance risk over more people. The longer term two year credits also allows the exchange system to be fully operational and for the pooling and risk spreading aspects of them to take effect. The Congressional Budget Office estimates that with the law’s small business tax credits, the average premiums per person in the small group market will decline by 8 to 11 percent in 2016 relative to the current law.<sup>4</sup>

### **MYTH NO. 3: SMALL BUSINESSES SHOULD BE ABLE TO POOL TOGETHER TO PURCHASE INSURANCE, AND THE NEW LAW DOES NOT ALLOW THAT.**

Not true. In fact, the Health Insurance Exchange concept is based on the pooling idea. The health reform law mandates the creation of exchanges in every state by 2014, and allows businesses of up to 100 employees to participate. (Sections 1304 and 1311) The result is the creation of a health insurance pool of small businesses, their employees and the self-employed. When fully implemented the exchange will allow for more attractive insurance as a result of lower administrative costs (costs will be spread across the larger pool) and the spreading of risk across the larger pool. A larger pool will also allow annual premium volatility to moderate and enhance competition (more potential customers in the larger pool).

The law also allows states to create the Small Business Health Options Program (SHOP), a special exchange for small businesses, either within the larger state exchange or as a separate exchange. The SHOP Exchange is designed to assist small business employers in enrolling their employees in small group health plans.

The law also enables other insurance alternatives within the exchanges that could result in small business pools or groups. The law enables establishment of state-based nonprofit health insurance cooperatives and funds such efforts with loans. Small businesses or small business organizations could presumably establish a health insurance co-op that would allow small businesses across a state to band together to purchase health insurance.

The law also allows exchanges to serve more than one state. (Section 1311) Regional, interstate or multistate exchanges may exist if the states involved permit and they are approved by the federal government. These exchanges also would be a reasonable response to criticism made by some that the law does not allow for purchase of health insurance across state lines. While the authority still granted to states may make interstate sales of insurance of dubious benefit and potentially bad policy, regional and interstate exchanges could be developed in ways that provide another insurance option to benefit small businesses.

**MYTH NO. 4: THE HEALTH REFORM BILL WILL CAUSE MY TAXES TO GO UP.**

It is true the health reform law imposes some new taxes and increases others. But the real question is who is responsible for those taxes. While each individual and business has unique circumstances that will determine tax liability, it is clear that most rural small businesses will not be affected by the tax changes contained in the Patient and Affordable Care Act. Some of those changes are:

- A new 10 percent excise tax on indoor tanning services (for services provided after June 30, 2010). This excise tax will obviously be paid only by those businesses providing indoor tanning services.
- A 0.9 percent Medicare surcharge on the wages of single taxpayers earning more than \$200,000 per year and couples earning more than \$250,000 per year (starting in 2013). In addition, these taxpayers would incur a special Medicare tax of 3.8 percent on unearned income (interest, dividends, capital gains, annuities, royalties and rents; tax exempt interest and income from retirement accounts would not be considered “unearned income”). While some rural small business taxpayers may earn enough income to activate these taxes, that case will be extremely rare. The non-partisan Tax Policy Center finds that less than two percent of taxpayers with small business income are in the federal income tax brackets that include the \$200,000/\$250,000 income levels.<sup>5</sup>
- An excise tax beginning in 2018 on insurance companies providing “high-cost” employer-sponsored health plans, defined as those with values exceeding \$10,200 for individual coverage and \$27,500 for family coverage. The tax is equal to 40 percent of the value of the plan exceeding the threshold amount. This tax will likely not apply to many health plans offered by rural small businesses as the 2008 average value of health plans offered nationally by businesses with 10 or fewer employees ranged from \$4,536 (individual) to \$11,952 (family) and for businesses with 11 to 25 employees ranged from \$3,984 (individual) to \$10,51 (family).<sup>6</sup>
- Fees assessed on businesses that do not provide health insurance to employees will only be charged to businesses with 50 or more employees. As explained above, that's a small fraction of businesses nationwide and even fewer in rural areas.

**CONCLUSION**

The rural economy is unique in its composition, with small businesses the dominant economic driver of economies in most rural places. Rural areas not only have higher rates of uninsurance and underinsurance, but significantly lower rates of employer-provided health insurance. And these trends are growing, as rural areas have lost jobs with higher rates of employer-sponsored health insurance while gaining jobs with much lower rates of employer-sponsored coverage since the 1990s. With increasing insurance costs many rural small employers are finding it difficult to continue providing health insurance coverage for employees, exacerbating the issues of uninsurance, underinsurance, and health care costs for many rural people. Taken together, these issues act as barriers to creating a strong rural economy based on entrepreneurial development. The Patient and Affordable Care Act will begin to lower these barriers for many rural small businesses. While exempt from mandates requiring insurance coverage for employees, the tax credits provided by the law will make health insurance more affordable for businesses and provide an incentive to help insure employees. Over time as the primary features of the law are implemented and take effect, particularly the Health Insurance Exchanges, rural small employers will reap the benefits of pooling and larger group coverage that provides comprehensive, affordable, and continuous health care coverage for their business and their employees

**REFERENCES**

- <sup>1</sup> U.S. Census Bureau. 2008. *2007 County Business Patterns*.
- <sup>2</sup> Internal Revenue Service. 2010. “Small Business Health Care Tax Credit Scenarios.” Scenarios and figures courtesy of Internal Revenue Service: [http://www.irs.gov/pub/irs-utl/small\\_business\\_health\\_care\\_tax\\_credit\\_scenarios.pdf](http://www.irs.gov/pub/irs-utl/small_business_health_care_tax_credit_scenarios.pdf)
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- <sup>5</sup> Tax Policy Center. 2007. “Distribution of Tax Units with Small Business Income.”
- <sup>6</sup> America’s Health Insurance Plans (AHIP), Center for Policy and Research. 2009. *Small Group Health Insurance in 2008: A Comprehensive Survey of Premiums, Product Choices, and Benefits*.

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The *Rural Brief* is made possible by the support of the Otto Bremer Foundation.

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