Health-Related Revenue Provisions: Changes Made by H.R. 4872, the Health Care and Education Reconciliation Act of 2010

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Summary

On March 23, the President signed into law H.R. 3590, the Patient Protection and Affordable Care Act (PPACA; P.L. 111-148) as passed by the Senate on December 24, 2009, and the House on March 21, 2010. The new law will, among other things, raise revenues to pay for expanded health insurance coverage by imposing excise taxes and fees on industries in the health care sector, limiting tax-advantaged health accounts, and increasing the Medicare payroll tax on upper-income households.

On March 21, the House also passed an amendment in the nature of a substitute to H.R. 4872, the Health Care and Education Reconciliation of 2010 (hereinafter referred to as the Reconciliation bill). The Reconciliation bill amends provisions in PPACA and is now before the Senate for consideration.

This report summarizes the health-related revenue provisions (Title 1, Subtitle E) in the Reconciliation bill as they relate to PPACA. Specifically, the report discusses the amendments to the revenue provisions related to changes to thresholds, implementation date, and other provisions relating to the 40% excise tax on high-cost health insurance plans. The Reconciliation bill also includes provisions to add a 3.8% tax on net investment income and convert the fee on medical device manufacturers to an excise tax based on sales revenue. The bill would also delay implementation dates for a number of other revenue provisions in PPACA, including implementation of the flexible spending account limitations, and provisions to eliminate the deduction for expenses allocable to the Medicare Part D subsidy.

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Introduction

On March 21, the House passed H.R. 4872, the Health Care and Education Reconciliation Act of 2010, which amends health-related revenue provisions in the recently enacted Patient Protection and Affordable Care Act (PPACA; P.L. 111-148). These amendments include modifications to taxes and fees imposed on firms in the health care sector and other employers as well as imposing additional taxes on upper-income individuals. The Reconciliation bill would also delay implementation of a number of health-related revenue provisions in PPACA. This report details the changes that would be made to those health-related revenue provisions.

Health-Related Revenue Provisions

The health-related revenue provisions in the Reconciliation bill amend PPACA in a number of areas. The most significant differences include changes to the 40% excise tax on high-cost plans and the imposition of a new tax on net investment income for upper-income tax filers. Other changes include delays in the implementation date of the various provisions.

Table 1 shows the implementation date and projected preliminary revenues from each provision in the two bills. Note that the revenues in **Table 1** under the column labeled H.R. 4872 represent a combination of the revenue effects of PPACA as amended by H.R. 4872. According to projections by the Congressional Budget Office (CBO) and the Joint Committee on Taxation (JCT), if both bills are enacted, this would raise $391.5 billion in health-related provisions over 10 years. Other revenues would come from penalties on individuals and employers as well as other non-health related revenue provisions.[1] CBO projects that the deficit would be reduced by $143 billion over the 10-year period 2010-2019 if both bills were enacted. Of those savings, 63% ($90 billion) is on-budget and the remaining 37% ($53 billion) is off-budget, reflecting increases in the Medicare Hospital Insurance (HI) and Supplementary Medical Insurance (SMI) Trust Funds.[2]

[1] For more information on penalties paid by employers who do not provide coverage or individuals who do not have health insurance coverage, see CRS Report R41126, *Private Health Insurance: Changes Made by H.R. 4872, the Health Care and Education Reconciliation Act of 2010*, by Hinda Chaikind et al.

[2] Congressional Budget Office, Letter to Honorable Nancy Pelosi, March 20, 2010.

Table 1. Health-Related Revenue Provisions in Title IX of PPACA and Subtitle E of H.R. 4872

