



## Federal Health Care Reform Includes Hidden Penalties for New Hampshire Businesses

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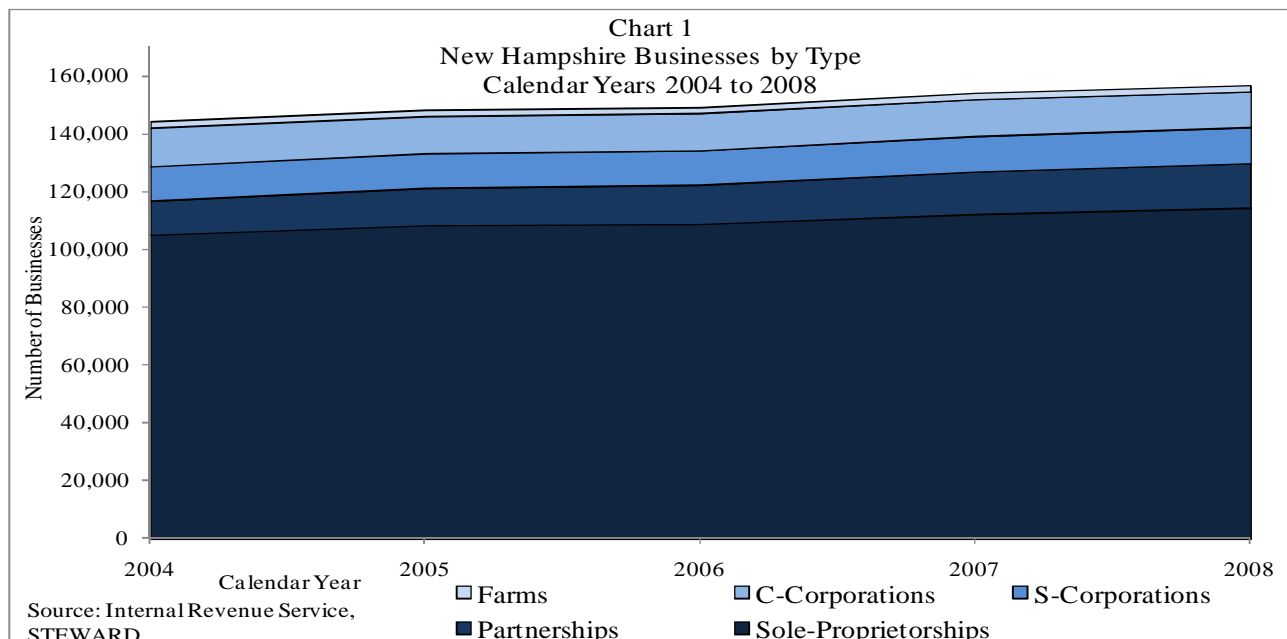
### Executive Summary

New Hampshire’s business community is large and diverse, comprised of 156,568 enterprises that have enjoyed robust growth. If each business represented one person, the group would out-number the population of Merrimack County (148,161), or the cities of Manchester and Concord combined (150,841). These New Hampshire businesses should brace themselves for the negative economic impact of health care reform proposals currently being debated in Congress—especially the “play-or-pay” health insurance mandate and the income tax surcharge on higher income individuals.

The “play-or-pay” health insurance mandate would cost New Hampshire businesses \$215 million to \$229 million every year. Despite being called a “mandate,” this proposal represents the economic equivalent of a tax. If New Hampshire’s state government were to fund this mandate from taxes, the state would, to put this issue into a broader context, have to double the Business Enterprise Tax (\$222 million in FY 2008) or double the Meals and Rental Tax (\$207 million in FY 2008). Now we understand why it’s called a “mandate” and not a “tax.” Unfortunately, the economic carnage is the same.

The income tax surcharge would add three new marginal tax rate brackets to the federal income tax code in order to pay, at least in part, for the cost of health care reform. As a result, in 2011, New Hampshire businesses that file through the individual income tax code will face a federal marginal income tax rate of 47.25 percent. This higher tax rate will erode New Hampshire’s ability to compete internationally. In fact, 21 of the 30 member countries in the Organization for Economic Cooperation and Development (OECD) will have marginal income tax rates below all U.S. states, including countries such as Canada (46.41 percent), France (45.8 percent) and Italy (44.9 percent).

