



May 26, 2009

Sen. Max Baucus
Chairman
Senate Finance Committee
219 Dirksen Senate Office Building
Washington, DC 20500

Sen. Charles Grassley
Ranking Minority Member
Senate Finance Committee
219 Dirksen Senate Office Building
Washington, DC 20500

Dear Chairman Baucus and Ranking Member Grassley:

On behalf of the National Small Business Association (NSBA), I am pleased to present our comments in response to your May 18, 2009, paper titled “Financing Comprehensive Health Care Reform: Proposed Health System Savings and Revenue Options.”

NSBA is pleased to have the opportunity to articulate the needs of the small business community in the health care reform debate. The orderly and transparent process undertaken by the committee to develop health care reform policy options is a sign of dedication, focus and proficiency that is necessary to achieve comprehensive health care reform this year. NSBA looks forward to continuing a dialogue with the Committee as deliberations progress.

NSBA is the nation’s oldest small-business advocacy group representing employers in every state. As an organization, we represent all sectors and industries of the U.S. economy from retail to trade to technology—our members are as diverse as the economy which they fuel. As is often acknowledged, the health care crisis is not exclusive to those who do not currently have health insurance. The percentage of small businesses offering health insurance to their employees has declined at an alarming rate in the few years from 67 percent in 1995 to 38 percent in 2008. Even the small businesses that do currently offer health insurance are faced with tough decisions on how to adjust to sky-rocketing health insurance costs, and they are running out of options. While 58 percent of small businesses who reported premium rate increases in a recent NSBA survey were unable to provide employees with salary increases, 39 percent held off on hiring a new employee and the percentage of those laying off employees is only expected to grow if the current economic recession does not turn around.

The policy options paper for financing comprehensive health care reform seeks to achieve health care coverage for all Americans while reducing the rate of growth in health care spending in a fiscally responsible approach, as well as ensuring a high level of quality care. NSBA’s health care proposal shares the same goal. In 2003, NSBA published *Small Business Health Care Reform—A Long-Term Solution for All*. This broad reform proposal of the health care system seeks to achieve universal coverage,

focus on individual responsibility and empowerment, the creation of the right market-based incentives, and a relentless focus on improving quality while driving out unnecessary, wasteful, and harmful care. The cornerstone of NSBA's proposal is to reduce health care costs so that small businesses, their employees and dependents have access to quality, affordable health insurance. Thus, NSBA is pleased the Committee is intent on addressing cost through deliberations in the delivery system reform policy options paper and within the health care financing policy options paper.

Similar to comments NSBA submitted to the previous policy papers, we have chosen to address the general principles that we apply to promoting health reform outlined in *Small Business Health Care Reform: A Long-Term Solution for All*, and speak to the specific provisions outlined in your paper in the order in which they appear. As is expressed in prior comments, small businesses need relief from rising health care cost without delay.

SECTION I: Health Systems Savings

While small businesses need immediate relief from soaring health care costs, NSBA supports a comprehensive approach to bend the health care cost curve. It follows our comments on delivery system reform that savings in the current system must be realized prior to exploring other means of revenues.

Peter Orszag, Director of the Office of Management and Budget (OMB), recently testified before the House Budget Committee that "health care costs could be reduced by a stunning 30 percent—or about \$700 billion a year—without harming quality if we moved as a nation toward the proven and successful practices adopted by lower-cost areas and hospitals." These savings alone could provide each uninsured U.S. citizen with approximately \$15,000 towards health insurance—more than what is needed with respect to currently yearly premiums.

NSBA is supportive of the non-partisan Medicare Payment Advisory Commission (MedPAC) and Congressional Budget Office (CBO) in providing recommendations to Congress that produces appropriate savings and public program solvency. Furthermore, NSBA supports frequent and periodic assessments and updates to reimbursement policies for providers, facilities and device manufacturers with the goal to accurately reflect the value of services or goods, and to eliminate or correct potential overpayments or underpayments in the current system.

SECTION II: Options to Modify the Exclusion for Employer-Provided Health Coverage

NSBA supports limits on the value of employer-provided health coverage that is excludible from gross income based on a minimum benefit package. There currently is an open-ended tax exclusion for employer-provided health coverage for both the employer and employee. This tax status has made health insurance preferable to other forms of compensation, leading many Americans to be "over-insured." This over-insurance leads to a lack of consumer behavior, increased utilization of the system, and significant

increases in the aggregate cost of health care. Insurance now frequently covers (on a tax-free basis) non-medically necessary services, which would otherwise be highly responsive to market forces.

The health insurance tax exclusion also creates equity concerns for small employers and their employees. Since larger firms experience less volatile rate increases, and have greater bargaining power than a small firm, their health insurance packages are typically richer than what a small business can afford. Therefore, a large firm can build very rich benefit packages which are tax exempt for the business and are considered a piece of the employees' compensation package. This gives large employers a significant competitive edge over small businesses with regards to both their tax treatment as well as their ability to recruit employees.

