



Good BUSINESS SENSE:

The New Small Business
Health Care Tax Credit
In California

Good Business Sense: The New Small Business Health Care Tax Credit in California

A Report from Families USA and Small Business Majority

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Families USA is the national organization for health care consumers. It is nonprofit and nonpartisan, and its mission is the achievement of high-quality, affordable health care for all Americans. Since 1982, Families USA has engaged in research and public education to promote the expansion of health coverage for uninsured people, especially low-income working families; to rein in health care costs; and to make other improvements in the health care system.

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Small Business Majority is a national nonprofit, nonpartisan organization, founded and run by small business owners, that brings the voices of America's 28 million small businesses to the public policy table. It is focused on solving the single biggest problem facing small businesses: the skyrocketing cost of health care. Small Business Majority uses nonpartisan scientific research to understand and represent the interests and needs of all small businesses, from sole proprietors to 100-person companies.

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Introduction

In California and across the nation, small businesses are the cornerstone of local economies. They employ millions of workers; create more than half of our private, non-farm gross domestic product; drive innovation; and contribute to our communities in large cities, suburban settings, and rural towns. Despite these strengths, small businesses often operate with thin profit margins and, partly as a result, are less likely than big business to be able to offer health coverage to their workers.

To address this problem, Congress included in the Affordable Care Act a significant new tax credit for small business owners who provide their workers with health insurance. Under this new tax credit, businesses that have fewer than 25 full-time workers and average wages of less than \$50,000 are now eligible to receive a tax credit of up to 35 percent of the cost of the health insurance that they provide for their workers. To qualify for the tax credit, small businesses must cover at least 50 percent of each employee's health insurance premiums. In 2014, the size of the credit will increase to cover up to 50 percent of the cost of health insurance provided to workers. (For more details on how the tax credit works, see page 6.)

To understand the reach of this new small business health care tax credit, Families USA and Small Business Majority commissioned The Lewin Group to develop estimates of the number of small businesses that are eligible for this new tax break in tax year 2011 and how many workers could potentially benefit as a result. The Lewin Group used their widely respected Health Benefits Simulation Model for these estimates.

Our analysis found that more than 375,000 small businesses, employing 2.4 million workers in California, will be eligible for this tax credit when they file their 2011 taxes. In total, these small businesses are eligible for more than \$1.8 billion in credits for the 2011 tax year alone, an average of \$752 per employee.

While the potential reach of this new tax credit is great, educating the small business community about it remains a challenge. As with other new programs, awareness of the new tax credit will grow over time, but the federal government must still partner with the small business community to conduct outreach to eligible small business owners. Unfortunately, the current heated political debate about the Affordable Care Act has created additional barriers to effectively reaching America's small business owners with the facts about this new tax credit.

A Note about the Definition of “Small Business”

There are many different definitions of “small business.” Some are based on the number of employees, and some are based on sales volume. For the purpose of this analysis, the term “small business” refers to firms that have fewer than 25 full-time employees (or full-time equivalents). Small business owners, their families, and any shareholders are excluded from calculations of average wages and of the number of full-time equivalent positions. Where we refer to research that uses a different definition of small business, we have made that difference clear in the text.

Key Findings

Hundreds of Thousands of Small Businesses Are Eligible for Help with Health Insurance Premiums

- More than 375,000 small businesses in California (70.1 percent of California businesses with fewer than 25 workers) are eligible for tax credits to help with the cost of health coverage for their workers for the 2011 tax year (Table 1).
- More than 158,000 small businesses are eligible for the *maximum* tax credit when they file their 2011 taxes (Table 1).
- More than two in five (42.2 percent of) small businesses that are eligible for this tax credit are eligible for the *maximum* tax credit when they file their 2011 taxes (Table 1).

Table 1.

California Small Businesses Eligible for Health Care Tax Credits, 2011

Total Small Businesses	Share of Total Small Businesses			
	Eligible for Credit		Eligible for Maximum (35%) Credit	
	Number	Percent of Total Small Businesses	Number	Percent of Eligible Small Businesses
535,200	375,310	70.1%	158,430	42.2%

Source: Estimates developed by The Lewin Group for Families USA and Small Business Majority. For more details, see the Methodology on page 14.