Despite the progress that New Hampshire’s state and local governments have made to ensure the state remains economically competitive—both at home and abroad—the actions of the federal government stand to undermine these efforts. The proposals pending in Congress to address health care reform through the “play-or-pay” health insurance mandate and the income tax surcharge will represent hidden penalties for New Hampshire businesses. In the long-run, this will discourage job creation in New Hampshire and reduce access to quality health care.



## Introduction

While the debate over federal health care reform is very fluid, this study is based on the only definitive piece of federal legislation on the topic—“America’s Affordable Health Choices Act” (H.R. 3200), which has passed through several committees in the U.S. House of Representatives. Reconciling the differences between the U.S. Senate and House bills will ultimately decide the final form of any health care reform legislation that Congress sends to President Obama.

That being said, the two items examined by this study—the “play-or-pay” health insurance mandate and the income tax surcharge—are central to nearly every serious proposal that has been discussed to date. Therefore, while specific provisions may change, New Hampshire’s businesses should brace themselves for the negative economic impact of these two features of health care reform.

## Counting New Hampshire’s Businesses

Before estimating the consequences of health care reform on New Hampshire businesses, it is first necessary to understand the scope of the state’s business community. Chart 1 and Table 1 show the breakdown of New Hampshire business by type between 2004 and 2008.[1] Since 2004, the total number of businesses has grown by an estimated 8.6 percent, to 156,568 from 144,110.[2]

Calendar Year	Farms (a)	Sole-Proprietorships (a)	Partnerships	S-Corporations	C-Corporations	Total
2004	2,102	105,028	11,789	12,142	13,049	144,110
2005	2,069	108,314	12,976	12,085	12,672	148,116
2006	2,062	108,827	13,517	12,056	12,543	149,005
2007	2,154	112,246	14,749	12,253	12,506	153,908
2008	2,169	114,463	15,373	12,508	12,055	156,568
Percent Change	3.2%	9.0%	30.4%	3.0%	-7.6%	8.6%

(a) 2008 farms and sole-proprietorships are estimated.  
Source: Internal Revenue Service, STEWARD.

By far the most common form of business is sole-proprietorships, which comprised 73.1 percent of all businesses in 2008. The least common type of business was farms, at 1.4 percent. The remainder is nearly evenly split between partnerships, S-Corporations and C-Corporations. Every type of business increased in number between 2004 and 2008, with the exception of C-Corporations, which declined by 7.6 percent.

Overall, New Hampshire’s business community is large and diverse, and has shown healthy growth between 2004 to 2008. To put the scope of business in New Hampshire into perspective: if each business represented one person the group would out-number the population of Merrimack County (148,161), or the cities of Manchester and Concord combined (150,841).[3]

## Costs of “Play-or-Pay” Health Insurance Mandate[4]

H.R. 3200 includes a “play-or-pay” health insurance mandate. That means if businesses don’t offer qualified health insurance—the “play” portion—they must pay a penalty—the “pay” portion. More specifically, according to the bill: “Employers with more than \$250,000 in annual payroll must offer their employees health insurance coverage or pay an amount equal to 2 to 8 percent of each worker’s wages into a Health Insurance Exchange Trust Fund.”[5]

Overall, there are three basic scenarios from which new costs will be imposed on businesses: 1) the cost of paying the penalty, 2) the cost of providing insurance not currently provided, or 3) the higher share of the employer-paid premium. Table 2 shows that this health insurance mandate will cost businesses nationwide between \$49.4 billion and \$52.7 billion. New Hampshire’s businesses will bear up to \$215 million to \$229 million of those new costs.[6]

State	Total Cost (Billions of Dollars)
United States	\$49.4 to \$52.7
New Hampshire	\$0.215 to \$0.229 (a)

(a) See note 6 for details.  
Source: The Heritage Foundation, STEWARD.

