



Testimony

Before the Subcommittee on Economic
Growth, Tax and Capital Access,
Committee on Small Business, House of
Representatives

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SMALL EMPLOYER HEALTH TAX CREDIT

Limited Use Continues Due to Multiple Reasons

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Accessible Version

GAO Highlights

Highlights of [GAO-16-491T](#), a testimony before the Subcommittee on Economic Growth, Tax and Capital Access, Committee on Small Business, House of Representatives

Why GAO Did This Study

Many small employers do not offer health insurance. The Small Employer Health Insurance Tax Credit was established as part of the Patient Protection and Affordable Care Act to help eligible small employers—businesses or tax-exempt entities—provide health insurance for employees. The base of the credit is premiums paid or the average premium for an employer's state if premiums paid were higher. In 2016, for small businesses, the credit is 50 percent of the base unless the business had more than 10 FTE employees or paid average annual wages over \$25,900.

This statement summarizes and updates GAO's prior work in May 2012, November 2014, and March 2015 on the extent to which the credit is claimed, any reasons that limit claims, and changes to the credit proposed by Congress and the administration. To conduct the updates, GAO reviewed 2013 and 2014 IRS data on credit claims and academic and government studies, and summarized proposed legislation related to the credit.

What GAO Recommends

GAO is not making recommendations in this testimony statement.

View [GAO-16-491T](#). For more information, contact James R. McTigue, Jr. at (202) 512-9110 or mctiguej@gao.gov.

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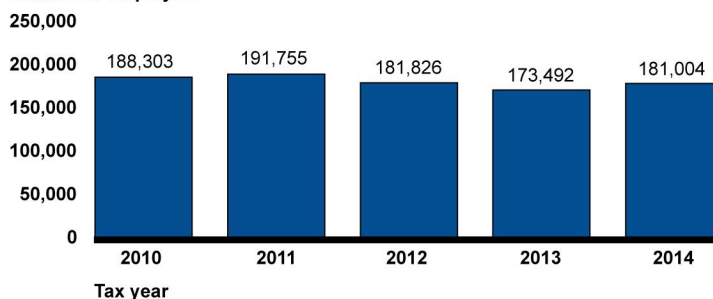
SMALL EMPLOYER HEALTH TAX CREDIT

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What GAO Found

Claims of the small employer health tax credit have continued to be lower than thought eligible by government agency and small business group estimates, limiting the effect of the credit on expanding health insurance coverage through small employers. In 2014, about 181,000 employers claimed the credit, down somewhat from 2010 (see figure). These numbers are relatively low compared to the number of employers eligible for the credit. In 2012, GAO reported that selected estimates of the number of employers eligible ranged from about 1.4 million to 4 million. In 2010, claims totaled \$468 million compared to initial estimates of \$2 billion by the Congressional Budget Office and the Joint Committee on Taxation. Actual claims for the credit in 2013 and 2014 increased slightly to about \$511 million and \$541 million, respectively.

Number of Employers That Claimed Small Employer Health Tax Credit
Number of employers



Source: IRS. | GAO-16-491T

The small employer health tax credit has not been widely claimed for a variety of reasons, as GAO reported in May 2012. The maximum amount of the credit does not appear to be a large enough incentive for employers to offer or maintain insurance. Also, few small employers qualify for the maximum credit amount. For those employers who do claim the credit, the credit amount “phases out” to zero as employers employ up to 25 full time equivalent (FTE) employees at higher wages. The amount of the credit is also limited if premiums paid by an employer are more than the average premiums for the small group market in the employer's state. Furthermore, the credit can only be claimed for two consecutive years after 2013. GAO also found that the cost and complexity involved in claiming the tax credit was significant, deterring small employers from claiming it. Many small businesses have also reported that they were unaware of the credit. Even so, the Internal Revenue Service (IRS) had been taking steps since April 2010 to raise awareness about the credit and reduce the burden on taxpayers by offering tools to help taxpayers determine eligibility for the credit.

Congress and the administration have proposed a number of changes to the credit. These include expanding the size of eligible employers, altering the phase out rules, and allowing the credit to be claimed in more than two consecutive years. Amending the eligibility requirements or increasing the amount of the credit may allow more businesses to claim the credit. However, these changes would increase its cost to the federal government.

Chairman Huelskamp, Ranking Member Chu, and Members of the Subcommittee:

Thank you for the opportunity to discuss our work on small employers' use of the health tax credit.¹ The Small Employer Health Insurance Tax Credit was established as part of the Patient Protection and Affordable Care Act (PPACA) to help eligible small employers—businesses or tax-exempt entities—provide health insurance for employees. This testimony updates our work that showed seemingly low usage of the credit and some of the reasons for this low usage.

