ACA Repeal and Replacement

July 17, 2017

Highlights

- House Repeals and Senate Retains Taxes on High Income Taxpayers
- House Replaces and Senate Modifies Premium Tax Credit (PTC)
- Employer and Individual Mandates Repealed
- Enhancements to HSAs
- Medical Deduction and Spending Account Changes
- Most ACA Excise Taxes Repealed

Inside

SPECIAL REPORT

Senate GOP Pulls Revised ACA Repeal and Replacement Bill from Consideration

The Senate has released a revised version of its Better Care Reconciliation Act of 2017 (BCRA), but leadership has announced that it will abandon this effort to repeal and replace the Affordable Care Act (ACA). The bill is an amended version of the American Health Care Act (AHCA) (H.R. 1638) approved by the House on May 4 by a vote of 217 to 213. Like the House bill, the Senate bill would repeal the ACA individual and employer mandates, as well as most ACA excise taxes. Unlike the House bill, the revised Senate bill keeps in place the ACA taxes on higher-income individuals. Late in the day on July 17, Senate Majority Leader Mitch McConnell, R-KY, announced that the bill was being pulled from consideration because of the unlikelihood of passage.

IMPACT. *Repeal of the 3.8% net investment income (NII) tax, the 0.9% Additional Medicare tax, and the $500,000 cap on deductible compensation paid to executives of health insurance providers was included in both the House's AHCA and the first version of the Senate's BCRA. The latest Senate version would retain these taxes which would be a blow to upper income taxpayers who had hoped for repeal. If this version of the BCRA passes the Senate, it will still have to be reconciled with the House bill.*

COMMENT. *One major difference between the House and Senate versions involves the ACA premium tax credit (PTC) under Code Sec. 36B that helps an individual purchase health care insurance through a Health Insurance Marketplace. Under the current PTC, the amount of the credit depends on the individual's household income and the cost of a plan in the individual's state which delivers about 70% of the full actuarial value of coverage. The House version would replace the credit beginning in 2020 with a refundable tax credit that would vary depending on age only, and not by income level or geography. The Senate version, in contrast, would keep the PTC but add an age factor beginning in 2020 providing that an older individual would have to provide a higher proportion of his or her income before the credit would kick in. In addition, the Senate version would change the benchmark plan to one that provides 58% of the full actuarial value of coverage. Other changes would also limit eligibility.*

COMMENT. *This Briefing is intended to present a high-level overview of the revised proposed Senate bill, focusing on the tax provisions. Like the House bill,* *the Senate bill also encompasses substantial changes for Medicaid funding, insurance provider subsidies, and many other non-tax provisions.*

TAX CREDITS

The ACA created the PTC to help offset the cost of health insurance coverage. An eligible individual with household income between 100% and 400% of the federal poverty level (FPL) who buys coverage through a Marketplace is eligible for the credit. Generally, the credit ensures that a qualifying individual will pay no more than 2.04% – 9.69% (in 2017) of his or her income in premiums for a mid-level (silver) plan, with the tax credit covering the rest. The amount of the credit is based on the cost of the silver-level plan offered in the individual's geographical area. The House bill repeals this credit and creates a new refundable credit for health insurance. The Senate bill, however, keeps the existing PTC structure, but with some modifications.

> *"Unlike the House bill, the revised Senate bill keeps in place the ACA taxes on higher-income individuals."*

The House Bill's Credit for Health Insurance Coverage

The House bill repeals the PTC and creates a new refundable tax credit to help an individual purchase state-approved, major medical health insurance or unsubsidized COBRA coverage beginning after December 31, 2019. An eligible individual must not have access to government health insurance programs or an offer of health insurance from any employer.

The new credit would vary by age only based on the following table, with no adjustments for an individual's income or location.

Under age 30	$2,000
Between 30-39	$2,500
Between 40-49	$3,000
Between 50-59	$3,500
Over age 60	$4,000

Total age-based credit for any family would be capped. The credit amount and cap would be inflation adjusted.

The Senate Bill's Revision of the Premium Tax Credit

Instead of replacing the PTC entirely, the Senate bill revises the ACA's current tax credit structure. The Senate bill would make three key changes that would alter the way the PTC is administered, and would take effect for tax years beginning after December 31, 2019.

