SMALL BUSINESS LEGISLATIVE COUNCIL

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HAPPY NEW YEAR

Hope you enjoyed the holidays! Too short for me! Let me start the New Year by reminding you of the SBLC Annual Meeting on Monday, February 8, 2010 at 8 a.m. - 10 a.m. It will be held at the Westin Grand, 2350 M Street N.W. Washington, D.C. I will be sending out a registration form soon. Hope you can join us.

HEALTH CARE QUESTIONS

Health care reform will dominant the headlines for the next several weeks. I have been sifting through the details of the two bills, H.R.3962, Affordable Health Care for America Act, aka the "House bill," and H.R. 3590, Patient Protection and Affordable Care Act, aka the "Senate bill." (The Senate took up another House-passed bill, stripped out everything, and inserted its own health care bill. The House bill happened to be the one that would modify the first-time homebuyers' credit in the case of members of the Armed Forces and certain other Federal employees, and for other purposes. Congress dealt with the issue in another bill and thus did not need the bill. Unfortunately, this parliamentary maneuver just causes confusion because if you pull up the text of the bill, you see the old header. Nothing is simple about this initiative!)

Both are massive bills, with the Senate version coming in at over 2,400 pdf pages. Not surprisingly, the bills are very technical in nature. Yet, at the same time, they leave enormous discretion to regulators and administrators to fill in the details of some of the most crucial elements. Further, continuing a trend in Federal legislation in general, the drafters routinely use undefined terms. Precise definitions are the building blocks of well-drafted legislation.

Then there are the hidden connections. Citations are always the bane of legislative analysts. Is there something in the citation that changes the impact of the words on the page? The Senate bill sets a new low. As we have reported, the Senate amended the draft with a late "manager's amendment," before passage. That is common but a number of the manager's amendments that change provisions of the bill are not incorporated into the text of the bill! They have simply been added to the end of the bill. So one would have to know to look at the end of the bill for some changes to earlier text in the bill.

Let me illustrate with an example that will be particularly important to business. The original draft of the Senate bill required employers to use waiting periods of 30 days or pay penalties for longer waiting periods of 60 or 90 days ($400 or $600 for each employee to which the longer waiting period applies).

All business owners know that there is a significant amount of the turnover of new employees. The choices are to opt for the 30-day waiting period, avoid a penalty, and undertake the time and expense of enrolling what turn out to be short-term employees or, absorb the penalties – not much of a choice.

The Senate manager's amendment provided some relief by changing the provision to permit a 60-day waiting period and impose the $600 penalty for longer waiting periods up 90 days (over 90 days is not allowed). The waiting period language is found on page345 of the bill. The manager's amendment that changes it is on page 2407. A legislative analyst's nightmare. (PS The House bill is silent on the issue of appropriate waiting periods.

The manager's amendments to the small business tax credit are also handled the same way with the change tacked on to the end of the bill, rather than integrated into the text.

So let me move on to the rest of the analysis.

GRANDFATHERS

On many occasions, the President has said, "no one will have to change their health care plan, if they like the one they have." For employers currently offering plans, the statement appears to be true – to a certain extent. Both bills have "grandfather" clauses that allow employers to continue to offer the plans they have in place without exposing their business to the mandate penalties. The House version "grandfathers" the plans for five years. The Senate version "grandfathers" plans indefinitely. There is a vigorous debate around the scope of the grandfather clauses, particularly the Senate version. It appears to me that some requirements such as the waiting period prohibition and perhaps out of pocket limits are not "protected" by the grandfather clause in the Senate bill. If I had to choose one for clarity, I would pick the House version, but as noted, it is only a five-year deferral.

EMPLOYER MANDATES

The House employer mandate is firm and reaches further down into the small business community, covers employees AND dependents, and requires providing coverage to part-time employees on a pro-rata basis. The Senate version is a "soft" mandate and would seem to be the better option.

The House bill includes a "play or pay" penalty for not providing health care benefits to employees and dependents. The requirement takes effect in 2013.

To play, employers must offer coverage to their employees and dependents. Employers must contribute at least 72.5 percent of the premium cost for single coverage and 65 percent of the premium cost for family coverage of the lowest cost plan that meets the essential benefits package requirements defined by the law.

If the employer chooses to pay, the penalty structure is as follows:
Wages do not exceed $500,000 - 0 percent of payroll
Wages exceed $500,000, but do not exceed $585,000 - 2 percent
Wages exceed $585,000, but do not exceed $670,000 - 4 percent
Wages exceed $670,000, but do not exceed $750,000 - 6 percent
Wages exceed $750,000 - 8 percent.

Under the Senate bill, all employers with more than 50 full-time employees (defined as employees working on average at least 30 hours per week) that did not provide coverage and any of its full-time employees were enrolled in an exchange plan for which a premium credit is paid, a penalty would be owed. The employer must pay 60 percent of the cost and the employee's cost must meet affordability standards, otherwise the employees will be deemed to be eligible for various credits and subsidies, if they are otherwise eligible for them.

The bill does allow smaller employers to go over the 50-employee threshold for 120 days or fewer without triggering any obligations, if the threshold number is exceeded because of the use of seasonal workers.

