Iowa State University CALT Center for Agricultural Law and Taxation

Summary of Tax Provisions in Recently Enacted Health Care Legislation

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Overview

Late on the night of March 21, the U.S. House, with a very slim and partisan vote (no Republicans supported the legislation) and despite bipartisan opposition and significant lack of public support, passed H.R. 3590, the Patient Protection and Affordable Care Act (Act). The $938 billion Act was signed into law on March 23 as Pub. L. No. 111-148. The Act significantly overhauls the nation's health care system.[1] The Congressional Budget Office has estimated that the Act will extend health insurance coverage to more than 30 million previously uninsured persons, with about 15 million of those being covered under Medicaid by 2019.

Note: On January 19, 2011, the House voted to repeal the Act by a 245-189 vote. The repeal bill, H.R. 2, "Repealing the Job-Killing Health Care Law Act," fell four votes short of being considered by the Senate.

The Act represents the most significant social legislation enacted in decades and, as estimated, contains over $400 billion in tax increases that have the potential to impact all individuals and business in the U.S. The administrative cost of the Act itself is over $1 billion.[2] In addition it has already been projected by the non-partisan Congressional Budget Office (CBO) that the Act will trigger an average nationwide increase in health insurance premiums for many families of $2,100 per family as a result of fees, taxes and economic incentives in the legislation.[3]

A few days after passage of the Act, the House and Senate approved the Health Care and Education Reconciliation Act of 2010 (Reconciliation Bill), H.R. 4872, which contains certain amendments to the Act. The following is a summary of the most significant tax provisions in the Act and Reconciliation Bill.

Tax Provisions (By Date of Enactment)

Retroactive Provisions

- **Refundable adoption credit.** Both the Act and the Reconciliation Bill make the adoption credit refundable, increase the maximum credit to $13,170 (up from $12,170) and extend the credit through 2011 (by delaying the scheduled expiration of the credit under the EGTRRA provisions). *Act, Sec. 10909, effective for tax years beginning after 2009.*

  Note: The provision applies to both handicapped and non-handicapped adoptions. The adoption credit is also indexed for inflation for tax years beginning after December 31, 2010.

- **Small business insurance tax credit.** The Act creates a tax credit (as a general business credit) for businesses with 25 or fewer full-time equivalent employees (determined by taking total paid employee hours (excluding owners, partners, family members and seasonal workers employed 120 days or less) for hours worked that don't exceed 2,080 hours during the year, divided by 2,080) and average annual wages of less than $50,000. To be eligible for the credit, the employer must offer health insurance to its employees and pay at least one-half of employees' premiums. The maximum credit is 50 percent of non-elective contributions that a qualified business makes for employees for insurance premiums for years 2014 and 2015 (it is capped at 35 percent for years 2010-2013). Any premium that is paid in accordance with a salary reduction arrangement under an I.R.C. §125 cafeteria plan is not treated as paid by the employer. *Act, Sec.1421, creating I.R.C. §45R, as amended by Sec. 10105, effective for amounts paid or incurred after December 31, 2009.*

Note: Businesses with 10 or fewer employees and average wages of less than $25,000 are eligible for a full credit, with the credit being phased out ratably up to the 25 employee limit. In addition, the $25,000 wage amount is indexed for inflation for tax years beginning after 2014. For purposes of determining "employees" five percent owners and 2 percent S corporation shareholders are not taken into account. However, leased employees do count.

For non-profit (tax-exempt) organizations, the credit is 25 percent for years 2010-2013 and is in the form of a reduction in income and Medicare tax that the employer is required to withhold from employees' wages and the employer share of Medicare tax on employees' wages. For all other businesses, the credit is a general business credit that is not refundable. Any unused credit can be carried forward up to 20 years.

- **Insurance company executive compensation limitat*ion.*** *The Act and the Reconciliation Bill places a $500,000 salary cap on the tax deduction (via* I.R.C. §162(m)) for salaries of employees of health insurance companies – except for deferred compensation (effective for *remuneration paid in tax years* beginning after 2012 with respect to services performed after 2009). *Act, Sec. 9014, amending I.R.C. §162(m), effective for tax years beginning after December 31, 2009, for services performed after December 31, 2009.*

- **Therapy tax credit.** Both the Act and the Reconciliation Bill create a new tax credit for "qualified therapeutic discovery projects" that are paid for in 2009 or 2010. *Act, Sec. 9023, creating new I.R.C. §48D, effective for amounts paid or incurred after 2008 in tax years beginning after 2008.*

- **New BCBS requirement.** The Act eliminates the tax deduction for Blue Cross and Blue Shield companies if they don't spend at least 85 percent of premiums on clinical services. *Act, Sec. 9016, amending I.R.C. §833, effective for tax years beginning after December 31, 2009.*

- **Repeal of "Black Liquor" cellulosic biodiesel credit.** The Reconciliation Bill, but not the Act, contains a provision that disqualifies unprocessed fuels (such as "Black Liquor" – the by-product of the paper milling process) from the cellulosic biofuel credit contained in I.R.C. §40(b) (which IRS had previously ruled qualifies for the credit). [4] *Reconciliation Bill, Sec. 1408, effective for tax years beginning after 2009.*

Provisions Effective on Signing (March 23, 2010)

- **Codification of economic substance doctrine.** The Reconciliation Bill, but not the Act, contains a provision that codifies the economic substance doctrine. *Reconciliation Bill, Sec. 1409.* This provision is applicable to transactions entered into after the date of enactment and to underpayments, understatements and refunds and credits attributable to transactions entered into after the date of enactment.