First, the Senate bill ties the calculation of the credit to higher-deductible health plans. The PTC is designed so an individual can afford coverage under a "benchmark plan." The benchmark plan under the ACA is a silver plan with an actuarial value of 70%, which means an enrolled individual pays, on average, 30% of his or her health care expenses through deductibles, co-pays, and coinsurance. Under the Senate bill, the benchmark plan would be a bronze plan with an actuarial value of 58%, which means an enrolled individual pays, on average, 42% of his or her health care expenses.

Second, the Senate bill would eliminate entirely the credit for an individual with income between 350% and 400% of the FPL (between about $42,000 and $48,000 for a single individual in 2017).

Third, the Senate bill adjusts the PTC for age. An older individual who qualifies for the credit would pay a higher share of his or her income compared to a younger individual with the same income. Currently, under ACA, because premiums vary by age but the share of income an individual is responsible for paying does not, an older individual generally receives a larger PTC while paying the same amount for his or her health plan.

EXAMPLE. *Currently, an individual with income between 300% and 350% of the FPL is required to pay about 9.5% of his or her household income (adjusted for inflation) for the premium of a silver-level plan before becoming eligible for the PTC. Under the Senate plan, a 60-year-old who earns between 300% and 350% of the FPL could have to spend up to 16.2% of his or her household income on premiums for a bronze-level plan before becoming eligible for the PTC, while a 27-year-old could only have to pay 4.3% of his or her household income.*

In terms of dollars, assume an individual who earns $40,000 currently pays on average about $3,800 in premiums for a silver-level plan, with the PTC making up the rest. Under the Senate plan, a 27-year-old individual with an annual household income of $40,000 may pay up to about $1,720 in premiums, while a 60-year-old individual with the same annual household income may pay up to about $6,480 in premiums before the PTC kicks in for a bronze-value plan.

IMPACT. *The following charts show the difference in the average net amount an individual might pay for coverage under the ACA and under the BCRA at different household incomes. The first chart is for an individual who is 27 years old and the second is for an individual who is 60 years old. Note that the figures calculated under BCRA are a range to account for other factors–-the individual will pay somewhere between those estimated amounts.*

From early estimates, it appears that an individual who earn less than 150% of the FPL can generally expect to pay the same amount for premiums (except for a higher-deductible bronze-plan rather than silver-plan) on BCRA versus the ACA. A younger individual with income between 150% and 350% of the FPL can generally expect to pay less, while an older individual can expect to pay more.

Annual Household Income for a 27-Year-Old (FPL percentage bracket)	Average Estimated Amount of Premium Paid Under ACA (for a silver-level plan)	Average Estimated Amount of Premium Paid Under BCRA (for a bronze-level plan)
$12,000 (up to 133%)	$275	$240 - $300
$17,000 (133%-150%)	$625	$475 - $760
$21,000 (150%-200%)	$1,125	$840 - $900
$27,000 (200%-250%)	$2,000	$1,160
$32,000 (250%-300%)	$2,800	$1,370
$40,000 (300%-350%)	$3,800	$1,720 - $2,560
$45,000 (350%-400%)	$4,275	Full premium, no tax credit

Annual Household Income for a 60-Year-Old (FPL Percentage bracket)	Average Amount of Premium Paid UnderACA (for a silver-level plan)	Average Amount of Premium Paid Under BCRA (for a bronze-level plan)
$12,000 (up to 133%)	$275	$240 - $300
$17,000 (133%-150%)	$625	$475 - $760
$21,000 (150%-200%)	$1,125	$840 - $1,740
$27,000 (200%-250%)	$2,000	$2,240 - $2,700
$32,000 (250%-300%)	$2,800	$3,200 - $3,680
$40,000 (300%-350%)	$3,800	$4,600 - $6,480
$45,000 (350%-400%)	$4,275	Full premium, no tax credit

COMMENT. *Insurance rule changes under both the House and Senate bills would generally make coverage for a younger individual less expensive and coverage for an older individual more expensive.*

COMMENT. *In the latest draft of the Senate bill, an individual may receive a tax credit even if he or she purchases a "catastrophic" plan, which ACA defines as a plan that does not provide bronze, silver, gold, or platinum coverage and that provides no benefits for any plan year until the individual reaches a certain amount in cost-sharing expenses. Under ACA, an individual who purchases catastrophic plans is not eligible for the credit.*

COMMENT. *Under the Senate plan, starting for plan years after December 31, 2017, the PTC cannot be used if the individual chooses a plan that offers abortion coverage, except when the woman's life is at risk or for a pregnancy resulting from rape or incest.*

Code Sec. 45R Small Employer Credit

A qualified small employer is currently eligible for a tax credit under Code Sec. 45R for a percentage of the premiums it pays toward health insurance for its employees. Both the House and Senate bills would repeal the small employer health insurance credit for tax years beginning after 2019.

