Joint Economic Committee
Representative Pat Tiberi, Chairman

July 18, 2017

How Obamacare Tax Hikes Hurt Low- and Middle-Income Americans

In spite of President Obama's promise not to raise taxes on the middle class, Obamacare's $1 trillion in tax hikes hurt those least able to afford the burden.

Individual mandate
Taxing uninsured Americans

Americans without government-approved insurance are required to pay Obamacare's individual mandate tax unless they manage to qualify for an exception. In 2015, people with incomes between only $15,000 to $20,000 were the largest group hit by this tax (1.3 million taxpayers). The annual penalty ranges from $695 (increasing with family size) to 2.5 percent of household income or the cost of a bronze Obamacare insurance plan for the family, whichever is higher. The penalty tied to the cost of a bronze plan is particularly unfair to Americans who are uninsured because they can't afford Obamacare's rising premiums.

Cut in medical expense deduction
Taxing families with catastrophic medical costs

Before Obamacare, Americans could take a tax deduction for out-of-pocket medical expenses that exceeded 7.5 percent of their adjusted gross income. This design ensures that only taxpayers with very high medical costs relative to their income can use the deduction. Obamacare made it harder to obtain relief from catastrophic costs by raising the income threshold to 10 percent. (Seniors received a temporary exception that expired last year.) In 2015, almost 1.9 million Americans with incomes of less than $25,000 used this deduction. Further, the Joint Committee on Taxation (JCT) estimated this tax hike will hit 1.7 million more Americans this year than will be helped by Obamacare's premium tax credits.

Limit on Flexible Spending Arrangments (FSAs)
Preventing families from managing rising out-of-pocket health costs

Employers offer FSAs that allow employees to set aside a portion of their paycheck free from tax in order to pay for out-of-pocket medical costs. In another blow to families struggling to afford rising health costs, Obamacare imposed a limit ($2,600 in 2017) on the amount that can be placed in an FSA. This cap is particularly harsh for families dealing with multiple chronic conditions or who use FSAs to finance services for children with special needs.

Health Savings Account (HSA) penalty hike
Taxing families with non-medical expenses more severely

HSAs combine the benefit of a lower-premium high deductible health plan with a tax-free savings account to cover out-of-pocket medical expenses. Previously, when consumers withdrew funds from an HSA for unexpected non-medical expenses, the rules were similar to those governing retirement accounts—the funds would be taxable and a 10 percent penalty applied. Aside from creating other problems for HSAs, Obamacare doubled the HSA penalty to 20 percent, making it more difficult for families facing situations like the sudden loss of a job.

"Medicine cabinet tax"
Taxing over-the-counter medicines

Over-the-counter (OTC) medications theoretically allow consumers to treat their ailments without the hassle and expense of dealing with the health care system. Previously, Americans could easily use tax-free FSAs, HSAs, or Health Reimbursement Accounts (HRAs) to purchase OTC products like allergy medications or smoking cessation aids. Obamacare prohibits using these accounts for OTC medicines unless consumers first obtain a doctor's prescription, causing more costly and time-consuming interactions with the health system.

Health insurance tax (HIT)
Taxing families with private insurance

Obamacare not only imposes taxes on people who don't have insurance, but also on those who do. One of Obamacare's taxes on private insurers known as the HIT is passed directly to consumers in the form of higher premiums and even shows up as a line item on monthly premium bills. JCT estimates this tax raises the cost of premiums 2 to 2.5 percent and that repealing it would have reduced premiums for the average family by $350-$400 in 2016. While Congress temporarily suspended the HIT for 2017, it returns in 2018 and is already being priced into next year's premiums by insurers.

Other insurance taxes
More fees that raise the cost of insurance

Obamacare levied other taxes on insurance that have raised costs for consumers. A reinsurance tax ranged from $27 to $63 for each person covered by private insurance and finally expired at the end of last year, with final payments due this year. Another tax that finances a trust fund for comparative effectiveness research is currently $2.26 per person (affecting both private insurance and some Medicare supplemental plans) and will grow with inflation until it expires, with final payments due in 2020. The institute financed by this fund has been criticized by a left-leaning organization for not focusing enough on its core mission.