The Small Employer Health Insurance Tax Credit is generally available to eligible small employers and tax-exempt employers who have fewer than 25 full-time equivalent (FTE) employees with average annual wages that fall below a statutorily-specified cap.² For tax year 2016, the wage cap is \$51,800.³ These small employers must cover at least 50 percent of the cost of each of their employees' self-only health insurance coverage. The credit amount is a percentage of the employer's contributions to employees' health insurance premiums. The percentage varies according to the number of FTEs, average wage paid by the employer, and whether the employer is a for-profit or tax-exempt employer. The larger the average annual wage and the greater the number of FTEs, the lower the

¹See GAO, *Small Employer Health Tax Credit: Factors Contributing to Low Use and Complexity*, [GAO-12-549](#) (Washington, D.C.: May 14, 2012), GAO, *Small Business Health Insurance Exchanges: Low Initial Enrollment Likely due to Multiple, Evolving Factors*, [GAO-15-58](#) (Washington, D.C.: Nov. 13, 2014), and GAO, *Private Health Insurance: Early Evidence Finds Premium Tax Credit Likely Contributed to Expanded Coverage, but Some Lack Access to Affordable Plans*, [GAO-15-312](#) (Washington, D.C.: March 23, 2015).

²A tax-exempt eligible small employer is one that is exempt from federal income tax under section 501(a) and described in section 501(c) of the Internal Revenue Code. 26 C.F.R. §1.45R-1(a)(20). An eligible small employer can include businesses that are corporations in a controlled group of corporations, or members of an affiliated service group, as well as partnerships, sole proprietorships, cooperatives, and trusts. A sole proprietor is an individual who owns an unincorporated business but may employ others. Credit amounts claimed by partnerships and S corporations are to be passed through to their partners and shareholders, respectively, who may claim their portions of the credit on their individual income tax returns.

³To be eligible for the full credit, employers must have 10 or fewer FTEs with average wages below \$25,900 in 2016. For 2010 to 2013, the wage cap to be an eligible employer was \$50,000, with the full credit available for small employers with averages wages for FTEs at \$25,000. Starting in 2014, the wage cap is adjusted for inflation each year using the Consumer Price Index–Urban.

credit percentage the small employer can claim, until the credit is entirely phased out. Beginning in 2014, small employers who qualify for the credit generally must purchase coverage through a Small Business Health Options Program (SHOP) exchange.⁴ SHOP exchanges, as established under PPACA, are marketplaces where small employers can shop for and purchase health coverage for their employees. All health plans available through SHOP exchanges must meet certain federally required criteria, such as providing plans that offer minimum essential health benefits. Our 2014 report noted that a primary incentive for small employers to use SHOPs has been this tax credit.⁵

The vast majority of small employers do not offer health insurance to their employees. The Medical Expenditures Panel Survey (MEPS) estimates that 83 percent of employers who may be eligible for the full credit did not offer health insurance in 2010 and that 67 percent who could be eligible for a partial credit did not offer insurance.⁶ As we discussed in our 2012 report, various factors have explained why small, low-wage employers historically tend not to offer health insurance. For example:

- For very low-wage employees, health insurance drives up total compensation costs.
- Low-wage employees generally prefer wages over insurance benefits. While employees pay income and employment taxes on wages, employees do not pay these taxes on premiums that employers pay for health insurance. However, the income tax exclusion is worth less to low-wage employees—being in a lower-income tax bracket—compared to those with higher wages.
- Insurers of small employers face higher-average fixed costs for billing and marketing and are less able to pool risk across many employees.

⁴IRS Notices 2014-6 and 2015-8 provide transition relief for certain small employers that cannot obtain coverage through a SHOP exchange because SHOP coverage is not available in their location. SHOP exchanges cover small employers with either 100 or fewer employees or 50 or fewer employees, as chosen by each state; this means that not all small employers as defined for SHOP purposes would be small enough to qualify for the credit.

⁵See [GAO-15-58](#).

⁶MEPS is a set of large-scale surveys. MEPS is administered by the Agency for Healthcare Research and Quality in the Department of Health and Human Services. In a subsequent 2013 MEPS—Insurance Component, 34.8 percent of private-sector firms with fewer than 50 employees offered health insurance compared to 95.7 percent of firms with 50 or more employees in 2013.

As a result, plans for small employers are likely to have higher premiums, less coverage, and higher costs than plans for large employers.

