



Testimony of

**Robert Hughes, President of
The National Association for the Self-Employed**

**House Committee on Small Business
“Prescriptions for Health Care”**

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On behalf of the National Association for the Self-Employed’s 250,000 member businesses, representing over 600,000 owners and employees, we would like to thank Chairman Manzullo, Ranking Member Nydia Velazquez and the Members of the House Committee on Small Business for convening this hearing on a very important issue facing our nation’s small business owners. The NASE is the nation’s leading resource for the self-employed and micro-businesses, businesses with ten or less employees. Today, this vital segment of the small business population within our nation numbers more than 18 million. Micro-businesses are the drivers of America’s economic engine, creating well over a third of all new jobs to the economy. The last U.S. Census reported that these firms employ more than 12.3 million workers with a total annual payroll of more than \$309 billion.

The chief impediment that micro-businesses and the self-employed are facing in this current economic climate is the ever-increasing costs of health coverage. The state of health care among the nation’s self-employed and micro-businesses is critical. According to a June 2002 study released by the NASE entitled “Affordability in Health Care: Trends in American Micro-Business,” seven in 10 micro-business owners report they do not provide any type of health care

coverage to eligible employees nor have coverage for themselves. Costs are cited as the chief reason for this trend. Participants in the study say the situation is worsening as health insurance premiums for micro-businesses are increasing at double-digit rates while insurance benefits and plan choices are decreasing.

Current Legislative Solutions

The NASE strongly supports legislative proposals such as Association Health Plans, health care tax credits, and deductibility of plans with HSAs to help increase access to and affordability of health care. We also strongly support removing current inequities in the tax code that make the purchase of health coverage more costly and a disincentive for the self-employed.

NASE Member Marcos Pissianti, owner of Brasilican Construction in St. Charles, Missouri had to give up his health insurance because of the high cost of premiums. “I could no longer afford to pay the premium, and therefore my wife, child, and myself are not insured. I feel it is wrong, and I am angry about it” says Marcos. “if people cannot afford insurance, what makes anyone think they can afford taxes on top of that? Big business gets too many breaks. How about us little guys?” Marcos is of course referring to the fact that he – and 16 million other sole proprietors and partnerships with earned income have to pay the equivalent of payroll taxes on their health insurance premiums.

All employees who receive compensation from employers pay FICA taxes. FICA comprises Social Security (6.2 percent) and Medicare (1.45 percent) taxes. Employers are required to withhold from gross compensation 7.65 percent for FICA. In addition to the FICA withheld from the employee, the employer is required to “match” the FICA withholding. Therefore, the employee and employer contribution for FICA is 15.3 percent of compensation (subject to applicable annual limits).

The self-employed pay into the Social Security Fund at a rate equivalent to employees and employers. FICA tax for the self-employed is called “self-employment tax.” The self-employment tax is computed at the same rates (15.3 percent) as employee/employer FICA and is subject to the same annual limits.

The tax inequity faced by the self-employed when purchasing health insurance lies in the fact that Schedule C filers (sole-proprietors) and Schedule E filers (partners in partnerships with

earned income and 2 percent owners in S Corporations) do not receive a “business deduction” for health insurance premiums. The premiums are not deducted for purposes of the self-employment tax and, accordingly, the sole proprietor(s), partners in partnerships and S corporation owners pay self-employment tax (15.3 percent on self-employment income up to \$86,000) on the insurance premiums. **The self-employed are the only segment of the business population that has to pay this extra tax on health insurance.**

C corporations, on the other hand, receive a deduction for health insurance premiums as an ordinary and necessary business expense for all employees including owners. Since the premiums paid for health insurance are not considered compensation to the employee or employee owner, they are not subject to FICA (Social Security and Medicare) taxes for either the employee or the employer.

While 100 percent deductibility of health insurance premiums has phased in, it does not solve this tax inequity. The self-employed are required to pay two types of taxes on their annual tax returns: income tax and self-employment tax. One hundred percent deductibility relates only to income tax and not self-employment tax. Thus, the self-employed still pay the 15.3 percent self-employment tax on their health insurance premiums.

