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# MEDICAL DEVICE EXCISE TAX – 2014 YEAR-END UPDATE

## Legislative Prospects for Repeal

As 2014 comes to a close, the prospects for repeal of the medical device excise tax in 2015 have improved. In September, the House of Representatives approved the "Jobs for America Act," which would have repealed, retroactive to its effective date, the 2.3% excise tax on a manufacturer's sale of certain medical devices. Neither this bill nor other legislation that would repeal the tax has come to a vote in the Senate. Senate Republicans made several efforts in the 113th Congress to include repeal of the medical device excise tax as an amendment to other legislation, but the efforts were blocked by Majority Leader Harry Reid (D-NV). When the 114th Congress convenes in 2015, Senator Reid will no longer be the Majority Leader, and the Republicans will control the agenda in the Senate.

Repeal of the medical device excise tax is not a foregone conclusion despite Republican control of both houses of the next Congress, Republican leadership identifying repeal of the tax as one of their goals and bipartisan support for the elimination of the medical device tax. (Seventy-nine Senators voted in March 2013 for a nonbinding resolution to repeal the tax.) The President could veto a bill that would repeal the tax. If the repeal is part of legislation to obliterate the Affordable Care Act (ACA), a veto would seem likely. Repeal of the tax also could get tied up in the debate over tax reform or by budget hawks who want to see the revenue from the tax replaced.

A November 3, 2014, Congressional Research Service (CRS) report will provide fuel for opponents of the tax, but also will provide some arguments for those seeking to retain the tax. The report questioned the justification for the tax and noted its administrative burdens, but it did not find dire economic consequences.

The report – contrary to other economic studies – found the economic consequences of the tax to be minimal with output and employment in the industry falling by no more than two-tenths of a percent. The report said that the impact was limited because of the small tax rate, exemption for approximately half of the output and "relatively insensitive demand for health services." The report concluded that it was unlikely that there will be significant consequences for innovation. The CRS analysis suggested that "most of the tax will fall on consumer prices, and not on profits of medical device companies" and further concluded, "The effect on the price of health care, however, will most likely be negligible because of the small size of the tax and small share of health care spending attributable to medical devices."

The CRS found that "in most cases," the justifications for the tax are "weak." "In general, tax policy is more efficient when differential excise taxes are not imposed." The CRS report noted that finding an alternative source of revenue to fund ACA would be difficult.

In addition, the report found that the "tax also imposes administrative and compliance costs that may be disproportionate to revenue. It stated, "A relatively small tax on medical devices means that economic effects are likely to be small, but also that administrative costs relative to revenue are large."

A report from the Treasury Inspector General for Tax Administration (discussed below) indicated that the tax raised less money than expected during the first half of 2013. Incoming Senate Finance Committee Chair Orrin Hatch (R-UT) told *Bloomberg BNA* that if the trend continues in 2015, Republicans may have an easier time pushing repeal.

## Rulings

In private letter ruling 201443016, which was released in November, the IRS ruled that a manufacturer that leased medical devices to end users could pay the tax as lease payments were received and that the amount of the tax was capped at the tax that would have been imposed if the devices had been sold. The ruling did not break any new ground. Instead, it applied provisions of existing law. Section 4217(b) of the Internal Revenue Code states that in cases in which an excise tax is based on the price of an article, there shall be paid on each lease payment a percentage of each payment equal to the rate of tax then in effect until the tax payments equal the "total tax." The "total tax" is generally the tax computed on the constructive sales price for the article if such article were first sold at retail on the date of the first lease of the article. Under section 4217(d)(1), the total-tax cap applies if, at the time of the lease, the lessor is also engaged in the business of selling, in arm's length transactions, the same type and model of article. The manufacturer in the ruling was selling similar products at arm's length in installment-type sales.

Section 4217(a) treats the lease of a product as a sale for purposes of excise taxes. The private letter ruling did not address the question of whether lease payments made pursuant to leases entered into before the January 1, 2013, effective date of the excise tax were subject to tax. The excise tax regulations take the position that the tax applies to lease payments made on or after January 1, 2013, but the author of this update has argued in comments to the IRS that the IRS has misinterpreted the law.

In private letter ruling 201420004, which was released in May, the IRS ruled that a company that produced a medical device for another company pursuant to an irrevocable license agreement was not the manufacturer for purposes of the medical device excise tax. The licensor, which had complete control over the quantity to be produced, was treated as the manufacturer. The producing company was required to sell all of its non-exported production to the licensor.

## Compliance Report

The Treasury Inspector General for Tax Administration (TIGTA) conducted an audit of the medical device excise tax as part of its continued coverage of the IRS's implementation of ACA tax provisions. In its July 17, 2014, report TIGTA found that the number of forms reporting the medical device excise tax and the amount of revenue reported were lower than expected. The report said that while the IRS is attempting to develop a compliance strategy to ensure that businesses are compliant, the IRS cannot identify the population of manufacturers registered with the FDA that are required to pay the tax.

TIGTA found that the IRS erroneously assessed 219 failure-to-deposit penalties for the quarters ending March 31 and June 30, 2013. The IRS has reversed the penalties and issued apology letters to affected taxpayers.

TIGTA recommended that the IRS "continue refining its compliance strategy to include actions that can be taken to identify noncompliant manufacturers." TIGTA also recommended that the IRS establish procedures for verifying the accuracy of paper-filed Forms 720. TIGTA had identified discrepancies in the amount of tax or taxable sales amounts from 276 paper returns. The discrepancies resulted from taxpayer errors or tax examiner errors, many of which were attributable to the absence of a cents column on Form 760. The Form 760 has been revised to include a cents column.

The TIGTA reports states that the IRS agreed with TIGTA's recommendations.

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