



Health-Related Revenue Provisions: Changes Made by the Reconciliation Act of 2010 to Senate-Passed H.R. 3590

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Summary

This report summarizes the health-related revenue provisions in the Reconciliation Act of 2010, introduced in the nature of a substitute to H.R. 4872. The bill amends provisions in H.R. 3590, the Patient Protection and Affordable Care Act, passed by the Senate on December 24, 2009.

Title 1, Subtitle E of H.R. 4872 includes amendments to the revenue provisions in H.R. 3590. This report identifies the changes made by H.R. 4872 to the health-related revenue provisions in H.R. 3590. Specifically, the report discusses the amendments to the revenue provisions related to changes in the thresholds, health plans included, and implementation date for the 40% excise tax on high-cost health insurance plans. The Reconciliation Act also includes provisions to add a 3.8% Medicare tax on net investment income, and converts the fee on medical device manufacturers to an excise tax based on sales revenue. H.R. 4872 would also delay implementation dates for a number of revenue provisions in H.R. 3590 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

The Senate passed H.R. 3590, The Patient Protection and Affordable Care Act on December 24, 2009 (hereinafter referred to as the Senate bill or H.R. 3590). On March 18, 2010, The House Rules Committee introduced H.R. 4872, The Reconciliation Act of 2010 (hereinafter referred to as the Reconciliation bill or H.R. 4872) that amends health-related revenue provisions in H.R. 3590. These amendments include modifications to taxes and fees imposed on firms in the health care sector and other employers by H.R. 3590 as well as additional taxes on high-income individuals. The Reconciliation bill also would delay implementation of a number of health-related revenue provisions in H.R. 3590. This report details the changes made to the health-related revenue provisions in H.R. 3590 by the Reconciliation Act of 2010.

Health-Related Revenue Provisions

The health-related revenue provisions in H.R. 4872 amend H.R. 3590 in a number of ways. The most significant differences include changes to the 40% excise tax on high cost plans and the imposition of a new tax on investment income for high-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 the **Table 1** under the column labeled H.R. 4872 represent a combination of the revenue effects of H.R. 3590 as amended by H.R. 4872. According to the Congressional Budget Office (CBO) and the Joint Committee on Taxation (JCT), the health-related revenue provisions are projected to be \$388.8 billion over 10 years if both bills are enacted. CBO further estimates that the deficit would be reduced by \$138 billion over the 10-year period 2010-2019 if both bills were enacted. Of those savings 62% (\$85 billion) is on-budget and the remaining 38% (\$53 billion) is off-budget reflecting increases in the Medicare Hospital Insurance (HI) and Supplementary Medical Insurance (SMI) Trust Funds.¹

¹ Congressional Budget Office, Letter to Honorable Nancy Pelosi, March 18, 2010.

Table I. Health Related Revenue Provisions in Title IX of H.R. 3590 and Subtitle E of H.R. 4872

H.R. 3590			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	2013 ^b	\$20.0 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

H.R. 3590			H.R. 4872 ^a	
	Effective Date, Taxable Years Beginning	Increase in Revenues (FY2010-FY2019)	Effective Date, Taxable Years Beginning	Increase in Revenues (FY2010-FY2019)
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 Private Health Insurance	—	\$378.5 billion	—	\$388.8 billion

Source: Joint Committee on Taxation, December 19, 2009, JCX-61-09, and additional note by CBO Letter to Senator Harry Reid dated March 11, 2010, noting that the FSA revenue estimate increased by about \$1 billion from previously published estimate. Joint Committee on Taxation, March 18, 2010, JCX-16-10.

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 H.R. 3590 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 enactment of H.R.3590 as passed by the Senate and the related amendments within H.R. 4872 would impose the following taxes or fees directly on health insurers and plan administrators:

- 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.

In addition, the bill would limit the deductibility of compensation for health insurance executives. The bill would also limit the ability of employers to deduct from their taxable income the federal subsidies for retiree prescription drug coverage. The following section describes the current law (where applicable), current revenue provisions in the Senate bill and 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.² The Senate bill would impose a 40% excise tax on health insurers and health plan administrators for coverage that exceeds certain thresholds. Health insurance coverage subject to

² See CRS Report RL33505, *Tax Benefits for Health Insurance and Expenses: Overview of Current Law and Legislation*, by Janemarie Mulvey.

the excise tax in H.R. 3590 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, etc.) 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 (Sec. 1401) would amend the excise tax provisions in the Senate bill as shown in **Table 2**. Specifically, H.R. 4872 would amend H.R. 3590 to:

- raise thresholds for all groups;
- remove stand alone dental and vision plans from threshold calculation;
- delay implementation of the excise tax until 2018;
- 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 H.R. 3590 and H.R. 4872

	Senate-Passed H.R. 3590	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. 3590, except excludes stand alone dental and vision plans
Alternative Thresholds	High Risk professions and retirees ages 55 to 64	Same as H.R. 3590
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

In addition to the differences between the two bills identified in **Table 2**, the Reconciliation bill would amend the Senate bill to allow employers to adjust the cost of health insurance coverage (when compared to the thresholds) if the demographics of their workforce in terms of age and gender is different from that of a national risk pool.³ The amendments in H.R. 4872 to the excise

³ The national risk pool is based on the rates in the standard Blue Cross Blue Shield FEHBP health insurance plan.

tax provisions would reduce the 10 year revenue projection by \$117 billion as compared to H.R. 3590 (see **Table 1**).

