DESCRIPTION OF TAX PROPOSALS RELATING TO THE HEALTH AND SAFETY OF INNER-CITY RESIDENTS AND OTHER MISCELLANEOUS HEALTH-RELATED TAX ISSUES

Scheduled for a Hearing

Before the

SUBCOMMITTEE ON SELECT REVENUE MEASURES

of the

HOUSE COMMITTEE ON WAYS AND MEANS

On June 29, 1993

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

JCX-8-93

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INTRODUCTION

The Subcommittee on Select Revenue Measures of the House Committee on Ways and Means has scheduled a public hearing on tax issues affecting the health and safety of inner-city residents and other miscellaneous health-related tax issues on June 29, 1993.

In announcing this hearing, Subcommittee Chairman Rangel stated: "Residents of distressed neighborhoods in this country face severe and relatively unique threats to their well-being on a daily basis because of the difficult health and social problems confronting these neighborhoods. The Subcommittee is holding this hearing to focus attention on these problems and on possible ways to ameliorate them through the use of the tax laws."

In particular, the Subcommittee indicated its interest in receiving testimony on proposals to tax firearms, drugs, and unsafe needles, as well as proposals to enhance the provision of charity care and other services benefiting the community by tax-exempt hospitals. In addition to the specific proposals described in this document, the Subcommittee invited testimony on related issues and any alternative solutions to the problems addressed by these proposals.

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of present law and certain specific proposals, based on proposals submitted to Chairman Rostenkowski by Members of the Committee on Ways and Means.

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[1] This document may be cited as follows: Joint Committee on Taxation, Description of Tax Proposals Relating to the Health and Safety of Inner-City Residents and Other Miscellaneous Health-Related Tax Issues (JCX-8-93), June 28, 1993.

DESCRIPTION OF PROPOSALS

1. Increase excise tax on firearms; Hospital Gunshot Cost Relief Trust Fund (Title III of H.R. 737)

Present Law

A Federal excise tax is imposed at 10 percent of the manufacturer's or importer's price on the sale of pistols and revolvers and at 11 percent of the manufacturer's or importer's price on the sale of rifles, shotguns, and ammunition (sec. 4181). Revenue equivalent to the 10-percent and 11-percent excise taxes are dedicated (in the year following receipt) to financing of the Federal Aid to Wildlife Program for support of State wildlife programs.

Description of Proposal

Excise tax rate

The bill would increase the excise tax on pistols and revolvers from 10 percent to 20 percent and the tax on other regular firearms (rifles and shotguns) from 11 percent to 20 percent. The proposal would not increase the 11-percent tax on ammunition. A floor stocks tax would apply to such firearms on the date of the tax increase.

Trust Fund

The bill would establish a new Hospital Gunshot Cost Relief Trust Fund ("Gunshot Trust Fund") in the Internal Revenue Code, to be financed by amounts equivalent to 50 percent of the "net" revenues from all the taxes on firearms (under sec. 4181). Net revenues are defined as the gross revenue from the excise tax on firearms less the decrease in income tax resulting from the firearms tax.

Amounts in the Gunshot Trust Fund would be available, as provided in appropriation Acts, for expenditures to assist urban hospitals in defraying the costs of providing medical care to gunshot victims not covered under any health plan.

Effective Date

The bill would be effective on the first day of the first calendar month beginning more than 30 days after the date of enactment. The floor stocks tax would be payable before the end of the 6-month period after the tax-increase date.

2. Excise tax on certain unsafe needle devices

Present Law

There is currently no Federal excise tax on medical equipment relating to syringes and intravenous systems.

Description of Proposal

The proposal would impose an excise tax of 10 cents per item on taxable sales of syringes and certain components of other intravenous systems which do not satisfy certain safety requirements. Only the first sale after manufacture or importation of an item to health care providers for use in the United States would be taxable. The safety standards relate specifically to the prevention of accidental needlestick injuries to health care providers, and would be prescribed by the Commissioner of the Food and Drug Administration and reviewed annually.

