



## JOINT LEGISLATIVE AUDIT AND REVIEW COMMISSION Fiscal Impact Review

**Bill Number:** SB 1442  
**Review Requested By:** Senator Colgan

### JLARC Staff Fiscal Estimates

JLARC staff concur with the Department of Taxation's statement that SB 1442 may result in a significant revenue loss, and estimate that the annual revenue loss to the State could be as much as \$91 million annually.

This estimate is based on information from the 2009 Medical Expenditure Panel Survey – Insurance Component (collected by the Agency for Healthcare Research and Quality, an agency of the U.S. Department of Health and Human Services), data from the U.S. Census Bureau, 2009 County Business Patterns: Geography Area Series, and some key assumptions. Among the key assumptions are:

1. Average health insurance expenditures observed for small firms nationwide would also apply to small firms in Virginia.
2. Among firms with fewer than 25 employees from a nationwide sample, the average annual salary is the same as all firms of equal size in Virginia that pay for health insurance.
3. Employers in small firms offering health insurance to their employees pay at least 50 percent of each individual's premium cost of health insurance.

SB 1442 would allow a State tax credit equal to thirty percent of the federal health insurance tax credit (not to exceed \$5,000 for any taxable year). So any violation of assumption (3) that would result in a small Virginia firm not qualifying for a federal health insurance tax credit would also mean that the total cost of a State tax credit would also be reduced. But the frequency or magnitude of this reduction could not be estimated.

An explanation of the JLARC staff review is included on the following pages.

Authorized for Release:

  
Glen S. Tittermary  
Director

## Bill Summary

SB 1442 would allow a State individual or corporate income, bank franchise, insurance premiums, or public service corporation tax credit for eligible small employers who make contributions towards their employees' health insurance premiums. The credit would equal thirty percent of the federal health insurance tax credit, not to exceed \$5,000 for any taxable year.

Three conditions must be met for the small employer to be eligible for the federal tax credit:

- less than 25 full-time equivalent employees must be employed;
- the average salary must be less than \$50,000; and
- the employer must pay an amount equal to 50 percent or more of the premium cost of the health insurance coverage.

Because premiums vary widely by state, the IRS has capped the amount of single employee and family insurance premiums eligible for the tax credit. For Virginia, the cap is \$4,890 for single employee coverage and \$11,338 for family coverage. If an employer's total premium exceeds those caps, it would use those caps and not its actual premium rate.

The federal credit also contains a "phase-out" that reduces it when the number of full-time equivalent employees exceeds 10 or the average annual salary exceeds \$25,000. If the number of employees exceeds ten, then the initial amount of the credit (the employer's approved cost) is multiplied by the fraction:  $(\# \text{ of employees} - 10) / 15$ . If the average annual salary exceeds \$25,000, then the initial amount of the credit is multiplied by the fraction:  $(\text{average salary} - 25,000) / 25,000$ .

## Discussion of Fiscal Implications

Estimating the State tax credit is relatively simple once the federal credit is estimated. But estimating the federal tax credit is more complicated, for example because caps and phase-out reductions for small employers should be taken into account, meaning that more information is needed on small employers who pay health insurance premiums. However, the 2009 Medical Expenditure Panel Survey conducted by the Agency for Healthcare Research and Quality (an agency of the U.S. Department of Health and Human Services) has information on health insurance expenditures of a nationwide sample of employers, including establishments with 25 or fewer employees. Assuming that the patterns shown in the nationwide sample are generally representative of those of Virginia employers as well, an approximate upper bound of the fiscal impact of a State tax credit as described in S.B.1442 can be estimated, in two basic steps.

*Step 1: Estimate the average cost per employee to the employer of employee health insurance premiums.*

First, many employers pay for none of their employees' health insurance, and would not qualify for the proposed tax credit. In fact, according to the Medical Expenditure survey, only about one-third of the firms with less than ten employees (and about two-thirds of firms with ten to 24 employees) pay anything towards their employees' health insurance. Further, it is assumed in this analysis that all small employers who include at least some of their employees' health insurance as part of the compensation package would pay for at least 50 percent of each employee's total health insurance premium. Relaxing this assumption would result in some employers not being eligible for the tax credit and therefore the final estimate of this analysis being reduced. But there currently is no information available on how many employers pay less than 50 percent of their employees' health insurance premiums. The Medical Expenditure survey indicates, however, that among the employers who do pay for their employee's health insurance, on average they are

paying from 70 to 85 percent of the total insurance premiums. (Exact percentages by type of coverage and size of employer are provided in Table 1.)