	PPACA		H.R. 4872[a]	
	Effective Date, Taxable Years Beginning	Increase in Revenues (FY2010-FY2019)	Effective Date, Taxable Years Beginning	Increase in Revenues (FY2010-FY2019)
Provisions Affecting Health Care Firms and Employers				
Excise Taxes and Fees				
40% Excise Tax on High-Cost Plans	2013	$148.9 billion	2018	$32.0 billion
Impose Annual Fee on Health Insurance Providers	2011	$59.6 billion	2014	$60.1 billion
Annual Fee on Manufacturers and Importers of Branded Drugs	2010	$22.2 billion	2011	$27.0 billion
Annual Fee/ Excise Tax on Manufacturers and Importers of Certain Medical Devices	2011	$19.2 billion	2012[b]	$20.0 billion
10% Excise Tax on Indoor Tanning Services	July 1, 2010	$2.7 billion	July 1, 2010	$2.7 billion
Limitations on Employer Deductions				
Eliminate Deductions for Expenses Allocable to Medicare Part D subsidy	2011	$5.4 billion	2013	$4.5 billion
Limit Deduction for Compensation to $500,000 for Executives of Health Insurance Companies	2013	$0.6 billion	2013	$0.6 billion
Provisions Affecting Individuals				
Medicare Tax				
Medicare Payroll Tax	2013	$86.8 billion	2013	$86.8 billion
Medicare Tax on Investment Income	NA	NA	2013	$123.4 billion
Modifications to Tax-Advantaged Accounts and Itemized Deductions Used for Health Care				
Limit Health Flexible Spending Accounts (FSAs) to $2,500	2011	$14.3 billion	2013	$13.0 billion
Raise Penalty for Non-Qualified HSA Withdrawals from 10% to 20%[c]	2011	$1.3 billion	2011	$1.4 billion
Change the Definition of Medical Expenses for FSAs and Health Savings Accounts (HSAs)	2011	$5.0 billion	2011	$5.0 billion
Raise 7.5% Floor for Itemized Medical Expenses to 10% for Those Under Age 65	2013	$15.2 billion	2013	$15.2 billion
Total Revenues Relating to Health Care	—	$381.2 billion	—	$391.5 billion

Source: Joint Committee on Taxation, December 19, 2009, JCX-61-09, and Joint Committee on Taxation, March 20, 2010, JCX-17-10.

Notes: This table does not include those revenue provisions not directly related to health care.

a. Represents the combination of provisions in H.R. 4872 with the revenue effects of PPACA as passed by the Senate.

b. Imposed on sales after this date.

c. The differences between the revenue estimates between the two bills do not reflect differences in provisions but rather technical corrections.

Provisions Affecting Health Care Firms and Other Employers

The Reconciliation bill would amend the following taxes or fees imposed on health insurers, plan administrators, and health companies imposed by PPACA:

- an excise tax on high-cost employer-sponsored health insurance;
- an annual fee on health insurance providers;
- an annual fee on manufacturers and importers of brand name pharmaceuticals; and
- an excise tax on manufacturers and importers of certain medical devices.

The Reconciliation bill would also delay the limitations on the ability of employers to deduct from their taxable income the federal subsidies for retiree prescription drug coverage. The Reconciliation bill would not amend the 10% tax on indoor tanning services or the limit for the deductibility of compensation for health insurance executives, both of which were specified in PPACA.

The following section describes the current law (where applicable), provisions in the PPACA, and proposed amendments in the Reconciliation bill.

Excise Tax on Health Insurance Plans

Under current law, there is no tax on the value of health care insurance coverage provided by insurers.[3] PPACA would impose a 40% excise tax on health insurers and health plan administrators for coverage that exceeds certain thresholds. Health insurance coverage subject to the excise tax in PPACA was broadly defined to include not only the employer and employee premium payments for health insurance (including self-insured plans), but also premiums paid by the employee and the employer for dental and vision coverage. In addition, tax-advantaged health-related accounts such as flexible spending accounts (FSAs), health savings accounts (HSAs), and health reimbursement accounts (HRAs) are also specified as health insurance coverage and subject to the excise tax. For these tax-advantaged accounts, the plan administrator (which is often the employer) would be subject to the excise tax. The excise tax would be levied on each of these components (i.e., health insurance, dental and vision, FSAs) based on their share of the total for health insurance coverage. This share would then be applied to the amount of the total contribution that exceeds the applicable threshold to determine the excise tax imposed on each component.

The Reconciliation bill (Section 1401) would amend the excise tax provisions in the Senate bill as shown in **Table 2**. Specifically, the bill would amend PPACA to

- raise thresholds for all groups;
- remove stand alone dental and vision plans from threshold calculation;
- delay implementation of the excise tax until 2018;

[3] See CRS Report RL33505, *Tax Benefits for Health Insurance and Expenses: Overview of Current Law and Legislation*, by Janemarie Mulvey.