The threshold for the construction industry is five employees and a payroll of more than $250,000 annually.

In 2014, the penalty assessed to the employer would be equal to the number of full-time employees times 1/12 of $750, for any applicable month.

Both bills penalize employers if employees opt out of the employer's coverage. Why would employees opt out? Under the House version, probably because of some calculation of what benefits are offered by the employer and the opportunity to obtain "better" coverage directly from an exchange.

Under the House bill if employees opt out, the employer pays a penalty of 8 percent of the average payroll for each opt out employee.

Under the Senate bill, the circumstances are limited to when the employer does not pay at least 60 percent of the costs or the employee's share exceeds 9.8 percent of his/her income. This results in the individual being eligible for a premium subsidy. Thus, an employer that offers its employees coverage could be subject to penalties, if one or more of its full-time employees were enrolled in an exchange plan for which a premium credit is paid, for that employee. In 2014, the annual penalty assessed to the employer for each such employee would be $3,000 ($250 per month).

However, the total annual penalty for an employer would be limited to the total number of the firm's full-time employees times $750, which is basically the same as if the employer did nothing.

INDIVIDUAL SUBSIDIES

Both bills create “Exchanges” where individuals can obtain coverage. I will not go into details. The critical issue is the fact that if individuals obtain their coverage through the exchange, they may be eligible for a premium subsidy. The premium subsidies in the bills are substantial. Basically, there is a sliding scale based of a percentage of the Federal Poverty Level (FPL). The lower your income, the bigger the subsidy (or looking at it the other way, the less of your income you are required to pay for obtain coverage). Individuals and families with household income of up to 400 percent of FPL would not be required to spend more than a percent of the income on premiums. Under the House bill, the 400 percent of FPL households would not have to pay more than 12 percent of income on premiums and under the Senate bill, they are limited to paying no more than 9.8 percent of their incomes. (The 2009 Poverty Guidelines for the 48 Contiguous States and the District of Columbia for one person in the family - $10,830, for two - $14,570, for three - 8,310 ,or for 4 - $22,050 and so forth). Therefore, a family of four with household income of $88,000 (400 percent of $22,050) would be eligible for a premium subsidy.

Under the House bill, individuals are not eligible for subsidies if they are eligible for employer-sponsored coverage as a full-time employee, or if they are enrolled in Medicare, Medicaid, coverage related to military service, an employer-sponsored plan, a grandfathered plan, or other coverage recognized by the law. Under the Senate version, individuals are not eligible for subsidies if they are eligible for that coverage—Medicare, Medicaid, CHIP, coverage related to military service, an employer-sponsored plan, a grandfathered plan, or other coverage recognized under the law.. An exception to the exclusion for those eligible for employer-sponsored coverage in 2014 and after, exists in House bill, if the employee’s contribution would exceed 12 percent of income in 2014, and in the Senate bill, if the employee’s contribution would exceed 9.8 percent of income or if the plan pays for less than 60 percent of covered expenses.

EMPLOYER PARTICIPATION IN EXCHANGE

Under the House bill, in 2013, employers with up to 25 employees may use the exchange; in 2014, up to 50 employees; and in 2015, up to 100 employees. Once employers qualify for and enroll employees in an exchange plans, the employer would continue to be considered exchange eligible—unless the employer offered direct coverage not through an exchange.

Under the Senate bill, before 2016, states choose which employers are eligible: up to 50 or up to 100 employees. I n 2016, the cap is 100 employees; in 2017, states could allow large employers to obtain coverage through an exchange.

SMALL BUSINESS TAX CREDITS

While the bills have tax credits for small business, they are short-lived in nature and the plans have to meet the basic standards established by the bills. (Looking at the glass half-full, for those offering health care benefits now and are otherwise eligible for the credit, it would provide some short-term relief.

In the House bill, there is a maximum credit of 50 percent credit toward the employer share of the cost of a qualified health plan (this includes “grandfathered or otherwise acceptable plans), for no more than two taxable years. A small business must have a tax liability in order to take the credit. Small businesses with 10 or fewer full-time employees and with average taxable wages of $20,000 or less could claim the full credit amount. The credit is phased out as average employee compensation increases from $20,000 to $40,000 and as the number of employees increases from 10 to 25. Employees would be counted if they received at least $5,000 in compensation, but the credit could not apply toward insurance for employees whose compensation exceeds $80,000. The self-employed are eligible for the credit.

In the Senate bill, there is a 35 percent credit (2010-2013) and 50 percent credit (beginning in 2014 for no more than two consecutive taxable years) of the lesser of (1) the employer premium contribution toward plans offered by the employer through an exchange, or (2) the contribution the employer would have made if each of those same employees had enrolled in a QHP with a premium equal to the average for the small group market in the rating area in which the employee enrolls for coverage. (As I understand the Senate language, before 2014, the small business does not have to obtain the coverage through an exchange, but for years beginning with 2014, it must be an exchange provided plan.) It not restricted to those with a tax liability. Small employers would have to contribute at least 50 percent of the cost of premiums towards a qualified health plan. Small businesses with 10 or fewer full-time employees and with average taxable wages of $25,000 or less could claim the full credit. It is phased out as average employee compensation increases from $25,000 to $50,000 and as the number of full-time employees increases from 10 to 25. Full-time employees would be calculated by dividing the total hours worked by all employees during the tax year by 2,080 (with a maximum of 2,080 hours for any one employee). Seasonal workers would be exempt from this calculation. The self-employed are not eligible for the credit.