However, don’t be fooled by legislative language that calls this provision in H.R. 3200 a “health insurance mandate.”

This mandate is the economic equivalent of a tax. In fact, Lawrence Summers, the Director of the White House’s National Economic Council for President Obama, found that “mandated benefits are like public programs financed by benefit taxes.”[7]

Accordingly, it is appropriate to compare the magnitude of the mandate cost with other New Hampshire taxes in order to shed some perspective on its negative economic impact. If New Hampshire’s state government were to fund this new federal mandate from taxes, the state would have to double the Business Enterprise Tax (\$222 million in FY 2008) or double the Meals and Rental Tax (\$207 million in FY 2008).[8] Now we understand why it’s called a “mandate” and not a “tax.” Unfortunately, the economic carnage is the same.

### Costs of Income Tax Surcharge

H.R. 3200 would add three new marginal tax rate brackets to the federal income tax in order to pay, at least in part, for the cost of health care reform: a 1 percentage point surtax for income between \$350,000 and \$500,000; a 1.5 percentage point surtax for income between \$500,000 and \$1,000,000; and a 5.4 percentage point surtax for income over \$1,000,000.[9] The legislation contains a trigger provision that if certain cost savings fail to materialize by 2012, the surtax will increase—the 1 and 1.5 percentage point surtaxes will rise to 2 and 3 percentage points, respectively.

While these tax rate hikes are in the individual income tax, it will affect the vast majority of New Hampshire’s businesses because every business—except C-corporations—file through the individual income tax. In fact, as shown in Table 3, 73.7 percent of all taxpayers in the top 1 percent of income (over \$317,000 in 2004) report some business income.[10] Additionally, the percentage climbs with income, including 82.7 percent of those earning over \$1 million reporting business income.[11] Therefore, higher marginal income tax rates on taxpayers earning more than \$350,000 is really a disguised tax hike on business.

Table 4 shows what the top marginal tax rate (combined federal, state and local) will be for the 50 states in 2011, when the proposed health care legislation would take effect and the first year after President Bush’s tax cuts expire.[12] Also shown are the top combined marginal tax rates for member countries in the OECD. Despite New Hampshire’s domestic reputation as a low-tax state with no broad-based income or sales taxes, New Hampshire businesses will face a federal marginal income tax rate of 47.25 percent.[13]

Income Range	Percentage of Taxpayers with Business Income
\$317,000 to \$499,999	68.2%
\$500,000 to \$999,999	76.6%
\$1 million and above	82.7%
Average of Taxpayers in the Top 1 percent of Earners (over \$317,000)	73.7%

Source: Tax Foundation, see notes 10 and 11.

This high marginal tax rate is a testament to how much of New Hampshire’s business competitiveness is driven by federal tax policies. Consider how this high tax rate affects New Hampshire’s ability to compete internationally: out of the 80 U.S. states and OECD member countries, New Hampshire would only rank in the middle-of-the-pack in a nine-way tie at the 42<sup>nd</sup> spot. Only eight of the OECD countries rank higher than New Hampshire. New Hampshire’s poor international standing is due entirely to federal taxes.

New Hampshire’s nearest international competitor, Canada, would even have a lower tax rate at 46.41 percent. In fact, 21 of the 30 OECD countries will have marginal income tax rates below any U.S. state including countries such as France (45.8 percent) and Italy (44.9 percent). Ironically, the two former Communist countries which are members of the OECD have the lowest marginal income tax rates of them all—the Slovak Republic (19 percent) and the Czech Republic (15 percent).

New Hampshire’s Congressional delegation should reflect long and hard before working against the long-term efforts of New Hampshire’s state and local governments to keep the state economically competitive. These higher income tax rates at the federal level will harm New Hampshire’s international economic competitiveness.

### Conclusion

Despite the progress that New Hampshire’s state and local governments have made to ensure the state remains economically competitive—both at home and abroad—the actions of the federal government stand to undermine these efforts. The proposals for federal health care reform through the “play-or-pay” health insurance mandate and the income tax surcharge will represent hidden penalties for New Hampshire businesses. In the long-run, this will discourage job creation in New Hampshire and reduce access to quality health care.

