

Testimony of Paul Hense

Hense & Associates

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



**House Small Business Subcommittee on Workforce, Empowerment, and Government
Programs**

Hearing:

**“Healthcare and Small Business: Proposals That Will Help Lower Costs and Cover the
Uninsured”**

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1156 15th Street, N.W., Suite 1100
Washington, DC 20005
202-293-8830

Chairwoman Musgrave, Ranking Member Lipinski 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 Paul Hense and I am the president of Hense and Associates, a CPA firm located in Grand Rapids, Mich. I also serve as the chair of the National Small Business Association.

As members of this committee are very aware, the tax treatment of health insurance is an important factor in plan participation. 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 a small-business owner upon their discovery that, in their new role as a self-employed taxpayer, they are excluded from those tax savings granted the CEOs of *Fortune 500* companies. This is the reality of our current tax code, which 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 premium on their health insurance that no one else has to pay.

It used to be worse for the self-employed. Before 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 now are 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.

Many of you also are aware that 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.

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 recent report released by the U.S. Small Business Administration’s Office of Advocacy (entitled, “Health Insurance Deductibility and Entrepreneurial Survival,”) shows that the allowance of health-insurance deductions for income tax purposes has a major impact on business survival rates.

When a family’s principle-earner makes the decision to leave the predictable and structured world of a large employer and strike out 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 Office of Advocacy report would grow if Congress allowed the self-employed full deductibility.

Fortunately, many members of Congress agree that it is unfair and unwise to penalize the self-employed. Just a few weeks ago, Rep. Melissa Hart and House Small Business Committee Chairman Donald Manzullo stepped up to the plate and offered legislation to fix this inequity. *H.R. 4961*, "The Self-Employed Health Care Affordability Act of 2006," would allow our nation's roughly 16-million self-employed business owners to fully deduct the cost of their health insurance. I wish to thank those members of the committee who have already added their names as cosponsors to the bill.

In the 108th Congress, Manzullo and Ranking Member Nydia Velazquez introduced identical legislation, *H.R. 1873*. That bill, supported by many members of this committee, ultimately gained 68 bi-partisan co-sponsors and was joined by complimentary legislation in the Senate authored by Sens. Craig Thomas and Jeff Bingaman.

Our advocacy on this issue sprung from our landmark study of the tax code. NSBA's report, entitled "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 health care, 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 Web site, *nsba.biz*.

In closing, I hope that all members of this committee will think of the inequity faced by self-employed individuals and *H.R. 4961* when they wrestle with the crisis in rising health insurance costs faced by your constituents. 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.