Medical device tax
Discouraging innovation, jobs, and access to lifesaving treatments

Because Obamacare's 2.3 percent excise tax on medical devices is based on gross sales and not profits, it is particularly harmful to small companies that are not yet profitable but are struggling to launch lifesaving devices. Additionally, before Congress temporarily suspended the tax for 2016 and 2017, there was evidence it caused job losses even among large companies. This tax on innovation returns next year, threatening patients' access to devices that save and improve lives.

Brand-name drug tax
Making prescription drugs more expensive

Obamacare specifies a certain amount of taxes that must be collected from branded prescription drug manufacturers and importers, totaling billions of dollars each year. Patients have very little discretion to forgo a medication when it becomes more expensive, which under basic economic theory of inelastic demand makes the tax likely to be passed to consumers in the form of higher prices. According to Tax Foundation analysis, the tax may have contributed to recent spikes in prescription drug costs.

Repealed deduction for retiree drug coverage
Discouraging employers from offering prescription drug coverage to their retirees

When Congress created Medicare Part D to provide seniors with prescription drug coverage, it also created a tax incentive for companies to maintain retiree drug coverage out of concern that they might otherwise drop the coverage and shift costs to retirees and Medicare. Obamacare repealed the 28 percent deduction for retiree coverage, which human resources professionals warned would likely cause retirees to lose access to employer drug plans.

Tanning tax
Destroying small businesses and jobs

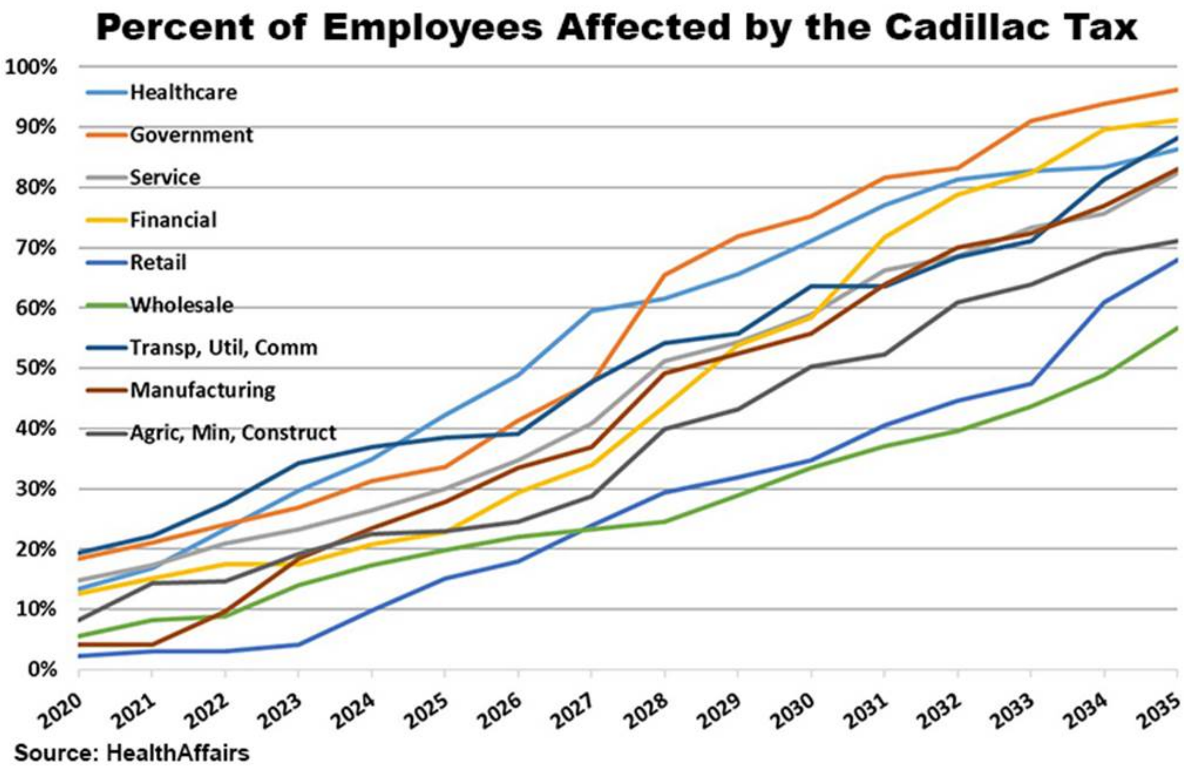
Obamacare's 10 percent excise tax on tanning services is another tax JCT indicated would likely adversely affect lower- and middle-income Americans. While the tanning tax has only raised a fraction of the revenue initially expected, the collateral damage has been severe. According to industry estimates, the tax caused the closure of almost 10,000 businesses (many of which were owned by women) and the loss of over 80,000 jobs.