For these reasons, the individual tax exclusion for health insurance coverage should be limited to the value of the basic benefits package. But this exclusion (deduction) should also be extended to individuals purchasing insurance on their own. Moreover, the tax treatment of both health insurance premiums and actual health care expenses should be the same. These changes would bring equity to small employers and their employees, eliminate the federal subsidy for over-insurance, induce much greater consumer behavior, and reduce overall health care expenses.

NSBA supports a dollar amount indexed to the per capita growth in National Health Expenditures (as calculated by the center for Medicare and Medicaid Services), as long the initial exclusion level is set at a reasonable and accurate level.

NSBA Supports Equity for Our Nation's Self-Employed Act

In addition to the Committee's proposed options, NSBA believes Congress has a tremendous opportunity to address a great inequity under the tax code impacting the self-employed.

Currently, all workers at a large C corporation can exclude employer provided health insurance from their taxable income; however, small-business owners are excluded from those tax savings. The current tax code excludes self-employed individuals from deducting the cost of their health insurance for self-employment tax purposes. This inequity in the tax code means that the self-employed pay a 15.3 percent additional tax on their health insurance premiums that no one else has to pay.

As the law stands now, self-employed individuals still pay for their health insurance with money that has been subject to the self-employment tax. All employed individuals pay the FICA tax on their income, of which 6.2 percent is allotted for Social Security and 1.45 percent goes to Medicare. Employers are required to match employee contributions with a 7.65 percent contribution of their own.

Self-employed individuals are required to pay both sides of this tax resulting in a total 15.3 percent tax on income, commonly referred to as the "self-employment tax."

Contrary to rules for C Corporations, a provision of the Internal Revenue Code requires self-employed individuals to pay the additional 15.3 percent self-employment tax on the cost of their health insurance premiums. No other worker is required to pay FICA taxes on any portion of their employer-sponsored health benefits. With health insurance costs already sky-high, our members find it unbelievable that the federal government would slap an extra tax on those who have the hardest time securing coverage in the first place.

The issue of full deductibility for the self-employed goes far beyond the simple inequity of the matter, there is a very real economic impact as well. A report released by the SBA's Office of Advocacy titled, *Health Insurance Deductibility and Entrepreneurial Survival*, shows that, "the health insurance deduction for the self-employed has decreased the likelihood of entrepreneurial exit by 10.8 percent for single filers and 64.9 percent for married filers." While these numbers are staggering at first glance; if you think about the issue from a personal point of view, the impact of deductibility in entrepreneurial growth seems like common sense. When a family's principle earner makes the decision to leave the predictable and structured world of a large employer and strike out on their own, availability of health insurance is a major issue. It stands to reason that the positive results from income tax deductibility for health insurance discovered by the SBA Office of Advocacy report would grow if Congress allowed the self-employed full deductibility.

Fortunately, *Equity for Our Nation's Self-Employed Act (S. 725/H.R. 1470)* would address this inequity and allow our nation's roughly 21.3 million self-employed business owners to fully deduct the cost of their health insurance. NSBA wholeheartedly believes allowing self-employed business owners to fully deduct the cost of health insurance is an important part of the health care reform that will bring immediate relief and equity.

NSBA supports the SIMPLE Cafeteria Plan Act of 2009

Another option to address tax code inequities to provide small businesses with more choices for quality, affordable health insurance is the *SIMPLE Cafeteria Plan Act of 2009 (S. 988)*, legislation to update the tax code to allow small business employees to purchase employer-provided health insurance with pre-tax dollars.

The SIMPLE Cafeteria Plan Act of 2009 would create a Simple Cafeteria Plan for small businesses that would be modeled after the Savings Incentive Match Plan for Employees (SIMPLE) pension plan enacted in 1996. Under current law, employers must demonstrate that a certain percentage of their employees actually participate in the plan in order to qualify for tax-free treatment. However, because most small businesses cannot satisfy these rules simply because of their size, they are prevented from creating regular cafeteria plans, and their employees are oftentimes unable to purchase health insurance and other employee benefits from the employer. The bipartisan measure will update the tax code to allow more entrepreneurs to offer their employees quality, affordable health care coverage. In addition, the bill would strengthen current law for all cafeteria plans by expanding dependent flexible spending accounts (DCFSA) and including coverage for long-term care benefits.

SECTION III: Other Health Care Related Revenue Raisers

Modify or Repeal the Itemized Deduction for Medical Expenses

NSBA believes that there should not be a tax preference for individuals to directly purchase health insurance versus health care services. In other words, if an individual purchases qualified health care services and incurs expenses below the 7.5 percent AGI threshold, they should be able to deduct those expenses to the degree that insurance premiums are deductible or exclusive.

