

Testimony of Keith Ashmus

Frantz Ward LLP

**On Behalf of
The National Small Business Association**



Senate Committee on Small Business and Entrepreneurship

Hearing:

**“Reform Done Right: Sensible Health Care Solutions for
America’s Small Businesses”**

October 20, 2009

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Chairwoman Landrieu, Ranking Member Snowe and members of the committee, thank you for the opportunity to testify on an important piece of legislation that can immediately reduce the cost of health insurance for self-employed individuals. My name is Keith Ashmus and I am a co-founding partner of Frantz Ward LLP, an entrepreneurial law firm, located in Cleveland, Ohio. I also serve as the Chairman of the Board for the National Small Business Association (NSBA).

As members of this committee are well aware, the tax treatment of health insurance is an important factor in plan participation. Currently, all workers at a large C corporation, from the mail room to the board room, can exclude employer provided health insurance from their gross income. This ability to treat health insurance as a form of tax free compensation is today taken for granted by many Americans.

Imagine then the shock of start-up business owners upon their discovery that, in their new role as a self-employed tax payer, they are excluded from many tax savings granted the CEOs of Fortune 500 companies. This is the reality of our current tax code, which excludes self-employed individuals and partners 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 employer-provided health insurance that no one else has to pay.

This is a heavy burden for this group of small businesses, who already pay on average over \$12,680 annually on health insurance premiums for family coverage. This figure, according to a 2008 Kaiser Family Foundation study, represents a national average, so it is important to note that health care coverage costs can range from state to state. However, based on this average, sole-proprietors will have to pay \$1,940 more than any one else to the federal government, in payroll taxes on their premiums. This is money that could be used toward reinvesting in and growing our businesses, hiring part-time help, or covering increasing health care costs.

Yet, it used to be even worse for the self-employed. Prior to 1997, the self-employed were prohibited from fully deducting the cost of health insurance when calculating both income tax and payroll taxes. Thankfully, Congress recognized this glaring inequity and small business owners are now able to deduct the cost of personal health insurance against their income taxes. A genuine thank you to all who helped fix this glaring error.

However, it is important to note that the one hundred percent deductibility of health insurance premiums that phased-in fully in 2003 does not take care of the payroll tax inequity. Sole-proprietors pay two types of taxes: income tax and payroll tax. Current deductibility only applies to deducting the cost of health insurance premiums before calculating income tax, not the payroll tax.

So, as many of you are aware, our job is not finished. 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. Therefore, the employee and employer contribution for FICA is 15.3 percent of compensation.

However, since the self-employed health insurance deduction is not considered an ordinary and necessary business expense for the self-employed, as it is for the corporate entity, self-employed individuals are required to pay both sides of this tax, resulting in a total 15.3 percent tax on their income, commonly referred to as the “self-employment tax.”

Contrary to rules for C Corporations, 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. Therefore, if a self-employed individual pays \$4,500 per year for their health insurance, since she is not able to deduct these costs as a business expense, she is paying an extra \$688.50 (per year premium cost X 15.3 percent) self-employment tax each year.

No other worker or employer in the United States 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 U.S. Census Bureau and Department of Labor estimates that sixty percent of Americans without health insurance (24 million) are from families where the head of household is self-employed or works for a small business. According to a Feb. 2008 NSBA survey, only 15 percent of sole proprietors offered health insurance as a benefit, as compared with 38 percent of small businesses overall that offered health insurance. Furthermore, sole-proprietors ranked health insurance the most important benefit regardless of whether or not they were able to offer it.

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 U.S. Small Business Administration’s Office of Advocacy titled, *Health Insurance Deductibility and Entrepreneurial Survival*, shows that “the health insurance deduction for the self-employed has increased 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. Adding to the cost of health insurance for that individual by not allowing their health insurance the same tax treatment they received at a former employer makes the final calculation for striking out on an entrepreneurial path much more difficult. 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.

