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The House-Passed Health Care Plan Revisited: Employer Mandate Penalties on Small Firms

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As the President, the House Speaker, and the Senate Majority Leader continue closed-door negotiations on a final health care reform bill, they should reacquaint themselves with the crippling impact the employer mandate penalties would impose on small businesses.

The House-passed bill, for example, would create an 8 percent payroll tax—even on small businesses with 25 or fewer workers.¹ Businesses expanding total annual payroll to \$500,000 would face a \$10,000 penalty; this penalty rises to \$19,200 for small firms expanding total wages to \$750,000. Consequently, this additional cost would create a strong disincentive for small firms to increase compensation or hire additional employees.

Increasing Costs on Small Businesses. The House-passed health care plan (H.R. 3962) outlines a detailed employer mandate that would affect small firms with 25 or fewer employees. (See Table 1.) The bill 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.² This penalty would effectively impose a new tax on many small businesses.³

H.R. 3962 imposes new costs on businesses, regardless of whether they decide to offer health insurance coverage or pay the assessment penalty.⁴ It explicitly states that these additional payments for health insurance cannot be directly taken out of an employee's wages and that any employer-based coverage must satisfy the House-passed plan's coverage requirements.⁵

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 business expanded its total payroll from \$499,999 to \$500,000, it would incur an incremental (or marginal) penalty of \$10,000. This impact holds at each specified threshold, increasing to a \$19,200 incremental cost for a business expanding total payroll from \$749,999 to \$750,000. Thus, the employer mandate structure in the House-passed health care bill would create a strong disincentive for a business to expand compensation or even acquire new workers.

How Many Small Businesses Would Be Affected? The House-passed plan's employer mandate system is a substantial change from the Senate-passed plan (H.R. 3590), in which firms with 25 or fewer workers not only would 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. H.R. 3962 eliminates the exemption for firms with 25–49 workers created in H.R. 3590, and a significant number of these firms would face the 8 percent payroll tax.

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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 I • WM 2753  heritage.org

Moreover, H.R. 3962 imposes a new cost on a majority of small firms with 25–49 workers. A significant number of small businesses could 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 than 25 workers per firm that would face employer mandate penalties if they elect not to offer coverage—and 68,288 could face the full 8 percent penalty.⁶ These estimates also suggest that the total employer mandate penalties for these firms could reach approximately \$9,256,891,925.⁷

1. The penalty structure will begin with a 2 percent payroll tax on businesses with total payroll between \$500,000 and \$584,999, 4 percent on businesses with total payroll between \$585,000 and \$669,999, 6 percent on businesses with total payroll between \$670,000 and \$749,999, and 8 percent on businesses with total payroll of \$750,000 or more. See Affordable Health Care for America Act, H.R. 3962, October 20, 2009, pp. 276, at http://www.washingtonpost.com/wp-srv/politics/documents/house_bill_102909.pdf?sid=ST2009102902154 (November 5, 2009).
2. The Pelosi plan ensures that firms that do not offer coverage to their workers at the established level would 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.” *Ibid.*, pp. 276, 312–313.
3. Small-business owners making more than \$500,000 per year and who file as individuals will also be hit with a 5.4 percent surtax under the House-passed plan. For a detailed analysis of this plan and the number of individual filers making more than \$500,000 per year, see Rea S. Hederman, Jr., and Guinevere Nell, “Pelosi Health Care Plan: Who Pays the Surtax?,” Heritage Foundation *WebMemo* No. 2687, November 6, 2009, at <http://www.heritage.org/Research/HealthCare/wm2687.cfm>.
4. The proposal includes a provision that 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 the 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.
5. 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 such spouse and children, employers are responsible for paying “not less than 65 percent of such applicable premium of such lowest cost plan.” *Ibid.*

Businesses Would React to Costs. The 8 percent employer mandate penalty would affect small businesses' bottom line, and businesses facing new marginal penalties could subsequently determine that it is too costly to expand their labor force.⁸ As a consequence of H.R. 3962, 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 exactly have to take the form of firing some of the labor force or changing the 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 would 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.⁹ Thus, firms with a high composition of low-income, low-skilled workers would likely reduce wages in order to offset the additional costs.¹⁰

Leave Small Businesses Alone. Again, federal health care reform cannot ignore how such legislation's employer coverage mandates would negatively affect small businesses. The House-passed health care bill eliminates the exemption for businesses with 25–49 workers that is created in the Senate-passed bill, and it would also impose new marginal penalties on small firms with 25 or fewer workers. This would create a punitive cost that would significantly raise the costs for businesses on the margin.¹¹

Since firms of all sizes make decisions on the margin, establishing steep marginal costs for expanding would create strong disincentives for small firms to expand. Moreover, altering these incentive structures is harmful to small businesses and the way they allocate labor, which would ultimately lead to a slower, less robust economy—and labor market. Federal health care reform legislation, therefore, should avoid creating steep new incremental (marginal) costs relating to business growth—particularly in terms of wages and worker compensation.¹²

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6. U.S. Census Bureau, 2006 Country Business Patterns, unpublished data under agreement with Mark Wilson of Applied Economic Strategies.
 7. The Heritage Foundation calculation assumes the extreme scenario in which all of these small businesses decide not to offer coverage and subsequently pay the employer penalty at the respective threshold. See *ibid.*
 8. 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>.
 9. However, companies with a sizeable share of highly skilled—and thus highly productive—workers would easily justify expanding their wages and compensation.
 10. 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>.
 11. John L. Ligon, "The Pelosi Health Care Plan: Employer Mandate Penalties on Small Businesses," Heritage Foundation *WebMemo* No. 2683, November 5, 2009, at <http://www.heritage.org/Research/HealthCare/wm2683.cfm>.
 12. *Ibid.*