COMMENT. *Under both the House and Senate bills, starting for tax years beginning after December 31, 2017, the small employer health insurance credit cannot be used if the employer offers a plan that includes coverage for abortion, except when the woman's life is at risk or for a pregnancy resulting from rape or incest.*

ELIMINATED OR POSTPONED ACA TAXES

Both the House and Senate versions of the ACA repeal bill would eliminate the employer and individual health insurance mandates, and most of the ACA excise taxes with the exception of the "Cadillac Plan" tax on high-dollar health plans. Under both versions, the effective date of that tax is postponed. The House bill would also eliminate certain taxes targeted at higher-income individuals, while the Senate bill keeps those taxes.

Individual and Employer Mandate Penalties

One key goal of the ACA is to have as many individuals as possible covered by health insurance in an effort to spread the risk and lower the costs. Part of this goal is to be achieved through tax credits and other incentives, as well as through a penalty structure by way of the individual and employer mandates.

These mandates would be repealed under both the House and Senate bills by retroactively reducing the penalties to zero, effective for months beginning after December 31, 2015.

COMMENT. *To discourage a healthy individual from leaving an insurance plan, which would tend to drive overall premiums up, the House bill would amend the ACA market reforms to permit insurance companies to impose up to a 30% premium penalty for up to a year on an individual who lets his or her insurance lapse for more than two months. This change, along with loosening of the restriction on the 3-to-1 spread between what insurers may charge an older individual and a younger individual to 5-to-1, is designed as a substitute for the individual mandate. The Senate version allows insurers to charge an older individual more and a younger individual less, but it does not contain the 30% penalty provision. Instead, an individual who lacks current coverage for more than two months would have to wait six months before obtaining new coverage.*

	ACA	AHCA	BCRA
Individuals	Mandate: Must either maintain coverage or pay a penalty unless exempt	Incentive: 30% premium penalty if lack continuous coverage for more than two months	Incentive: six-month waiting period if lack continuous coverage for more than two months
Employers	Mandate: Large employer must either provide affordable, minimum value coverage or pay a penalty	No mandate or incentive	No mandate or incentive

Medical Device Excise Tax

The ACA imposes a 2.3% excise tax on the sale of certain medical devices. However, Congress approved a moratorium on the excise tax for 2016 and 2017. The House and Senate bills would repeal the tax before it comes back into effect in 2018.

Excise Tax on Tanning Services

Under the ACA, amounts paid for indoor tanning services are subject to a 10% excise tax. The House bill would repeal this tax, effective July 1, 2017. The Senate bill would move the repeal date to September 30, 2017.

Health Insurance Provider Fee

The ACA imposes a fee on health insurance providers. Congress earlier imposed a moratorium on the fee for 2017. The House and Senate bills both repeal the fee.

Health Flexible Spending Arrangements

The ACA limits contributions to health flexible spending arrangements (health FSAs) to $2,500 (adjusted for inflation). The House bill would repeal this limitation for tax years beginning after December 31, 2016. The Senate bill would repeal the limitation for plan years beginning after December 31, 2017.

Over-the-Counter Medicines

Generally, expenses for health FSAs and similar arrangements incurred for a medicine or drug may be reimbursed as a qualified medical expense only if the medicine or drug is a prescription drug, or insulin. The House and Senate bills eliminate this rule for distributions and reimbursements, effective after December 31, 2016.

Retiree Drug Subsidy

The House and Senate bills would reinstate the business-expense deduction by employers for the value of providing retiree prescription drug subsidies to employees without reduction for the amount of any federal subsidy, including Medicare Part D. The reinstatement is effective for tax years beginning after December 31, 2016, under both the Senate and House bills.

Branded Prescription Drug Fee

The ACA imposes an annual fee on each covered entity engaged in the business of manufacturing or importing branded prescription drugs. The House and Senate bills would repeal the branded prescription drug fee effective for sales after December 31, 2017.