Workers in Firms Eligible for Help with Health Insurance Premiums

- More than 2.4 million Californians are employed by a small business that is eligible for a tax credit for the 2011 tax year (Table 2).
- Of these workers, more than 759,000 are employed by a small business that is eligible for the *maximum* credit (Table 3).
- The total value of the tax credits that are available to eligible small businesses for 2011 is more than \$1.8 billion, an average of \$752 per worker (Table 2).
- The total value of the tax credits that are available to small businesses eligible for the *maximum* credit is more than \$759.1 million, an average of \$1,000 per worker (Table 3).

Table 2.

Californians Employed by Small Businesses Eligible for Health Care Tax Credits, 2011

Total Number Employed by Small Businesses	People Employed by Small Businesses Eligible for Credit			
	Number	Percent	Total Dollar Value of Credit	Average Credit Per Worker
3,813,400	2,442,900	64.1%	\$1,836,269,100	\$752

Source: Estimates developed by The Lewin Group for Families USA and Small Business Majority. For more details, see the Methodology on page 14.

Table 3.

Californians Employed by Small Businesses Eligible for the Maximum Health Care Tax Credit, 2011

Total Number Employed by Small Businesses Eligible for Credit	People Employed by Small Businesses Eligible for Maximum Credit			
	Number	Percent	Total Dollar Value of Credit	Average Credit Per Worker
2,442,900	759,400	31.1%	\$759,102,300	\$1,000

Source: Estimates developed by The Lewin Group for Families USA and Small Business Majority. For more details, see the Methodology on page 14.

Help for Black and Hispanic Small Business Workers

- Diverse workers are employed by small businesses that are eligible for credits for tax year 2011, including the following:
 - More than 100,000 black, non-Hispanic workers (Table 4).
 - Nearly 1.2 million Hispanic workers (Table 4).
 - Nearly 929,000 white, non-Hispanic workers (Table 4).
- Millions of dollars of help with premiums is available to small businesses that employ Hispanic and black workers:
 - The total dollar value of the tax credits that could help black, non-Hispanic workers employed by eligible small businesses is nearly \$75.7 million for tax year 2011, or an average of \$756 per worker (Table 4).
 - The total dollar value of the tax credits that could help Hispanic workers employed by eligible small businesses is more than \$869.8 million for tax year 2011, or an average of \$749 per worker (Table 4).
 - The total dollar value of the tax credits that could help white, non-Hispanic workers employed by eligible small businesses is more than \$703.5 million for tax year 2011, or an average of \$758 per worker (Table 4).

Table 4.

Californians Employed by Small Businesses Eligible for Health Care Tax Credits, by Race and Hispanic Origin, 2011

Race and Hispanic Origin	Total Number Employed by Small Businesses	Workers Employed by Small Businesses Eligible for Credits			
		Number	Percent	Total Dollar Value of Credit	Average Credit Per Worker
Black, Non-Hispanic	155,420	100,120	64.4%	\$75,694,100	\$756
Hispanic	1,582,230	1,160,750	73.4%	\$869,847,800	\$749
White, Non-Hispanic	1,633,210	928,690	56.9%	\$703,517,000	\$758

Source: Estimates developed by The Lewin Group for Families USA and Small Business Majority. For more details, see the Methodology on page 14.

Discussion

Small Businesses Are Less Likely to Offer Coverage

Nationally, in 2011, only 71 percent of small businesses with 10 to 24 workers offered coverage to their workers. Among small businesses with fewer than 10 workers, only 48 percent offered coverage. By contrast, 99 percent of businesses with 200 or more workers offered coverage.¹

Among small businesses with low-wage workers, the likelihood that such businesses offer coverage to their workers is even lower. As a result, lower-wage workers who are employed by small businesses are much more likely to be uninsured than other working Americans.²

Why Small Businesses Struggle to Offer Coverage

The primary reason that small business owners do not offer health coverage to their workers is cost. Insurance premiums for small businesses are often significantly higher than those for larger businesses. The cost of health insurance for small business has historically been driven up by higher administrative expenses and premiums per employee in the small group insurance market.³ In addition, until the Affordable Care Act was passed, most states, including California, did not do much to limit premium increases or require that a reasonable percentage of the premiums that insurers collected be used to pay for health care rather than high salaries, excessive profits, and administration. Moreover, most states, including California, currently allow insurers to charge a small business even more if its workforce is sicker or older.⁴ And while the premiums that small businesses pay are often higher, the coverage they receive typically requires more cost-sharing and includes fewer benefits than the coverage larger companies can provide at a lower price.⁵

In addition, many small business owners find the process of comparing insurance plans and selecting a benefit package that provides good value to be time-consuming and complicated. And small business owners who do offer coverage are often concerned that they will not be able to predict or afford the increases in premiums they could face if even one worker develops a health problem.