- **Additional requirements for tax-exempt hospitals.** The Act establishes additional requirements for I.R.C. §501(c)(3) hospitals (such as a requirement to conduct periodic "community health needs assessments" among other things). *Act, Sec. 9007, effective upon enactment.* The Act imposes an excise tax of $50,000 on each charitable hospital that fails to meet Department of Health and Human Services regulations. *Act, Sec. 9007, amending I.R.C. §501, effective for tax years beginning after the date of enactment of the Act.*

- **Definition of dependent for exclusion for employer-provided health coverage.** The Reconciliation Bill contains a provision that amends I.R.C. §105(b) to extend the general exclusion for reimbursements for medical care expenses under an employer-provided accident or health plan to any child of an employee who has not attained age 27 as of the end of the taxable year. The change is intended to apply to the exclusion for employer-provided coverage under an accident or health plan for injuries or sickness for such a child. The same change is made for VEBAs and 401(h) accounts. The provision also amends I.R.C. §162(l) to allow self-employed persons to claim as a deduction any child of such taxpayer who has not reached age 27 as of the end of the taxable year. "Child" is defined as a son, daughter, stepson, stepdaughter or eligible foster child of the taxpayer. *Reconciliation Bill, Sec. 1004, effective upon enactment*.

- **Group health plans and health insurance issuers that offer group or individual health insurance coverage.** The Act incorporates the group market health insurance coverage requirements of Title XXVII of the Public Health Service Act into ERISA and the I.R.C. In part, the Act specifies that a plan or coverage that provides dependent coverage of children is required to make coverage available for an adult child who is not married until the child reaches age 26. *Act, Sec. 1001, et seq., and Reconciliation Bill, Sec. 10101, effective upon signing.*

Provision Effective July 1, 2010

- **Pale people tax.** Both the Act and the Reconciliation Bill impose a 10 percent excise tax on persons using indoor tanning services (effective for services rendered on or after July 1, 2010). *Act, Sec. 10907, creating I.R.C. §5000B., effective for services performed on or after July 1, 2010.*

  Note: (1) The tax is to be paid by the customer and the service provider is to collect the tax and remit it to IRS on a quarterly basis.

  (2) IRS issued regulations for this provision on June 11, 2010.[5]

Provisions Effective January 1, 2011

- **Disclosure of health coverage costs.** The Act specifies that employers must file a W-2 reporting the value of health benefits for each employee that the employer sponsors. *Act, Sec. 9002, amending I.R.C. §6051(a). Effective for tax years beginning after 2010.*

  Note: The amount reported on the 2011 Form W-2 is for informational purposes only. The additional tax on health benefits begins in 2018. At that time insurers must pay a 40 percent tax on the portion of employer-sponsored "Cadillac" health plan benefits exceeding certain limits. While the tax will be imposed on insurers, insurers can be expected to pass the cost on to employers which can be expected to pass the cost on to employees by reducing coverage via increasing deductibles so that the premiums will remain under the tax threshold.

Note: In mid-October of 2010, the IRS issued a draft Form W-2 for 2011 and announced that it was deffering the employer-reporting requirement of the cost of coverage under an employer-sponsored group health plan thereby making it optional for 2011. The draft Form includes codes that employers may use to report the cost of coverage under an employer-sponsored group health plan. IR 2010-103 (Oct. 12, 2010)

- **Penalty on non-qualified HSA withdrawals.** Both the Act and the Reconciliation Bill increase the penalty on non-qualified withdrawals by 100 percent (from 10 to 20 percent) on non-qualified distributions from a health savings account (HSA) and by 33 percent (from 15 percent to 20 percent) on non-qualified withdrawals from a Medical Savings Account (MSA). *Act, Sec. 9004, amending I.R.C. §223(f)(4)(A). Effective for distributions made in tax years beginning after 2010.*

- **Limits on tax breaks for non-prescription medicine.** Both the Act and the Reconciliation Bill change the rules governing HSAs, FSAs, MSAs and HRAs to eliminate the deduction for over-the-counter medicines – except insulin (in other words, they will no longer be qualified medical expenses) prescribed by a physician, and disallows the use of FSA funds for nonprescription drugs (effective for distributions and reimbursements made after 2010.[6] *Act, Sec. 9003, amending various sections of the Internal Revenue Code. Effective for tax years beginning after December 31, 2010.*