Annual Fee on Health Insurance Plans

Under current law, while some states impose premium taxes and there are general corporate taxes, there are no federal taxes targeted explicitly toward health insurers. The Senate bill 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 2011.⁴ 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 the Senate bill the annual fee would apply to companies or organizations that underwrite government-funded insurance (i.e., Medicaid managed care plans, Federal Employees Health Benefits Program [FEHBP]).

The Reconciliation bill (Sec. 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 Manufacturers⁵

Under current law, beyond corporate taxes, there are no fees or excise taxes targeted toward drug companies and medical device manufacturers. The Senate bill 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 set to reach a certain revenue target each year. The Reconciliation bill (Sec. 1404) would amend the annual target revenues to \$2.5 billion for 2011, \$3 billion per year for 2012 through 2016, \$3.5 billion for 2017, \$4.2 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 the Senate bill's projected revenues (see **Table 1**).

An annual fee on certain manufacturers and importers of medical devices would also be imposed by H.R. 3590. However, the Reconciliation bill (Sec. 1405) would repeal this fee and replace it with a new excise tax of 2.9% on the sale of a medical device by a manufacturer, producer, or importer. H.R. 4872 would exempt Class 1 medical devices,⁶ 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, 2010. With the H.R. 4872 amendments,

⁴ 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.

⁵ 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.

⁶ Defined in Federal Food, Drug, and Cosmetic Act (FFDCA), Sec. 201(h).

revenues over the 10-year period would increase \$0.8 billion as compared to the Senate-passed bill (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. The employer is 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 expenses. The Senate-passed bill (H.R. 3590) 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 Act (Sec. 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 Taxes

Under current law, employers and employees each pay a payroll tax of 1.45% to finance Medicare Part A. The Senate bill includes additional hospital insurance taxes on high-income taxpayers. This bill 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 (Sec. 1402) amends this to clarify that married taxpayers filing separately are subject to a \$125,000 threshold. According to the Joint Committee on Taxation, the revenue provisions under the Senate bill and the Reconciliation bill are the same and would raise \$86.8 billion over a 10-year period (see **Table 1**).

The Reconciliation bill (Sec. 1402) would also impose an additional tax on net investment income with the revenues going to the Federal Supplementary Medical Insurance Trust Fund (often called Part B). The Reconciliation 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.⁷ Households with modified adjusted gross income 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:

⁷ As defined in IRC Sec. 401(a), 403(a), 403(b), 408, 408A, or 457(b).

- (1) Net investment income for such taxable year; or
- (2) The excess of modified adjusted gross income (MAGI)⁸ 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.⁹ 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.

As shown in **Table 1**, the investment income provision in H.R. 4872 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 H.R. 3590. The Reconciliation bill makes minor adjustments to one these provisions.

Modifications to Tax-Advantaged Accounts

H.R. 3590 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) all allow workers under varying circumstances to exclude a certain portion of qualified medical expenses from income taxes.¹⁰

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.¹¹ About one-third of workers in 2007 have access to an FSA.¹² Each employer may set their limits on FSA contributions. In 2008, the average FSA contribution was \$1,350.¹³ The Senate-passed H.R. 3590 would limit the amount of annual FSA contributions to \$2,500 per FSA beginning in 2011. The Reconciliation bill would amend the Senate bill and delay implementation of the limits on FSA contribution by two years until 2013.

⁸ 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.

⁹ 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.

¹⁰ See CRS Report RL33505, *Tax Benefits for Health Insurance and Expenses: Overview of Current Law and Legislation*, by Janemarie Mulvey.

¹¹ See CRS Report RL32656, *Health Care Flexible Spending Accounts*, by Janemarie Mulvey.

¹² Bureau of Labor Statistics, *Table 24. Pretax benefits: Access, private industry workers*, National Compensation Survey, March 2007.

¹³ Mercer Human Resources Consulting, *National Survey of Employer-Sponsored Health Plans 2008*.

According to JCT, this provision would reduce revenues compared to H.R. 3590 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.¹⁴ 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 age 65. The Senate bill 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 the Senate-passed bill.

H.R. 3590 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 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.¹⁵ Taxpayers with adjusted gross income below \$50,000 accounted for 52% of those taking this itemized deduction for medical expenses.¹⁶ The Senate bill would increase the threshold to 10% of AGI for taxpayers who are under age 65, which would limit the amount of medical expenses that can be deducted. Taxpayers over age 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.

¹⁴ See CRS Report RL33257, *Health Savings Accounts: Overview of Rules for 2010*, by Janemarie Mulvey.

¹⁵ 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*.

¹⁶ Joint Committee on Taxation, *Tax Expenditures: Compendium of Background Material on Individual Provisions*, December 2008.

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