- allow multi-employer plans to be subject to family thresholds only; and
- eliminate high-cost state designations eligible for phased-in thresholds.

Table 2. Comparison of Excise Tax Provisions on High-Cost Health Plans

In PPACA and H.R. 4872

	PPACA	H.R. 4872
General Threshold Amounts	$8,500 single $23,00 family	$10,200 single $27,500 family
Insurance Coverage Subject to the Thresholds	Health insurance, dental, vision, flexible spending and health savings accounts.	Same as H.R. PPACA, except excludes stand alone dental and vision plans
Alternative Thresholds	High Risk professions and retirees aged 55 to 64	Same as H.R. PPACA
Alternative Thresholds for Special Groups	$9,850 single $26,000 family	$11,850 single $30,950 family
Multi-Employer Plans (Unions)	Same thresholds as general category above	Only subject to general threshold for family coverage (even for self-only coverage)
High Cost State Designation	Phased-in thresholds	Eliminate Provision
Implementation Date	2013	2018

Source: Compiled by CRS.

In addition to the differences between the two bills identified in **Table 2**, the Reconciliation bill would amend PPACA to allow employers to adjust the cost of health insurance coverage (when compared with the thresholds) if the demographics of their workforce in terms of age and gender is different from that of a national risk pool.[4] The amendments in H.R. 4872 to the excise tax provisions would reduce the 10-year revenue projection by $117 billion as compared to PPACA (see **Table 1**).

Annual Fee on Health Insurance Plans

Under current law, there are special rules for determining the taxable income of insurance companies.[5] The rules differ depending on whether the company is a life insurance or a property and casualty insurer. Insurance companies are also subject to federal income tax at regular corporate rates. PPACA would impose a fee on all health insurers based on their market share. The fee would be applied to net premiums written and would be imposed beginning in 2011.[6] The aggregate fee would equal $8 billion in 2014, $11.3 billion in 2015 and 2016, $13.9 billion in 2017, and $14.3 billion in 2018. After 2018, the fee amount is indexed to the rate of growth in premiums. The fee would not apply to self-insured plans and federal, state, or other government entities. Certain nonprofit insurers who have medical loss ratios within specific limits would also be excluded. However, under PPACA, the annual fee would apply to companies or organizations

[4] The national risk pool is based on the rates in the standard Blue Cross Blue Shield FEHBP health insurance plan.

[5] Subchapter L of the Internal Revenue Code.

[6] See CRS Report R40834, *The Market Structure of the Health Insurance Industry*, by D. Andrew Austin and Thomas L. Hungerford, for information on market share of individual health insurance companies.

that underwrite government-funded insurance (i.e., Medicaid-managed care plans and Federal Employees Health Benefits Program [FEHBP]).

The Reconciliation bill (Section 1406) would delay the implementation of the fee on health insurers by three years to 2014. The Reconciliation bill also adds additional provisions for tax-exempt insurance providers. Only 50% of net premiums for tax-exempt insurer are taken into account when calculating the fee. The bill would also exempt Voluntary Employee Benefit Associations (VEBAs) and nonprofit providers for whom more than 80% of revenues are received from public programs that target low-income, elderly, or disabled populations.

Annual Fee On Pharmaceutical Companies and Medical Device Manufacturers[7]

Under current law, beyond corporate taxes, there are no fees or excise taxes targeted toward drug companies and medical device manufacturers. PPACA would impose an annual fee on certain manufacturers and importers of branded prescription drugs (including biological products and excluding orphan drugs). The fee structure would be based on annual sales and would be set to reach a certain revenue target each year. PPACA specifies that these additional revenues should be transferred to the Federal Medicare Supplementary Insurance (Part B) Trust Fund. The Reconciliation bill (Section 1404) would amend the annual target revenues to $2.5 billion for 2011, $2.8 billion per year for 2012 and 2013, $3.0 billion 2014 through 2016, $4.0 billion for 2017, $4.1 billion for 2018, and $2.8 billion for 2019 and thereafter. The bill would also delay imposition of the fee from one year (to 2011). JCT projects that the Reconciliation provisions would raise the 10-year revenue projection by $4.8 billion over PPACA's projected revenues (see **Table 1**).