Employer mandate
Penalizing full-time work and small businesses hiring

The employer mandate forces employers to provide insurance or face a penalty tax, triggered if even one full-time worker receives an insurance subsidy in the Obamacare exchanges. Since the tax is generally assessed per full-time worker (redefined by Obamacare as someone working 30 hours or more per week), the mandate provides an incentive to cut worker hours. Even if employers do provide insurance, another tax applies if the government determines it isn't "affordable." Also, because the mandate applies to companies with 50 or more full-time employees, it discourages small businesses approaching that threshold from hiring additional workers, causing an estimated loss of 250,000 jobs.

"Cadillac tax"
Imposing higher costs and fewer health benefits on employees

An employer offering health insurance that meets Obamacare's definition of "affordable" may face yet another tax if Obamacare determines the benefits are too "generous" to employees. Beginning in 2020, Obamacare will impose a 40 percent excise tax known as the Cadillac tax on the value of health benefits that exceed a certain threshold, including both employer and employee contributions to the plan. The tax is broad, covering not only the value of basic health plans offered by employers but also any pre-tax wellness programs, disease-specific coverage, HRAs, FSAs, and contributions to HSAs by either the employer or employee. Because the threshold that triggers the tax is designed to grow more slowly than costs, a growing number of employees will be trapped by the tax over time. The likely result is fewer benefits, reduced networks for receiving care, and higher costs for employees.