- **Lower ceiling on flex-accounts.** The Act imposes a $2,500 cap on the amount in an FSA that can be used to reimbursed incurred medical expenses of an employee, the employee's dependents, and any other eligible beneficiaries of the employee. The provision is effective beginning in 2011 with the amount indexed to the CPI-U after 2011. *Act, Sec. 9005, amending I.R.C. §125. Effective for tax years beginning after December 31, 2010.*

  The Reconciliation Bill changes the effective date of the provision to contributions made after 2012. *Reconciliation Bill, Sec. 1403.*

Provisions Effective January 1, 2012

- **Extension of 1099 reporting to corporate payees.** Both the Act and the Reconciliation Bill mandate information reporting (Form 1099) for payments made in the conduct of a trade or business that total $600 or more to a single payee (for the providers of services and sellers of goods for property of any sort) during a calendar year, including corporations (except tax-exempt entities). *Act, Sec. 9006, amending I.R.C. §6041, effective for payments made after December 31, 2011.*

  Note: While some partisan commentators have attempted to downplay the impact of the provision, the IRS National Taxpayer Advocate, in her mid-year report to the Congress (which outlines the fiscal 2011 objectives of the Taxpayer Advocate Service) has stated the provision will apply to two million farming businesses--essentially all farming business in the United States.

  Note: The provision was repealed by H.R. 4, the "Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011." The Act was signed into law on April 14, 2011.

Provisions Effective in 2013

- **Additional .9% Medicare tax on Wages and SE income.** For wage income in excess of threshold amounts that are to be adjusted annually for inflation, the Act imposes a 62.1 percent increase in the employee portion of the Medicare payroll tax – the hospital insurance tax part of FICA - (from 1.45 percent to 2.35 percent) on AGI over $200,000 (single); $250,000 (married filing jointly or surviving spouse); and $125,000 for married persons filing separately.[7] The AGI test is a new twist on the Medicare tax. Because employers have no way of knowing what their married employees' joint incomes are, the tax will have to be computed on Form 1040. Until now the Medicare tax was entirely a payroll tax.

  For self-employed persons, the tax increase is the same and applies to the hospital insurance portion of SECA tax on self-employment income. The provision is effective for remuneration received and tax years beginning after December 31, 2012, and is not indexed for inflation. *Act, Sec. 9015, adding I.R.C. §3101(b), and amended by Act, Sec. 10906(a); Act, Sec. 9015(b)(1), adding I.R.S. §1401(b)(2)(A), and amended by Act §10906(b).*

  Note: The Act severs the link between Medicare payroll tax and Medicare benefits. In other words, the new revenue flows to the general fund. As such, the Act effectively turns social insurance into welfare.

  Also, the Act defunds Medicare by $716 billion to pay for the implementation costs of the Act.[8]

- **3.8% Medicare tax on "unearned" income.** The Reconciliation Bill also imposes a 3.8 percent tax (deceptively termed an "unearned income Medicare contribution") on "investment" income" for taxpayers with modified adjusted gross income over $250,000 (married filing joint return) or $200,000 (single return).[9] This tax uses an all-new definition of "investment income." In addition to the items that are "investment income" under the old investment income limitations -- interest, dividends and capital gains – the 3.8% tax also applies to royalties, rents, annuity distributions, and gross income from passive activities as so defined under the Sec. 469 passive loss rules. Net investment income is computed by claiming any allocable deductions. The provision is not indexed for inflation, and is effective for taxable years beginning after December 31, 2012. *Reconciliation Bill, Sec. 1402.*

  Note: The portion of gain on sale of the taxpayer's primary residence that is not covered by the I.R.C. §121 exclusion is subject to the tax.

  Note: The tax will also apply to income from employer-sponsored plans. While annuity income on such qualified plans above the threshold amounts is not subject to the 3.8 percent additional tax, all annuity income (including income from qualified plans) is to be used in calculating a taxpayer's income that is potentially subject to the 3.8 percent tax. Non-qualified annuities are typically marketed to higher income taxpayers, including self-employed taxpayers who lack access to employer-sponsored qualified annuity plans.

- **Increase in itemized deduction floor for medical expenses.** Both the Act and the Reconciliation Bill increase the floor of I.R.C. §213 medical expense deductions to 10 percent (up from 7.5%) of AGI for regular income tax purposes (except for taxpayers (and the taxpayer's spouse) over age 65 by the end of the tax year).[10] *Act, Sec. 9013, amending I.R.C. §213, effective for tax years beginning after December 31, 2012.*

- **Employer Medicare D deduction.** The Act eliminates the deduction for employers who maintain prescription drug coverage for their Medicare Part D-eligible employees.[11] *Act, Sec. 9012, amending I.R.C. §139A, effective for tax years beginning after December 31, 2012*.