Modify or Repeal the Exclusion for Employer-Provided Reimbursement of Medical Expenses Under Flexible Spending Arrangements and Health Reimbursement Arrangements

NSBA supports flexible spending account and health reimbursement account tax exclusion limits that are in line with tax exclusion limits related to a minimum benefit package in traditional health plans.

NSBA Supports Reforms to Medical Liability

While medical malpractice reform has its challenges, NSBA supports common-sense reforms that provide system savings that can be passed along consumers.

There is an enormous array of financial pressures and incentives that act upon the health-care provider community. Too often, the incentive for keeping patients healthy is not one of them. Our medical malpractice system is at least partly to blame. While some believe these laws improve health care quality by severely punishing those who make mistakes that harm patients, the reality is that they simply lead to those mistakes—and much more—being hidden.

In addition to instituting reasonable limits on medical liability awards, NSBA supports the creation of “health courts.” Health courts would serve as administrative courts to handle medical injury disputes. Judges would be health-care trained professionals assisted by independent experts to settle malpractice disputes between patients and health care providers.

Plaintiffs would receive full economic damages, as well as non-economic damages based on a compensation schedule. This new process for medical liability would also provide the injured party with an avenue to appeal with further review in the traditional court system. In addition to easing the medical liability burden, health courts would establish a mechanism that clear and consistent standards be developed based on cases and the opinions of the judges.

SECTION V: Administration's Revenue Raising Proposals

Earlier this month, the President outlined a number of possible revenue raising provisions as part of the administration's FY2010 budget proposals. As Congress and the administration grapples with a down-turned economy, banking failures and a skyrocketing deficit, it is only natural to look for ways to off-set spending and raise revenues.

Of the different proposals outlined, several of them would impose new regulatory, reporting and withholding burdens on small business—all in an effort to close the so-called tax gap and try to catch other businesses that might not be reporting all of their income. Given the extraordinary burden that compliance with the tax code already imposes on small businesses, it strikes our members as unfair at best to ask honest small businesses to do even more in order to catch a few potential cheats.

Internal Revenue Service (IRS) data from the National Research Program (NRP) develops its tax gap estimates by measuring the rate of taxpayer compliance—the degree to which taxpayers fully and timely comply with their tax obligations. That rate is then used, along with numerous other assumptions, to estimate the dollar amount of taxes not timely or accurately paid. However, little attention is paid to the fact that the sheer complexity of the tax code is likely a huge factor in compliance rates. For tax year 2001, the IRS estimates nearly 17 percent of owed taxes were late or not paid at all, which translates into an estimated gross tax gap of \$345 billion. The IRS recovered about \$55 billion of this sum, leaving a net tax gap of \$290 billion.

The most burdensome proposals would expand information reporting on payments to corporations, and require a certified taxpayer identification number from contractors. NSBA has thoroughly reviewed these recommendations and found they would not effectively increase compliance and minimize the tax gap. Instead, they add additional and unnecessary burdens on already over-burdened small-business owners.

Information Reporting Requirements on Payments to Corporations

Under current law, service recipients are only required to send 1099 forms to non-corporation service providers. For each non-corporation service provider, the service recipient is required to issue two 1099 forms—one to the IRS and one to the service provider. The FY2010 budget proposal recommends an expansion to the Form 1099 filing system by requiring a business to file an information return on payments to corporations aggregating to \$600 or more in a calendar year. The Department of Treasury argues that the exemption of corporations under the current system has created compliance issues and this new proposal will level the playing field. However, if this legislation goes into effect and corporations are no longer exempt from information reporting, the small business will have to issue two more 1099 forms for every service other provider that is classified as a corporation.

In practicality, this means that every time a small-business owner ships a package with Federal Express or uses some other service, and the expenses total more than \$600 by

year-end, the small-business owner would need to keep the receipts, prepare a Form 1099 and file them not only with the IRS, but with Federal Express and any other companies exceeding the \$600 threshold. If enacted, every small-business owner will face increased paperwork and administrative burden for each additional 1099 Form prepared. Increased costs are incurred for mailing additional forms and for hiring outside assistance to ensure that businesses are correctly complying with the law. Furthermore, if a business previously has not been required to utilize the Form 1099 filing system, greater difficulty with compliance is likely to ensue. While the proposal seeks to capture non-compliant corporations, it clearly places the burden on the wrong taxpayer—the compliant small-business.

NSBA is concerned with what the IRS will do with this amount of data. We believe that the IRS lacks the capacity to utilize these new reports as well as the necessary staff to handle the massive volume of paperwork resulting from this proposal. There is no data available to justify this additional burden. It is unclear whether business-to-business versus business-to-consumer transactions are the problem, or if underreporting is more prominent in payments over or under \$600. Furthermore, there is no breakdown of the underreporting of income by cash or credit card transactions, and no clear indication of whether some industries are more non-compliant than others.