Effective Date

The proposal would apply to sales after December 31, 1996 through December 31, 1999.

3. Treatment of certain charitable risk pools

Present Law

An organization described in section 501(c)(3) or 501(c)(4) of the Code is exempt from tax only if no substantial part of its activities consists of providing commercial-type insurance (sec. 501(m)). In the case of an organization that remains exempt from tax, the activity of providing commercial-type insurance is treated as an unrelated trade or business but, in lieu of the usual tax on unrelated trade or business taxable income, the unrelated trade or business activity is taxed under the rules relating to insurance companies (subchapter L of the Code).

Commercial-type insurance generally includes any insurance of a type provided by commercial insurance companies, although certain exceptions are provided (for example, commercial-type insurance does not include insurance provided at substantially below cost to a class of charitable recipients).

Description of Proposal

Under the proposal, a charitable risk pool would be treated as an organization exempt from tax under section 501(c)(3) of the Code, and section 501(m) would not apply to it. A charitable risk pool would mean an organization (1) organized under State law as a nonprofit charitable risk pool and that is exempt from State income tax (if any); (2) operated solely to pool the insurable risks of its members (other than risks relating to medical malpractice) and to provide information to members with respect to loss control and risk management; (3) no part of the net earnings of the organization inures to the benefit of members other than as reduced insurance rates; (4) at least $1 million of the capital of which was provided by organizations that are exempt from tax under section 501(c)(3) and that do not benefit, directly or indirectly, from the insurance coverage provided by the pool; (5) all the members of which are organizations exempt from tax under section 501(c)(3); and (6) that is controlled by a board of directors elected by its members. Rules would be provided for the treatment of members of the charitable risk pool that lose tax-exempt status during any taxable year.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1991.

4. Treatment of certain health maintenance organizations

Present Law

Present law provides that an organization described in sections 501(c)(3) and (4) of the Code is exempt from tax only if no substantial part of its activities consists of providing commercial-type insurance (sec. 501(m)). The activity of providing commercial-type insurance is treated as an unrelated trade or business but, in lieu of the usual tax on unrelated trade or business taxable income, the unrelated trade or business activity is taxed under the rules relating to insurance companies (subchapter L of the Code).

When this provision was enacted as part of the Tax Reform Act of 1986, the legislative history stated, "the Act is not intended to alter the tax-exempt status of an ordinary health maintenance organization that provides health care to its members predominantly at its own facility through the use of health care professionals and other workers employed by the organization. HMOs provide physician services in a variety of practice settings primarily though physicians who are either employees or partners of the HMO or through contracts with individual physicians or one or more groups of physicians (organized on a group practice or individual practice basis). Similarly, organizations that provide supplemental health maintenance organization-type services (such as dental services) would not be affected if they operate in the same manner as a health maintenance organization."[2]

In the Technical and Miscellaneous Revenue Act of 1988, legislative history to a technical correction under section 501(m) restated the last sentence of the above 1986 Act legislative history as follows: "organizations that provide supplemental health maintenance organization-type services (such as dental or vision services) are not treated as providing commercial-type insurance if they operate in the same manner as a health maintenance organization."[3]

The 1986 Act provided several exceptions under section 501(m), including an exception (as modified by the technical correction in the

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[2] General Explanation of the Tax Reform Act of 1986 (H.R. 3838, 99th Cong., 2d Sess.) 585.

[3] Report of the House Committee on Ways and Means, Miscellaneous Revenue Act of 1988 (100th Cong., 2d Sess., Rpt. 110-795) 116; Report of the Senate Committee on Finance, Technical Corrections Act of 1988 (100th Cong., 2d Sess., Rpt. 100-445) 121; Conference Report to accompany H.R. 4333, Technical and Miscellaneous Revenue Act of 1988 (100th Cong., 2d Sess., H.R. Rpt. 100-1104) 9.

1988 Act) for dental benefit coverage by Delta Dental Plans Association organizations that are members of the Delta Dental Plans Association through contracts with independent service providers so long as the provision of such coverage is the principal activity of such organization.