- **Non-deductible excise tax on medical devices.** Annual (non-deductible) excise tax imposed on companies that manufacture or import medical devices (amount is $2 billion for 2011, $4 billion for 2012, $7 billion for 2013 and $9 billion annually for 2014 through 2016 and $10 billion thereafter). *Act, Sec. 9009, effective for medical device sales after December 31, 2008.*

  The Reconciliation Bill also imposes a 2.3 percent excise tax on medical device makers for sales after 2012. However, the excise tax is not imposed on eyeglasses, hearing aids, contact lenses and other items that are "generally purchased by the general public at retail for individual use." *Reconciliation Bill, Sec. 1405.*

  > **Note:** The tax is imposed on gross sales of the medical device company rather than the company's profits. Thus, the tax, in reality, will approximate 15 percent of company profits and will be in addition to the 35 percent corporate tax.

Provisions Effective in 2014

- **Mandatory coverage for individuals.** The Act requires all U.S. citizens (with some exceptions) and legal residents (but not persons in the U.S. illegally) to maintain a government-prescribed minimum amount of health insurance coverage. For those persons 18 and older, the fine for failing to maintain the required government-approved health insurance is $750 and $375 dollars for younger persons, with the total household penalty not to exceed $2,250. The fine is phased-in from 2014-2016 and is indexed for inflation beginning in 2017. *Act, Sec. 1501, creating I.R.C. §5000A, effective for tax years ending after December 31, 2013.*

  The Reconciliation Bill changes the amount of the fine. Under the Reconciliation Bill, the fine is reduced from $495 to $325 in 2015 and from $750 to $695 in 2016. The Reconciliation Bill also increases the percentage of income that is subject to fine from 0.5 percent to 1.0 percent in 2014, to 2.0 percent in 2015 and to 2.5 percent in 2016. These percentage amounts apply to the excess of the taxpayer's household income[12] over the applicable filing threshold. *Reconciliation Bill, Sec. 1002.*

  The mandated coverage requirement does not apply to persons that cannot afford coverage because their required contribution for employer-sponsored coverage exceeds eight percent of household income annually; persons with income below the applicable filing threshold; incarcerated persons; persons who object for religious reasons and are members of a recognized religious sect in accordance with I.R.C. Sec. 1402(g)(1);[13] U.S. citizens residing outside the U.S. that are deemed to maintain acceptable minimum coverage; and members of Indian tribes.

  Note: IRS has no enforcement authority concerning the fine for violations of this provision, making it voluntary as a practical matter. *Act, Sec. 1501(b), adding I.R.C. §5000A, effective for taxable years ending after December 31, 2013.*[14] However, the IRS Commissioner has indicated that the IRS would offset any tax refund by the amount of any fine owed. That will place a premium on appropriate tax planning to ensure that a tax obligation exists at the time of filing.

- **Individual premium assistance tax credit.** The Act creates an advanceable and refundable tax credit for use in covering (at least partially) the cost of health insurance premiums for insurance purchased through a mandated state health benefit exchange[15] for taxpayers that are not covered via an employer's "affordable" plan or a spouse's employer's "affordable" plan.

Note: Persons eligible for Medicare, Medicaid, Veteran's Benefits or military insurance are not eligible for the credit.

New I.R.C. §36B requires taxpayers to report the taxpayer's income to the exchange so that the amount of the taxpayer's "premium assistance credit" can be determined. Then, the Treasury Department will pay to the plan in which the taxpayer is enrolled the difference between the premium tax credit and the premium for the plan. In other words, the credit can be advanced directly to an insurance company. *Act, Sec. 1401, creating I.R.C. §36B, effective for tax years ending after 2013.*

Note: A taxpayer's eligibility for the "premium assistance credit" is to be determined by the taxpayer's income for the tax year that ends two years before the enrollment period. The amount of the credit varies depending on *household income* between one and four times the federal poverty level (according to family size).[16] The Secretary of Health and Human Services is to determine the amount of the credit which is 2 percent of income for taxpayer's at the poverty level, and 9.5 percent of income for taxpayers at four times the poverty level (tied to family size). *Reconciliation Bill, Sec. 1001.*

> **Note:** "Household income" is defined as the employee's MAGI and the MAGI of any spouse and dependents that are required to file a return. Treasury expects to propose a safe harbor that would determine affordability of an employer's coverage by referring to an employee's wages from the employer reported in Box 1 of Form W-2. ***IRS Notice 2011-73.***

- **Non-deductible excise tax on drugs.** The Act imposes an annual non-deductible excise tax of $2.5 billion for 2011 on manufacturers and importers of "branded" drugs (brand-name pharmaceuticals). The excise tax is increased to $2.8 billion for 2012 and 2013, $3 billion annually for 2014 through 2016, $4 billion for 2017, $4.1 billion for 2018 and $2.8 billion for 2019 and each year thereafter. *Act, Sec. 9008, effective for any branded prescription drug sales after December 31, 2008.*

  The Act also imposes additional non-deductible excise tax on health insurance providers beginning in 2011.

  The Reconciliation Bill imposes the same excise tax on pharmaceuticals and on health insurance companies and increases them and delays implementation of the "fee" on health insurers to 2014. *Reconciliation Bill, Sec. 1404.*

  Note: Both the Act and the Reconciliation Bill contain a provision that specifies that the tax on insurers and self-insured healthcare plans are to be used to establish a "patient-centered outcomes research trust fund." The taxes for the fund are to be imposed on plans ending after September 30, 2012, and before September 30, 2019.