In my own case, in 2000, when a group of my partners and I left our large firm to co-found Frantz Ward LLP, we hired a number of our former coworkers, several of whom had serious health issues. Without the availability of insurance through the Council of Smaller Enterprises (COSE), these qualified people could never have risked joining our new venture.

Instead of Congress continuing to bail-out the large corporations, they should take a look at who is making a real and positive economic impact on this country. Recent economic indicators suggest that the worst of the recession is over, and small businesses are leading the way out of the recession as the economy begins to recover. After all, they are the key contributors to innovation, investment, leaders in the global marketplace and the drivers of our economy. According to data provided by the U.S. Bureau of the Census, since 1989, small businesses have created 93.5 percent of all net new jobs. This has been especially true as the current economy recovers, which has seen small business-owners hold their own while many large and well-established businesses flounder and close. As early retirees invest severance packages in new ventures and downsized personnel discover a lack of new employment opportunities, the number of new businesses established during troubled economic times tends to increase—and this is not a new trend.

According to SBA's Small Business Economic Indicators for 2003, when the economy gained momentum after the previous downturn in the early 1990s, firms with fewer than 500 employees increased their net employment in the first year after the recession, while large firms continued to shrink. And from March 2000 to March 2001, small firms added 1.15 million net new jobs while large firms lost 0.15 million net new jobs. Additionally, SBA's report found that small businesses played a role in the 2003 economic rebound based on the increase in employer firms of 0.3 percent and the increase in self-employed of 3.7 percent in 2003.

As critical a component of our nation's economy as small business is, one has to wonder why Congress continues to harm these budding business-owners. Fortunately, many members of Congress agree that it is unfair and unwise to penalize the self-employed. Senators Jeff Bingaman and Orrin Hatch stepped up to the plate and offered legislation to fix this inequity. *Equity for Our Nation's Self-Employed Act (S.725)* would allow our nation's roughly 21.3 million self-employed business owners to fully deduct the cost of their health insurance. Companion legislation (*H.R. 1470*) has been introduced in the House by Reps. Ron Kind, Wally Herger, Suzanne Kosmas and Dave Reichert.

Our advocacy on this issue sprang from our landmark study of the tax code. NSBA's report, titled "The Internal Revenue Code: Unequal Treatment Between Large and Small Firms," details a broad array of tax policies that discriminate and act as a disincentive to entrepreneurship. Aside from the unfair self-employment tax on healthcare, the report has encouraged legislation that would allow business owners to participate in Section 125 "Cafeteria Plans" along with their employees and allow business owners and their employees to contribute to SIMPLE 401(k) plans at the same dollar amounts as

traditional 401(k) plans. I encourage all members of the panel to read the report, a copy of which can be found on our website, www.nsba.biz.

Unfortunately, this deduction was left out of Senate Finance Committee Chairman Max Baucus' health care reform bill, but NSBA is hopeful members of this committee will find an appropriate vehicle for it. The four million sole proprietors and partners who pay self-employment taxes on their health insurance premiums have not given up hope that this discrimination will be eliminated once overall health care reform is completed by Congress. NSBA encourages you to seek changes to the pending proposals to include a provision incorporating language from S. 725. Fixing this inequity within the tax code is a critical step towards helping entrepreneurs gain access to more affordable health care options.

While this statement is focused on one particular issue, I would like to emphasize to the committee that NSBA has a range of concerns and comments on many different components of the various health reform bills, which I would be happy to discuss further during the Q & A.

The health care reform proposals in each chamber have addressed provisions to better our health care system. Insurance market reforms that ensure guaranteed issue policies and eliminate rates based on preexisting conditions and health status are essential to reform. NSBA is also pleased all the proposals include an individual mandate and tax credits for small businesses, as well as goals to reach greater affordability.

However, NSBA believes further modifications are needed in order to ensure that affordability is realized for small businesses, their employees, and their dependents. First, the final bill must include necessary health care cost-reducing and containment provisions; second, guarantee that the individual mandate is viable and small businesses are not being held to strict mandates to provide insurance; and, among others, reconsider the model proposed to implement an excise tax on high cost insurance plans. Again, I can go into more detail on each of these during the Q & A.