According to the most recent Kaiser Family Foundation study, the self-employed pay on average \$9,950 for family health coverage. Because they cannot deduct these premiums as an ordinary business expense, they are required to pay \$1,522 in additional taxes that no other business entity must pay. This is money that our members tell us they would use to reinvest into their business, hire part-time assistance, or utilize to offset the rising premium costs they face each year so they may hold on to their coverage a little longer. NASE Member Gene Bergoffen, owner of MaineWay Services in Fryeburg, Maine, tells us he would invest these tax savings into upgrading his business software and technology. Robert and Tracy Debbelaere, custom homebuilders in Trimble, Missouri tell us that they would invest these tax savings in their business, or put the money towards medication or their children’s college fund.

To achieve tax equity between all forms of business entities, the self-employed must receive exclusion of health insurance premiums from self-employment tax regardless of the entity form under which they choose to operate. Health insurance premiums of the self-employed should be deductible on Schedule C or E as an ordinary and necessary business expense rather than the deduction above the line on Form 1040. This issue is not only one of fairness but, in the current

health care climate, the self-employed are disproportionately affected. Removing this extra tax on health insurance premiums would make health coverage slightly more affordable.

The NASE was successful in the 108th Congress, with the leadership and assistance of Chairman Manzullo and Rep. Velazquez, to introduce H.R. 1873, the Self-Employed Health Care Affordability Act, which removed this inequity in the tax code faced by our nation's self-employed. Our association is working with them and other key Members to reintroduce this legislation in the 109th Congress.

Larger Reform

The NASE and our members appreciate the current efforts of Congress to attempt to mitigate the cost burden and access difficulties that they face with health coverage. However, the NASE believes that the current legislative solutions are merely band aids on the larger wounds in the delivery of health care in this country.

Micro-business owners and the self-employed are involved in every aspect of their business. They are typically the CEO, accountant, human resource manager, administrative assistant and janitorial staff for their business. Yet, the way our current health care system is set up, business owners and individuals are observers rather than participants in their health care. Just as they do in every other aspect of their business, micro-business owners want to have access to essential information that will allow them to manage the complexity of our current system and take charge of their health care.

Transparency and access to information within our health care system would greatly assist micro-business owners and individuals in making cost effective, informed decisions regarding their health care. Currently, we go to our doctor's office for a visit, we pay a \$5, 10 or \$20 copay, and then we may get a bill in the mail that requires us to pay costs not covered by our provider. However, we never fully know the cost of the visit or what our provider paid out. With our technology today, there should be transparency and quick access for health care consumers regarding doctor and hospital costs as well as costs paid for by provider. We ask Congress to lead efforts to encourage transparency amongst doctors, hospitals and insurance providers.

In addition, to alleviate some of the overhead costs faced by doctors that is many times is passed on to patients in the form of higher fees, the NASE feels that Congress should facilitate and expedite the use of technology in medical offices. We live today in an electronic era, yet the majority of medical providers still use paper medical records. Implementation of electronic medical records would alleviate burdens such as high costs, medical errors, and administrative inefficiencies to our health care system. We are aware that the Department of Health and Human Resources through the Agency for Healthcare Research and Quality is working on implementing a national health information technology program to improve our current health care system. However, we feel more needs to be done to assist doctors in this transition.

Conclusion

The NASE feels current legislative solutions such as Association Health Plans, health tax credits, deductibility of premiums of plans with HSAs, and self-employment tax deductions for health insurance premiums would go a long way to ease some of the burden of micro-business access to affordable health care and alleviate the growing ranks of the uninsured. Yet, the National Association for the Self-Employed strongly supports continued efforts to find proactive solutions, rather than reactive, to address the root causes of continual health insurance premium increases and lack of quality health coverage while also increasing understanding and active participation in our health care system.