- **Employer coverage mandate.** The Act mandate that companies with 50 or more "employees" provide "acceptable" health coverage or pay a $750 penalty tax per employee for those that get insurance through the newly established health insurance exchange. *Act, Sec. 1513, adding I.R.C. §4980H, effective for months beginning after December 31, 2013.*

The Reconciliation Bill subtracts the first 30 employees from the penalty tax calculation. Also, the Reconciliation Bill specifies that the penalty tax is $2,000 per full-time employee. *Reconciliation Act, Sec. 1003.*

- **New coverage reporting requirement.** The Act mandates that insurers (including employers that self-insure) providing coverage to any person during a calendar year must report information concerning the covered person's coverage information to the individual and the IRS including: name, address and taxpayer I.D. number of the primary insured, and the name, taxpayer I.D. number of each other person covered under the policy; the dates of coverage; whether the coverage is through a government mandated exchange; the amount of any premium tax credit or cost-sharing reduction that the person received; and any other information that the Secretary requests. *Act, Sec. 1502, effective for calendar years beginning after 2013.*

Provisions Effective in 2018

- **Cadillac Tax.** The Act imposes a 40 percent (nondeductible) excise tax to be paid by health insurers on the annual premiums associated with "Cadillac" health care plans (those where the premiums exceed $8,500 for an individual and more than $23,000 for families). The threshold amounts are indexed to the CPI for urban consumers (CPI-U) plus one percentage point. The provision also provides for a three-year transition period for 17 high cost states as well as higher-cost thresholds for non-Medicare retirees older than 55 and those with high-risk jobs. The provision is effective for tax years beginning after 2012. *Act, Sec. 9001, amending I.R.C. §4980I.*

  The Reconciliation Bill changes the threshold levels to $10,200 for individuals and $27,500 for families. Under the Reconciliation Bill provision, the effective date of the provision is changed to tax years beginning after 2017. *Reconciliation Bill, Sec. 1401.*

  Note: The Reconciliation Provision does not include dental and vision benefits and provides a mechanism for the accounting of gender and age in the workforce. In addition, beginning in 2021, the thresholds are indexed for inflation. Also, in a somewhat related provision, the Act specifies that premiums for coverage under a qualified health plan that is offered through a newly-created government health-care exchange are a qualified benefit under a cafeteria plan. The provision is applicable to cafeteria plans established by a small employer that elects to make all of its full-time employees eligible for at least one qualified plans offered in the small group market through an exchange. The provision is effective for tax years beginning after December 31, 2013.

Conclusion

The Act and the Reconciliation Bill represent the largest foray by the Congress into social policy in many decades, and will have implications not only for all individuals, but also state budgets and corporate bottom lines.[17] The impact on state budgets is particularly acute. Because the Act significantly increases the scope of Medicaid, states will have to account for the cost of additional citizens becoming enrolled and what the cost to the taxpayers in the state will be. The Act will substantially increase the number of citizens in any particular state that will be on some form of public assistance. In addition, states will also be subject to additional costs due to the Act's mandate of an increase in the Medicaid provider reimbursement rate (which is designed to help ensure that primary care doctors are available to care for the influx of new Medicaid patients).[18]

The Act also does nothing to rein in health care costs attributable to medical practices associated with the practice of "defensive medicine.[19]

From a broader perspective, tax policy in recent years has been characterized by numerous non-permanent provisions. That makes long-term tax planning particularly difficult. The tax provisions contained in the Act and Reconciliation Bill are no different given the significant unpopularity of the legislation and the likelihood of a substantially reconstituted Congress after the fall 2010 Congressional elections.

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[1] The Act's enactment was hailed by Fidel Castro, Cuban Revolutionary Leader and First Secretary of the Cuban Communist Party. See Haven, "Cuban Leader Applauds US Health-Care Reform Bill," Associated Press, Havana, Cuba, March 25, 2010, accessible at http://www.boston.com/news/world/latinamerica/articles/2010/03/25/cuban_leader_applauds_us_health_care_reform_bill/. After the Act became law, Howard Dean, past chairman of the Democratic National Committee and present "Chairman Emeritus" of the DNC" stated on CNBC that the Act was about "balancing" wealth and "…When it gets out of whack as it did in the '20s and it has now, you need to do some redistribution. This is a form of redistribution." See Ellis, "Howard Dean: Obamacare Is Redistribution," Dakota Voice, Mar. 28, 2010, accessible at http://www.dakotavoice.com /2010/03/howard-dean-obamacare-is-redistribution/. Wealth redistribution has been a long-held policy objective of Presdient Obama. See the video at this link: http://www.youtube.com/watch?v=ge3aGJfDSg4 Likewise, Senator Max Baucus (D-Mont. and Chairman of the Senate Finance Committee) stated that the Act involved an "income shift" to help the poor. Baucus stated, " Too often, much of late, the last couple three years, the mal-distribution of income in American is gone up way too much, the wealthy are getting way, way too wealthy and the middle income class is left behind," he said. "Wages have not kept up with increased income of the highest income in America. This legislation will have the effect of addressing that mal-distribution of income in America." See, Fox News.com, "Democratic Senator: Health Care Law To Address 'Mal-Distribution of Income,'" accessible at http://www.foxnews.com/politics/2010/03/26/democratic-senator-health-care-law-address-mal-distribution-income/. However, families in the lowest income group will not actually received the most redistribution of wealth under the Act due to those families already receiving public assistance and benefits. Under the Act, it is likely that the families in the second-lowest income category that will received the most income redistribution. Relatedly, the Administration made a recess appointment over the July 4 Congressional recess to appoint Donald Berwick as head of the Centers for Medicare and Medicaid which will have primary responsibility in administering various provisions of the Act. Berwick has publicly stated his support for health care legislation that redistributes wealth and that "excellent health care is by definition redistributional." While many Presidents have made recess appointments pursuant to the Constitutional power to do so (Art. 2, Sec. 2, Clause 3), legal scholars have raised questions as to whether an exercise of the power is constitutional when the committee responsible for scheduling a hearing on a prospective nominee (in this instance, the Senate Finance Committee) was not deliberately refusing to hold a hearing.