<b>Table 1 – Average Percentage of Employees’ Health Insurance Premium Paid by Employers, by Type of Coverage</b>		
<b>Type of Coverage</b>	<b>Number of Employees in Establishment</b>	
	<b>Less than Ten</b>	<b>Ten to 24</b>
<b>Single</b>	84.2	85.4
<b>Employee + 1</b>	76.1	71.1
<b>Family</b>	75.2	78.3

Source: Agency for Healthcare Research and Quality, Center for Financing, Access and Cost. 2009 Medical Expenditure Panel Survey – Insurance Component.

According to the Medical Expenditure survey, employers with less than ten employees that pay for health insurance on average have about 59 percent of their employees receiving Single Employee coverage, about 13 percent receiving Employee-Plus-One coverage, and about 27 percent receiving Family coverage. The comparable percentages for employers with ten to 24 employees are also provided in Table 2.

<b>Table 2 – Average Percentage of Employees in Small Establishments Taking Different Types of Coverage</b>		
<b>Type of Coverage</b>	<b>Number of Employees in Establishment</b>	
	<b>Less than Ten</b>	<b>Ten to 24</b>
<b>Single</b>	59.2	59.2
<b>Employee + 1</b>	13.4	14.6
<b>Family</b>	27.3	26.2

Source: Agency for Healthcare Research and Quality, Center for Financing, Access and Cost. 2009 Medical Expenditure Panel Survey – Insurance Component.

Calculating the average premium costs that are eligible for the tax credit for each type of coverage is more challenging, because of the caps imposed on the total premiums. For example, according to the Medical Expenditure survey, for establishments with less than ten employees, the average premium for single employee coverage is \$4,982, but that average includes employers who pay over Virginia’s cap of \$4,890. Table 3 shows that employers at or above the 75<sup>th</sup> percentile are paying at least \$6,000 for single employee coverage. That means 25 percent of employers are paying at least \$1,110 above the cap that is recognized for Virginia. Further, Table 3 shows that employers at or above the 90<sup>th</sup> percentile are paying at least \$8,000, meaning that 10 percent (out of that 25 percent) of employers are paying at least \$3,110 above the cap. So the average \$4,982 should be adjusted downwards, to account for the 15 percent of employers who are known to be paying at least \$1,110 above the cap, and the 10 percent of employers known to be paying at least \$3,110 over the cap. The resulting adjusted average of premiums recognized for the tax credit among employers with less than ten employees who offer single employee coverage is \$4,504.50.

Using the information in Table 3, similar adjustments can be made to the average premiums for other types of coverage and for employers with ten to 24 employees. (The cap for family coverage is assumed to apply to employee-plus-one coverage.) These adjustments would tend to understate the actual differences, on average, between the actual premiums paid and the caps that are recognized for the tax credit. But at least they would reduce the error in the final upper-bound estimate. Estimates of the adjusted average recognized premium costs for the different types of coverage and the different employer groups are shown in Table 4.

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**Table 3 – Premium Distributions (in Dollars) for Employees Enrolled in Single, Employee-Plus-One, and Family Coverage at Private-Sector Establishments that Offer Health Insurance**

	Number of Employees in Establishment	
	Less than Ten	Ten to 24
<b>Single coverage</b>		
Average (mean)	4,982	4,573
10 <sup>th</sup> percentile	2,400	2,500
25 <sup>th</sup> percentile	3,500	3,300
50 <sup>th</sup> percentile (median)	4,600	4,200
75 <sup>th</sup> percentile	6,000	5,500
90 <sup>th</sup> percentile	8,000	6,900
<b>Employee + 1 coverage</b>		
Average (mean)	9,687	9,163
10 <sup>th</sup> percentile	4,900	4,900
25 <sup>th</sup> percentile	6,600	6,500
50 <sup>th</sup> percentile (median)	9,200	8,900
75 <sup>th</sup> percentile	12,000	11,000
90 <sup>th</sup> percentile	14,000	14,000
<b>Family coverage</b>		
Average (mean)	12,040	11,900
10 <sup>th</sup> percentile	6,200	6,900
25 <sup>th</sup> percentile	8,500	9,100
50 <sup>th</sup> percentile (median)	12,000	11,000
75 <sup>th</sup> percentile	15,000	14,000
90 <sup>th</sup> percentile	18,000	17,000

Source: Agency for Healthcare Research and Quality, Center for Financing, Access and Cost. 2009 Medical Expenditure Panel Survey – Insurance Component.

**Table 4 – Adjusted Average Recognized Premium Costs (in Dollars)**

Type of Coverage	Number of Employees in Establishment	
	Less than Ten	Ten to 24
<b>Single</b>	4,504.50	4,280.50
<b>Employee + 1</b>	9,321.50	8,896.80
<b>Family</b>	10,659.00	10,934.50

Source: JLARC staff analysis of information from the Agency for Healthcare Research and Quality, Center for Financing, Access and Cost. 2009 Medical Expenditure Panel Survey – Insurance Component.