Excise Tax on High-Dollar Health Plans

When the aggregate cost of qualified employer-sponsored health insurance coverage (known as “Cadillac plans”) exceeds certain dollar amounts, the ACA imposes a 40% excise tax. The original effective date for this provision was for tax years beginning after 2017, but was delayed until 2020. The House and Senate bills would delay the tax until 2026.

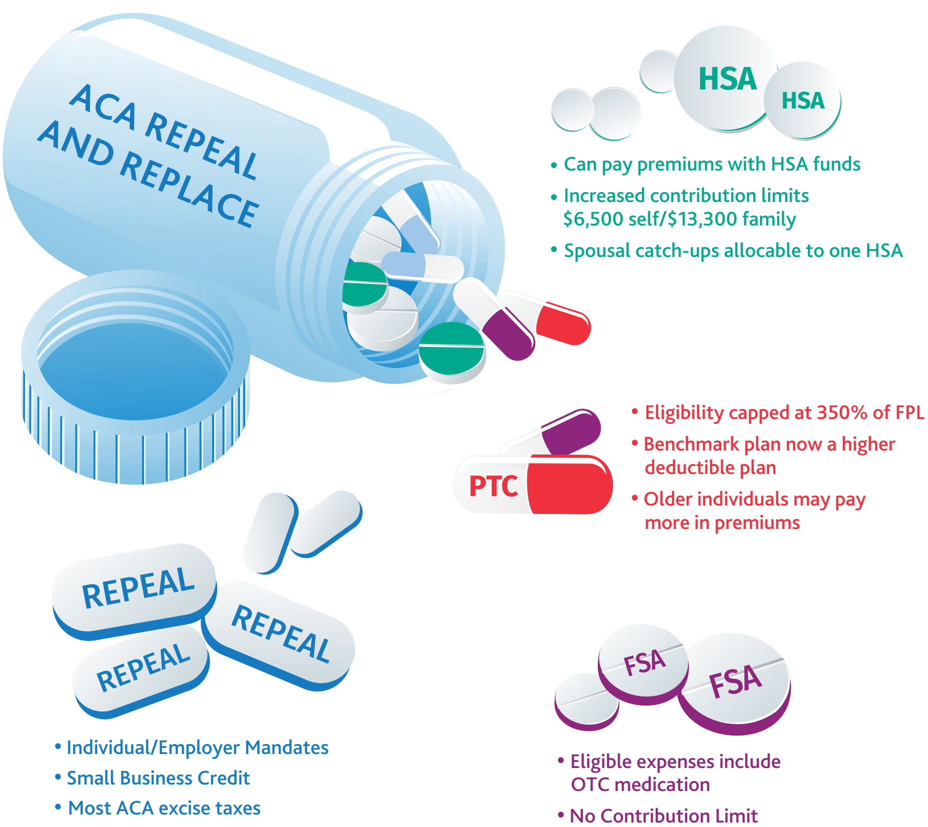
ACA TAXES RETAINED IN THE SENATE’S REVISED VERSION

Net Investment Income Tax

Unlike the initial Senate version of the bill, the Senate’s revised version does not touch the net investment income tax. The House version would repeal this tax effective for tax years beginning after December 31, 2016.

The net investment income tax (NII tax) equals 3.8% of the lesser of an individual’s net investment income for the tax year or the excess of his or her modified adjusted gross income (MAGI) for the tax year over a threshold amount. The threshold amount is $250,000 in the case of a taxpayer filing a joint return or a surviving spouse, $125,000 in the case of a married taxpayer filing a separate return, and $200,000 in any other case.

COMMENT. *This might not be the last word on repeal of the NII tax. If the Senate passes the revised version of the bill, it may need to be reconciled with the House version.*



Additional Medicare Tax

Closely related to the NII tax is the 0.9% Additional Medicare tax on employee compensation and self-employment income above certain threshold amounts (the same as for the NII tax). Unlike the initial Senate version of the bill, the revised Senate version leaves this tax in place. The House version repeals the tax for years beginning after December, 31, 2022.

Remuneration

Under the ACA, the allowable deduction for applicable individual remuneration and deferred deduction remuneration attributable to services performed by applicable individuals that is otherwise deductible by a covered health insurance provider is limited to $500,000. Unlike the initial Senate version of the bill, the revised version leaves this tax in place. The House version would repeal it effective for tax years beginning after December 31, 2016.

MEDICAL CARE TAX CHANGES FOR INDIVIDUALS

Included in the Senate and House bills are a number of other provisions, affecting the itemized deduction for medical expenses, health savings accounts (HSAs), and more.

