

POLICY FOCUS

Tax Burden of the Affordable Care Act

RECIPES FOR RATIONAL GOVERNMENT FROM THE INDEPENDENT WOMEN'S FORUM

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WHAT YOU NEED TO KNOW

The Affordable Care Act includes trillions of dollars in new spending on healthcare subsidies and programs. This new spending is financed by new taxes, tax increases, and reductions to Medicare's budget.

The creators of the ACA (ObamaCare) understood that the law's benefits (subsidies, expansions of existing programs, and new programs) would be more popular with the public than its tax increases, so many of the tax increases did not take immediate effect. The implementation of the **more than 20 tax increases** in the law was spread out over several years. The latest of the taxes is scheduled to come into effect in 2018.

Americans need to be aware of the cost of ObamaCare, not just in terms of their health insurance premiums, but as it affects their tax bill. In spite of the rhetoric that was used to sell the legislation, the ACA's tax increases do not just impact the wealthy, big business or healthcare companies; many of the tax changes directly hit middle-class families, by reducing their ability to save tax free, limiting deductions for medical expenses, and imposing new taxes, including the individual mandate which will hit middle-class Americans who lack ACA-compliant health insurance.

The real tragedy of ObamaCare's massive tax hikes is that they simply aren't necessary. There's a better way to reform our healthcare system that relies on market competition instead of massive government spending and control.

WHY YOU SHOULD CARE

The tax burden of ObamaCare affects us all.

- **Taxes on the Middle Class:** Despite promising not to raise taxes on anyone earning less than \$250,000, President Obama signed off on the Affordable Care Act, which includes at least seven tax increases that will directly affect low- and middle-income families.
- **Taxes on High Earners:** While everyone suffers under ObamaCare's tax regime, a few of the law's most harsh tax increases are aimed at high earners. This doesn't just soak the rich, but discourages job creation and slows economic growth.
- **Taxes on Business:** Some of ObamaCare's taxes increase the cost of doing business. This also negatively affects hiring, job creation, and the labor market.
- **A Better Way:** There is a better, more fiscally responsible way to provide better access to health care for all Americans. Rather than attempting to tax and spend our way to a better healthcare system, policymakers should consider broad, structural reforms that would return control to patients and doctors, and use market-competition to make health care more affordable for everyone.

MORE INFORMATION

Taxes on the Middle Class

President Obama famously promised not to raise taxes on anyone who earns less than \$250,000 annually. But at least seven of the taxes included in the Affordable Care Act can impact those with middle incomes.

Several of these tax changes impact tax-free accounts called Health Savings Accounts (HSAs) and Flexible Spending Accounts (FSAs). These types of accounts are intended to create an incentive for people to set money aside for healthcare-related purchases. Americans should be encouraged to save responsibly so that they are prepared if they face high health costs.

Prior to the Affordable Care Act, Americans could use HSAs or FSAs to pay for over-the-counter drugs tax-free. The ACA prohibits the use of these accounts for over-the-counter drugs, effectively amounting to a tax increase.

The ACA also put a cap on how much employees can contribute to their FSAs (\$2,500). If families have expenses that go beyond that cap, they will not be able to benefit from the use of this tax-free account for those additional dollars. Some people have referred to this as the "Special Needs Kids Tax," because families of special needs children can use FSA dollars toward special needs education. Those families will face the most devastating effects of this tax increase.

The ACA **increases the penalty for withdrawing HSA dollars** for non-medical expenses. Before the law, the penalty was 10 percent. Now it's 20 percent. This is a harsh punishment for saving too much and then later facing the need to spend that money on something other than health care.