[2] See H.R. 4872, Sec. 1005 which transfers $1 billion to the Secretary of Health and Human Services to finance the administrative costs of implementing health insurance reform.

[3] The CBO projects an increase in health insurance premiums under the Act because the factors that cause rising health care costs in the health care system are made worse rather than controlled by the Act.

[4] The provision is projected by the non-partisan Tax Foundation as a $23.6 billion tax increase for the U.S. paper milling industry.

[5] Under the regulations, IRS notes that the provider must collect the tax from the person receiving the service with a "taxable service" defined as "...a service using any electronic product designed to incorporate one or more ultraviolet lamps intended for the irradiation of an individual by ultraviolet radiation, with wavelengths in air between 200 and 400 nanometers, to induce skin tanning." IRS notes that if the provider doesn't collect the tax, the recipient of the service is liable for the tax. Likewise, if the tax is not collected at the time the service is rendered (i.e., the invoice does not separately state the tax), the provider is to multiply the invoice amount by .09091. The provider is to report the tax on a timely filed Form 720 (Quarterly Federal Excise Tax Return).

The regulations exclude phototherapy service from the tax if the service is performed by a licensed medical professional on such person's premises. Exempt phototherapy services include those performed for dermatological conditions, sleep disorders, seasonal affective disorders, neonatal jaundice and wound healing. An exemption also exists for "qualified physical fitness facilities" where access to indoor tanning services are included as part of the overall membership fee and access to the tanning service is merely incidental to the facility's predominant business purpose. Also, the tax has no application to spray tans or topical creams.

[6] This provision is believed to have been a concession to pharmaceutical companies to help win their support for the legislation.

[7] Thus, the provision contains a stiff marriage penalty applicable to those persons in legitimate marriages for federal income tax purposes.

[8] See Congressional Budget Office, Letter to the Honorable John Boehner, July 24, 2012.

[9] *Id.*

[10] The increase in the floor is projected as a $15.2 billion tax increase by the non-partisan Tax Foundation, and the Joint Committee on Taxation (see Estimated revenue effects of the amendment in the nature of a substitute to H.R. 4872, The "Reconciliation Act of 2010," as amended, in combination with the revenue effects of H.R. 3590, the "Patient Protection and Affordable Care Act ('PPACA')," as passed by the Senate, and scheduled for consideration by the House Committee on Rules on March 20, 2010, Joint Committee on Taxation, March 20, 2010, JCX-17-10), with the JCT estimating that the provision will impact 14.8 million taxpayers once the provision is fully implemented in 2019, with 14.7 million of that number earning less than $200,000 annually).

[11] This is the provision that has triggered charges to earnings by large companies, including a $1 billion charge by ATT, a $100 million charge in the first quarter of 2010 by Caterpillar, a $150 million fiscal year charge by Deere, a $150 million charge by Boeing – charges required by SEC and accounting rules. Even so, Henry Waxman (D-CA) is outraged and has called committee hearings to browbeat company executives for taking these required charges to earnings. See, Viola Gienger, "AT & T, Deere CEOs called by Waxman to Back Up Health-Bill Costs," Business Week, Mar. 27, 2010, and accessible at http://www.businessweek. com/news/2010-03-27/at-t-deere-ceos-called-by-waxman-to-back-up-health-bill-costs.html. The Medicare Prescription Drug Improvement and Modernization Act of 2003 added a new prescription drug benefit to the Medicare program for senior citizens, and included a 28 percent subsidy for employers offering retiree prescription drug coverage to encourage such employers to continue to offer prescription drug coverage to retirees as an alternative to the retirees electing to participate in Medicare Part D at greater taxpayer expense. Under the Act, the subsidy will continue, but, beginning in 2013, corporations will not be able to deduct the portion of their prescription drug plans that are subsidized. The JCT's March 20, 2010, estimate is that the removal of the deduction amounts to a $4.5 billion tax increase on corporations (between 2013 and 2019). See the JCT's estimate at the following link: http://waysandmeans.house.gov/ Media/pdf/111/Estimated_Revenue_JCT.pdf. By utilizing the 2009 Medicare Trustees Report (accessible here: http://www.cms.gov /reportstrustfunds/downloads/tr2009.pdf), which measures total benefit payments including the employer subsidy, it can be projected how the Act's removal of the deductibility of the subsidy will impact the federal budget if corporations that now offer retiree prescription drug coverage stop providing such coverage - which is a likely outcome because the cost of providing such coverage is greater than the combined value of the deduction and the 28 percent subsidy. Under that projection, federal expenses for Medicare Part D will rise and the total taxpayer expense of covering prescription drugs for retirees will be greater (to the tune of tens of billions of dollars) than under the system put in place in 2003 - 28 percent subsidy to corporations providing such coverage and deductibility of the subsidy."