The lack of predictability in insurance premium increases in the small group market has historically been due to two key factors: the changing health status of workers and lack of regulation of premium increases in the small group insurance market.

The small business health care tax credit, the focus of this analysis, helps address this lack of predictability, which can leave small businesses facing large premium increases from one year to the next. By reimbursing a substantial share of a small business's health insurance costs, the impact of any premium increase will be softened. In addition, as described below, the new state insurance marketplaces for small business, the SHOP exchanges, will help slow premium increases and prevent high rate hikes from year to year.

How the New Small Business Health Care Tax Credit Works

Under the Affordable Care Act, many small employers are now eligible to receive a tax credit to pay for up to 35 percent of the average cost of a small group health insurance plan in their state (or a 25 percent refund for nonprofits).⁶ Congress designed this credit with the intent of providing the greatest help to those businesses and workers who are most in need—the smallest employers who face the highest premiums and are the least able to offer coverage to their workers. As such, small businesses with fewer than 25 full-time workers (or the equivalent) and average wages of less than \$50,000 are now eligible to receive a credit, but the smallest firms with the lowest wages—those that employ 10 or fewer workers who earn an average wage of less than \$25,000—are eligible for the greatest help and receive the full 35 percent tax credit (or a 25 percent refund for nonprofits). From there, the size of the credit phases out on a sliding scale.

To qualify for the tax credit, small businesses must cover at least 50 percent of each employee's health insurance premiums. Small businesses that employ part-time workers are also eligible for help, and their credits are calculated by determining the number of "full-time equivalents" that they employ. For example, two half-time workers count as one full-time worker for the purposes of calculating tax credit eligibility. In addition, small businesses are eligible for the tax credit even if they already receive assistance from their state to help them buy coverage for their workers, and they can continue to deduct the remainder of their health care costs when they file their federal income taxes.

In 2014, once the state health insurance exchanges are up and running, small businesses will be eligible for tax credits of up to 50 percent of the cost of covering their workers through the exchanges (or a 35 percent refund for nonprofits).

While the Affordable Care Act created this new tax credit to help small business owners and workers, it does not force these small business owners to provide coverage for their workers. There are no employer mandates in the law, and there are no employer responsibility requirements at all for businesses with fewer than 50 workers, which account for 96 percent of all firms in the United States.⁷ Starting in 2014, businesses with 50 or more workers that do not offer coverage or that offer only unaffordable coverage to their workers will be assessed a fee if one or more of their workers receives a federal individual premium tax credit to purchase coverage in an exchange.

Looking Forward:

Increasing the Number of Small Businesses Participating in the Small Business Health Care Tax Credit

The White House estimates that at least 360,000 small businesses will take advantage of the small business health care tax credit in 2011. These small businesses provide health insurance to an estimated 2 million workers.⁸ These estimates are likely on the low end because they do not take into account three timing issues: 1) Many small business owners request an extension and will not file tax year 2011 returns until September or October of 2012; 2) qualifying small businesses that do not take the tax credit in 2011 can claim it by filing an amended return within three years; and 3) a small business that qualifies for the credit in 2011 but does not owe taxes for that year can instead apply the value of the credit to the previous year's tax liability or to taxes owed in any of the next 20 years.

Despite these caveats, these estimates do indicate that a large number of small businesses that employ many workers are already being helped. However, they also clearly show that more outreach and education about the new small business health care tax credit is needed.

There are four key reasons why more small businesses will use the small business health care tax credit in the future: 1) More small business owners will know about the tax credit, 2) accounting software packages will have integrated information about the small business health care tax credit into their products, 3) the size of the tax credit will be larger beginning in 2014, and 4) small businesses will have the advantage of purchasing coverage in new state small business health insurance exchanges beginning in 2014. We discuss each of these reasons in more detail below.