This statement (1) describes the extent to which the credit is being claimed by smaller employers (2) describes the reasons, if any, limiting employer claims, and (3) summarizes legislative proposals on the credit. It is based on reports we issued from May 2012 through March 2015. Detailed information about the scope and methodology for this prior work can be found in each of these reports. Much of this statement discusses findings from our May 2012 report. For that report, we reviewed Internal Revenue Service (IRS) data on credit claims for tax year 2010. We interviewed IRS officials and subject-matter specialists from government, academia, research foundations, and think tanks. We also interviewed officials of groups representing employers, tax preparers, and insurance brokers, and worked with them to assemble discussion groups on the credit. Finally, we reviewed literature about the credit and health insurance as well as IRS documentation.

We updated selected data in this statement with 2013 and 2014 data from IRS on claims of the credit by small employers. To assess the reliability of the data, we reviewed the data and supporting documentation for obvious errors, reviewed our prior use of the data, and interviewed IRS officials about the data. We found the data to be sufficiently reliable for our purposes. We also reviewed academic and government studies about the tax credit, including reports from the Congressional Research Service and the Treasury Inspector General for Tax Administration, and a web page about the credit from the Taxpayer Advocate Service. We also summarized proposed legislation on the credit.

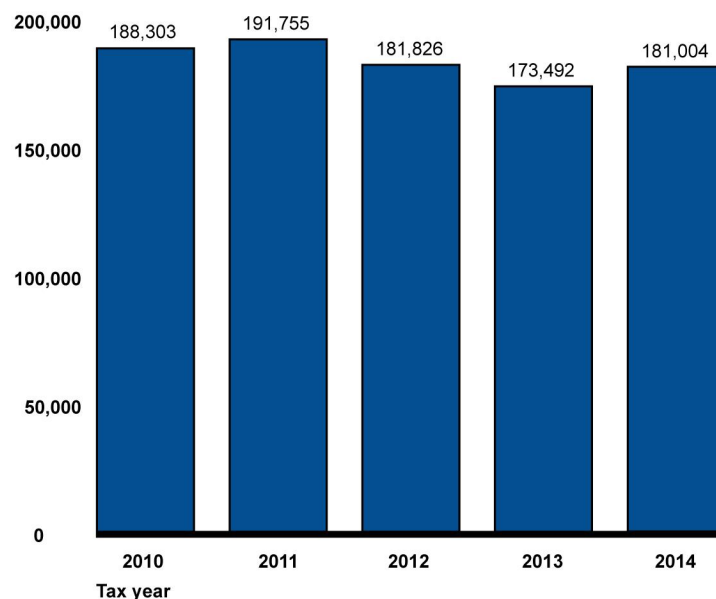
The work upon which this statement is based was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Fewer Small Employers Claimed the Credit Than Were Thought to Be Eligible

Claims of the small employer health tax credit have continued to be lower than thought eligible by government agency and small business group estimates, limiting the effect of the credit on expanding health insurance coverage through small employers. In 2014, about 181,000 employers claimed the credit, down somewhat from 2010 (see figure 1).

Figure 1: Number of Employers That Claimed Small Employer Health Tax Credit, Tax Years 2010 to 2014

Number of employers
250,000



Source: IRS. | GAO-16-491T

Note: Data for 2014 are reported on a calendar-year basis. These data differ from those we reported in [GAO-12-549](#) and [GAO-15-312](#) because additional returns were processed for a given tax year after the data were compiled by IRS.

These numbers are relatively low compared to the number of employers thought eligible for the credit. In 2012, we reported that selected estimates of the number of employers eligible ranged from about 1.4 million to 4 million.⁷ The Council of Economic Advisors estimated 4 million

⁷See [GAO-12-549](#).

and the Small Business Administration (SBA) estimated 2.6 million.⁸ Estimates made by small business groups included the Small Business Majority and the National Federation of Independent Businesses. Their estimates were 4 million and 1.4 million, respectively.⁹

A similar outcome is seen when the dollar value of credits claimed is compared to initial estimates. In 2010, claims totaled \$468 million compared to initial estimates of \$2 billion by the Congressional Budget Office (CBO) and the Joint Committee on Taxation (JCT). In March 2012, CBO and JCT estimated that the credit would cost \$1 billion in 2012 and \$21 billion from 2012 to 2021, down considerably from the original estimate of \$5 billion and \$40 billion, respectively.¹⁰ The revised estimates appear overstated as well given that actual claims for the credit in 2013 and 2014 were about \$511 million and \$541 million, respectively.¹¹

Small Employers Have Been Unlikely to Claim the Health Tax Credit for Various Reasons

Based on our interviews, discussion groups, and literature review conducted for the 2012 report, we found the small employer health tax credit has not provided a strong enough incentive for employers to begin to offer health insurance for various reasons, as discussed below.