INDIVIDUAL MANDATES

There are individual mandates in both bills. I think this is the issue that is going to drive many employer health care decisions in ways we cannot anticipate. As employees sort out their own options between their mandates, the "grandfathered" employer plans, and subsidies, their expectations and/or demands are going to alter the compensation/ health care benefits equation.

Under the House bill, individuals who did not meet the mandate for themselves and their children could be required to pay a tax, prorated for the time the individual (or family) does not have coverage during the year, equal to the lesser of (1) 2.percent of the taxpayer's modified adjusted gross income (MAGI) over the amount of income required to file a tax return, or (2) the national average premium for applicable single or family coverage.

Under the Senate bill, individuals who did not meet the mandate would be required to pay a penalty for each month they were in non-compliance. The per person, annual dollar penalty would be phased in—the greater of 0.5 percent of adjusted gross income or $95 in 2014, 1.0 percent or $495 in 2015, reaching 2.0 percent or $750 in 2016 (adjusted for inflation thereafter), reduced by one-half for any dependents under the age of 18. In any given year, there would be a limit of no more than 300 percent of the per person penalty in total for the taxpayer and any dependents.

TAXES

There are plenty of tax increases in the bills. At this point, the requirement for all businesses to issue Forms 1099 to all their vendors to which they pay more than $600 annually for goods and/or services remains in both bills. It looks like this will become law.

The House bill would impose a tax equal to 5.4 percent on modified adjusted gross income (AGI) that exceeds $500,000 for single filers and $1 million for joint filers.

The Senate bill would increase the Medicare Hospital Insurance (HI) trust portion) of the payroll tax to 2.35 percent from 1.45 percent (i.e. a 0.9 increase) on wages or self-employment income over $200,000 for individual return and $250,000 for a joint return. There is no limit on the amount of wages or self-employment income that is subject to the tax (unlike the social security portion of the FICA tax, which has a wage cap). The introduction of the concept of imposing an employment tax at different income levels for individuals and for joint returns creates a whole new wrinkle for two wage-earner families. Up to this point, FICA taxes have been applied to each individual's wages regardless of how income taxes were filed. The bill provides that employer can continue to withhold the employee's share as if an employee's spouse's wages were not applied towards the threshold. This means joint return taxpayers will have to make an adjustment somewhere on their income tax return for the fact extra HI tax might have been withheld. Same for self-employment income.

This is an increase in the employee's share only. The employer would continue to pay to its 1.45 percent rate share on the employee's wages. In the case of the self-employed, they would pay "only" the additional 0.9 percent.

The Senate bill would impose an excise tax of 40 percent on health insurers and health plan administrators for coverage that exceeds certain thresholds ($8,500 single coverage and $23,000 for family coverage in 2013). Health insurance coverage subject to the excise tax is broadly defined to include not only the employer and employee premium payments for health insurance (including self-insured plans), but also premiums paid by the employee and the employer for dental and vision. In addition, tax advantaged accounts such as flexible spending accounts (FSAs), health savings accounts (HSAs) and health reimbursement accounts (HRAs) are also specified as health insurance coverage and subject to the excise tax. I would say compliance is likely to be more complicated than it sounds, but it sounds pretty complicated.

Both bills would limit the amount of annual FSA contributions to $2,500 per person effective January 1, 2013. Both bills increase the penalty on non-qualified distributions from HSA from 10 percent to 20 percent of the disbursed amount for individuals under age 65. Both bills modify definition of medical expenses for FSAs, HSAs, and HRAs to not allow over-the counter prescriptions to be covered by these tax-advantaged accounts unless they are prescribed by a physician. The Senate bill would also increase the threshold the threshold for taking an itemized deduction for medical expenses from 7.5 percent to 10 percent of AGI for taxpayers who are under age 65.

ENOUGH QUESTIONS?

So the logical final question is "So, what do I think?"

Completion of a final bill is not going to get hung up because of concerns about small business. The 60 votes in the Senate do not hinge on that issue. It would be something like the abortion issue.

My view is that you could tinker with these bills until the cows come home and one could never anticipate all of the consequences. They are too many movable parts that are going to affect decisions. The "status quo" in 2014 or 2015 is not going to look anything like what folks believe now what it will look like then.

Frankly, I am not even sure that setting the "employer mandate" at any particular level is going to make a difference. I am increasingly inclined to think the reality of the closed loop of health care coverage (i.e. the individual mandate) is going to override arbitrary artificial lines. Don't get me wrong, I think it is still good to give small businesses all the flexibility in the decision-making we can, but it may be illusory.

So what does that mean? No sense of working about too big a case of angst anymore. We are going to be back to this issue more than once as those unintended consequences reveal themselves. Time to move on to helping small businesses make informed decisions.