[12] "Household income" is defined as the sum of modified AGIs of the taxpayer and all individuals accounted for in the family size required to file a tax return for that year. I.R.C §5000A(c)(4).

[13] I.R.C. §1402(g) applies only to an individual "who is a member of a recognized religious sect or division thereof" which has established tenets or teachings opposing the provision of public or private insurance. The Act does not contain a provision parallel to I.R.C. § 1402(e), which specifically permits ministers and adherents of the teachings of the Christian Science belief system to claim exemption from self-employment tax. It is uncertain how the provision will be applied. It is likely that groups such as the Amish that have an established history of declining Social Security benefits would qualify for the exemption. Whether Muslims would qualify is harder to determine. Some Muslim groups object to insurance and others do not. The bottom line, is that the extent of the exemption will be left up to bureaucrats to define via regulations.

[14] New I.R.C. §5000A(g)(2)(B) specifies that "...(A)... in the case of any failure by a taxpayer to timely pay any penalty imposed by this section, such taxpayer shall not be subject to any criminal prosecution or penalty with respect to such failure. (B)...the Secretary shall not - (i) file notice of lien with respect to any property of a taxpayer by reason of any failure to pay the penalty imposed by this section, or (ii) levy on any such property with respect to such failure."

As forcing individuals into coverage is critical to make the plan work under any scenario, expect either the full force of normal IRS penalties to be imposed, or for the system to collapse almost immediately in 2014. The voluntary nature of the health insurance mandate will likely defeat any constitutional challenge to the provision and will incentivize persons to not seek insurance coverage until a medical condition arises since the Act also prohibits insurance companies from denying coverage for pre-existing conditions. Consequently, insurance company costs will necessarily rise and the industry could be forced into severe economic hardship.

[15] Under Sec. 1311 of the Act, every state must establish a state benefit health exchange. Also, IRS interprets the affordability test of I.R.C. § 368(c)(2)(C)(i) to mean that coverage is deemed unaffordable if the employee's required plan contribution for self-only coverage exceeds 9.5 percent "of the applicable taxpayers household income." How employers legally obtain household income information remains unknown. But, the Treasury expects to prepare a safe number that would determine affordability of an employer's coverage by referring to an employee's wages from the employer reported in Box 1 of Form W-2. *IRS Notice 2011-73.*

[16] Thus, the amount of the credit that a taxpayer is entitled to is tied to the poverty level, and is not tied directly to the taxpayer's income. The effect of tying the credit eligibility level to the poverty level is to impose a steep marriage penalty - married couples will receive much less publicly-funded support for acquiring health insurance. For 2011, a person earning $10,890 is at 100 percent of the poverty line (see United States Department of Health and Human Services, 2011 Poverty Guidelines (which have been extended through at least May 2012), as are two married persons that earn $14,710. The numbers for 400 percent of the poverty line are $43,560 for single persons and $58,840 for married persons. Thus, a single person with income at 400 percent of the poverty line ($43,320) is eligible for a tax credit to help offset the cost of health insurance, but a married couple with $86,640 is not (indeed, the couple cannot exceed $58,280 in income).

[17] At the present time, U.S. unemployment is reported to be hovering around 10 percent. At the present time, it remains to be seen what the Act's impact on unemployment will be. Already, as noted above in the text of footnote 8, some U.S. corporations have announced their projections of what the Act's impact on their profitability will be. For example, Deere & Co. (a significant employer in Iowa) has stated that the Act will raise its fiscal year 2010 expenses by approximately $150 million, with most of the expenses being incurred in the second quarter. Caterpillar, Inc. has projected a $100 million drop in first-quarter earnings.

