

# WebMemo



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## Adding Insult to Injury: The Baucus Health Plan Imposes New Taxes on the Sick

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Public support for health care reform is based on a desire to help the sick or, at the very least, to protect the non-wealthy from the financial impact of illness, chronic disease, and accidents. Unfortunately, the reform proposals under active consideration in Congress do precisely the opposite.

In particular, the Baucus health reform proposal, recently passed by the Senate Finance Committee, imposes new taxes on those who need health care the most and on lower-income people with the least ability to pay—in some cases to fund coverage subsidies that will primarily go to young, healthy people with moderate incomes.

The proposal would impose higher taxes on taxpayers at all income levels who face high out-of-pocket medical expenses or have high-cost health plans, including patients living in poverty. It would impose “annual fees” (i.e., taxes) on the medical device and pharmaceutical industries, which would have to be passed on in the form of higher prices to patients who pay out of pocket, and to insurance plans, which will have to raise their premiums. There is also an “annual fee” on insurance companies that will be passed on to patients directly in the form of higher premiums.

**Taxing Medical Devices.** The Baucus proposal imposes an “annual fee” on medical device companies, which amounts to an excise tax on medical devices. Although it would not apply to Class I devices (simple items like tongue depressors and bedpans) or Class II devices priced under \$100, it would apply to all other medical devices, including items from

powered wheelchairs and breast-milk pumps for working mothers to pacemakers, hearing aids, prosthetics, and replacement joints. It would also apply to diagnostic tools like MRI and CT scanners.

The tax is structured in an unprecedented way: as an “annual fee” on the “industry sector,” to be “allocated” across companies according to their U.S. market share. The tax would be passed on to patients who need these devices both directly (through higher prices for out-of-pocket purchases and higher co-payments) and indirectly (through higher health insurance premiums).

The total tax would initially be set at \$4 billion per year. Yet the true impact would be higher because the annual fee would be treated as profit for corporate income tax purposes. This would make the effective tax as much as \$5.4 billion and could result in money-losing companies paying tax on profits they do not actually have—in addition to their allocated share of the industry sector fee. For example, a company with market share but no after-tax profit would have to pay its share of the annual fee, the amount of which would be treated as profit and taxed as such. Thus, a pre-tax profit would turn into an after-tax loss.

This paper, in its entirety, can be found at:  
[www.heritage.org/Research/HealthCare/wm2651.cfm](http://www.heritage.org/Research/HealthCare/wm2651.cfm)

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## Taxing the Sick at All Income Levels

President Obama promised that taxes on people making less than \$250,00 per year would “not increase one dime.” But many of the taxes in the Senate Finance Committee bill would fall on Americans at all income levels. For example, new limits on the income tax deduction for medical expenses will raise taxes on those with high health care needs, the vast majority of whom earn much less than \$250,000 per year.

Income Range*	Maximum Income in Quintile (Figures Rounded to Nearest \$100)	Number of Households Taking the Medical Expense Deduction	Percentage of Households Taking the Medical Expense Deduction	Cumulative Percentage
1st quintile**	\$19,000	582,254	9.7%	9.7%
2nd quintile	\$37,900	1,057,906	17.6%	27.2%
3rd quintile	\$60,800	1,423,990	23.6%	50.9%
4th quintile	\$100,500	1,943,388	32.3%	83.2%
5th quintile, below top 5%	\$213,800	939,035	15.6%	98.8%
Top 5%, below top 1%	\$570,100	71,728	1.2%	99.9%
Top 1%	n/a	3,053	0.1%	100.0%
Total		6,021,354	100.0%	

\* Income quintiles based on data from the U.S. Census Bureau. \*\* Includes those with zero or negative income.

Source: Heritage Foundation calculations based on the Center for Data Analysis Individual Income Tax Model. The projection is for year 2014, the first full year the Baucus plan would be in effect.

Table I • WMM 2651  [heritage.org](http://heritage.org)

**Taxing Prescription Drugs.** The Baucus bill would also impose a tax (“annual fee”) on prescription drugs (excluding FDA-designated orphan drugs and generics). As with the device tax, the prescription drug tax is structured as an annual fee on the pharmaceutical industry sector. But the drug tax would be “allocated” to drug companies according to their share of sales only to federal health care programs—Medicare, Medicaid, the Veterans Health Administration, and TRICARE.

Since the tax will be charged on the basis of sales only to government programs, the government will pass much of the tax onto itself and the rest onto Medicare beneficiaries through higher co-payments.

The total pharmaceutical-sector tax would initially be set at \$2.3 billion. Like the device tax, the pharmaceutical tax would be treated as profit, making the effective tax as much as \$3.1 billion and possibly forcing some drug companies to pay a “profits” tax on profits that do not exist.