We hope that Congress continues to work to ensure that small businesses, their employees, and their dependents have access to quality, affordable health insurance that does not hinder small businesses' ability to carry on as the economic engine of our nation.

In closing, I hope that all members of this committee will think of the inequity faced by self-employed individuals and the solution of S. 725 when they wrestle with the crisis in rising health insurance costs faced by your constituents. NSBA wholeheartedly believes allowing self-employed business owners to fully deduct the cost of health insurance is an important part of the health care debate that will bring immediate relief and equity to your constituents.

Appendix



October 7, 2009

The Honorable Harry Reid
Majority Leader
US Senate
522 Hart Senate Office Building
Washington, DC 20510

The Honorable Nancy Pelosi
Speaker
US House of Representatives
H-232 US Capitol
Washington, DC 20515

Dear Senator Reid and Madam Speaker Pelosi:

I am writing on behalf of the National Small Business Association (NSBA) to encourage additional refinements to the health care reform proposals currently being considered in Congress. Further modifications are needed in order to ensure that the necessary health care cost-reducing and containment provisions are included and affordability is realized for small businesses, their employees, and their dependents; guarantee that the individual mandate is viable and small businesses are not being held to strict mandates to provide insurance; and, among others, reconsider the model proposed to implement an excise tax on high cost insurance plans.

Health care reform proposals in each chamber have addressed provisions to better our health care system. Insurance market reforms that ensure guaranteed issue policies and eliminate rates based on preexisting conditions and health status are essential to reform. NSBA is also pleased all the proposals include an individual mandate and tax credits for small businesses, as well as goals to reach greater affordability. However, while deliberations have come a long way in the past few months, more must be done to ensure that small businesses, their employees, and their dependents have access to quality, affordable health insurance that does not hinder small businesses ability to carry on as the economic engine of our nation.

As we have witnessed, the process of reforming our health care system can be contentious and partisan. A lot rides on reform for every individual, family, and small business. We appreciate that any reform hinges on a delicate balance of interconnected policies. Nevertheless, small business owners often feel the brunt of unintended consequences that result from the best intended public policies. Whether it is the time-consuming requirements associated with compliance of a new regulation or the new financial commitment that results in the readjustment of their bottom line, small businesses are generally wary of massive public policy reform because so much comes back on their shoulders. However, despite the controversy associated with the health care debate and the uneasiness with comprehensive reform, NSBA found in a recent survey

that 62 percent of small-business owners still want Congress to enact some kind of reform within the year.

In order to eliminate the unintended consequences and reduce the potential burden on small businesses from comprehensive health care reform, NSBA suggests the following considerations and modifications.

Affordability

Small businesses are exceptionally vulnerable to health insurance cost fluctuations. Employers offer health insurance to their employees as a means to attract a high-quality and reliable workforce; however, extreme health care costs increases in recent years have simply made it unaffordable for many small-business owners. The ramifications of these increased trends have been evident for some time. In a September 2009 survey by NSBA, among those small businesses not offering health insurance, 89 percent of respondents do not expect to offer health insurance in the next 12 months. Moreover, among those currently offering health insurance, 92 percent expect an increase to the cost of their health insurance premiums in 2010. Although the average expected premium increase is 13 percent, those expecting higher increases are much higher than the average. Among the 20 percent who expect premium increases in excess of 20 percent, the average expected increase is 29 percent.

Affordability is critical not only from the perspective of the purchaser of health insurance, but also from the perspective of the nation. Passing health care reform that drives the nation further into debt is not acceptable, whether it be within the 10 year budget window outlined by the Congressional Budget Office or beyond. Using accounting gimmicks or back loading the cost of reform would not be responsible public policy for the American people. Furthermore, there is no question that a costly reform package, whether in the near or long-term, would ultimately come back to individuals and small business owners in the form of higher taxes. For these reasons, it is imperative that cost-reducing and containment provisions be the focal point of reform. In addition, the overall cost of reform should be calculated in an honest and responsible approach, such that cost in any other form is not passed down to small businesses and their employees.