Requiring a Business to Obtain a Certified Taxpayer Identification Number from Contractors

Another proposal included in the FY2010 budget recommends that a contractor be required to supply to the business the contractor's certified Taxpayer Identification Number (TIN). The business would be required to verify the contractor's TIN with the IRS, who would determine whether the certified TIN-name combination matches the IRS records. If the contractor fails to furnish an accurate TIN, the business would be required to withhold a flat-rate percentage of gross payments to that contractor.

NSBA supports an accurate and real-time verification system that is easily accessible via on-line or phone to businesses so they can properly verify these TINs. Otherwise, this will result in delays in performing and paying for contractors' services. A system with substantial requests for paperwork and long wait times to receive needed approvals would harm daily operations of the business and disrupt the contractor's cash flow.

Included in this proposal is the creation of a voluntary withholding system. Contractors receiving payments of \$600 or more in a calendar year from a business can require a business to withhold a flat-rate percentage of their gross payments, with the flat rate of 15, 25, 30 or 35 percent being selected by the contractor.

By allowing the contractor the option to require the business to withhold a flat-rate percentage from their gross payments places the business under an additional burden, especially if the business has no choice but to comply with the contractor's request. NSBA asserts this is especially burdensome and complex to small businesses if each contractor requests a different rate. Then business owners may have to withhold from

some contractors and report information returns on others—resulting in increased administrative nightmares for the small business. Allowing the contractors the option transfers the compliance burden from the contractor to the business owner creating further disincentives to utilize contractor services.

Upper-Income Tax Provisions Dedicated to Deficit Reduction

Another burdensome proposal included in the administration's FY 2010 budget is the call to restructure the upper income tax brackets. The income of most small businesses is taxed at the individual level. The administration's proposal would raise the top two tax rates from 33 percent and 35 percent to 36 percent and 39.6 percent, while at the same time raising the threshold for entry into the new 36 percent bracket. Entry into the 36 percent bracket would start at \$231,300—up from \$208,850 for couples, and at \$190,650—up from \$171,550 for individuals.

This is bad news for small-business owners who report more than \$190,00 in income as individuals or more than \$230,000 as joint filers. NSBA members also argue that this income tax increase comes with a host of other burdens. Under the administration's plan, those affected by the higher rates would not receive the full value of their itemized deductions, will see their capital gains and dividends taxed at a 20 percent rate instead of 15 percent, and may be forced to pay the alternative minimum tax.

While NSBA analysis based on the 2008 Survey of Small and Mid Sized Business shows that likely less than 13 percent of small businesses would be impacted, it is important to remember that those small businesses above that threshold are likely those creating the largest share of new jobs. According to well-known small-business researcher David Birch, the fastest growing companies—so-called “gazelles”—represent no more than 3 percent of U.S. companies, yet created 5 million jobs between 1990 and 1994. Gazelles have at least 20 percent sales growth every year for four years, starting with base revenue of at least \$100,000. Many of these gazelles would likely be over the profit threshold in Obama's proposal, and could face higher taxes which would certainly impact their ability to create jobs and grow the U.S. economy.

Additionally, higher tax rates on the country's most successful small-business owners will discourage them from building cash reserves and reinvesting in their companies. A large number of business owners who have reported income that is very high typically reinvest a large chunk of it. This proposal takes away their incentive to take risks and grow their company—harming the very people who create jobs in this country.

This proposal also represents yet another complicated tax law change that small businesses would be forced to keep track of, adding to the growing complexity of the tax code. Instead, Congress should be examining ways to reform our tax system, making it more efficient and equitable.

When it comes to revenue raising proposals, NSBA supports proposals that are fair and reasonable to address issues such as the tax gap and to increase tax compliance. NSBA

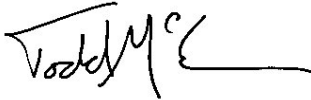
endorses the development of a comprehensive tax reform strategy that does not target the same source of non-compliance through multiple legislative or regulatory efforts. This will minimize expense on taxpayers or compliant businesses while maximizing the return to the government.

The majority of small-business taxpayers want to comply with existing tax laws, thus tax simplification and taxpayer education and outreach is the most effective and equitable way to improve compliance. Congress needs to support proposals that are fair and reasonable, without hindering the survival, growth and innovation of our nation's entrepreneurs.

Conclusion:

Thank you for the opportunity to share with the Committee NSBA's perspective on the financing of health care and the need to address the unsustainable growth in health care costs. We look forward to working with the Committee this summer to achieve comprehensive health care reform for all Americans.

Sincerely,

A handwritten signature in black ink, appearing to read "Todd McCracken", with a long horizontal flourish extending to the right.

Todd O. McCracken
President