1. Over time, more small businesses will learn about this new tax credit.

A survey of small businesses conducted in November 2010 shows that the initial educational challenge has been significant. The survey found that only 43 percent of small business owners were aware of the tax credits. However, when informed about the credit, 31 percent of small business owners (and 40 percent of owners of the smallest businesses—those with three-nine employees) who offered insurance said the tax credits would make them more likely to continue providing insurance. Among small business owners who didn't offer health insurance, 33 percent said they would be more likely to do so because of the tax credits.⁹

A more recent survey conducted between January and May of 2011 shows that more needs to be done to educate small business owners about the tax credit. This survey looked at small businesses with fewer than 50 workers—both those that offered and those that did not offer health coverage.¹⁰ Among businesses that offered health coverage, only 29 percent said they had attempted to determine if they were eligible for the new tax credit. Among small businesses that did not offer health insurance, the survey found that only half of the businesses said they were even aware of the credit.¹¹ A similar survey of small businesses in California conducted between July and October 2011 found that just 21 percent of small businesses with fewer than 50 workers that offered health coverage attempted to determine whether they would be eligible for the tax credit (of those that did explore eligibility, 46 percent planned to take advantage of the credit). Among California small businesses that were not offering health insurance, only 32 percent were aware that the tax credit existed.¹² Finally, a September 2011 report issued by the Treasury Inspector General for Tax Administration concluded that “more needs to be done to ensure that taxpayers are aware of the Credit and to improve accuracy in Credit claims.”¹³

2. Accounting software packages will have integrated information about the small business health care tax credit into their products.

One stumbling block to implementation of the small business health care tax credit is the initial lack of integration of the tax credit into accounting software packages that are used by small business owners, certified public accountants, and tax preparers. Moving forward, these software packages will automatically “tee-up” information about the new tax credits.

3. More small businesses will apply for the tax credit in 2014 because the size of the tax break will be larger.

The tax credit will grow until it reimburses businesses for up to 50 percent of the cost of health insurance provided to workers. Cost is the key factor that drives decisions by small business owners to offer coverage to their workers. A larger credit will induce more owners to offer or continue offering health coverage to their workers. (President Obama has also proposed additional improvements to the tax credit that would increase the size of the tax credit and simplify how it is calculated. See “President Obama Calls for Expanding the Small Business Health Care Tax Credit” on page 9.)

President Obama Calls for Expanding the Small Business Health Care Tax Credit

In his fiscal year 2013 budget, President Obama proposed expanding the small business health care tax credit. Under the proposal, small businesses with up to 50 workers could qualify for the tax credit. The proposal also includes a new methodology for calculating the sliding scale size of the tax credit, which would allow many small businesses to qualify for a larger credit. In addition, the proposal expands and simplifies the credit by eliminating the current cap that limits the size of the credit to the average premium in the state.

The White House estimates that an additional 2 million workers would benefit from this expansion of the current small business health care tax credit.^a For example, a small

business with 15 full-time employees with average wages of \$35,000 per employee and that makes a premium contribution of \$6,000 per employee would be eligible for an \$8,400 tax credit under current law. Under the President's budget proposal, that tax credit would increase to \$18,900 in 2012 and \$27,000 in 2014.

A small business that has 30 full-time employees is not currently eligible for a small business health care tax credit. Under the President's proposal, a small business with 30 employees with average wages of \$25,000 and an employer premium contribution of \$5,000 per employee, for example, would be eligible for a \$35,000 tax credit in 2012 and a \$50,000 tax credit in 2014.

^a *President Obama's Budget Expands, Simplifies Small Business Health Care Tax Credits* (Washington: The White House Office of the Press Secretary, February 16, 2012), available online at <http://www.whitehouse.gov/the-press-office/2012/02/16/fact-sheet-president-obama-s-budget-expands-simplifies-small-business-he>.

4. In 2014, small businesses that are eligible for the tax credit will find it easier and more affordable to purchase coverage for their workers through the new state insurance exchanges called Small Business Health Options Programs (SHOPs).

These new marketplaces for insurance will be open to small businesses with up to 50 employees in the first two years and can then be expanded to businesses with up to 100 employees. In the exchanges, small employers will be able to compare easily understandable information on benefits and costs for a range of insurance plans so that they can find the policies that best meet the needs of their workers. This simplified system of shopping for and enrolling in health coverage will ease administrative burdens on small employers, who may have limited staff and time for searching for health coverage.