The law changed the medical expense deduction threshold **from 7.5 percent of income to 10 percent of income**. The medical expense deduction, just as its name suggests, is a tax deduction that mainly benefits people with very high health costs. For example, a person with an income of \$50,000 and \$6,000 in health costs would be able to deduct \$2,250 in medical expenses in a tax year prior to this change (because 7.5 percent of \$50,000 is \$3,750, and \$6,000 exceeds this amount by \$2,250), but now that same person can only deduct \$1,000 (because 10 percent of \$50,000 is \$5,000, and \$6,000 exceeds this amount by \$1,000). This is a considerable tax increase for someone facing a significant illness and big medical bills.

The remaining three taxes that can also hit middle-income Americans are specific to certain behaviors. They are the indoor tanning tax, the so-called "Cadillac tax," and the individual mandate penalty.

The indoor tanning tax is a 10 percent excise tax on tanning salons. Many people who own tanning businesses are in the middle class; **this tax has significantly harmed their ability to do business**.

The so-called "Cadillac tax" is a tax on high-cost employer-sponsored health insurance plans. If the annual cost of a plan exceeds \$10,200 for an individual or \$27,500 for a family in 2018, then every dollar above the threshold will be taxed at 40 percent. This is without regard to the income level of the employee. These price thresholds are also tied to the consumer price index, which is typically much slower than premium growth. Therefore, more and more people will become subject to this tax in the future.

The **individual mandate** is perhaps the most infamous tax in the Affordable Care Act (see text box.) Like many of the law's provisions, it was phased in, beginning in 2014. Starting in that tax year, filers who did not have health insurance coverage that met the government's requirements would face a penalty. The penalty was \$95 per uninsured person or 1 percent of household income (in 2014). It is now \$325 per uninsured person or 2 percent of household income (in 2015), and will be \$695 per uninsured person or 2.5 percent of household income (in 2016 and beyond). Filers must pay the *greater* of the two options.

There are many exemptions, including one for people who face a financial "hardship," which is determined by formulas in the law. However, most of the burden of this tax will be borne by the middle class. The **Congressional Budget Office (CBO) estimates** that this tax will generate about \$4 billion in revenues in 2016 and \$5 billion per

year on average in future years. According to the CBO, approximately 69 percent of those who pay the mandate penalty have incomes below 400 percent of the federal poverty level (\$47,080 for individuals and \$97,000 for families of four in 2016, which is solidly middle class).

Taxes on High Earners

While fewer of the taxes in the ACA apply to high earners, these few taxes on the wealthy generate a large share of the law's revenue.

In 2013, the law implemented **a new 3.8 percent surtax on investment income**, applicable to only those earning over \$250,000 (\$200,000 for a single person). This tax alone is supposed to generate \$123 billion in revenues in 10 years.

The same income thresholds and implementation date apply to a new hike in the **Medicare payroll tax**. Before 2013, the combined Medicare payroll tax rate was 2.9 percent of earnings; in 2014, it rose to 3.8 percent. This tax hike is estimated to bring in \$86 billion in revenues over 10 years. The law also includes a \$500,000 limit on compensation for health insurance executives, which affects those high earners specifically.

Taxes on Businesses

A handful of taxes in the law are aimed at specific industries and businesses, but there is at least one tax that will affect any business with more than 100 employees: **the employer mandate penalty**.

Starting in 2016, businesses that do not offer government-compliant health insurance will have to pay \$2,000 per worker per year as a punitive tax. In some cases, businesses will pay \$3,000 per worker if their workers are also eligible for financial help in the ObamaCare exchanges.

Policy experts on the **right** and **left** agree that the employer mandate does more harm than good. It hasn't led to any significant expansion of health insurance coverage (since many businesses offered health insurance prior to the mandate). Instead, it is a drag on the labor market, raising the cost of employment and creating perverse incentives (for example, moving employees to part-time status to avoid the mandate's requirements).

The ACA also includes **industry-specific taxes**, such as an annual tax on health insurance companies with more than \$50 million in profits, a "black liquor" tax on a type of bio-fuel, a tax on innovator drug companies, and a 2.3 percent excise tax on medical device manufacturers.