## Notes and Sources:

- [1] 2004 is the earliest data available from the Internal Revenue Service that distinguishes between S-Corporations and C-Corporations. As discussed later in the study, this distinction is important.
- [2] 2008 farms and sole-proprietorships are estimated.
- [3] Population data is from the U.S. Department of Commerce's Census Bureau and is current as of July 1, 2008. The data can be found at: <http://www.census.gov/popest/cities/tables/SUB-EST2008-05-33.xls>
- [4] This section and Table 2 draws heavily from: Wilson, D. Mark, "Economics of Play-or-Pay Mandates in Health Care Reform Bills," The Heritage Foundation, Backgrounder No. 2312, August 28, 2009. [http://www.heritage.org/Research/Health care/bg2312.cfm](http://www.heritage.org/Research/Health%20care/bg2312.cfm)
- [5] Ibid, pg. 2.
- [6] New Hampshire's share was calculated by multiplying the national costs by New Hampshire's share of total businesses. From Table 1, in 2008, New Hampshire had an estimated 156,568 businesses out of 36,019,456 nationally—or 0.43 percent.

Rank	State/Nation	Top Rate	Rank	State/Nation	Top Rate	Rank	State/Nation	Top Rate
--	<b>Denmark</b>	<b>59.73%</b>	25	Oklahoma	52.23%	42	South Dakota*	47.25%
1	Oregon	57.54%	--	<b>U.S.</b>	<b>52.14%</b>	42	Tennessee*	47.25%
2	Hawaii	57.22%	26	Massachusetts	52.05%	42	Texas*	47.25%
3	New Jersey	57.07%	--	<b>Netherlands</b>	<b>52.00%</b>	42	Washington*	47.25%
4	New York	56.92%	27	Connecticut	51.78%	42	Wyoming*	47.25%
5	California	56.81%	27	Mississippi	51.78%	--	<b>Australia</b>	<b>46.50%</b>
--	<b>Sweden</b>	<b>56.44%</b>	27	Utah	51.78%	--	<b>Canada</b>	<b>46.41%</b>
6	Rhode Island	56.22%	30	New Mexico	51.69%	--	<b>France</b>	<b>45.80%</b>
7	Vermont	55.77%	31	North Dakota	51.65%	--	<b>Italy</b>	<b>44.90%</b>
8	Maryland	55.61%	32	Iowa	51.61%	--	<b>Spain</b>	<b>43.00%</b>
9	Minnesota	54.36%	33	Michigan	51.59%	--	<b>Portugal</b>	<b>42.00%</b>
10	Idaho	54.32%	34	Colorado	51.44%	--	<b>Switzerland</b>	<b>41.67%</b>
11	North Carolina	54.27%	35	Indiana	51.38%	--	<b>Ireland</b>	<b>41.00%</b>
11	Wisconsin	54.27%	36	Arizona	51.36%	--	<b>Greece</b>	<b>40.00%</b>
11	Ohio	54.27%	37	Pennsylvania	51.16%	--	<b>Poland</b>	<b>40.00%</b>
--	<b>Belgium</b>	<b>53.70%</b>	38	Montana	50.48%	--	<b>United Kingdom</b>	<b>40.00%</b>
14	Delaware	53.69%	39	Louisiana	50.05%	--	<b>Norway</b>	<b>40.00%</b>
15	Arkansas	53.65%	--	<b>Finland</b>	<b>50.05%</b>	--	<b>New Zealand</b>	<b>39.00%</b>
16	South Carolina	53.59%	--	<b>Japan</b>	<b>50.00%</b>	--	<b>Luxembourg</b>	<b>38.95%</b>
17	Maine	53.46%	--	<b>Austria</b>	<b>50.00%</b>	--	<b>Korea</b>	<b>38.50%</b>
18	Nebraska	53.45%	40	Illinois	49.97%	--	<b>Hungary</b>	<b>36.00%</b>
19	Kentucky	53.37%	41	Alabama	49.67%	--	<b>Iceland</b>	<b>35.70%</b>
20	West Virginia	53.14%	--	<b>Germany</b>	<b>47.48%</b>	--	<b>Turkey</b>	<b>35.60%</b>
21	Kansas	53.09%	42	Alaska*	47.25%	--	<b>Mexico</b>	<b>28.00%</b>
22	Missouri	52.79%	42	Florida*	47.25%	--	<b>Slovak Republic</b>	<b>19.00%</b>
23	Georgia	52.69%	42	Nevada*	47.25%	--	<b>Czech Republic</b>	<b>15.00%</b>
24	Virginia	52.46%	42	New Hampshire*	47.25%			