**Taxing Patients with High Health Care Expenses.** One provision of the bill would raise

taxes on people with high health care needs—but only if they have jobs—by reducing the limit on employer-sponsored tax-free flexible spending accounts from \$5,000 to \$2,000.<sup>1</sup> Most affected workers would see an increase in income taxes; there would also be a payroll tax increase that would fall most heavily on lower- and moderate-income workers. Those with incomes *under* \$106,800 would pay up to \$459 more; workers with higher incomes would see an increase of no more than \$87.

Another provision would increase taxes on those with high out-of-pocket health expenses, as well as those who pay their own health insurance premiums regardless of their employment status. Currently, medical expenses (other than those paid pre-tax through an employer) that exceed 7.5 percent of adjusted gross income are tax deductible. The Baucus proposal would raise this threshold to 10 percent, increasing taxes on more than 6 million households at all income levels.

About half of affected households have incomes low enough that they would qualify for the subsidi-

1. A proposed amendment would set the cap at \$2,500.

dies for which these taxes are intended to pay. Despite the President’s promise that families with incomes under \$250,000 would not pay higher taxes, 98.8 percent of those affected by this tax increase have incomes below \$213,800.<sup>2</sup>

Affected households have higher health expenses because they have pre-existing conditions or buy health insurance themselves because they do not have access to employer-sponsored insurance. This group includes over 250,000 people who are disabled or in very poor health.<sup>3</sup> By any reasonable standard, health care reform should be directed at helping precisely these households. However, the Baucus plan would make them pay extra—to foot the bill for subsidies to healthy households with lower health care expenses.

**Taxing “High-Cost” Health.** The Baucus proposal would impose a 40 percent tax on plans with premiums or actuarial value over \$8,000 for individuals or \$21,000 for families.<sup>4</sup> This tax rate is higher than the top income tax rate for even the richest Americans—and it would apply to everyone with high-valued plans, regardless of income.

Union members are particularly likely to be affected, as their contracts often call for comprehensive, high-value health plans. Even more cruelly, those with more health problems are most likely to select comprehensive plans with higher premiums, bending the cost curve in the wrong direction.

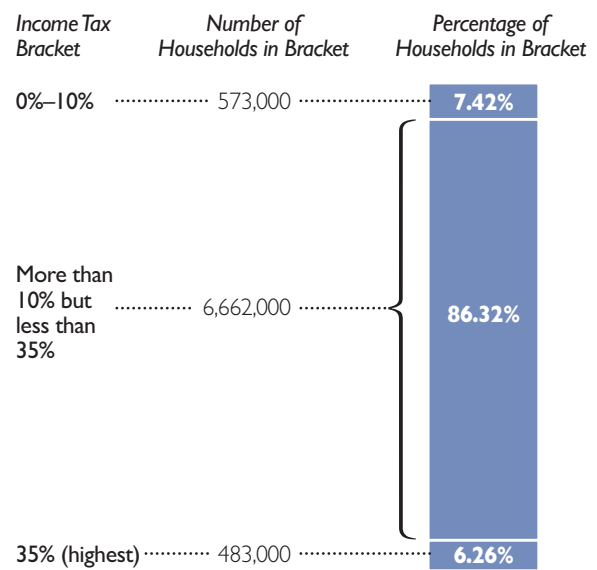
**Taxing the Sick to Subsidize the Healthy.** Despite President Obama’s promise not to raise taxes “one dime” for those earning below \$250,000, this proposal would increase taxes on households with incomes substantially below that level—and especially on households facing the worst health problems.

The revenue from these taxes is intended to offset premium subsidies for households with incomes

### Excise Tax on Insurance Exceeds Highest Income Tax Rate

Under the revised Baucus health care bill, 7.7 million households in the U.S. would pay a 40 percent excise tax on their health insurance. That rate is higher than the highest income tax rate on the richest Americans. President Obama promised that taxes on people making less than \$250,000 per year would “not increase one time.” But the vast majority of people paying this 40 percent tax make much less than \$250,000.

Number of American Households Subject to the 40% Tax on High-Value Health Plans, by Tax Bracket



Source: Heritage Foundation calculations using data from the 2008 Current Population Survey and the 2001–2003 Insurance Components of the Medical Expenditure Panel Survey.

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below four times the federal poverty level (FPL), but these taxes would be imposed on Americans who need medical devices or prescription drugs, have

2. Authors’ calculations based on the Center for Data Analysis Individual Income Tax Model. The projection is for 2014, the first full year the Baucus plan would be in effect.
3. Based on the Current Population Survey including those either categorized as “disabled” or whose health is categorized as “poor.”
4. Slightly higher limits would apply for retirees (but not workers) over age 55 and workers in certain yet-to-be-specified “high-risk” professions. These limits would be \$9,850 for individuals and \$26,000 for families. It is unclear why family members of high-risk workers are at higher risk.

high out-of-pocket costs, or pay their own health insurance premiums—including many households with incomes below four times the FPL.

The Baucus proposal would tax the sick to subsidize insurance for the healthy. And much of the tax burden would fall on the same people “helped” by the subsidies. In short, the Baucus plan would

harm those it should help and help those who need help the least.

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