Taking the information in Tables 1, 2, and 4 altogether, the average premium cost per employee to the employer that is recognized for the tax credit is \$5,402.80 for employers with less than ten employees, and \$5,330.70 for employers with ten to 24 employees.

*Step2: Apply the average cost per employee to firms with varying numbers of employees to estimate the potential cost of the federal tax credit and State tax credit.*

Step 2 can be thought of as having two parts. The first part entails using the average cost per employee to estimate the average credit to each firm with varying numbers of employees. The second part is to estimate the number of each type of establishment in Virginia that would be eligible for the tax credit, and to estimate the total potential federal and State tax credits.

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Table 5 shows how the first part can be carried out. The average total health insurance cost to the employer (Column 3) is determined by multiplying the number of employees in the firm (Column 1) times the average health insurance cost per employee (Column 2, which was determined at the end of Step 1). The “initial credit” is determined as 35 percent of the employer’s health insurance costs. (It may be lower for tax-exempt small employers, but because the proportion of small employers who are tax exempt could not be determined, this complication was not taken into account in the JLARC staff estimate.) This “initial credit” is subject to two possible reductions: if the firm has more than ten employees, and if the average salary exceeds \$25,000. The reduction for having more than 10 employees is relatively simple to calculate: it is the initial credit times a fraction (namely  $[\# \text{ employees} - 10] / 15$ ) (Column 4). But estimating the reduction for having an average salary over \$25,000 somewhat more complicated (Column 5).

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Number of employees in establishment	Average health ins. cost per employee (\$)	Average total health ins. cost to employer (\$)	Initial credit (\$)	Credit reduction for having more than 10 employees (\$)	Credit reduction for having average salary over \$25,000	Average federal credit per establishment (\$)	Average State credit per establishment (\$)
1	5,403	5,403	1,891	-	1,269	622	187
2	5,403	10,806	3,782	-	2,538	1,244	373
3	5,403	16,208	5,673	-	3,807	1,865	560
4	5,403	21,611	7,564	-	5,077	2,487	746
5	5,403	27,014	9,455	-	723	8,732	2,620
6	5,403	32,417	11,346	-	867	10,479	3,144
7	5,403	37,820	13,237	-	1,012	12,225	3,668
8	5,403	43,222	15,128	-	1,156	13,971	4,191
9	5,403	48,625	17,019	-	1,301	15,718	4,715
10	5,331	53,308	18,658	-	8,292	10,366	3,110
11	5,331	58,629	20,524	1,368	9,121	10,035	3,010
12	5,331	63,970	22,389	2,985	9,950	9,454	2,836
13	5,331	69,300	24,255	4,851	10,779	8,625	2,588
14	5,331	74,631	26,121	6,966	11,608	7,547	2,264
15	5,331	79,962	27,987	9,329	12,437	6,221	1,866
16	5,331	85,293	29,852	11,941	13,266	4,645	1,394
17	5,331	90,623	31,718	14,802	14,096	2,821	846
18	5,331	95,954	33,584	17,911	14,925	748	224
19	5,331	101,285	35,450	21,720	15,754	-	-
20	5,331	106,616	37,316	24,877	19,989	-	-
21	5,331	111,947	39,181	28,733	20,989	-	-
22	5,331	117,277	41,047	32,838	21,988	-	-
23	5,331	122,608	42,913	37,191	22,988	-	-
24	5,331	127,939	44,779	41,793	23,987	-	-

Source: JLARC staff analysis of data from: the Agency for Healthcare Research and Quality, Center for Financing, Access and Cost. 2009 Medical Expenditure Panel Survey – Insurance Component; and the U.S. Census Bureau, 2009 County Business Patterns: Geography Area Series: County Business Patterns by Employment Class Size.

The average salary paid by small employers who also offer health insurance is not known. But the payrolls and number of paid employees of all small firms in Virginia is known, as shown in Table 6. If it is assumed that employees of firms that offer health insurance are paid about the same as those of all firms of comparable size, then the reduction due to average salaries being higher than \$25,000 could be approximated.

<b>Number of Employees in Each Establishment</b>	<b>Number of Establishments</b>	<b>Number of Paid Employees</b>	<b>Annual Payroll (\$1,000s)</b>	<b>Average Portion of Payroll Paid per Employee</b>
<b>1 – 4</b>	102,964	182,463	7,623,081	41,779
<b>5 – 9</b>	37,084	245,518	8,607,095	26,911
<b>10 – 19</b>	25,786	347,933	12,563,887	36,110
<b>20 - 49</b>	17,694	534,134	20,506,490	39,392

Source: JLARC staff analysis of data from the U.S. Census Bureau, 2009 County Business Patterns: Geography Area Series: County Business Patterns by Employment Class Size.

