PPACA repeal-and-replace legislation clears House, but Senate revisions likely

The House of Representatives on May 4 voted 217-213 to approve a modified version of budget reconciliation legislation that would repeal major pieces of the Patient Protection and Affordable Care Act of 2010 (PPACA) and replace it with a system aimed at facilitating the purchase of health insurance on the individual market through refundable tax credits and liberalized rules for tax-favored health savings accounts.

A difficult needle to thread

Passage of the American Health Care Act of 2017 (AHCA, H.R. 1628) concludes – for now, at least – what has proved to be a tortured process for moving a Republican-drafted PPACA repeal-and-replacement bill through the Republican-controlled House. Since the initial version of the AHCA was unveiled in early March, Democrats, as expected, have been united in their opposition to the measure; but GOP leaders have had to grapple with concerns of lawmakers at both ends of the Republican ideological spectrum in an effort to forge a majority. Conservative Republicans – namely members of the Freedom Caucus – contended that the AHCA left in place too many elements of the law they want to dismantle; more moderate lawmakers, meanwhile, voiced concerns about the impact of the new bill on older and less affluent individuals.

As the bill headed toward a planned floor vote on March 24, House GOP leaders offered two different managers' amendments that accelerated repeal of many of the PPACA's tax provisions, carved out revenue to modify the health care tax credit, and made numerous additional nontax policy changes (most notably, allowing states to opt out of the PPACA's "essential benefits" provisions), all in an effort to address the mounting reservations from the Republican rank-and-file. But those modifications ultimately proved insufficient to allow House Republican leaders to cobble together a majority, and Speaker Paul Ryan, R-Wis., decided to cancel the floor vote rather than risk an outright defeat. (For prior coverage, see *Tax News & Views*, Vol. 18, No. 11, Mar. 24, 2017.)
URL: http://newsletters.usdbriefs.com/2017/Tax/TNV/170324_1.html

In the intervening six weeks, Ryan and the Trump administration negotiated additional – nontax – changes to the measure in an effort to win over skeptics and fence-sitters. Those efforts allowed the leadership to eke out a narrow victory. When the floor vote came, the bill was approved solely on the strength of Republican votes but it failed to garner unanimous GOP support. Indeed, 20 conservative and moderate Republicans joined 193 Democrats in the "no" column. (Republicans could afford only 22 defections to maintain the majority they needed for the legislation to pass.)

But the needle-threading process is not over yet. The bill now heads to the Senate, where Republican leaders are expected to propose major revisions to satisfy the sometimes conflicting policy demands of conservative and moderate GOP lawmakers in that chamber. And that process potentially sets the stage for a new round of negotiations once the Senate-approved measure is returned to the House for consideration.

Mandates gone

As approved in the House, the AHCA would effectively repeal the PPACA's individual and employer mandates by reducing the penalty for noncompliance to zero for months after December 31, 2015. However, a new rule would permit insurance companies to impose a surcharge on policy premiums of up to 30 percent in the case of individuals who fail to maintain continuous coverage over a specified timeframe.

Most tax provisions repealed retroactively

The measure continues to call for eliminating most of the business and individual taxes enacted under the PPACA and adopts the accelerated repeal schedule included in the manager's amendment released on March 20.

Business provisions: The AHCA would repeal most of the business taxes enacted under the Affordable Care Act, generally effective for months beginning after December 31, 2016. These include the:

- Annual fee on US health insurance providers allocated based on net premiums for US health risks;
- Annual fee on manufacturers and importers of branded drugs;
- 2.3 percent excise tax on manufacturers and importers of certain medical devices; and

- The $500,000 deduction limitation on taxable remuneration to officers, employees, directors, and service providers of covered health insurance providers.

The measure also would reinstate – effective beginning in 2017 – the deduction for expenses allocable to the Medicare Part D subsidy, which was eliminated under the PPACA.

Under the bill as originally introduced, all of these provisions would have become effective beginning in 2018.

Individual provisions: On the individual side, the AHCA would eliminate:

- The 3.8 percent Medicare contribution on certain unearned income of individuals with adjusted gross income (AGI) over $250,000 for joint filers ($200,000 for single filers);
- The so-called "medicine cabinet tax," which provides that the purchase of over-the-counter drugs is not a qualified expense for purposes of rules governing health savings accounts (HSAs) and flexible spending accounts;
- The increased (20 percent) penalty for nonqualified distributions from an HSA or an Archer medical savings account; and
- The $2,500 limitation (indexed) on annual salary-reduction contributions to health flexible spending accounts in cafeteria plans.

