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The Pelosi Health Care Plan: Employer Mandate Penalties on Small Businesses

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Recently unveiled health care reform legislation known as the "Pelosi plan" would impose new costs on small businesses. This legislation would create an employer penalty system that would apply to small firms—even those with 25 or fewer workers. Businesses expanding total annual payroll to $500,000 would face a $10,000 marginal penalty; this penalty rises to $19,200 for small firms expanding total wages to $750,000. This additional cost would create a strong disincentive for small firms to increase compensation or hire additional employees.

Increasing Costs on Small Businesses. The Pelosi plan, H.R. 3962, outlines a detailed employer mandate that would affect small firms with 25 or fewer employees (see Table 1). This legislation includes an assessment penalty on businesses with total annual payroll of $500,000 or more that decide not to provide health insurance coverage to their workers.[1] This penalty would effectively impose a new tax on many small businesses.

The plan imposes new costs on businesses, regardless of whether they decide to offer health insurance coverage or pay the assessment penalty.[2] It explicitly states that these additional payments for health insurance cannot be directly taken out of an employee's wages, and any employer-based coverage must meet the Pelosi plan's minimum coverage requirements.[3]

Small firms with $500,000 of total annual payroll would have to absorb a $10,000 marginal penalty, which increases to $19,200 on small firms with total annual payroll of $750,000 (see Table 1). If, for example, a firm with $499,999 in total payroll moves to $500,000 in total payroll, it would suddenly incur a $10,000 marginal penalty. The marginal impact on a firm expanding total payroll from $749,999 to $750,000 would be $19,200. This marginal impact holds at each specified threshold under the Pelosi employer penalty structure.

How Many Small Businesses Would Be Impacted? The Pelosi plan's employer mandate system is a substantial change from S. 1796, the "Baucus plan," in which firms with 25 or fewer workers would not only be exempt from any type of tax penalty for not offering health insurance coverage but would also qualify for the specified small firm tax credit. The Pelosi plan eliminates the exemption for firms with 25–49 workers created in the Baucus plan, and a significant number of these firms would face an 8 percent payroll tax.

Moreover, the Pelosi plan imposes a new cost on a majority of small firms with 25–49 workers. A significant number of small businesses could now face the full 8 percent penalty if they elect not to provide health care coverage. According to estimates by Mark Wilson of Applied Economic Strategies, there are approximately 330,839 businesses with fewer

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Pelosi Plan Penalizes Small Businesses

Under the Pelosi plan, small businesses with an annual payroll of $500,000 or higher would face assessment penalties if they do not provide health insurance for their workers. These penalties, which amount to a tax, would cost firms between $10,000 and $100,000 annually.

Annual Payroll	Number of Firms	Average Number of Workers per Firm	Total Payroll for All Firms	Total Penalty for All Firms	Penalty per Firm	Marginal Penalty per Firm
$500,000–$584,000	109,302	17.3	$54,313,707,462	$1,086,274,149	$10,858	$10,858
$585,000–$669,000	86,295	19.5	$48,381,984,805	$1,935,279,392	$24,977	$14,119
$670,000–$749,000	66,954	21.5	$41,412,471,734	$2,484,748,304	$42,237	$17,261
$750,000–$799,000	35,863	23.3	$24,104,461,000	$1,928,356,880	$61,925	$19,688
$800,000–$849,000	32,425	24.5	$22,777,915,000	$1,822,233,200	$65,927	$4,002
$850,000–$899,000	28,960	25.6	$21,559,646,000	$1,724,771,680	$69,922	$3,995
$900,000–$999,000	51,487	27.7	$40,680,838,000	$3,254,467,040	$75,826	$5,904
$1,000,000–$1,499,000	173,522	34.1	$163,959,880,000	$13,116,790,400	$97,465	$21,638

Source: Heritage Foundation calculations based on data from U.S. Census Bureau, 2006 Country Business Patterns, and unpublished data under agreement with Mark Wilson of Applied Economic Strategies.

