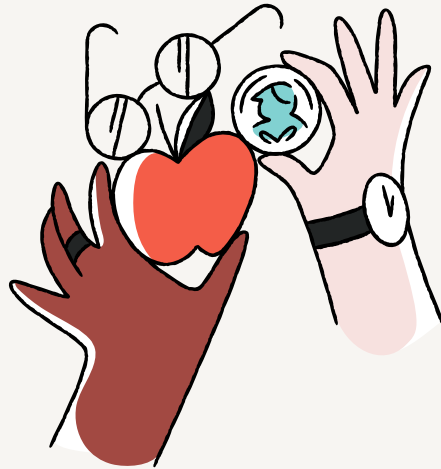


# How Health Insurance Reform Will Transform Small Businesses



# Executive summary

According to a recent study by the Urban Institute<sup>1</sup>, only 30% of small businesses (less than 50 full-time employees) offered group health insurance. Small business owners and their employees found some relief in the individual marketplace, now accounting for half of all enrollees. While encouraging, small business employees also make up 36% of the uninsured in America. We suggest reform that 1) supports small businesses, 2) helps them to compete with large companies offering health insurance, 3) makes insurance more affordable for small business employees and 4) solves a significant portion of the uninsured problem.

Currently, small businesses are not subject to the employer mandate and have no obligation to provide health insurance. To encourage them to do so, Gusto suggests allowing small employers who offer Affordable Care Act (ACA)-compliant plans to collect the premium tax credits their employees would have received in the marketplace. A second option is to reform Health Reimbursement Arrangements (HRAs) for small businesses. This would give owners more flexibility to provide tax-free funds to employees while still supporting the individual marketplace and helping to make plans more affordable. This reform would mean all small business employer HRA contributions would be additive to premium tax credits that individuals receive in the ACA marketplace.

1. <https://www.urban.org/>

## 1. Small business tax credit reform

### Rate of small businesses offering health insurance

The ACA's employer mandate proved effective in expanding health insurance to nearly all employees who work for companies with 50 or more full-time equivalent employees. However, the reason the employer mandate only applies to employers of this size is because of the significant compliance burden it would place on small business owners.

According to Kaiser Family Foundation's Annual Employer Health Benefits Survey<sup>2</sup> in 2021, the breakdown of employers offering health insurance was segmented as follows:

- 3–9 employees: **49%**
- 10–24 employees: **65%**
- 25–49 employees: **74%**

Gusto believes that one of the main goals of any health reform should be to better incentivize small employers to offer health insurance. This would lower the number of uninsured individuals among the 33 million employees in America who work for smaller companies.

2. <https://files.kff.org/attachment/Report-Employer-Health-Benefits-2021-Annual-Survey.pdf>

## Cost of health insurance for small businesses

The average annual premium for employees of small firms (3–199 employees) is \$7,813, according to Kaiser Family Foundation (KFF). While small businesses are typically required to pay 50% of the premiums for their employees, the amount contributed for family coverage varies greatly. On average, small business employees pay 37% for family coverage which amounts to \$7,710 (compared to large firms where employees on average pay 24% at \$5,269). This higher expense for employees of small firms helps explain why only 75% of small business employees eligible for health insurance enroll in a plan.

Price is the biggest factor preventing small businesses from offering health insurance to their employees. According to KFF, the top reasons small businesses choose not to offer health insurance were:

- High cost **29%**
- Too small to qualify with insurer **27%**
- Employees covered by another plan **23%**
- Employ mostly part-time staff **7%**



## The ACA's flawed SHOP tax credit solution

One of the intents of the ACA was to encourage small businesses who are not subject to the employer mandate to still offer health insurance to their employees. They did this by creating the Small Business Health Options Program (SHOP, meant to be the small business equivalent of the individual marketplace). The ACA then created tax credits exclusively for small businesses who buy insurance for their employees through SHOP, but designed these tax credits to only be applicable for the first two years that the small business provides SHOP health insurance. Additionally, to qualify for those credits, the small business must meet challenging, restrictive criteria: the small business must have less than 25 full-time equivalent employees and average salaries must be less than \$50,000.

Unfortunately, SHOP never achieved any real traction. The number of small businesses using SHOP declines every year, and in 2021, more than half of the states had no SHOP exchange plans available. In Gusto's experience, the plans offered through SHOP tend to be more expensive and offer more restrictive in-network offerings. In general the operational aspects (handling applications, enrollments, etc) are far more difficult than purchasing small group insurance directly from insurers. Additionally, the program design, including the two-year phaseout and the restrictive qualifications for the credit make the program undesirable for many small businesses. Given the restrictive nature of the tax credits, there is no real incentive for small businesses to utilize SHOP and brokers are not motivated to sell it.