Under PPACA, an annual fee would also be imposed on certain manufacturers and importers of medical devices. The Reconciliation bill (Section 1405) would repeal this fee and replace it with a new excise tax of 2.3% on the sale of medical devices by manufacturers, producers, or importers. This provision would exempt eyeglasses, contact lenses, hearing aids, and any device of a type that is generally purchased by the public at retail for individual use. The tax would apply to sales made after December 31, 2012. With the Reconciliation bill amendments, revenues over the 10-year period would increase $0.8 billion as compared with the stand-alone PPACA provisions (see **Table 1**).

Eliminate Employer Deduction for Retiree Prescription Drug Plans Eligible for Federal Subsidy

Under current law, employers who provide their retirees with prescription drug coverage that meets or exceeds federal standards are eligible for subsidy payments from the federal government. These qualified retiree prescription drug plan subsidies are excluded from the employer's gross income for the purposes of regular income tax and alternative minimum tax calculations. Employers are also allowed to claim a business deduction for retiree prescription drug expenses even though they also receive the federal subsidy to cover a portion of those

[7] See CRS Report R40943, *Public Health, Workforce, Quality, and Related Provisions in H.R. 3590, as Passed by the Senate*, coordinated by C. Stephen Redhead and Erin D. Williams.

expenses. PPACA would require employers to coordinate the subsidy and the deduction for retiree prescription drug coverage beginning in 2011. The amount allowable as a deduction for retiree prescription drug coverage would be reduced by the amount of the federal subsidy received. The Reconciliation bill (Section 1407) would delay implementation of this provision by two years to 2013. This delay would reduce the 10-year revenue projection by $0.9 billion (see **Table 1**).

Provisions Affecting Individuals

Medicare Payroll Tax

Under current law, employers and employees each pay a payroll tax of 1.45% to finance Medicare Part A. PPACA includes additional hospital insurance taxes on high-income taxpayers. Specifically, PPACA would impose an additional payroll tax of 0.9% on high-income workers with wages over $200,000 for single filers and $250,000 for joint filers effective for taxable years after December 31, 2012. The additional tax only applies to wages above these thresholds. For these workers, the payroll tax would increase to a total of 2.35% for wage income over the thresholds noted above. These additional revenues would go to the Medicare Hospital Insurance Trust Fund (often called Part A). The Reconciliation bill (Section 1402) amends this to clarify that married taxpayers filing separately are subject to a $125,000 threshold. According to the JCT, the revenue provisions under PPACA and the Reconciliation bill are the same and would raise $86.8 billion over a 10-year period (see **Table 1**).

Unearned Income Medicare Contribution

The Reconciliation bill (Section 1402) would also impose an additional tax on net investment income. The bill defines net investment income to be interest, dividends, annuities, royalties, rents, and taxable net capital gains. It excludes distributions from a qualified annuity from a pension plan.[8] Households with modified adjusted gross income (MAGI) under these thresholds would not be subject to the investment income tax. Specifically, effective for taxable years after December 31, 2012, the bill would impose a tax equal to 3.8% of the *lesser* of (1) net investment income for such taxable year or (2) the excess of MAGI[9] over $250,000 for joint filers ($125,000 for married filing separately and $200,000 for all other returns).

This tax is also applicable to income from estates and trusts. The active income from trade for self-employed and S-corporations would not be subject to the tax.[10] For these entities, the tax would apply only to passive income and trade income related to commodity trading. There is also a special provisions for the application of the tax to S-Corporations who sell their businesses.

[8] As defined in IRC Sec. 401(a), 403(a), 403(b), 408, 408A, or 457(b).

[9] Modified adjusted gross income is defined as adjusted gross income increased by the excess of foreign earned income (defined in IRC Sec. 911(a)(1)) over the amount of any deductions or exclusions disallowed under IRC Sec. 911(d)(6) when determining foreign earned income.

[10] Corporations may elect S-corporation status if they meet a number of Internal Revenue Code requirements. Among other things, they cannot have more than 100 shareholders or more than one class of stock. S-corporations are tax-reporting rather than tax-paying entities, in contrast to C-corporations, which are subject to the corporate income tax.

As shown in **Table 1**, the investment income provision in the Reconciliation bill would raise $123.4 billion in revenues over a 10-year period.

