

Health Insurance in the Small Business Market: Availability, Coverage, and the Effect of Tax Incentives

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Lack of access to affordable health insurance coverage among employees of small businesses is one of the most intractable problems facing the U.S. health care system. Employer-sponsored health insurance offers distinct advantages over private purchases of health insurance, including favorable tax treatment for federal tax purposes and, in many cases, state income tax. However, these advantages disappear for small employers who face high per employee costs to offer health insurance. The smaller the employer, the more likely the per employee costs will be similar to the costs of privately purchased insurance.

States have used various approaches to address this problem, including the adoption of specific tax incentives to encourage small employers to offer health insurance. Federal health care reform enacted in 2010 is likely to have wide ranging impacts on the availability of health insurance. It permits employees to participate in state insurance exchanges and adopts a small business health insurance tax credit.

The researchers examine whether existing tax incentives at the federal and state level provide sufficient inducement to small businesses to adopt health insurance plans. The paper analyzes trends in access to employer-sponsored health insurance using Census, IRS, and non-profit organization data sources. They also analyze the small business health insurance tax credit adopted as part of the federal health care reform legislation and estimate the number of small businesses that may be able to benefit from such a tax credit.

Overall Findings

States have tried a variety of approaches to improve health plan coverage and, particularly, to improve health insurance offered by small businesses. The

researchers found that most existing state-tax incentive programs apply to very narrow classes of employers (typically the smallest of employers) and provide relatively narrow tax benefits. They also found no correlation between state tax rates (corporate and individual) and state insurance offer rates by size of firm.

The new federal tax credit for small employer insurance, effective 2010, offers a more generous incentive to encourage small businesses to offer health insurance to their employees. However, because the tax credit is nonrefundable, many employers will not be able to take full advantage of it. The researchers found that approximately 2.6 million of the 4.0 million firms estimated to be eligible for the credit would have received a benefit from the tax credit in 2010. In addition, the credit would have most likely benefited those small businesses that offered health insurance to their employees in 2010.

National Trends

- Between 1998 and 2009, health insurance offer rates in the establishments of small firms declined.
- Employees in small businesses faced a significantly larger decline in employment-based insurance between 2007 and 2009 than those in firms with 100 or more employees.
- The increase in the self-employed health insurance tax deduction in 2003 created an incentive for some self-employed individuals to purchase health insurance or more health insurance.
- In 2007, it is estimated that small employers deducted approximately \$53.8 billion for health insurance benefits.
- Self-employed health insurance coverage is correlated positively with income. Overall, only

17 percent of tax returns reporting self-employment income also reported the deduction for self-employed health insurance.

- Over the 10-year period 1998-2008, the percent of tax returns with self-employed income that reported the deduction for self-employed health insurance declined for all but two income classes (adjusted gross income of \$500,000 or more and those with no net income)
- Unlike the exclusion for employer-sponsored health insurance that delivers sizable benefits to lower income taxpayers, the self-employed deduction distributes the tax benefits more evenly among income classes.
- During the economic downturn, employees in small businesses faced a significantly larger decline in employment-based insurance between 2007 and 2009 than workers in firms with 100 or more employees.

State-Level Results

- Health insurance offer rates vary significantly by firm size and state. For example the offer rate was over 50 percent for small establishments with fewer than 10 workers in Hawaii, New Jersey, and the District of Columbia in 2009; by comparison, the offer rates for this size category in Alaska, Arkansas, Indiana, Louisiana, Mississippi, and Wyoming were between 20 and 29 percent.
- Relatively few states have adopted state tax incentives for health insurance. As of 2009, only ten states and the District of Columbia had adopted state tax incentives for small businesses to offer health insurance to their employees.
- In 2008 and 2009, the effects of the recession may have masked any positive effects of tax credits on employer health insurance offer rates.

Effect of Health Care Reform

- The authors estimate that approximately 2.6 million (or 65 percent) of the 4 million eligible firms would receive a current benefit from the small business health insurance tax credit (effective beginning in 2010) included in the Patient Protection and Affordable Care Act of 2010. This estimate is based on an analysis of Medical Expenditure Panel Survey data on small firm employees, offer rates, and enrollment, as well as IRS Statistics of Income data.

Scope and Methodology

The research uses a wide range of data sets to explore the use of tax incentives at the state and federal level to encourage small businesses to offer health insurance to their employees. These data sets include the Medical Expenditure Panel Survey (MEPS), the Current Population Survey (CPS), the Survey of Income and Program Participation (SIPP), the Kaiser Family Foundation Annual Survey of Employer Health Benefits, and tax return data from the Internal Revenue Service.

Using data from the MEPS that allows a look at establishment health insurance access rates by firm size on a state-by-state basis, the authors examine employer tax incentives adopted by Kansas and Montana to ascertain whether they had an effect on the rate at which small businesses offer health insurance to their employees. In addition, they use MEPS data to analyze whether the pattern of health insurance offer rates changed by firm size and state over the 2006-2009 period. IRS Statistics of Income (SOI) data is used to analyze the self-employed health insurance deduction.

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