Maximum Small Employer Credit Amount is Too Small

The maximum amount of the credit does not appear to be a large enough incentive to get employers to offer or maintain insurance. For example, the maximum amount is available to small businesses with 10 or fewer FTE employees that pay an average of \$25,900 or less in wages in tax

⁸The Council of Economic Advisors, within the Executive Office of the President, is charged with offering objective advice on forming domestic and international economic policy. SBA is a government agency that offers a variety of programs and support services to help small businesses.

⁹It is important to recognize data limitations make these estimates rough. It is not possible to combine data from available sources on three basic eligibility rules for the credit—wages, FTEs, and health insurance—to closely match the rules. Further, limited data are available on the distribution of claim amounts for business entities.

¹⁰See [GAO-12-549](#).

¹¹Data from 2013 are on a tax year basis and 2014 data are on a calendar basis because only partial tax year 2014 data were available at the time of this report.

year 2016 (adjusted for inflation in future years).¹² Such an employer could be eligible for a credit worth up to 50 percent of the premiums paid.¹³ These employers did not consider the maximum credit amount to generally be high enough, and the amount tended to be less than the maximum, as discussed below.

Few Small Employers Qualify for Maximum Small Employer Credit Amount

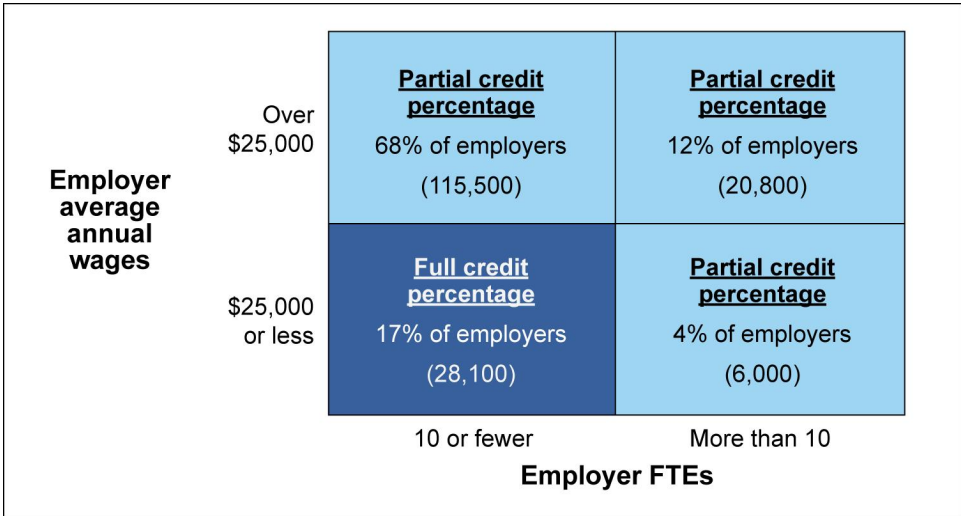
Most small employer credit claims are likely to be for less than the maximum credit percentage. To illustrate, our 2012 report analyzed how many of the approximately 170,300 small employers making claims for tax year 2010 could claim the full credit.¹⁴ As figure 2 shows, only 28,100—17 percent—could use the full credit percentage. Usually, employers could not meet the average wage requirement to claim the full percentage, as 115,500—68 percent—did not qualify based on wages, but did meet the FTE requirement.

¹²Pursuant to the requirements of the Balanced Budget and Emergency Deficit Control Act of 1985, as amended, refund payments issued to certain small tax-exempt employers claiming the refundable portion of the Small Business Health Care Tax Credit under Internal Revenue Code Section 45R, are subject to sequestration. This means that refund payments processed on or after October 1, 2015, and on or before September 30, 2016, to a Section 45R applicant will be reduced by the fiscal year 2016 sequestration rate of 6.8 percent. The Congressional Budget Office estimates that a sequestration for fiscal year 2016 will not be required.

¹³Through 2013, small businesses received up to 35 percent and tax-exempt entities received up to 25 percent of their health insurance premium payments; these portions rose to 50 percent and 35 percent, respectively, in 2014.

¹⁴This amount differs from figure 1 because additional returns were processed for tax year 2010 since we initially reported this amount in [GAO-12-549](#).

Figure 2: Percentage and Number of Small Employers Claiming the Full and Partial Credit Percentages, by FTE and Wage Requirements for the Credit, Tax Year 2010



Source: GAO analysis of IRS data on Form 8941. | GAO-16-491T

Note: This information is based on 170,300 small employer claims. This number has increased since our 2012 report because IRS later processed additional claims for tax year 2010. Numbers do not add to total because of rounding to the nearest hundred.