Description of Proposal

The proposal would modify the exception to section 501(m) to provide an exception for dental benefit coverage provided by a Delta Dental Plans Association organization and vision benefit coverage provided by a Vision Service Plan association organization through contracts with independent professional service providers so long as the provision of such coverages is the principal activity of such organizations.

Effective Date

The proposal would be effective as if enacted with the Tax Reform Act of 1986.

5. Provide organ donor information to taxpayers

Present Law

Organ donor information is not required to be included in income tax refund mailings.

Description of Proposal

The proposal would require organ donor information to be included in income tax refund mailings between February 1 and June 30 of the first calendar year beginning more than four months after date of enactment. The information would "encourage organ donation" and would include an organ donor card.

Effective Date

The proposal would be effective on the date of enactment.

6. Discounting of loss reserves by medical malpractice insurers

Present Law

Discounting methodology

Property and casualty insurance companies may deduct additions to their reserves for unpaid losses (sec. 832). Section 846 (as added by The Tax Reform Act of 1986) generally requires the deduction for such reserves to be discounted to take account in part the time value of money. Discounting is separately applied with respect to each line of business for each accident year.[4] The amount of discounted unpaid losses is determined based upon a loss payment pattern (for the applicable line of business) and a statutorily prescribed rate of interest.

The Code requires the Secretary of the Treasury to determine and publish the loss payment pattern applicable to each line of business on an industry-wide basis once every five years beginning in 1987. This determination is based upon (1) the aggregate experience reported on the annual statements of insurance companies to which the discount provisions apply, (2) the most recent published aggregate data from the annual statements relating to loss payment patterns available on the first day of the determination year, (3) the assumption that all losses paid in a given year are paid in the middle of such year, and (4) certain other computational rules and assumptions.

In certain cases, an insurance company may elect to discount unpaid losses using its own historical loss payment pattern, rather than the industry-wide loss payment pattern published by the Secretary.

Medical malpractice insurers

During the 1980s, many medical malpractice insurers changed from writing contracts on an occurrence basis to a claims-made basis. Because little or no historical data has been available with respect to the claims-made form of insurance, however, the payment pattern for the medical malpractice line of business published by the Secretary has been determined largely on the basis of insurance contracts written on an occurrence basis. The payment pattern for claims made insurance differs from the payment pattern occurence basis insurance because the former covers claims made (as opposed to occurrence of the event giving rise to the claim) during the accident year. Consequently, the Internal Revenue Service permitted eligible medical malpractice insurers to discount unpaid losses for a qualified line of business using "Composite Schedule P" discount factors published by the Secretary for taxable years beginning prior to January 1, 1992. (See Rev. Proc. 91-21, 1991-1 C.B. 525).

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[4] The term "accident year" means the calendar year in which the incident occurs giving rise to the related unpaid loss.

In certain cases, a medical malpractice insurer may compute its discounted unpaid losses based on its own historical payment pattern. The IRS has set forth certain requirements to qualify for such treatment, including: (1) the company must have at least five accident years of loss and loss expenses incurred for the line of business; and (2) the company's cumulative fraction of loss and loss expense payments in each of at least two accident years for the line of business must equal or exceed the cumulative fraction of loss and loss expense payments for the earliest accident year shown on the table published by the IRS for the line of business. (See Rev. Proc. 92-76, 1992-38 I.R.B. 28.)

Description of Proposal

The proposal would permit certain medical malpractice insurers to elect to discount unpaid losses for a qualified line of business using "Composite Schedule P" discount factors published by the Secretary of the Treasury. To qualify for the election under the proposal, a company must currently write claims-made policies and must not be able to calculate its own discount factors under present law.

Effective Date

The proposal would apply to taxable years beginning on or after January 1, 1992 and before January 1, 1994.

With respect to subsequent taxable years, the Secretary would be required to issue separate discount factors applicable to claims-made medical malpractice insurance.