NSBA is pleased with the Senate Finance Committee's approach on delivery system reform and near-term relief for small businesses via tax credits. In addition, we applaud the attempt to address medical malpractice reform in the Senate Finance proposal. We encourage the aggressive pursuit of delivery system reform in any final package, as well as detailed language that provides for comprehensive tort reform beyond the sense of the Senate language included in the Senate Finance Committee proposal.

Furthermore, essential to affordability is a truly basic, yet meaningful benefit package. NSBA previously provided comments on the need for legislative language identifying small-business representation and consultation on an anticipated independent commission or health benefits advisory council created under pending comprehensive health care

reform legislation. These councils or commissions would recommend and develop an essential benefits package or minimum credible coverage package sold to small-business owners, their employees and their dependents; thus, it is imperative that small businesses have an ongoing role in this regulatory process and subsequent deliberations.

Finally, NSBA strongly suggest that the current proposal be amended to allow self-employed business owners to fully deduct the cost of health insurance in order to bring immediate relief and equity to the self-employed. *Equity for Our Nation's Self-Employed Act (S. 725/H.R. 1470)* would address the current inequity that exist for the self-employed and allow our nation's roughly 21.3 million self-employed business owners to fully deduct the cost of their health insurance. We encourage you to amend the pending proposals to include a provision incorporating language from S. 725/H.R. 1470.

Shared Responsibility

NSBA shares the belief with the designers of the current health care proposals that an individual mandate is essential for comprehensive health care reform to work. Critical to a viable individual mandate is a penalty for noncompliance. However, there must also be an opportunity for an individual to appeal the requirement if they are unable to afford what is being mandated.

NSBA has concerns that changes made to the Senate Finance Committee's proposal could undermine the viability of the individual mandate and result in higher cost for small businesses, their employees, and their families. The combination of lowering the penalty for noncompliance to the individual mandate; lowering the affordability threshold that applies to the individual mandate; and, implementing the insurance market reforms with tighter age rating ratios could persuade individuals to game the system. A young, healthy individual could reason that paying the penalty for noncompliance is more financially attractive than paying the cost of the premium associated with the individual mandate. The consequences of the Senate Finance Committee's amendments could destabilize the remainder of the health insurance market; thus, resulting in continued inflated cost for small businesses.

NSBA has been engaged in health care policy for decades, and in 2004 published *Small Business Health Care Reform—A Long-Term Solution for All*. This proposal for broad reform 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. What is inherent about this proposal is opposition to employer mandates to provide health insurance.

In NSBA's September survey on health care reform, 73 percent of respondents said employers above a certain size (i.e. number of employees or total payroll) should not be required to make a financial contribution to their employees' health coverage. It is clear that any new financial obligation handed down to small businesses who currently do not offer health insurance coverage to their employees, or who offer less than what is deemed

acceptable in some proposals before Congress, would have a negative impact on the business, the employees and their families, and consumers.

The reactions of small businesses to increased health care premiums in recent years illustrate the potential impact of any new financial obligations born from an employer mandate. Small businesses have seen a significant impact from recent premium increases, including 61 percent of small business owners not giving salary increases for employees and 31 percent holding off on hiring new employees.

Public Health Insurance Option vs. CO-OP vs. Reformed Private Insurance Market

NSBA's greatest fear with respect to the goal of spurring more competition between health insurance providers in order to provide more choices, reduced premiums, and greater transparency is that it has fallen on ideological lines. A lack of bipartisan support could undermine the longevity of reform and further destabilize our nation's health care system. NSBA's survey shows that 37 percent of respondents believe that private health insurance plans under tighter regulations would achieve the aforementioned goal, while 31 percent favor the CO-OP, and 12.5 percent favor a public health insurance option. Although 12.5 percent of respondents registered support for a public health insurance option, those respondents were the smallest businesses with very low payroll levels, many of whom are likely purchasing insurance in the individual market, and therefore in the most dire situation regarding health insurance.