### Gusto's proposed changes to the ACA SHOP tax credit

1. Permit small businesses who meet the qualification criteria to receive tax credits, regardless of where they purchase health insurance, so long as coverage meets ACA requirements. This would include essential health benefits and meets minimum essential coverage standards. It would also avoid limiting the tax credits to only those small businesses that purchase through SHOP, useful given that half of the states no longer provide small businesses a viable insurance option through this exchange.
2. Adjust qualification criteria for tax credits to expand access to more businesses.
  - a. Expand the credit from those businesses with fewer than 25 employees to any employer that is not subject to the employer mandate in a calendar year.
  - b. Eliminate the maximum average employee salary of \$50,000. This will still have proper restrictions if you follow the proposed changes in suggestion three below. This fix would incentivize employers with higher average salaries to offer health insurance to lower income employees who would not previously have been able to afford it.
  - c. Eliminate the 2-year limit on availability of tax credits.
3. Redefine the amount of the small business tax credit to an aggregate of what each employee would have received in the individual marketplace. Employees who make between 100–400% of the federal poverty level qualify for tax subsidies in the individual marketplace. The closer they are to 100% of the poverty level, the higher their tax subsidies will be. Gusto suggests giving employers the same amount for each qualified employee. This will allow small businesses to structure their offering in a way that will always bring, at minimum, the same value that each employee would have received if the employer did not offer health insurance. Here's an example scenario of an employer with three employees.

Assume the insurer requires the employer to pay at least 50% of each employee's premium and that the employer selected a plan that mirrors the marketplace's plan in coverage and cost.

  - a. Employee 1's income: \$20,000. Individual marketplace subsidy would be 70%.
  - b. Employee 2's income: \$30,000. Individual marketplace subsidy would be 40%.
  - c. Employee 3's income: \$40,000. Individual marketplace subsidy would be 10%.

## 2. Small business HRA reform

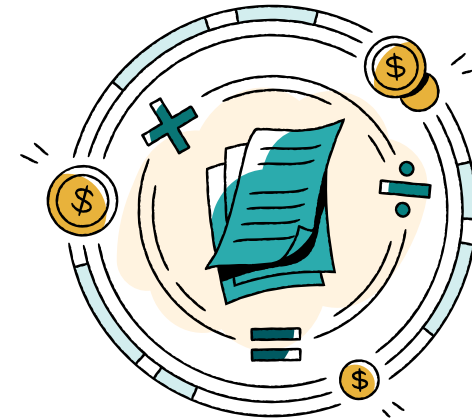
- d. The employer decides to offer all employees a 10% employer contribution with a maximum of 50% employee contribution to avoid discrimination issues and meet insurer requirements.
- e. Employee 1's total cost would be 20% (70% subsidy plus the employer's 10%).
- f. Employee 2's total cost would be 50% (40% subsidy plus the employer's 10%).
- g. Employee 3's total cost would be 50% (since the 10% subsidy and 10% employer contribution do not meet the maximum 50% employee contribution, the employer must pay an additional 30% for this employee).

Instead of paying 50% of the total monthly premiums for the entire group, which is very often cost-prohibitive for small businesses, the employer would end up paying 10%, 10%, and 40%, the cost to the government is identical, and every employee pays less than they would have on the marketplace.

- 4. Allow the employer to receive its tax credit on a monthly basis as well to lower its burden. Currently, the tax credit for small businesses is paid out on an annual basis, but the tax subsidy for individuals in the marketplace is paid on a monthly basis.

### Tale of two HRAs

There are currently two main HRAs available to small businesses: the Qualified Small Employer HRA (QSEHRA) and the Individual Coverage HRA (ICHRA). QSEHRA was established by the Obama administration via legislation wherein small employers (those not subject to the employer mandate) are eligible to provide its employees with tax-free dollars to use in the individual marketplace to purchase insurance. ICHRA was established by the Trump administration via regulation and aimed to accomplish a very similar goal, but expanded its usage and created rules by which large employers could also use HRAs to meet their employer mandate requirements.



### The biggest drawback

Unfortunately, for most small business employees, neither of these options resulted in a tax-free way to get additional funds for purchasing insurance. The problem is that if an employee or their family qualified for premium tax credits on the individual exchange, the amounts they received from their employer via an HRA would reduce their tax credits dollar for dollar. In other words, the tax credit paid by the government got lower, the premium for insurance stayed exactly the same for the employee, and the employer just spent more money. That's not really an incentive for any small employers to provide HRAs, especially those who are already strapped for cash.

The only individuals who actually benefited from the current HRA structure for small businesses were the employees who did not qualify for tax credits at all because their income was too high. Since these employees had no tax credits, HRA funds from their employers did not reduce any benefit on the marketplace for them. In practice, the HRAs today are largely only benefiting small business employees with high incomes. Small businesses should instead be prioritized to ensure that more working Americans have the opportunity to become insured.

### The solution

Gusto's proposed solution is to make all QSEHRA or ICHRA funds that small businesses (and exclusively small businesses) provide, additive to the premium tax credits that their employees receive in the individual marketplace. This will allow employees to achieve more affordable premiums on the marketplace and will incentivize the employers to offer HRA funds not only to high-income employees, but to all. This will serve the dual purpose of helping small businesses compete with large employers in terms of health benefit offering, without forcing them to bear the full burden of paying for 50% or more of their group's health insurance—a cost that's out of reach for the majority of small business owners.

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