To the extent that a small employer qualifies to claim the credit, the employer may not be able to fully claim the credit amount for the tax year. For tax-exempt employers, the credit amount claimed cannot exceed the total amount of the employer’s payroll taxes for the calendar year. For other small employers such as small businesses, the credit is not refundable but is limited to the actual income tax liability. If a small business had a year in which it ended up paying no taxes (i.e., it had no taxable income after accounting for all its other deductions and credits), then the small business tax credit could not be used for that year as there would be no income tax for the credit to reduce.¹⁵

¹⁵An unused credit amount can generally be carried back for 1 year and carried forward up to 20 years.

Certain Credit Design Features Reduce the Amount of Credit That Can Be Claimed

Credit Amount is “Phased Out”

The credit amount that can be claimed “phases out” to zero as employers employ up to 25 FTE employees at higher wages—up to an average of \$51,800 for 2016. Table 1 shows the phasing out of the tax credit amount we calculated for a tax-exempt employer’s contribution to health insurance in 2016. Table 2 shows the phasing out for other small employers in 2016.

Table 1: Phase out of the Credit as a Percentage of Employer Contributions to Premiums, Tax-Exempt Employers, 2016

Firm size (number of full-time equivalent employees)	Average wage					
	\$25,900 and less	\$30,000	\$35,000	\$40,000	\$45,000	\$51,800
10 and fewer	32.5%	27.3%	21.1%	14.8%	8.5%	0.0%
11	30.3%	25.2%	18.9%	12.6%	6.4%	0.0%
12	28.2%	23.0%	16.7%	10.5%	4.2%	0.0%
13	26.0%	20.8%	14.6%	8.3%	2.0%	0.0%
14	23.8%	18.7%	12.4%	6.1%	0.0%	0.0%
15	21.7%	16.5%	10.2%	4.0%	0.0%	0.0%
16	19.5%	14.4%	8.1%	1.8%	0.0%	0.0%
17	17.3%	12.2%	5.9%	0.0%	0.0%	0.0%
18	15.2%	10.0%	3.7%	0.0%	0.0%	0.0%
19	13.0%	7.9%	1.6%	0.0%	0.0%	0.0%
20	10.8%	5.7%	0.0%	0.0%	0.0%	0.0%
21	8.7%	3.5%	0.0%	0.0%	0.0%	0.0%
22	6.5%	1.4%	0.0%	0.0%	0.0%	0.0%
23	4.3%	0.0%	0.0%	0.0%	0.0%	0.0%
24	2.2%	0.0%	0.0%	0.0%	0.0%	0.0%
25	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

GAO analysis of the Patient Protection and Affordable Care Act. | GAO-16-491T

Note: The maximum credit for tax-exempt employers in 2016 is 32.5 percent, which is calculated by using the 2015 and 2016 budget sequester rates in the following formula: $(((0.35)(1-0.073)(9)) + ((0.35)(1-0.68)(3))) / 12 = 32.5$ percent.

Table 2: Phase out of the Credit as a Percentage of Employer Contributions to Premiums, For-Profit Employers, 2016

Firm size (number of full- time equivalent employees)	Average wage					
	\$25,900 and less	\$30,000	\$35,000	\$40,000	\$45,000	\$51,800
10 and fewer	50.0%	42.1%	32.4%	22.8%	13.1%	0.0%
11	46.7%	38.8%	29.1%	19.4%	9.8%	0.0%
12	43.3%	35.4%	25.8%	16.1%	6.5%	0.0%
13	40.0%	32.1%	22.4%	12.8%	3.1%	0.0%
14	36.7%	28.8%	19.1%	9.4%	0.0%	0.0%
15	33.3%	25.4%	15.8%	6.1%	0.0%	0.0%
16	30.0%	22.1%	12.4%	2.8%	0.0%	0.0%
17	26.7%	18.8%	9.1%	0.0%	0.0%	0.0%
18	23.3%	15.4%	5.8%	0.0%	0.0%	0.0%
19	20.0%	12.1%	2.4%	0.0%	0.0%	0.0%
20	16.7%	8.8%	0.0%	0.0%	0.0%	0.0%
21	13.3%	5.4%	0.0%	0.0%	0.0%	0.0%
22	10.0%	2.1%	0.0%	0.0%	0.0%	0.0%
23	6.7%	0.0%	0.0%	0.0%	0.0%	0.0%
24	3.3%	0.0%	0.0%	0.0%	0.0%	0.0%
25	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

GAO analysis of the Patient Protection and Affordable Care Act. | GAO-16-491T

Notes: The maximum credit for for-profit employers is 50 percent in 2016.

