NCPA
NATIONAL CENTER FOR POLICY ANALYSIS

News Release

FOR IMMEDIATE RELEASE

Contact: Catherine Daniell 972-308-6479 Catherine.Daniell@ncpa.org or
Leah Gipson 972-308-6486 Leah.Gipson@ncpa.org

HEALTH CARE TAX CREDIT FOR SMALL BUSINESSES COMES WITH A PRICE

New NCPA Report Says Employer Penalties Will Negatively Affect Job Creation

Dallas, TX (May 18, 2010) – Although the IRS announced yesterday the ground rules for small businesses expecting to claim a new federal tax credit, small business owners may be in for a big surprise. The tax credit penalizes employers if they hire more workers or increase salaries, according to a new report by the National Center for Policy Analysis.

"The tax credit is supposed to offset the burden of a new employer mandate to provide health insurance for their employees," said Pamela Villarreal, NCPA Senior Policy Analyst and co-author of the report. "However, the credit is arbitrarily reduced as firms grow, which will likely discourage firms from hiring more workers or offering raises."

The NCPA report explains that from 2010 to 2014, many businesses that employ 25 workers or fewer will qualify for a tax credit worth up to 35 percent of the employer's contribution to workers' health coverage. The credit increases to 50 percent beginning 2014. The credit is not available to sole proprietorships and their families.

As a firm's average pay rises above $25,000, the tax credit slowly decreases at a rate of 4 percentage points for every additional $1,000 in average pay, and is completely withdrawn once average pay reaches $50,000.

Suppose, for example, a firm with 13 workers hires an additional worker, which raises the average pay for all employees:

- If the addition of a more highly paid worker, such as a supervisor, raises the firm's average wage 10 percent to $27,500, the total tax credit the firm receives falls from $36,400 to $32,760, making the marginal cost of adding the supervisor $3,640.
- If the addition of the supervisor raises the firm's average wage 20 percent to $30,000, the total tax credit the firm receives falls from $36,400 to $27,300, making the marginal cost of the supervisor $9,100.
- If the firm's average wage increases 50 percent to $37,500, the total tax credit it receives falls from $36,400 to $14,560, making the marginal cost of the supervisor $23,660.

"The employer mandate for low wage workers will cause some employers to substitute capital for labor and more highly skilled workers for less skilled ones," said NCPA Senior Fellow Devon Herrick, co-author of the report. "An unintended consequence of the law is that some low wage workers will be unemployed who otherwise would not be"

To review the full report, log on to http://www.ncpa.org/pub/ba703. To read her blog entry on this topic, log on to http://tiny.cc/jejxz. To arrange an interview with the authors of the study, contact Leah Gipson or Catherine Daniell.