Assuming that the average portion of payroll paid per employee is comparable to the small firms' average salaries, Table 6 shows that the average salaries paid by small businesses often far exceed \$25,000. The average portion of payroll paid per employee in Table 6 was treated as the average salary for each type of employer in Table 5. Column 6 in Table 5 indicates that the average employer in each category receives a substantial reduction because of salaries exceeding \$25,000.

For each category of employer in Table 5, the average federal and State tax credits per eligible firm are shown. The federal tax credit was derived by taking the initial tax credit (Column 4) and subtracting the reductions in Columns 5 and 6. The average State tax credit was derived by multiplying the average federal tax credit by 30 percent. (The cap of \$5,000 on the State tax credit did not apply to these averages.)

As shown in Table 7, the second part of Step 2 is to derive the total cost of the tax credit from the average credit per employer. To get the total cost from an average, the number of corresponding employers eligible for the credit needs to be known. Table 6 shows that, according to the U.S. Census Bureau, in 2009 there were in Virginia 102,965 establishments with 1 to 4 employees, 37,084 establishments with 5 to 9 employees 25,786 establishments with 10 to 19 employees, and 17,694 establishments with 20 to 49 employees. The simplest assumption is made that these aggregated numbers are evenly distributed across establishments with specific numbers of employees within each group. Although the aggregate pattern appears to be an exponential function, specifying an exponential function with varying values within each group would be highly speculative.

Further, it was known from the Medical Expenditure survey that 36 percent of all establishments with one to nine employees, and that 63 percent of all establishments with ten to 24 employees, offered health insurance to them. And it is assumed in this analysis that all of these firms offering health insurance would be eligible for the tax credit.

**Table 7 – Estimating Total Cost of Tax Credit from Average Establishment’s Tax Credit**

Number of employees in establishment	Average federal credit per establishment (\$)	Average State credit per establishment (\$)	Assumed number of establishments in VA	Proportion of establishments providing health insurance	Potential cost of federal tax credit (\$)	Potential cost of State tax credit (\$)
1	622	187	25,741	0.34	5,378,138	1,613,441
2	1,244	373	25,741	0.34	10,756,276	3,226,883
3	1,865	560	25,741	0.34	16,134,413	4,480,324
4	2,487	746	25,741	0.34	21,512,551	6,453,765
5	8,732	2,620	7,417	0.34	21,760,948	6,528,284
6	10,479	3,144	7,417	0.34	26,113,135	7,833,941
7	12,225	3,668	7,417	0.34	30,465,325	9,139,597
8	13,971	4,191	7,417	0.34	34,817,514	10,445,254
9	15,718	4,715	7,417	0.34	39,169,703	11,750,911
10	10,366	3,110	2,579	0.63	16,706,527	5,011,958
11	10,035	3,010	2,579	0.63	16,172,095	4,851,628
12	9,454	2,836	2,579	0.63	15,236,737	4,571,021
13	8,625	2,588	2,579	0.63	13,900,456	4,170,137
14	7,547	2,264	2,579	0.63	12,163,250	3,648,975
15	6,221	1,866	2,579	0.63	10,025,119	3,007,536
16	4,645	1,394	2,579	0.63	7,486,064	2,245,819
17	2,821	846	2,579	0.63	4,546,064	1,363,825
18	748	224	2,579	0.63	1,205,179	361,554
19	-	-	2,579	0.63	-	-
20	-	-	590	0.63	-	-
21	-	-	590	0.63	-	-
22	-	-	590	0.63	-	-
23	-	-	590	0.63	-	-
24	-	-	590	0.63	-	-
<b>TOTAL</b>					<b>303,549,511</b>	<b>91,064,853</b>

Source: JLARC staff analysis of data from: the Agency for Healthcare Research and Quality, Center for Financing, Access and Cost. 2009 Medical Expenditure Panel Survey – Insurance Component; and the U.S. Census Bureau, 2009 County Business Patterns: Geography Area Series: County Business Patterns by Employment Class Size.

The components and assumptions described in this review can be used to estimate a total cost of the proposed State tax credit for each type of establishment (that is, each establishment with a specific number of employees), and then to sum across establishments with one to 24 employees. The total estimate of the cost of the State tax credit could be as high as \$91 million. However, if some assumptions made in this analysis are relaxed and fewer employers are eligible for the tax credit, then this total estimate could be lower.

**Budget Amendment Necessary:** No

**Agencies Affected:** Department of Taxation

**Date Released, Prepared By:** 12/05/2011; Greg Rest

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