Credit Amount is Reduced by State Average Premiums

The amount of the credit is also reduced if premiums paid by an employer are more than the average premiums for the small group market in the state in which the employer offers insurance. The credit percentage is multiplied by the allowable premium to calculate the dollar amount of credit claimed. For example, if the state average premium is \$4,441 for a single employee, but a small employer in that state paid \$5,000 for an employee's health premium, the credit would be calculated using the state average premium of \$4,441 rather than the \$5,000. According to IRS data, this cap reduced the credit for around 30 percent of employer claims as of 2012.

Credit is Temporary

Regardless of the allowable credit amount, small employers can claim the credit for just two consecutive years after 2013, which detracts from the incentive for small employers to begin offering coverage. Employers are

reluctant to provide a benefit to employees that would be at risk of being taken away later when the credit is no longer available. As of 2014, the two consecutive tax years for credit claims starts with the first year a qualified employer obtains coverage through a SHOP exchange. In other words, if a qualified employer first obtains coverage through a SHOP exchange in 2016, the credit would only be available to the employer in 2016 and in 2017. From 2010 through 2013, the credit was available to qualifying employers that purchased coverage in the small group market outside of SHOP exchanges, which were first established in 2014. Receipt of the credit for any years between 2010 and 2013 does not disqualify an employer from receiving the credit in 2014 and in subsequent years.

Costs and Complexity Deter Credit Claims

Small employers have not viewed the credit as a sufficient incentive to begin offering health insurance because the credit amount may not offset costs enough to justify the cost for health insurance premiums. In addition, our 2012 report described how small business owners generally do not want to spend the time or money to gather the necessary information to calculate the credit, given that the credit will likely be insubstantial. Tax preparers told us it could take 2 to 8 hours or possibly longer to gather the necessary information to calculate the credit and that the tax preparers spent, in general, 3 to 5 hours calculating the credit. To the extent that preparers did these tasks, small employers would generally incur additional cost for these services.

For example, a major complaint we heard in discussion groups with employers, tax preparers, and insurance brokers centered on gathering information on FTEs and the related health insurance premiums. Eligible employers reportedly did not have the number of hours worked for each employee readily available to calculate FTEs and their associated average annual wages nor did they have the required health insurance information for each employee readily available.

Our 2012 report also noted that the complexity involved in claiming the tax credit was significant, deterring small employers from claiming it. The complexity arises not only from the various data that must be recorded and collected (as just described), but also from the various eligibility requirements in the design of the credit and number of worksheets to be completed.

To determine eligibility requirements, exclusions from the definition of “employee” and from other rules make the calculations complex. For

calculating the number of FTEs and their wages, workers excluded from the definition of employee are seasonal workers (an employee who works no more than 120 days during the year), a self-employed individual, a 2 percent shareholder in an S-corporation, a 5 percent owner of an eligible small business, or someone who is related to or a dependent of these people. While seasonal workers are excluded from FTE counts, insurance premiums paid on their behalf count toward the tax credit. In determining premiums paid by the employer, the rules exclude employer contributions to health reimbursement arrangements, health flexible spending accounts, or health savings accounts. Similarly, an employer's premium payments exclude tobacco surcharges if an issuer charges higher premiums for tobacco users.

As for the complexity of the worksheets and paperwork to be completed to claim the credit, in 2012, tax preparers told us that they thought that IRS did the best it could with the Form 8941 given the credit's complexity.¹⁶ IRS officials said they did not receive criticism about Form 8941 itself but did hear that the instructions and its seven worksheets were too long and cumbersome for some claimants and tax preparers. On its website, as of 2012, IRS tried to reduce the burden on taxpayers by offering "3 Simple Steps" as a screening tool to help taxpayers determine whether they might be eligible for the credit. However, to calculate the actual dollars that can be claimed, we found in 2012 that the three steps become 15 calculations, 11 of which are based on seven worksheets, some of which require multiple columns of information.

Given the effort involved to make a claim and the uncertainty about the credit amounts, our 2012 report discussed the view that having a way to quickly estimate employers' eligibility for the credit and the amount they might receive would help them decide whether the credit would be worth the effort. However, we also noted in 2012 that this would not reduce the complication of finding all the documentation needed to file Form 8941. Further, some employers may believe they are eligible based on a calculator, but then turn out to be ineligible, or find they are eligible for a smaller credit amount when they complete Form 8941 with all the required information.

¹⁶See IRS Form 8941, *Credit for Small Employer Health Insurance Premiums*.