Medical Expense Deduction

The ACA revised the threshold to claim an itemized deduction for unreimbursed medical expenses from 7.5% of adjusted gross income (AGI) to 10% of AGI for tax years beginning after December 31, 2012 (tax years beginning after December 31, 2016, for an individual 65 years or older). The Senate version of the bill would reinstate the 7.5% threshold, effective for tax years beginning after December 31, 2016. A manager's amendment to the House bill would lower the AGI floor to 5.8%.

IMPACT. *The ACA only changed the medical expense deduction for purposes of the regular income tax. The ACA left untouched the rules for the medical expense deduction for alternative minimum tax (AMT) purposes.*

Health Savings Accounts

Under both the House and Senate bills, the annual limit on aggregate contributions a taxpayer can make to an HSA would be increased after 2017 to equal the sum of the maximum annual deductible and out-of-pocket expenses permitted under a high-deductible health plan (HDHP). Also, both spouses would be allowed to make a catch-up contribution to a single HSA.

HSA withdrawals could be used to pay qualified medical expenses incurred up to 60-days before the HSA is established by treating coverage as beginning on the date that an individual's coverage under a HDHP begins.

	ACA	AHCA / BCRA
Tax on HSAs	20% tax on distributions from HSAs or Archer MSAs that are not used for qualified medical expenses	10% tax on distributions from HSAs (15% tax on Archer MSAs) that are not used for qualified medical expenses
Maximum Contribution Limit to HSAs	$3,450 for self-only coverage, $6,900 for family coverage in 2018	$6,650 for self-only coverage, $13,300 for family coverage in 2018
HSA Catch-Up Contributions	Each spouse may make catch-up contributions only to his or her own HSA account	Both spouses may make contributions to one HSA
Medical Expenses Incurred Before HSA was Established	HSA is treated as established on the day it is actually established	If an HSA is established during the 60 day period beginning on the date that an individual's coverage under a HDHP begins, then HSA treated as having been established on date coverage begins under the HDHP

IMPACT. *Distributions from HSAs and Archer medical savings accounts (MSAs) not used to cover qualified medical expenses have been subject to an additional 20% tax under the ACA, as well as being included in taxable income. Effective for distributions made after December 31, 2016, the House and Senate bills would revert back to a 10% tax for HSAs and 15% tax for MSAs for distributions not used for qualified medical expenses.*

Under the revised Senate bill effective for 2018, a taxpayer could use HSA funds to pay premiums for a HDHP. This feature would be limited: individuals covered under an employer plan or deducting the premiums as a self-employed individual would not qualify. An individual receiving the premium tax credit to help purchase health insurance would have to offset a distribution by the amount of the credit. In addition, HSA funds must be available to pay the medical expenses of children under age 27.

IMPACT. *The availability of HSA funds to pay for insurance coverage coupled with higher contribution limits constitute a substantial benefit for upper income taxpayers as it effectively lowers the cost of coverage by their marginal tax rate. Although this provision is not in the House's AHCA, the use of HSA funds to pay for premiums is not controversial among almost all Republicans, and would probably be greeted favorably by the House.*

POSSIBLE AMENDMENTS

Included in the revised BCRA is a major non-tax change proposed by Senator Ted Cruz, R-TX which would allow insurers to offer inexpensive or bare-bones coverage that does have to comply with ACA requirements as long as they also offer an ACA-compliant plan. This means insurers could offer plans that do not cover pre-existing conditions.

COMMENT. *The Cruz amendment leaves in place the ACA requirement for insurers in a state to have only one risk pool. Thus, an insurer could not have separate risk pools for ACA-compliant plans and non-compliant plans. The insurance industry opposes the amendment as unworkable because insurers would be have difficulty administering different sets of rules and premium rates for customers while keeping them in the same risk pool.*

It is possible that this amendment will be removed prior to a final vote, depending on the Congressional Budget Office (CBO) score and whether the Senate parliamentarian believes the provision complies with the Senate reconciliation rules.

Senators Lindsey Graham, R-SC and Bill Cassidy, R-LA have proposed an amendment to the BCRA that could also be used as the basis for an eventual bipartisan bill. Under the proposed amendment, most ACA taxes would stay in place and the federal government would hand that money over to the states. States would be free to keep and administer an ACA-style system, or they could abandon the system and use the money in a different way as long as individuals with pre-existing conditions remained covered.

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