In addition, the SHOP exchanges will provide more coverage options with more affordable premiums and more predictable rate increases. Insurance plans that impose unreasonable rate hikes before 2014 may not be permitted to sell coverage through the exchanges. Starting in 2014, insurers will be prohibited from charging small businesses higher rates if their workers have pre-existing conditions. All premiums will be reviewed, and insurance companies will not be allowed to “pad” their premiums. And under the health care law, health plans for small businesses are required to spend at least 80 percent of the premium dollars that they collect on providing medical care and improving health care quality for enrollees. This will reduce the growth in premiums and provide more year-to-year stability and predictability in health insurance costs for small businesses and their workers.

Federal Programs Often Start Slow but Build over Time

Participation in new federal programs is frequently low in the early years but increases over time, particularly when the federal government and outside organizations undertake vigorous outreach efforts to educate those who are eligible for the new benefit. For example, nine years after they were created, the Medicare Savings Programs served fewer than half of the low-income seniors who were eligible to receive this new help with out-of-pocket Medicare costs.^a

The Children's Health Insurance Program, or CHIP, offers another example. Five years after it began, CHIP had enrolled roughly 3.5 million children—about half of those who were eligible for coverage.^b Experience with these programs and others, notably the Earned Income Tax Credit, has demonstrated that the passage of time, aided by outreach efforts, can lead to steady growth in participation.

^a Families USA, *Shortchanged: Billions Withheld from Medicare Beneficiaries* (Washington: Families USA, 1998).

^b Rachel Klein, *Children Losing Health Coverage* (Washington: Families USA, September 2002).

Addressing Health Care Disparities among Small Business Workers

The small business health care tax credit is an important tool that can be used to address the racial and ethnic disparities in access to coverage that exist among small business workers in our country. The rates of uninsurance among Hispanic and black workers are higher than the rate for white workers. According to the Kaiser Family Foundation (looking at smaller employers with fewer than 100 workers), nationally, 57 percent of Hispanic workers under the age of 65 (3.6 million) are uninsured, and 40 percent (1 million) of black workers are uninsured, compared to 24 percent of white, non-Hispanic workers.¹⁴

Many of these uninsured workers could benefit from the small business health care tax credit. As our findings show, nearly 1.2 million Hispanic and more than 100,000 black Californians work for small businesses that could qualify for this tax credit for the 2011 tax year. The potential total value of the benefit that could accrue to these workers is \$869.8 million and \$75.7 million, respectively (see Table 4 on page 4).

It is especially important that small businesses that employ Hispanic workers be educated about this new tax credit. Past focus group research has shown that Hispanic workers value health insurance, but uninsured Hispanic workers report that they didn't buy coverage because they were struggling financially and had to pay for other basics like food and rent first.¹⁵ Not only is a greater share of Hispanic workers employed by small businesses than white, non-Hispanic or black, non-Hispanic workers, but Hispanic workers are also more likely to have lower wages than black or white workers.¹⁶ In 2014, when the maximum tax credit increases to 50 percent of the cost of coverage, more eligible small businesses with Hispanic workers may be able to offer coverage. But first, these small businesses must know that the tax credit is available to them.

Conclusion

Californians in communities across the country depend on small businesses: the local diner, the family-owned hardware store, the trusted auto mechanic, and others that we rely on every day. To help these businesses and their workers prosper, the business community, the government, and the public will have to reach out together and make sure that the small business community learns about the new health care tax credit. As this analysis shows, millions of small business workers in California stand to benefit from the new small business health care tax credits in the Affordable Care Act.