As with the business taxes, the House-approved bill would accelerate the repeal of these provisions by a full year to months beginning after December 31, 2016. Repeal of the 10 percent excise tax on indoor tanning services, however, would be accelerated by only six months – to June 30, 2017. (According to a summary of the manager's amendment, this timing change "reflect[s] the quarterly nature of this collected tax.")

Floor for medical expense deduction: The House-approved bill also would repeal an Affordable Care Act provision that generally increased the floor for claiming the deduction for unreimbursed medical expenses to 10 percent of adjusted gross income, effective for months beginning after December 31, 2016. Instead of returning the floor to its prior-law level of 7.5 percent of AGI, however, the approved bill incorporates a provision from the manager's amendment that would reduce the floor for claiming the deduction to 5.8 percent of AGI.

Repeal of additional Medicare HI tax *delayed*: The additional 0.9 percent Medicare hospital insurance tax on wages over $250,000 for joint filers ($200,000 for single filers) also would be repealed; however, under a separate manager's amendment, that provision would be effective for taxable years beginning after December 31, 2022. (The bill as originally introduced called for repealing the levy beginning in 2018.)

Cadillac tax, economic substance doctrine: Still in there…

As approved by the House, the AHCA would retain the so-called "Cadillac" tax – a 40 percent excise tax levied at the insurance company level on employer-provided plans that exceed a certain premium threshold. Under current law, implementation of the tax is delayed until 2020. The amended bill would further delay implementation until 2026, one year longer than originally planned.

One Affordable Care Act revenue raiser left untouched in the AHCA is the "economic substance" doctrine, codified in section 7701(o), which generally requires taxpayers to show that a transaction changed their economic position in a meaningful way apart from the federal income tax effects and that they had a substantial nontax business purpose for entering into a transaction. It also imposes a strict liability penalty on understatements attributable to transactions determined to lack economic substance. (The penalty varies depending on whether or not the transaction was disclosed.)

Tax credit changes punted to Senate

On the incentive side, the House-approved bill would create a system of refundable, age-adjusted credits to replace the Affordable Care Act's premium assistance credits for low-income households; however, Republican leaders expect the provision to be modified in the Senate.

As the provision is currently structured, individuals not insured by an employer or government program (such as Medicare or Medicaid) would, beginning in 2020, receive a monthly credit at an annualized rate ranging from $2,000 (for eligible individuals under 30), increasing by $500 for every 10 years of age, up to $4,000 (for individuals over 60). The maximum family credit would be $14,000 per year, calculated taking into account the five oldest credit-eligible family members. The credit amount would still begin to phase out for individuals earning over $75,000 and couples earning over $150,000.

But the provision has been a target of ongoing criticism since it was unveiled in the Ways and Means Committee mark-up of the AHCA's tax title on March 9, with conservative Republicans characterizing it as a new tax entitlement and moderates objecting that it would provide insufficient financial assistance to older and less affluent individuals who would be relying on the credit to purchase health insurance.

House Republican leaders ultimately decided that the credit needs to be restructured; but they took no action to modify it as part of the manager's amendments they released in March and instead indicated that they would rely on the Senate to make the necessary changes. In a March 20 news release, House Ways and Means Chairman Kevin Brady, R-Texas, indicated that the decision to lower the floor for claiming the medical expense deduction in the manager's amendment to 5.8 percent of AGI rather than restore the prior-law floor of 7.5 percent was a strategic move to carve out revenue that would give the Senate "flexibility to potentially enhance the tax credit for those ages 50 to 64 who may need additional assistance." (The Congressional Budget Office estimated on March 23 that the change to the medical expense deduction would decrease federal receipts by roughly $90 billion over 10 years.)

Exactly what changes the Senate might make to the credit are not currently known. One proposal that has been floated by Finance Committee Republican John Thune of South Dakota would means-test the credit as a way to, in his words, avoid "creating a new middle-class entitlement" and make the benefit "more progressive."

HSA enhancements remain in place

Then House-approved bill retains several provisions that would expand access to and increase the flexibility of HSAs – tax-preferred savings accounts which, when used in conjunction with a high-deductible health insurance plan, allow individuals to pay for qualifying out-of-pocket health care expenses "using tax-free dollars." These include:

- Increasing the maximum HSA contribution limit to the combined amount of the plan's deductible and out-of-pocket contribution requirement;
- Allowing both spouses to make catch-up contributions to the same HSA; and
- Providing an administrative fix to allow certain expenses incurred after a taxpayer purchases an eligible high-deductible insurance plan, but before the taxpayer establishes an HSA, to be treated as eligible expenses under the HSA.

