THE HILL

May 23, 2010

Healthcare law tax credits encourage small businesses to stay small, not hire

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A study by the National Center for Policy Analysis shows that tax credits in the new healthcare law could negatively impact small-business hiring decisions.

The new law provides a 50 percent tax credit to companies offering health coverage that have fewer than 10 workers who, on average, earn $25,000 a year. The tax credit is reduced as more employees are added to the payroll.

The NCPA study finds the reduction in tax relief to be a cost concern for companies looking to hire additional workers, but operate on slim profit margin yet still provide employee health coverage.

"You wouldn't think this would have an impact, but at the margins, when they [business owners] decide to hire an extra worker, they're not only going to be paying that worker's salary, they're going to have to absorb the cost of losing the tax credit," Pamela Villarreal, NCPA Senior Policy Analyst and co-author of the report, told The Hill.

A Treasury spokesperson acknowledged the tax credit is on a sliding scale, but stressed its primary aim is to help struggling companies provide health coverage to workers.

"The small business tax credit was designed to provide the greatest benefit to employers that currently have the hardest time providing health insurance for their workers - small, low-wage firms," the spokesperson told The Hill in an e-mail. "Small employers face higher premiums and higher administrative costs than large firms, and in many cases cannot afford to provide coverage."

Villarreal said the credit creates a perverse incentive for business owners that fit the Treasury's profile. While the tax break is temporary and only returns a fraction of what employees cost a company, businesses owners might forego hiring an extra worker if it means losing a piece of the tax credit.

"If a business can make a decision to substitute capital for labor – say, contract the procedure out or automate it – I believe [losing the tax credit] will play an important part in the reluctance to hire," Villarreal said, adding, "It's puzzling that we have this perverse incentive not to have businesses grow by not encouraging them to hire additional workers."

Using insurance premium cost projections supplied by the nonpartisan Congressional Budget Office (CBO), the study states that the credit reaches its optimal point at 13

workers, with relief peaking at $36,400 for qualifying business. After the 13th worker the economics surrounding the credit change, the study says.

For employers with 15 workers, taking on an additional hire will reduce the credit by $1,400. For a company looking to expand from 20 to 21 workers, the credit will shrink by $3,733. And businesses will take a $5,600 reduction on the credit when hiring the 25th worker. The credit phases out for companies with at least 26 employees.

Bill Rys, tax counsel at the National Federation of Independent Businesses, told The Hill that while demand is the primary driver for hiring decisions, costs related to new hires is a key factor.

"To the extent that a tax credit is related to the benefits that you're paying your employees, it is going to be a factor in determining what is the cost of the employee," he said. "The fact that you're losing a portion of the credit because you brought in a new employee is going to have to factor into the cost of who you're hiring."

The tax credits are available to businesses until 2016, two years after the healthcare exchanges are up and running. In 2016, of the 159 million Americans that participate in employer-sponsored health plans, only 3 million will be eligible for the tax credits provided to their employer, the CBO predicts.