May 2012

SMALL EMPLOYER HEALTH TAX CREDIT

Factors Contributing to Low Use and Complexity

GAO — Accountability * Integrity * Reliability

Highlights

Highlights of GAO-12-549, a report to congressional requesters

Why GAO Did This Study

Many small employers do not offer health insurance. The Small Employer Health Insurance Tax Credit was established 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 2010, for small businesses, the credit was 35 percent of the base unless the business had more than 10 FTE employees or paid average annual wages over $25,000.

GAO was asked to examine (1) the extent to which the credit is claimed and any factors that limit claims, including how they can be addressed; (2) how fully IRS is ensuring that the credit is correctly claimed; and (3) what data are needed to evaluate the effects of the credit.

GAO compared IRS data on credit claims with estimates of eligible employers, interviewed various credit stakeholders and IRS officials as well as academicians on evaluation, compared IRS credit compliance documents with the rules and practices used for prior tax provisions and IRS strategic objectives, and reviewed literature and data.

What GAO Recommends

GAO recommends that IRS (1) improve instructions to examiners working on cases on the credit and (2) analyze results from examinations of credit claimants and use those results to identify and address any errors through alternative approaches. IRS agreed with GAO's recommendations.

View GAO-12-549. For more information, contact James R. White at (202) 512-9110 or whitej@gao.gov.

What GAO Found

Fewer small employers claimed the Small Employer Health Insurance Tax Credit in tax year 2010 than were estimated to be eligible. While 170,300 small employers claimed it, estimates of the eligible pool by government agencies and small business advocacy groups ranged from 1.4 million to 4 million. The cost of credits claimed was $468 million. Most claims were limited to partial rather than full percentage credits (35 percent for small businesses) because of the average wage or full-time equivalent (FTE) requirements. As shown in the figure, 28,100 employers claimed the full credit percentage. In addition, 30 percent of claims had the base premium limited by the state premium average.

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

Employer average annual wages	Employer FTEs: 10 or fewer	Employer FTEs: More than 10
Over $25,000	Partial credit percentage 115,500	Partial credit percentage 20,800
$25,000 or less	Full credit percentage 28,100	Partial credit percentage 6,000

Source: GAO analysis of IRS data on Form 8941.

Notes: This information is based on the approximately 170,300 small employer claims. Numbers are rounded to the nearest hundred. Numbers don't add up because of rounding.

One factor limiting the credit's use is that most very small employers, 83 percent by one estimate, do not offer health insurance. According to employer representatives, tax preparers, and insurance brokers that GAO met with, the credit was not large enough to incentivize employers to begin offering insurance. Complex rules on FTEs and average wages also limited use. In addition, tax preparer groups GAO met with generally said the time needed to calculate the credit deterred claims. Options to address these factors, such as expanded eligibility requirements, have trade-offs, including less precise targeting of employers and higher costs to the Federal government.

The Internal Revenue Service (IRS) incorporated practices used successfully for prior tax provisions and from IRS strategic objectives into its compliance efforts for the credit. However, the instructions provided to its examiners (1) do not address the credit's eligibility requirements for employers with non-U.S. addresses and (2) have less detail for reviewing the eligibility of tax-exempt entities' health insurance plans compared to those for reviewing small business plans. These omissions may cause examiners to overlook or inconsistently treat possible noncompliance. Further, IRS does not systematically analyze examination results to understand the types of errors and whether examinations are the best way to correct each type. As a result, IRS is less able to ensure that resources target errors with the credit rather than compliant claimants.

Currently available data on health insurance that could be used to evaluate the effects of the credit do not match the credit's eligibility requirements, such as information to convert data on number of employees to FTEs. Additional data that would need to be collected depend on the questions policymakers would want answered and the costs of collecting such data.