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Endnotes

- ¹ Kaiser Family Foundation and Health Research and Educational Trust, *Employer Health Benefits: 2011 Annual Survey* (Washington: Kaiser Family Foundation, 2011).
- ² Quantria Strategies, LLC, *Health Insurance in the Small Business Market: Availability, Coverage, and the Effect of Tax Incentives* (Washington: Small Business Administration, Office of Advocacy, September 2011); Paul Fronstin, *Sources of Health Insurance and Characteristics of the Uninsured: Analysis of the March 2011 Current Population Survey* (Washington: Employee Benefit Research Institute, September 2011); Michelle M. Doty, Sara R. Collins, Sheila D. Rustgi, and Jennifer L. Nicholson, *Out of Options: Why So Many Workers in Small Businesses Lack Affordable Health Insurance, and How Health Care Reform Can Help* (New York: The Commonwealth Fund, September 2009).
- ³ Paul Fronstin, op. cit.
- ⁴ Sara R. Collins, Karen Davis, Jennifer L. Nicholson, and Kristof Stremikis, *Realizing Health Reform's Potential: Small Businesses and the Affordable Care Act of 2010* (New York: The Commonwealth Fund, September 2010).
- ⁵ Kaiser Family Foundation and Health Research and Educational Trust, op. cit.; Quantria Strategies, LLC, op. cit.; Michelle M. Doty, Sara R. Collins, Sheila D. Rustgi and Jennifer L. Nicholson, op. cit.
- ⁶ The credit also covers the cost of premiums for dental, vision, and long-term care plans.
- ⁷ Small Business Administration, Office of Advocacy, *Employer Firms, Establishments, Employment, and Annual Payroll Small Firm Size Classes, 2006*, based on data provided by the U.S. Census Bureau, Statistics of U.S. Businesses, available online at http://www.sba.gov/advo/research/us_06ss.pdf.
- ⁸ *President Obama's Budget Expands, Simplifies Small Business Health Care Tax Credits* (Washington: The White House Office of the Press Secretary, February 16, 2012), available online at <http://www.whitehouse.gov/the-press-office/2012/02/16/fact-sheet-president-obama-s-budget-expands-simplifies-small-business-he>.
- ⁹ Small Business Majority, *Opinion Survey: Small Business Owners' Views on Key Provisions of the Patient Protection and Affordable Care Act* (Washington: Small Business Majority, January, 2011), available online at <http://smallbusinessmajority.org/small-business-research/healthcare/small-business-healthcare-survey.php>.
- ¹⁰ This survey looked at small businesses with fewer than 50 employees in order to capture some small business with more than 25 employees who would nonetheless be eligible for the tax credit because the new law is based on full-time equivalent employees and the survey counts all employees, including part-time employees. However, this also means that some small businesses that are unlikely to be eligible for the tax credit (because they have more than 25 full-time equivalent employees) were asked the questions.
- ¹¹ Kaiser Family Foundation and Health Research and Educational Trust, op. cit.
- ¹² California HealthCare Foundation and NORC at the University of Chicago, *California Health Care Almanac, California Employer Health Benefits Survey* (Oakland, CA: California HealthCare Foundation, December 2011), available online at <http://www.chcf.org/~media/MEDIA%20LIBRARY%20Files/PDF/E/PDF%20EmployerBenefitsSurvey2011.pdf>.
- ¹³ Treasury Inspector General for Tax Administration, *Affordable Care Act: Efforts to Implement the Small Business Health Care Tax Credit Were Mostly Successful, but Some Improvements Are Needed* (Washington: Department of the Treasury, September 19, 2011), available online at <http://www.treasury.gov/tigta/auditreports/2011reports/201140103fr.pdf>.
- ¹⁴ Kaiser Family Foundation, *Health Reform and Communities of Color: Implications for Racial and Ethnic Health Disparities* (Menlo Park, CA: Kaiser Family Foundation, September 2010).
- ¹⁵ Michael Perry, Susan Kannel, and Enrique Castillo, *Barriers to Health Coverage for Hispanic Workers: Focus Group Findings* (New York: The Commonwealth Fund, December 2000).
- ¹⁶ Catherine Singley, *Fractures in the Foundation: The Latino Worker's Experience in an Era of Declining Job Quality* (Washington: National Council of La Raza, 2009).

Methodology

For this study, Families USA and the Small Business Majority commissioned The Lewin Group to estimate the number of firms that are eligible for the small business health care tax credit under the Affordable Care Act in tax year 2011. We also asked The Lewin Group to estimate the number of workers that are employed by small businesses that are eligible for these tax credits and to provide demographic information about these workers.