IRS's Taxpayer Advocate Service developed a calculator in 2012 to quickly estimate an employer's eligibility, but this still requires gathering information such as wages, FTEs, and insurance plans. Our analysis showed that use of this tool peaked in March 2014 with 5,383 uses, and has declined since then, falling to less than 1,000 uses by February 2016.¹⁷ The Centers for Medicare & Medicaid Services officials said they launched a SHOP Small Business Health Care Tax Credit Estimator on the federal exchange website in early 2014 to help employers determine if they qualify for the tax credit as well as the size of the credit they might receive.

Lack of Awareness May Contribute to Low Credit Claims, Although IRS Engaged in Significant Outreach

Many small businesses reported that they were unaware of the credit, as discussed in our 2012 report. The National Federation of Independent Businesses Research Foundation and the Kaiser Family Foundation both estimated that about half of small businesses were aware of the credit as of May 2011. The extent to which the lack of awareness prevented eligible employers from claiming the credit is unknown, particularly given other reasons for not claiming the credit. Further, a number of small business employers would not be eligible for the credit regardless of their awareness. Even if employers were unaware, their accountants or tax preparers may have been aware, but did not inform their clients because they did not believe their clients would qualify or because the credit amount would be very small.

To raise initial awareness of the credit, IRS conducted significant outreach, as discussed in our 2012 report. First, IRS developed a communication and outreach plan, written materials on the credit, a video, and a website. Second, IRS officials reached out to interest groups about the credit and developed a list of target audiences and presentation topics. IRS officials began speaking at events in April 2010 to discuss the credit and attended more than 1,500 in-person or web-based events from April 2010 to February 2012. Discussion of the credit at the events varied from being a portion of a presentation covering many topics to some events that focused on the credit.

¹⁷This number includes uses of a new tool, which started in May 2015. According to the Advocate's website, the tool helps to determine credit eligibility and estimate the amount, but does not determine whether the health insurance plan is eligible and which employees should be included in the credit estimation.

When we issued our 2012 report, IRS did not know whether its outreach efforts increased awareness of the credit or were otherwise cost effective. It would be challenging however to estimate the impact of IRS's outreach efforts on awareness with a rigorous methodology. As we reported in 2012, based on feedback they received, IRS officials told us they believe their efforts have been worthwhile and used this feedback to expand its outreach to include insurance brokers in 2012. IRS also issued a press release in 2014 to urge small employers to consider claiming the tax credit.

Addressing Factors and Expanding Credit Use Could Require Substantive Design Changes

Our 2012 report discussed ways that the design of the credit could be altered to spur use of the tax credit. Given that most small employers do not offer insurance and that the credit may be too small an incentive to convince employers to provide health insurance, we found that it may not be possible to significantly expand use of the credit without changing its design.

Amending the eligibility requirements or increasing the amount of the credit may allow more businesses to claim the credit, but as we noted in 2012, these changes would increase its cost to the federal government.¹⁸ Options for changing the design of the credit include the following:

- increasing the amount of the full credit, the partial credit, or both;
- increasing the amount of the credit for some by eliminating state premium averages;
- expanding eligibility requirements by increasing the eligible number of FTEs and wage limit for employers to claim the partial credit, the full credit, or both; or
- simplifying the credit calculation by (1) using the number of employees and wage information already reported on the employer's tax return, which could reduce the amount of data gathering as well as credit calculations because eligibility would be based on the number of employees rather than FTEs; and (2) offering a flat credit amount per FTE (or per employee) rather than a percentage. A tradeoff inherent in these changes would be to reduce the precision in targeting the credit.

¹⁸The data limitations that made it difficult to estimate the number of businesses eligible for the current credit also make it difficult to estimate the impact of any design changes.

Administration and Legislative Proposals to Change the Design and Status of the Credit

The administration has offered proposals to alter the small employer health tax credit. The most recent proposal as of February 2016, would (1) expand eligible employers to include those with up to 50 FTEs; (2) begin the phase out at 20 FTEs; (3) provide for a more gradual phase-out based on average wage and number of employees; (4) eliminate the requirement that an employer make a uniform contribution for each employee (although nondiscrimination laws will still apply); and (5) eliminate the limit imposed by the area average premium.

Between 2011 and 2015, Congress has considered more than 20 bills on the small employer health tax credit. Many offered ways to expand usage of the credit. For example, the bills sought to increase the number of eligible small employers (e.g., allowing an employer to have 50 FTEs); changing the phase out formula; allowing the credit to be claimed in more than two consecutive years; increasing the average annual wage limitation; eliminating the requirement that employers contribute the same percentage of cost of each employee's health insurance; eliminating the cap limiting the credit amount to average premiums paid to a state health insurance exchange; and allowing a partial credit for health insurance purchased outside of SHOP exchanges. Some of these proposed bills restricted the use of the credit for abortion coverage. At least one would have eliminated the credit and a few offered alternatives to the credit.