Don't be fooled: Taxes on industry are also taxes on individuals, as most companies will be forced to pass along the costs to customers and patients.

A Better Way to Reform Health Care

As is clear from this long list, the Affordable Care Act seems not so affordable after all. For the most part, revenues from these taxes are used for the coverage-expansion provisions in the law: the

subsidies in the exchanges and Medicaid. This represents a huge pipeline of redistribution, and it's worth asking if there isn't a more efficient way to make health coverage and health care more affordable for more people.

Everyone wants their friends and neighbors to have access to the best health system possible, but there's simply no need to run trillions of dollars through government channels to make health care more affordable for all.

The fatal flaw in the ACA is that it treats the symptoms of the cost problem – not the root. The root cause of the problem is a lack of competition in the health sector. The current system (and indeed, the system preceding the ACA) was riddled with perverse incentives and inefficiency, but the ACA only made this problem worse, further separating patients from the cost of the care and coverage they consume.

We should go in the opposite direction by deregulating what insurance individuals must carry and encouraging conscientious healthcare spending. Instead of limiting the use of HSAs and FSAs, our policies should encourage Americans to save responsibly for health expenses and return control of health dollars to patients, not big health insurance companies and not big government. To find out more about free-market health reforms, read [chapter three of the Independent Women's Forum 2014 book *Lean Together*](#).

A Tax or a Penalty?

The individual mandate and its associated penalty caused constitutional controversy. Never before has the federal government imposed a financial penalty for an act of omission – in this case, failure to purchase health insurance.

Many plaintiffs – including 26 states – challenged this provision of the law in courts. They complained that the individual mandate was not constitutional while government lawyers argued that it was a legitimate exercise of Congress's power to regulate interstate commerce.

Throughout these lawsuits, ACA supporters maintained that the penalty associated with the individual mandate was not a tax. But in a landmark case in 2012, *National Federation of Independent Businesses v. Sebelius*, the Supreme Court ruled that “The Affordable Care Act's requirement that certain individuals pay a financial penalty for not obtaining health insurance may reasonably be characterized as a tax. Because the Constitution permits such a tax, it is not our role to forbid it, or to pass upon its wisdom or fairness.”

It seems now that ACA supporters are willing to accept that the mandate's penalty is technically a tax (at least according to the Supreme Court's constitutional definition of taxation), so long as the provision stands.

WHAT YOU CAN DO

You can help encourage reforms that would increase opportunity and broad-based prosperity.

- **Get Informed:** Learn more about the tax burden of ObamaCare. Visit:
 - Americans for Tax Reform
 - The Heritage Foundation
 - The Galen Institute
- **Talk to Your Friends:** Help your friends and family understand these important issues. Tell them about what's going on and encourage them to join you in getting involved.

- **Become a Leader in the Community:**

Get a group together each month to talk about a political/policy issue (it will be fun!). Write a letter to the editor. Show up at local government meetings and make your opinions known. Go to rallies. Better yet, organize rallies! A few motivated people can change the world.

- **Remain Engaged Politically:** Too many good citizens see election time as the only time they need to pay attention to politics. We need everyone to pay attention and hold elected officials accountable. Let your Representatives know your opinions. After all, they are supposed to work for you!

ABOUT THE INDEPENDENT WOMEN'S FORUM

The Independent Women's Forum (IWF) is dedicated to building support for free markets, limited government, and individual responsibility.

IWF, a non-partisan, 501(c)(3) research and educational institution, seeks to combat the too-common presumption that women want and benefit from big government, and build awareness of the ways that women are better served by greater economic freedom. By aggressively seeking earned media, providing easy-to-read, timely publications and commentary, and reaching out to the public, we seek to cultivate support for these important principles and encourage women to join us in working to return the country to limited, Constitutional government.

We rely on the support of people like you! Please visit us on our website www.iwf.org to get more information and consider making a donation to IWF.

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