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New Health Care House Bill Has Plenty of New Taxes

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The new House health care plan released by Speaker Nancy Pelosi (D-CA) contains more tax increases than were in the original House plans known as the “tri-committee bill.” While Blue Dog Democrats can take some consolation in the fact that a few more small businesses will be exempt from the employer mandate, Blue Dogs and others should still be concerned about the magnitude of the taxes in the bill. In particular, the House bill contains a surtax that will impact more and more Americans each year, because it is not indexed to inflation.¹

The Congressional Budget Office (CBO) estimates that taxes will be approximately \$200 billion over 10 years. The Joint Tax Committee (JTC) estimates \$560 billion in new taxes over the next 10 years, with the bulk of these increases coming from the surtax. These are large tax hikes that will slow hiring and economic growth, especially in the middle of a recession.

Business Taxes. The Pelosi plan makes small concessions to the Blue Dogs on the small business tax. For example, small businesses with under \$500,000 in payroll are exempt. But the tax penalty ramps up extremely quickly after that, reaching 8 percent of total payroll by \$750,000. So all the Blue Dogs really won was an exemption for small businesses with payrolls between \$250,000 and \$500,000. Other businesses will still face high payroll rates.

On average, businesses with \$500,000 to \$1 million in payroll employ slightly over 21 workers who earn approximately \$33,000.² For example, a small business with total payroll of \$700,000 that

pays an average wage of \$33,000 could be hit with a penalty of up to \$2,000. The CBO estimates that, as a result of this provision, employers will pay \$135 billion in tax penalties.³

Rate Table:

- Does not exceed \$500,000: 0 percent
- Exceeds \$500,000 but does not exceed \$585,000: 2 percent
- Exceeds \$585,000 but does not exceed \$670,000: 4 percent
- Exceeds \$670,000 but does not exceed \$750,000: 6 percent

The Surtax. The new Pelosi plan establishes a 5.4 percent surtax on joint filers with over \$1 million in adjusted gross income or \$500,000 for single filers. This is a single rate, which is different from the earlier House bills that had surtaxes at lower income levels. This surtax is not based on final adjusted gross income but instead on modified gross income. Modified gross income excludes only deductions for investment income and is calculated before considering all other exemptions and deductions. Thus, the effective rate of the surtax is higher than the effect of merely increasing marginal tax rates by 5.4 percent.

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www.heritage.org/Research/HealthCare/wm2675.qfm

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This surtax is also not indexed to inflation. Consequently, more and more taxpayers will be hammered by the surtax even as their real income does not increase. This is one of the reasons that the JTC expects the cost of the surtax to more than double in year 10 of its estimate—from \$30.9 billion to \$68.4 billion.⁴ The JTC estimates that taxpayers will be forced to pay \$460.5 billion in higher taxes due to this provision. This is a larger tax increase than the 1993 Clinton income tax increase provisions that created a new tax bracket for high-income taxpayers, increased the AMT, and limited deductions and exemptions for high income earners.

Copying Baucus. The House bill copies the Baucus plan's framework of raising additional revenues through several small tax increases. For example, the House bill now also limits flexible spending accounts (FSAs) to \$2,500 and limits the ability of FSAs or health spending accounts (HSAs) to purchase goods by excluding over-the-counter drugs. The new House plan also increases the penalty for non-health-related distributions from HSAs and puts an excise tax on medical devices sold for the first time.

Some of the House bill's smaller tax increases designed to help pay for health care include:

- **HSA tax.** Increases tax on HSA funds not used for medical purposes from 10 percent to 20 percent (\$1.3 billion saved),
- **FSA cap.** Caps contributions to FSAs at \$2,500 (\$13.3 billion saved),
- **Medical devices excise tax.** Imposes a 2.5 percent excise tax on the sale of medical devices (\$20 billion saved),
- **Self-insured health fee.** Imposes a fee on self-insured health plans,

- **Itemized deductions definition.** Conforms the definitions of medical expenses from employer-provide health insurance, merging flexible spending arrangements, health reimbursement arrangements, HSAs and Archer medical savings accounts to the definition of itemized deduction (\$5 billion saved),
- **Medicare Part D.** Eliminates deduction for expenses that can be allocated to the Medicare Part D subsidy (\$3 billion saved),
- **Payments to corporations.** "Requires information reporting on payments to corporations" (\$17.1 billion saved),
- **Worldwide interest allocation.** Delays the implementation of interest allocation (\$26.1 billion saved),
- **Treaty benefits limit.** Limits the treaty benefits for some deductible payments (\$7.5 billion saved),⁵ and
- **Economic substance payments.** Codifies economic substance doctrine and imposes penalties for underpayments (\$5.7 billion saved).

No Improvements Made. The new House health care bill has not been improved over the last few months. It still contains painful tax increases that will affect more and more Americans every year. Because the surtax applies to adjusted gross income, the effective marginal tax rates of successful business owners will skyrocket. The surtax, combined with the expiration of the Bush tax cuts, will result in some individuals having their effective tax rate increase by one-third. These tax increases will slow America's recovery from the current recession.

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1. A surtax is a tax that is enacted in addition to existing taxes. In this instance, the surtax is a tax in addition to the normal progressive income tax code with tax rates that increase with income.
2. Unpublished U.S. Census Bureau 2006 County Business Pattern data tabulated for Applied Economic Strategies, LLC.
3. Congressional Budget Office, "Preliminary Analysis of the Insurance Coverage Provisions Contained in H.R. 3962," October 29, 2009, at <http://cbo.gov/ftpdocs/106xx/doc10688/hr3962Rangel.pdf> (October 30, 2009).
4. Joint Committee on Taxation, "Estimated Revenue Effects of Possible Modifications to the Revenue Provisions of H.R. 3962, the 'Affordable Health Care for America Act,'" October 29, 2009, at <http://jct.gov/publications.html?func=startdown&id=3619> (October 30, 2009).
5. *Ibid.*