Tax-Advantaged Accounts and Itemized Deductions Used to Pay for Health Care Expenses

There are a number of tax-advantaged accounts and tax deductions for health care spending and coverage that would be affected by the revenue provisions in Title IX of PPACA. The Reconciliation bill makes minor adjustments to one these provisions.

Modifications to Tax-Advantaged Accounts

PPACA includes a number of provisions that would directly and indirectly affect tax-advantaged accounts to help workers pay for their health care expenses. Under current law, FSAs, HSAs, HRAs, and Medical Saving Accounts (MSAs) allow workers under varying circumstances to exclude a certain portion of qualified medical expenses from income taxes.[11]

Under current law, health FSAs are employer-established benefit plans that reimburse employees for specified health care expenses (e.g., deductibles, co-payments, and non-covered expenses) as they are incurred on a pre-tax basis.[12] About one-third of workers in 2007 had access to an FSA.[13] Each employer may set their limits on FSA contributions. In 2008, the average FSA contribution was $1,350.[14] PPACA would limit the amount of annual FSA contributions to $2,500 per FSA beginning in 2011. The Reconciliation bill would amend PPACA and delay implementation of the limits on FSA contribution by two years until 2013. According to JCT, this provision would reduce revenues relative to enactment of PPACA by $1.3 billion over 10 years (see **Table 1**).

HSAs are also tax-advantaged accounts that allow individuals to fund unreimbursed medical expenses (deductibles, copayments, and services not covered by insurance) on a pre-tax basis.[15] Eligible individuals can establish and fund accounts when they have a qualifying high deductible health plan and no other health plan (with some exceptions). Unlike FSAs, HSAs may be rolled over and the funds accumulated over time. Distributions from an HSA that are used for qualified medical expenses are not included in taxable income. Distributions from an HSA that are not used for qualified medical expenses are taxable as ordinary income and, under current law, an additional 10% penalty tax for those under the age of 65. PPACA would raise this penalty on non-qualified distributions to 20% of the disbursed amount. According to the JCT, this provision would raise $1.3 billion over 10 years (see **Table 1**). The Reconciliation bill would not amend the HSA provisions in PPACA.

PPACA would also modify the definition of qualified medical expenses. Under current law, qualified medical expenses for FSAs, HSAs, and HRAs can include over-the-counter

[11] See CRS Report RL33505, *Tax Benefits for Health Insurance and Expenses: Overview of Current Law and Legislation*, by Janemarie Mulvey.

[12] See CRS Report RL32656, *Health Care Flexible Spending Accounts*, by Janemarie Mulvey.

[13] Bureau of Labor Statistics, *Table 24. Pretax benefits: Access, private industry workers*, National Compensation Survey, March 2007.

[14] Mercer Human Resources Consulting, *National Survey of Employer-Sponsored Health Plans 2008*.

[15] See CRS Report RL33257, *Health Savings Accounts: Overview of Rules for 2010*, by Janemarie Mulvey.

medications. The bill would restrict this practice and exclude over-the-counter medications (except those prescribed by a physician) as a qualified medical expense. According to the JCT, this provision would increase revenues by $5 billion over 10 years (see **Table 1**). The Reconciliation bill would not amend these provisions.

Modify Itemized Deduction for Medical Expenses

Currently, taxpayers who itemize their deductions may deduct unreimbursed medical expenses that exceed 7.5% of adjusted gross income (AGI). Medical expenses include health insurance premiums paid by the taxpayer, but also can include certain transportation and lodging expenses related to medical care as well as qualified long-term care costs, and long-term care premiums that do not exceed a certain amount. About 7% of tax returns for tax year 2007 reported a deduction for medical expenses.[16] Taxpayers with AGI below $50,000 accounted for 52% of those taking this itemized deduction for medical expenses.[17] PPACA would increase the threshold to 10% of AGI for taxpayers who are under the age of 65, which would limit the amount of medical expenses that can be deducted. Taxpayers over the age of 65 would be temporarily excluded from this provision and still be subject to the 7.5% limit from 2013 through 2016. The Reconciliation bill would not amend these provisions.

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[16] Internal Revenue Service, Statistics of Income, *Table 1.3: All Returns: Source of Income, Adjustments, Deductions, Credits and Tax Items, by Marital Status, Tax Year 2007.*

[17] Joint Committee on Taxation, *Tax Expenditures: Compendium of Background Material on Individual Provisions*, December 2008.