



## Coalition Supporting Equity for Our Nation's Self-Employed

---

### Frequently Asked Questions

#### Self-Employment Tax Deduction on Health Insurance Costs

##### **What is the self-employment tax on health insurance premiums?**

Under the current tax code, corporations are able to deduct health insurance premiums as a business expense and to forego FICA (Social Security and Medicare) taxes on these expenses. In addition, their employees are able to pay for health coverage with pre-tax dollars. However, the self-employed are unable to deduct premiums as a business expense. Since they do not receive this deduction, they are required to pay significantly more in self-employment tax, their payroll taxes.

##### **Who pays this extra tax?**

The self-employed who file taxes as a sole proprietor (Schedule C filer) are the only business entity that is exposed to this extra tax.

##### **How much is the extra tax each year?**

As an employee, 7.65% of your earnings each pay period is taken out as payroll taxes. Additionally, the company the employee works for pays a matching 7.65% in payroll taxes for that employee, totaling 15.3% payroll (FICA) taxes. A sole proprietor must pay the full 15.3% of payroll taxes, which for this business structure is called self-employment tax.

Therefore, if a self-employed individual pays \$12,680 per year for their health insurance, since they are not able to deduct these costs as a business expense, he or she pays an extra \$1,940.04 (per year premium cost X 15.3 percent) self-employment tax each year to Uncle Sam.

**On average, how much does a self-employed person pay for health insurance?** According to a 2007 Kaiser Family Foundation study, the self-employed pay on average \$12,680 per year for family health coverage. This figure represents a national average, so it is important to note that health coverage costs can range from state to state. However, based on this average, sole-proprietors will have to pay \$1,940.04 more to the federal government, come tax season, in payroll tax on these premiums.

##### **How many self-employed (sole-proprietors) are there currently in the United States?**

According to the Internal Revenue Service, there are approximately 21.3 million sole proprietors in the United States.

(Source: Internal Revenue Service Statistics, 2005)

### **How many self-employed pay this tax?**

In 2005, there were 16.7 million self-employed individuals (sole proprietors) that paid self-employment tax. Of those 16.7 million paying self-employment taxes in 2003, 3.9 million paid self-employment tax on their health insurance premiums.

### **What would H.R. 1470/S.725 do?**

H.R. 1470/ S.725 – the *Equity for Our Nation's Self-Employed Act* – would remove paragraph (4) of IRS code section 162 that disallows a health insurance deduction for the self-employment tax purposes. Thus, if passed, the legislation would allow the IRS to provide sole-proprietors a means to deduct the cost of their health insurance premium for the purposes of calculating self-employment tax. For example, a line item on Schedule C to create a business deduction for health insurance. This would save the self-employed the 15.3 % additional tax they are paying on health costs.

### **Wasn't there legislation passed into law allowing 100% deductibility of health insurance premiums for self-employed? Didn't this address this inequity?**

The 100% deductibility of health insurance premiums that phased in fully in 2003 does not take care of this inequality. Sole-proprietors pay two types of taxes: income tax and self-employment tax (payroll tax). Current deductibility only applies to deducting the cost of health insurance premium before calculating income tax only.

Other business entities are able to deduct the costs they pay for health insurance as a business expense. The owner and employees pay for health coverage pre-tax without those costs being subjected to payroll tax. Sole-proprietors currently do not get the same benefits. H.R. 1470/ S.725 would address this inequity and create a fair, level playing field for all businesses.

### **What is the cost of the legislation?**

The Equity for Nation's Self-Employed Act has been scored between \$2 and \$2.5 billion a year, over a ten year period. This is a small price to pay to level the playing field when it comes to access to affordable health coverage. In view of the costly legislation being considered in Congress aimed at reducing health care costs for small businesses and all Americans, H.R. 1470/ S.725 is a lower cost, targeted alternative that would immediately help increase affordability of health care for all 21 million sole-proprietors in the U.S.

Reps. Ron Kind (D-Wis.) and Wally Herger (R-Calif.) are currently waiting for a new score from the Joint Committee on Taxation.

### **Is this a Republican or Democratic issue?**

Eliminating the extra payment of self-employment tax on health insurance premiums is not a Democratic or a Republican issue – it's a fairness issue and both the House bill, H.R. 1470, and Senate bill, S.725, are bipartisan legislation.

### **Is this a tax or health care issue?**

This is an issue that is rooted in the tax code but has significant health care implications. The inequity faced by the self-employed lies in the tax code and to address this unlevel playing field we must make changes to the tax code. However, because sole-proprietors do not currently receive a full deduction for their health insurance and they are paying payroll taxes on those costs, it makes it harder for this segment of the population to afford health coverage and creates a disincentive for new entrepreneurs to purchase coverage. Thus passage of H.R. 1470/ S.725.

would assist in making health care more affordable for millions of working Americans while also creating an equitable tax environment for all business entities.

### **How many uninsured are there in America?**

According to Census data, there are approximately 47 million Americans without health insurance.

### **How many self-employed are uninsured?**

Sixty percent of Americans without health insurance (24 million) are from families where the head of household is self-employed or works for a small business. According to a February 2008 NSBA survey, only 15 percent of sole proprietors offered health insurance as a benefit, as compared with 38 percent of small businesses overall that offered health insurance. Furthermore, sole-proprietors ranked health insurance the most important benefit regardless of whether or not they were able to offer it.

### **What is the official definition of self-employed?**

The official definition of a small business as put forth by the Small Business Administration is a business with 500 or less employees, including non employers (i.e. 1-person businesses). To better define such a large demographic, the NASE and other organizations have consistently identified businesses with ten or less employees as micro-businesses. Self-employed is typically used by organizations and businesses to describe the business owner but is not a technical term.

In addition, there is no official IRS code defining "self-employed". The IRS code utilizes the structure of a business as an identifier (i.e. sole proprietor, S corp, LLC, etc.). Therefore, all sole proprietors are considered small business owners, micro-business owners and/or self-employed.

Regarding this issue and bills H.R. 3660 and S.2239, sole-proprietors are the only business entities facing the current inequity. Businesses structured as a C corporation, LLC, LLP, S corporation are able to pay for their health pre tax and deduct their health care costs through their business. Thus, this legislation levels the playing field for all business entities.