Excise Tax on High-Cost Insurance Plans

NSBA's has two primary reservations with the Senate Finance Committee's proposed excise tax on high-cost insurance plans. First, it seems unavoidable that the tax will be passed down to small businesses in the form of higher premiums. The excise tax appears counterintuitive to the goals set forth by the President and members of Congress to lower health care costs for small businesses, their employees, and their families.

Following the same argument, NSBA has significant concerns with the Senate Finance Committee proposal to impose an aggregate tax of \$6.7 billion per year on "any U.S. health insurance provider," in proportion to market share, whether for profit or not for profit, but not on employers who "self fund" their employees' coverage. The tax would fall heavily and disproportionately on small employers who need to buy coverage from insurance companies. Similar to the excise tax on high-cost insurance plans, this tax will surely be passed through to the policy holders or their employers. Estimates show that it will be paid by 89 million insured Americans at a cost of about \$75 per person per year.

The second concern with the excise tax is what appears to be an administrative quagmire for small business owners. Small businesses with multiple vendors would face extraordinary administrative burdens in order to comply with the proposed mechanism for assigning tax responsibilities. Given that 30 percent of small businesses use 3 or more vendors, some as many as 12 different vendors, this could represent a significant new administrative burden on small business

While the tax on insurers is intended to be invisible to consumers, albeit there are no safeguards to prevent the aforementioned phenomenon, it will certainly not be invisible to employers. NSBA suggest this model to tax high-cost insurance plans be reconsidered in order to avoid the additional cost and administrative burden certain to hit small businesses.

In lieu of this approach, NSBA has supported limits on the value of employer-provided health coverage that is excludible from gross income based on a minimum benefit package. This approach would encourage greater consumer behavior, decrease utilization of the system, and lead to a decrease 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.

Corporate Information Reporting

NSBA also has significant concerns with the proposed corporate information reporting provision. 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. Sen. Baucus' proposal would expand the Form 1099 filing system by requiring businesses that pay more than \$600 annually to corporate providers of property and services to file an information report with each provider and with the IRS.

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 appreciates the opportunity to provide a small-business perspective to the pending health care reform legislation in the House of Representatives and the Senate. We hope to continue to work with you and your staff as a constructive participant on these issues as they are considered and negotiated in the coming days and weeks. Please do not hesitate to contact me or my staff to provide additional information or insight into the health care challenges faced by our nation's small businesses.

Sincerely,

A handwritten signature in black ink, appearing to read "Todd O. McCracken". The signature is stylized and includes a long horizontal flourish at the end.

Todd O. McCracken
President

Cc:

The Honorable Mitch McConnell, US Senate Minority Leader

The Honorable Richard Durbin, US Senate Majority Whip

The Honorable Jon Kyle, US Senate Minority Whip

The Honorable John Boehner, House Minority Leader

The Honorable Steny Hoyer, House Majority Leader

The Honorable Eric Cantor, House Minority Whip

The Honorable Max Baucus, Chairman, Senate Finance Committee

The Honorable Charles Grassley, Ranking Member, Senate Finance Committee

The Honorable Tom Harkin, Chairman, Senate Health, Education, Labor, and Pensions Committee

The Honorable Mike Enzi, Ranking Member, Senate Health, Education, Labor, and Pensions Committee

The Honorable Charles Rangel, Chairman, House Ways and Means Committee

The Honorable Dave Camp, Ranking Member, House Ways and Means Committee

The Honorable Henry Waxman, Chairman, House Energy and Commerce Committee

The Honorable Joe Barton, Ranking Member, House Energy and Commerce Committee

The Honorable George Miller, Chairman, House Education and Labor Committee

The Honorable John Kline, Ranking Member, House Education and Labor Committee