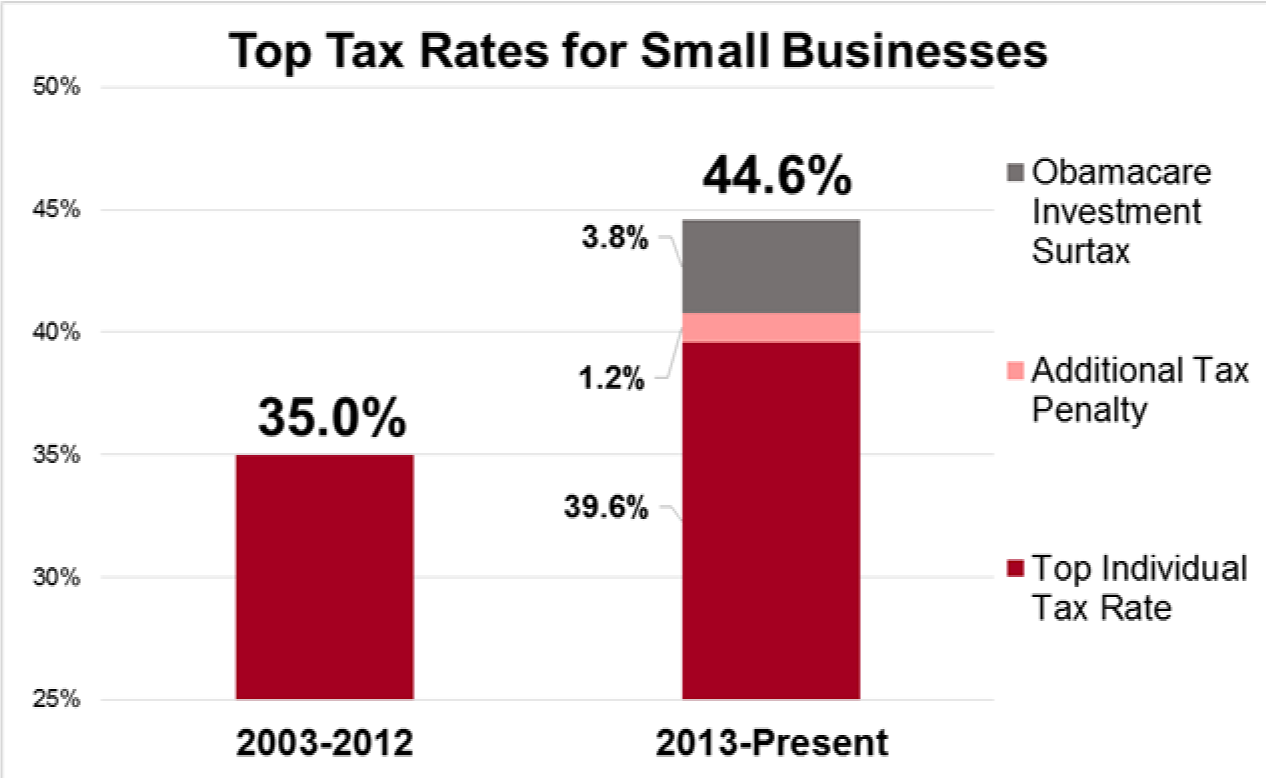


<u>Special penalty on compensation of insurance company executives</u>
Enabling premium increases

The tax code already imposes a $1 million limit on the amount of executive compensation that public companies can deduct from their taxes, but Obamacare singled out insurance companies for a lower limit of $500,000. Laying aside arguments about whether government should micromanage private-sector salaries or the wisdom of imposing special penalties on particular industries, the policy has not succeeded in curbing insurance executive compensation because companies want to attract top talent. Thus, insurance companies will spend premium dollars to cover the extra taxes rather than on paying claims or improving quality. This can only lead to higher premiums or fewer benefits for customers.

<u>Additional Medicare and investment income taxes</u>
Draining small business resources and reducing employment

Obamacare imposes an extra 0.9 percent Medicare payroll tax and a 3.8 percent investment income tax on individuals with incomes over $200,000 ($250,000 for married couples). Like many tax penalties aimed at higher-income Americans, both of these taxes hit small businesses. The vast majority of small businesses are organized so that income from the business is taxed on business owners' individual tax returns. An Obama Treasury Department study released shortly after Obamacare was enacted found the average gross income of small businesses was $270,000, putting many of them in the crosshairs of these tax hikes.



Draining small business resources. In 2013, small businesses faced a tax triple whammy: the top individual rate rose from 35 percent to 39.6 percent; a limit on itemized deductions was reinstated that added another 1.2 percent to their effective tax rate; and the Obamacare 3.8 percent investment surtax kicked in, meaning that their top rate spiked from 35 percent to 44.6 percent in a single year. With more small business income consumed by taxes, fewer funds are available to hire workers, expand the business, and give pay raises.

Reducing employment. Similarly, the 0.9 percent Medicare surtax affects owners who manage the day-to-day operations of the business and are compensated by the business for their work. The Congressional Budget Office (CBO) listed several Obamacare policies that contribute to its projection of the law causing a loss of the equivalent of 2 million full-time employees over the decade, and the Medicare surtax is one of them. CBO also noted the surtax would trap a growing share of workers over time because the tax is not indexed for inflation.

Direct tax increases. Aside from the possible loss of job opportunities from small businesses, low- and middle-income Americans will also face direct tax increases from these two tax hikes. While most of the impact will fall on high-income taxpayers, JCT estimated that people with incomes of less than $75,000 would face a total of $20 million in higher taxes in 2015 alone due to these two Obamacare taxes, and this includes some taxpayers earning less than $10,000.