These provisions generally would take effect after December 31, 2017.

Medicaid provisions

While the bill as approved would roll back Medicaid expansion beginning in 2020, it includes some significant changes that were added (as part of the March manager's amendments) to entice GOP members from both ends of the spectrum.

For the more conservative members, an option that would allow states to impose work requirements (with certain limitations) on Medicaid recipients helped to win over some members who saw the program as a new entitlement. The bill as amended also contains a provision allowing states to opt for block grants rather than per capita allotments.

To attract centrist members who were concerned about increased costs of care pricing their more vulnerable constituents out of Medicaid benefits, the manager's amendment would, among other things, increase the inflation factor for calculating reimbursement amounts for elderly and disabled individuals by 1 percentage point.

No CBO score yet

The House vote came before the Congressional Budget Office (CBO) had a chance to produce an updated revenue score that reflects the revisions to the legislation that were negotiated in recent weeks – for example, an amendment allowing states to opt out of certain PPACA rules regarding the cost of coverage for individuals with pre-existing conditions and a separate amendment allocating $8 billion to help fund state-sponsored high-risk pools.

The CBO score could prove critical in determining whether the plan meets the budgetary and procedural requirements that will permit it to move through the Senate under reconciliation protections, which would allow for passage with a simple majority vote, rather than the 60 votes normally required to advance legislation in that chamber under regular order. (Republicans control only 52 seats in the Senate and are relying on the reconciliation process to win approval of the measure.)

The forthcoming analysis from the CBO will help determine, among other things, whether the legislation complies with the so-called "Byrd Rules," which deny reconciliation protections to legislation that increases the deficit outside of the 10-year budget window and block provisions that are deemed to have no effect on the federal budget, or whose effect is "merely incidental" to the underlying policy.

The CBO score is likely also to include projections of how many individuals may gain or lose health coverage under the plan – statistics that could significantly impact the politics of moving the bill through Congress. (Moderate Republicans in both chambers have raised the issue of coverage levels under the AHCA as a potential source of concern.)

A Senate rewrite ahead

Although GOP leaders managed to pull together a majority to pass the AHCA in the House, the bill is unlikely to survive in its current form in the Senate, where a similar conservative-versus-moderate dynamic is playing out among Republicans and the margin for error is only two votes. (Senate Democrats, like their House counterparts, are expected to oppose the legislation.)

In late March, shortly before House leaders canceled their planned floor vote, a whip list published by *The Hill* showed six Republican senators – conservatives Tom Cotton of Arkansas, Ted Cruz of Texas, Mike Lee of Utah, and Rand Paul of Kentucky, and moderates Susan Collins of Maine and Dean Heller of Nevada – squarely against the House bill, and another 15 expressing reservations about the measure but still officially among the undecideds. If opposition to the House bill remains at those levels, Majority Leader Mitch McConnell, R-Ky., and others in the Senate GOP leadership will find themselves in the difficult position of having to rewrite the measure in a way that satisfies the different Republican factions in their chamber and still is able to attract a Republican majority when the revised bill is sent back to the House for reconsideration.

Also to be seen is whether the Senate parliamentarian exposes any provisions of the AHCA to a point of order on the grounds that the provision has no impact or only an incidental impact on the budget.

McConnell told reporters on May 3 that Senate leaders "don't want to give up on" the effort to repeal and replace the Affordable Care Act, but he acknowledged that "it'll be a real big challenge on the Senate side."

Republican Sen. Lamar Alexander of Tennessee, who chairs the Health, Education, Labor, and Pensions Committee (one of the Senate panels with jurisdiction over health care legislation) told reporters May 4 to expect substantive revisions from lawmakers on his side of the Capitol.

"We're writing a Senate bill and not passing the House bill. We'll take whatever good ideas we find there that meet our goals," he said.

Alexander added that there currently is no rigid timeline for producing a Senate version of the AHCA.

"There will be no artificial deadlines in the Senate. We'll move with a sense of urgency but we won't stop until we think we have it right," he said.

In a press conference after the House vote, however, President Trump declared that the AHCA "has brought the Republican Party together" and was optimistic that it would clear the Senate.

"We're going to get this passed through the Senate, I feel so confident," Trump said.

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