[18] For these reasons, multiple state attorney generals have filed a complaint challenging the constitutionality of the Act. The complaint alleged that the individual insurance mandate provision in the Act is unconstitutional and that the uninsured person tax is an unlawful capitation (direct) tax). In mid-October, the court issued a lengthy and scholarly opinion which will be difficult to reverse on appeal in which the court refused to grant the government's motion to dismiss the case because it determined that the Act violates the Commerce Clause. The court found the individual mandate provision of the Act to not have been passed pursuant to the Congress's taxing authority even though it is contained in the Internal Revenue Code and constitutes a penalty. Accordingly, the Anti-Injunction Act did not prevent the court from hearing the case. However, the court dismissed the plaintiffs' claim that the Act interferes with state sovereignty with respect to state employees performing governmental functions. Likewise, the court held that the Act did not constitute "improper coercion and commandeering" regarding health insurance under the Ninth and Tenth Amendments and dismissed that claim. Based on its finding that the individual mandate penalty is not a tax, the court dismissed as moot the plaintiffs' claim that the penalty was an unconstitutional direct tax. The court also dismissed the claim that the mandate violated the substantive due process clause of the Fifth Amendment. The court, however, did find that the plaintiffs had made a plausible claim regarding "coercion and commandeering" as to "fundamental changes in the nature and scope of the Medicaid program." As for the heart of the plaintiffs' case, the court found that the plaintiffs made a plausible claim that the individual mandate provision of the Act exceeded the Congress's power under the Commerce Clause. *Florida, et al. v. U.S. Dept. of Health and Human Services, et al., No. 3:10-cv-00091(N.D. Fla. Oct. 14, 2010).* On August 12, 2011, the U.S. Court of Appeals for the Eleventh

Circuit upheld the trial court in finding the mandate provision unconstitutional. *State of Florida, et al v. United States Department of Health and Human Services, Nos. 11-11021 & 11-11067 (11th Cir. Aug. 12, 2011), aff'g. in part and rev'g. in part, No. 3:10-cv-91 (N.D. Fla. Mar. 23, 2010).* The court, however, upheld the remainder of the Act.

In a similar case, *Commonwealth of Virginia, et al. v. Sebelius, No. 3:10CV188-HEH (E.D. Va. Aug. 2, 2010),* the court denied the federal government's motion to dismiss the plaintiff's constitutional challenge to the individual mandate provision of the Act. The court found that no court has ever determined whether the federal government's power to tax can regulate an individual's decision to not participate in commerce; but see *Thomas More Law Center, et al. v. Obama, No. 2:10-cv-11156 (E.D. Mich. Oct. 7, 2010)*(in case challenging individual mandate provision of Act, the court, in a cursory opinion with no legal analysis, refused to issue preliminary injunction against government; court determined that penalty is not an improperly apportioned direct tax and Congress has the power under the commerce clause to enact the Act - the decision to forego insurance will have a substantial effect on interstate commerce and is not an effort to regulate inactivity). On appeal, the U.S. Court of Appeals for the Sixth Circuit affirmed. *Thomas More Law Center, et al. v. Obama, et al., No. 10-2388 (6th Cir. Jun. 29, 2011).* The Court, in a split opinion, reasoned that the mandate provision is within the authority of the Congress to enact under the Commerce Clause, but also noted that its opinion did not preclude future as-applied challenges to the mandate provision. The dissent noted that the mandate does not regulate commercial activity, but regulates the status of being uninsured; thus, since no market activity involved, the Congress has no ability under the Commerce Clause to regulate such inaction. The dissent also pointed out that finding the mandate provision Constitutional removes all limits on the authority of the Congress under the Commerce Clause.

Importantly, the Act does not contain a severability clause. Thus, if a single provision of the Act is deemed unconstitutional, the entire Act is unconstitutional.

[19] The Congressional Budget Office (CBO) has determined that reforming the medical malpractice insurance system (a.k.a. "tort reform") could save $54 billion in health care costs over 10 years.
CBO Director Doug Elmendorf stated in a late 2009 letter to Senator Orrin Hatch (R-UT) that, based on CBO projections, changes to current federal liability laws would significantly reduce costs to health care providers and to Medicare and Medicaid. In the study, the CBO examined a cap on non-economic damages of $250,000, a cap on punitive damages of $500,000 and a shortening of the statute of limitations for bringing suit. Elmendorf stated that CBO's analysis revealed that liability costs associated with health care comprise 2 percent ($35 billion) of annual spending by health care providers. By reforming tort laws and reducing health costs for employers, the CBO projected that companies would use the savings to increase wages with a resulting increase in taxable income generating additional tax revenue. The CBO study did not analyze the impact on patient care of tort reform. Similarly, according to a study released in late 2009 by Gallup and Jackson Healthcare (accessible here: http://www.jacksonhealthcare.com/healthcare-research/healthcare-costs-defensive-medicine-study.aspx), physicians attribute approximately 26 percent of overall medical costs to defensive medicine. That percentage amounts to additional annual medical costs of approximately $2,167 for every U.S. citizen. Likewise, a significant academic study has determined that simply instituting medical tort reform has been projected as reducing medical costs by five to nine percent. See, Kessler and McClellan, "Do Doctors Practice Defensive Medicine?", Quarterly Journal of Economics, pp. 353-390, May 1996 (note: this study won the 1997 American Economics Association's award in health economics).