Table 1 • WM 2683 heritage.org

than 25 workers per firm that would face employer mandate penalties if they elect not to offer coverage—and 32,425 could face the full 8 percent penalty.[4] Moreover, these estimates suggest that the total employer mandate penalties for these firms could reach approximately $9,256,891,925.[5]

Businesses Would React to Costs. This 2–8 percent mandate cost would affect small businesses' bottom-line, and subsequently, businesses facing new marginal penalties could determine that it is too costly to expand their labor force.[6] Companies would have a strong incentive to:

- Outmaneuver the government in reaction to these penalties; and
- Find a way to absorb these costs.

These changes do not have to exactly take the form of firing some of their labor force or changing

1. The Pelosi plan ensures that firms that do not offer coverage to their workers at the established level pay assessment penalties to a Health Insurance Exchange Trust Fund, which "shall not be applied against the premium of the employee under the Exchange-participating health benefits plan in which the employee is enrolled." The Affordable Health Care for America Act, H.R. 3962, October 29, 2009, pp. 276, 312–313, at *http://www.washingtonpost.com/wp-srv/politics/documents/house_bill_102909.pdf?sid=ST2009102902154* (November 5, 2009).
2. The proposal requires employers to ensure automatic enrollment—at a minimum—into the "employment-based health benefits plan for individual coverage under the plan option with the lowest applicable employee premium." This requirement is not entirely binding on an employee; upon sufficient notification (e.g., a 30-day notification period) an employee may decide to "opt-out." Affordable Health Care for America Act, pp. 271–272.
3. Employers would be legally responsible for paying "72.5 percent of the applicable premium of the lowest cost plan offered by the employer that is a qualified health benefits plan" if electing to pay for health insurance coverage. In the case of family coverage that includes coverage of a spouse and children, employers are responsible for paying "not less than 65 percent of such applicable premium of such lowest cost plan." *Ibid.*
4. U.S. Census Bureau, 2006 Country Business Patterns, unpublished data under agreement with Mark Wilson of Applied Economic Strategies.
5. The Heritage Foundation calculation assumes that all of these small businesses decide not to offer coverage and subsequently pay the employer penalty at the respective threshold. See *ibid*.
6. John L. Ligon, "The Baucus Plan: Implications for Small- and Medium-Sized Firms," Heritage Foundation *WebMemo* No. 2656, October 20, 2009, at *http://www.heritage.org/Research/Healthcare/wm2656.cfm.*

their labor force mix to weigh more heavily on part-time or contract workers. Firms would likely have a strong incentive to change both the level and distribution of compensation.

For example, companies would likely reconsider any bonus and raise that would move the firm above a specified total payroll threshold so that they will not have to incur a higher marginal assessment penalty. Where the marginal cost of expanding compensation is too high, many firms would determine that it is easier to contain wages.[7] Thus, firms with a high composition of low-income, low-skilled workers would likely reduce wages in order to offset the additional costs.[8]

Leave Small Businesses Alone. Health care reform cannot ignore how such legislation's employer coverage mandates would negatively impact small businesses. The Pelosi plan eliminates the exemption for businesses with 25–49 workers created in the Baucus plan, and it would also impose new marginal penalties on small firms with 25 or fewer workers. This creates a punitive cost for firms, which significantly raises the costs for businesses on the margin.

Establishing disincentives for small firms to grow would lead to a slower, less robust economy—and labor market. Altering these incentive structures is harmful to small businesses and the way they allocate labor. Federal health care reform legislation, therefore, should avoid creating steep new marginal costs relating to business growth—particularly in terms of wages and worker compensation.

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7. However, companies with a sizeable share of highly skilled—thus highly productive—labor force would easily justify expanding their wages and compensation.
8. Firms with a high composition of these workers are also likely to drop health insurance coverage altogether, as it would be more expensive to offer—and pay—for single and family coverage at minimum thresholds established in H.R. 3962. See Robert Book, "The House Health Care Bill: The Mandates," The Foundry, October 29, 2009, at *http://blog.heritage.org/2009/10/29/the-house-health-care-bill-the-mandates.*