In closing, the Small Employer Health Insurance Tax Credit was intended to offer an incentive for small, low-wage employers to provide health insurance. However, utilization of the credit has been lower than expected, with the available evidence suggesting that the design of the credit is a large part of the reason why. While the credit could be redesigned, such changes come with trade-offs. Changing the credit to expand eligibility or make it more generous would increase the revenue loss to the federal government.

Chairman Huelskamp, Ranking Member Chu, and members of the Subcommittee, this concludes my prepared remarks. I look forward to answering any questions that you may have at this time.

GAO Contact and Staff Acknowledgments

If you or your staff have any questions about this testimony, please contact James R. McTigue, Jr., Director, Tax Issues, Strategic Issues, (202) 512-9110 or mctiguej@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. GAO staff who made key contributions to this

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Appendix I: Accessible Data

Data Tables

Data Table for Figure 1: Number of Employers That Claimed Small Employer Health Tax Credit, Tax Years 2010 to 2014

Tax Year	Number of Employers
2010	188,303
2011	191,755
2012	181,826
2013	173,492
2014	181,004

Data Table for Table 1: Phase out of the Credit as a Percentage of Employer Contributions to Premiums, Tax-Exempt Employers, 2016

Firm size (number of full time equivalent employees)	Adjusted for sequester rates					
	Average wage					
	\$25,900	\$30,000	\$35,000	\$40,000	\$45,000	\$51,800
10	32.5%	27.3%	21.1%	14.8%	8.5%	0.0%
11	30.3%	25.2%	18.9%	12.6%	6.4%	-2.2%
12	28.2%	23.0%	16.7%	10.5%	4.2%	-4.3%
13	26.0%	20.8%	14.6%	8.3%	2.0%	-6.5%
14	23.8%	18.7%	12.4%	6.1%	-0.1%	-8.7%
15	21.7%	16.5%	10.2%	4.0%	-2.3%	-10.8%
16	19.5%	14.4%	8.1%	1.8%	-4.5%	-13.0%
17	17.3%	12.2%	5.9%	-0.4%	-6.6%	-15.2%
18	15.2%	10.0%	3.7%	-2.5%	-8.8%	-17.3%
19	13.0%	7.9%	1.6%	-4.7%	-11.0%	-19.5%
20	10.8%	5.7%	-0.6%	-6.9%	-13.1%	-21.7%
21	8.7%	3.5%	-2.8%	-9.0%	-15.3%	-23.8%
22	6.5%	1.4%	-4.9%	-11.2%	-17.5%	-26.0%
23	4.3%	-0.8%	-7.1%	-13.4%	-19.6%	-28.2%
24	2.2%	-3.0%	-9.2%	-15.5%	-21.8%	-30.3%

Data Table for Table 2: Phase out of the Credit as a Percentage of Employer Contributions to Premiums, For-Profit Employers, 2016

Firm size (number of full time equivalent employees)	Average wage					
	\$25,900	\$30,000	\$35,000	\$40,000	\$45,000	\$51,800
10	50%	42.1%	32.4%	22.8%	13.1%	0.0%
11	46.7%	38.8%	29.1%	19.4%	9.8%	-3.3%
12	43.3%	35.4%	25.8%	16.1%	6.5%	-6.7%
13	40.0%	32.1%	22.4%	12.8%	3.1%	-10.0%
14	36.7%	28.8%	19.1%	9.4%	-0.2%	-13.3%
15	33.3%	25.4%	15.8%	6.1%	-3.5%	-16.7%
16	30.0%	22.1%	12.4%	2.8%	-6.9%	-20.0%
17	26.7%	18.8%	9.1%	-0.6%	-10.2%	-23.3%
18	23.3%	15.4%	5.8%	-3.9%	-13.5%	-26.7%
19	20.0%	12.1%	2.4%	-7.2%	-16.9%	-30.0%
20	16.7%	8.8%	-0.9%	-10.6%	-20.2%	-33.3%
21	13.3%	5.4%	-4.2%	-13.9%	-23.5%	-36.7%
22	10.0%	2.1%	-7.6%	-17.2%	-26.9%	-40.0%
23	6.7%	-1.2%	-10.9%	-20.6%	-30.2%	-43.3%
24	3.3%	-4.6%	-14.2%	-23.9%	-33.5%	-46.7%
25	0.0%	-7.9%	-17.6%	-27.2%	-36.9%	-50.0%

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