\* No state income tax

Source: Organization for Economic Cooperation and Development and Tax Foundation.

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- [7] Summers, Lawrence H., "What Can Economics Contribute to Social Policy? Some Simple Economics of Mandated Benefits," AEA Papers and Proceedings, vol. 79, no. 2, pg. 177.
- [8] Data from the New Hampshire Department of Revenue's 2008 Annual Report. [http://www.nh.gov/revenue/publications/reports/documents/annual\\_rpt.pdf](http://www.nh.gov/revenue/publications/reports/documents/annual_rpt.pdf)
- [9] To view the text of H.R. 3200, see here: <http://www.opencongress.org/bill/111-h3200/text>
- [10] Hodge, Scott A. and Moody, J. Scott, "Wealthy Americans and Business Activity," Tax Foundation, Special Report No. 131, August 2004. <http://www.taxfoundation.org/files/1d68c0e2054ad7e51ec0a90b9d989e5f.pdf>
- [11] Since the share of business income rises with income, it is really inappropriate to use income tax data to compare "high" and "low" income taxpayers—despite the reality that so many folks do so. For instance, it would be absurd to compare IBM (a c-corporation) with "Joe Average Taxpayer," yet we do compare farms, sole-proprietorships, partnerships and s-corporations to "Joe Average Taxpayer" whenever we make these comparisons using income tax data.
- [12] Dubay, Curtis S. and Riedl, Brian M., "Income Tax Surtax Should not Fund Government Health Care Expansion," The Heritage Foundation, Webmemo No. 2544, July 15, 2009. <http://www.heritage.org/Research/Taxes/wm2544.cfm>
- [13] Rates include national and average sub-national rates. In the U.S., state rates equal the 39.6% top federal rate under the Obama Budget, plus the top rates for each state (including local income taxes), the 5.4 percent surtax, the 2.9 percent Medicare tax, and accounts for federal and state deductibility and other federal adjustments. The national U.S. rate is calculated using the average of state income tax rates. The source data can be found here: <http://www.taxfoundation.org/publications/show/24848.html> and <http://www.oecd.org/dataoecd/46/18/2506453.xls>

## About the Authors

**J. Scott Moody**, of Haverhill, NH, has worked as a Tax Policy Economist for over 12 years with national think-tanks such as The Tax Foundation, The Heritage Foundation and numerous state-based think-tanks. He is the author, co-author and editor of over 100 studies and books. He has testified twice before the House Ways and Means Committee of the U.S. Congress. He has been interviewed by countless newspapers and radio and television stations and his work has appeared in Forbes, CNN Money, State Tax Notes, The New York Sun, Portland Press Herald, Hartford Courant, The Oklahoman and Albuquerque Journal. He received his Bachelor of Arts in Economics from Wingate University (Wingate, NC) and received his Master of Arts in Economics from George Mason University (Fairfax, VA).

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## About STEWARD of Prosperity

STEWARD of Prosperity is committed to holding politicians in Concord and Washington accountable to taxpayers. Using traditional grassroots tactics and harnessing the power of online communities, the group works to stop wasteful public spending and demands transparency in government. To advance its goal of putting government back on the side of the people, STEWARD releases investigative reports on key public policy issues and actively recruits new civic leaders across New Hampshire. The organization's Web site – [www.STEWARDofProsperity.org](http://www.STEWARDofProsperity.org) – is intended to provide a public information resource center for working families, policy-makers and members of the media.