The small business health care tax credit is worth up to 35 percent of a small business's premium costs in 2011 (or a 25 percent refund for tax-exempt employers). In 2014, this rate will increase to 50 percent (or a 35 percent refund for tax-exempt employers). The *maximum* credit is available to smaller businesses with 10 or fewer full-time equivalent (FTE) workers and annual average wages per FTE worker of \$25,000 or less. The credit phases out on a sliding scale for firms with average wages between \$25,000 and \$50,000 and for firms with between 10 and 25 FTE workers. In order to claim the credit, eligible firms must offer coverage and pay for at least 50 percent of each employee's premium.

In 2011, the maximum value of the tax credit is equal to 35 percent of the employer's share of premiums for the average small group plan within the state. Firms with 10 or fewer FTE workers and average wages per FTE worker below \$25,000 qualify for this maximum credit. The tax credit is phased out if the number of FTEs exceeds 10 or the average wage per FTE exceeds \$25,000. The phase out formula is $(\text{FTEs} - 10) / 15 + (\text{average salary per FTE} - \$25,000) / \$25,000$. For example, a firm with 15 FTEs and average wages per FTE of \$30,000 would have its credit reduced by $(15 - 10) / 15 = 0.333 + (\$30,000 - \$25,000) / \$25,000 = 0.2 = 0.533$.

The Lewin Group used their widely respected Health Benefits Simulation Model (HBSM) for this analysis. The HBSM includes a "synthetic firm" module, which is a database of employers and workers. These data provide information about an employer's size, industry, and whether it offers coverage today. The synthetic firms also include information on each worker's wage level, demographic characteristics, full-time/part-time status, single/family coverage, and health spending. The synthetic firms were created using a statistical match of Medical Expenditure Panel Survey (MEPS) workers to the 1997 Robert Wood Johnson Foundation

employer survey (RWJF) and the 2006 Kaiser Family Foundation and Health Research and Educational Trust (HRET) employer survey. (The RWJF data are used because they contain information on the distribution of workers in firms by wage level, age, sex, hours worked per week, and single/family coverage.)

The HBSM constructs synthetic firms for each worker in the MEPS data by statistically matching the worker to a firm in the RWJF data. The Lewin Group also supplements the older RWJF data with more current data from the HRET data for health plan benefits and employer contribution levels. The Lewin Group builds a synthetic firm for each MEPS worker (called the “primary worker”) by assigning other workers in MEPS to the RWJF-HRET firms so that the final synthetic firm matches the overall profile of the firm’s workers by wage level, age, sex, hours worked per week, and single/family coverage.

The data on wages and hours worked for each of the MEPS workers in the synthetic firm provide the information necessary to construct the number of FTEs and average wage per FTE that are used to determine eligibility for the small business health care tax credit. The Lewin Group estimated FTEs by adding up the number of hours worked per week for each worker (with a maximum of 40 hours) and dividing that total by 40 hours. For example, if there were 10 workers in a firm who all worked 30 hours per week, the number of FTEs was calculated as $30 \times 10 / 40 = 7.5$. Average wage per FTE was calculated by adding up the wages for all workers in the synthetic firm and dividing that total by the number of FTEs. In the above example, if the average wage per employee was \$20,000, total payroll would be $\$20,000 \times 10 = \$200,000$. The average wage per FTE would be calculated as $\$200,000 / 7.5 = \$26,667$.

The demographic characteristics and health spending data for each MEPS worker and his or her dependents are used to estimate premiums for the synthetic firm, and data from the HRET provide information on employer contributions to premiums. The Lewin Group modeled 2011 premiums for these synthetic firms based on current small group rating rules in each state (community rating, age rating, or rating bands), reported health expenditures, and the distribution of single and family coverage for the workers assigned to each plan and the actuarial value of the employer’s plan. The data also include information on the share of the premium paid by the employer for those that offer coverage. This information was used to estimate the amount of the tax credit for eligible firms offering coverage in 2011. For firms that do not currently offer coverage, The Lewin Group assumed that these small businesses would offer a plan with an actuarial value of 70 percent and that the employer would contribute only 50 percent of the premium, which is the minimum amount required to qualify for the tax credit.

The amount of the employer premium that would be eligible for the credit is capped so as not to exceed the average premium for the small group market in the state. The Lewin Group used their synthetic firm model to estimate the average premium for all firms with fewer than 50 workers, which is the typical definition of small groups, and capped total premiums to not exceed that amount for each employer.

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