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missouri's future

CMF White Paper Series: Impact of the 'Everything Tax' on Missouri Businesses

Part 3: The Impact of the Proposed Sales Tax on the Health Care Industry

Two ballot proposals on file with the Missouri Secretary of State seek to amend the Missouri constitution to eliminate the state income tax and replace it with an expanded, increased sales tax of up to 10%. These two initiative petitions, also known as Versions 12 and 13, require the legislature to “enact a law...imposing and levying a tax on all sales and services, except those sales and services exempted” under the proposals.

Versions one through nine, initially submitted by Let Voters Decide, did not contain language that raises serious questions about the taxation of healthcare, however, the latest versions do contain language that the Department of Revenue and Office of Administration have construed to mean that certain healthcare services and pharmaceuticals will be subject to the proposed new tax.

If It's Not Clearly Exempt, It's Taxed

In every case with the two versions, if it is not specifically exempt, it is subject to the proposed tax. The tax would apply to many goods and services not taxed today. Some of the new goods and services subject to tax under the proposals include healthcare services and sales of pharmaceuticals. This analysis will examine:

- The types of health care services and pharmaceutical transactions that would be subject to the proposed tax; and
- The implications of how such a tax would be administered.

Taxation of Health Care Under the Proposed Sales Tax

Current law in Missouri clearly defines which health-related products and services are exempt. This list includes: health care services (doctor, dentist or hospital fees), insulin, prosthetic or orthopedic devices, hearing aids, prescription medications, oxygen, home respiratory equipment, hospital beds, ambulatory aids, Braille equipment, and others.

The proposed initiative petitions, however, replace this clearly worded list with a one-sentence explanation of what is exempt:

Sales of pharmaceuticals or medical services provided by a licensed health care profession for the direct benefit of any individual's health care, where such sales or services are not subject to being recouped from another source.

The consequences of this change are profound, and will impose a new tax of up to 10% on purchases that have never before been taxed.

Most "Medical Services" Will Be Taxed

The petitions exempt "medical services," but only where they "are not subject to being recouped from another source." Most health care services are paid for by insurance or through government programs such as Medicare or Medicaid.

While Missouri cannot constitutionally tax federal Medicare or Medicaid payments, it can – and will – tax payments made by private insurers. In analyzing the petitions, both the state budget office and the Missouri Department of Revenue say that payments by private insurers to health care providers on behalf of insurers will be taxed.

All health care services, including doctor fees, dentist fees, and hospital payments, will be subject to the proposed tax. Over the past five years, the cost of health care has increased between 7.1 and 9.0 percent per year. [Source: Mercer.com 2011 survey of employers' health care costs].

Missourians should expect an additional increase in 2014 to account for the new tax on insurance payments if voters approve one of the petitions in November 2012.

No Exemption for Medical Devices

Medical devices are neither a "pharmaceutical" nor a "medical service." Medical devices include prosthetics, orthopedic devices, hearing aids, oxygen, home respiratory equipment, hospital beds, ambulatory aids and Braille equipment. Since they are not clearly exempted they will be subject to the new tax.

The elderly and the disabled, the primary users of such devices, would pay substantial taxes on such items. Missouri businesses that sell such devices would be at a competitive disadvantage compared to similar businesses in other states with lower or no taxes.

Many Prescription Drug Purchases Will Be Taxed

Just as with “medical services,” “pharmaceuticals” are exempt from sales tax only where sales “are not subject to being recouped from another source.” Many persons now enjoy pharmacy benefits as part of their health insurance protection. The payments by insurers and pharmacy benefit managers to pharmacies on behalf of their members will now be taxed.

Consumers should expect that those insurers and managers would raise premiums and/or co-pays to cover their increased costs if the proposal were to take effect.

An Uneven Playing Field

The initiative petitions exempt transactions involving charitable organizations and government entities. Since many hospitals are organized as charitable institutions or are operated by governments, the new tax will not apply to services provided by them, but instead only those that do not fall into those categories. This would create an unfair playing field for organizations subject to federal income taxes that provide similar services.

An Increased Tax Rate For Many Items

Even where the initiative petitions do not impose a new tax they impose a higher tax burden because they force a substantial increase in the sales tax rate. Health-related items subject to the higher rate of the proposed tax include eyeglasses, contact lenses, incontinent apparel, and over-the-counter drugs.

Implications of Administering the Tax on Health Care

Since the initiative petitions provide very little in the way of detail when it comes to how the new tax will be administered, they raise many questions, including:

- How will “services provided by a licensed health care professional” be defined by the General Assembly?
- What will be the test for determining what is a “direct benefit” as opposed to an indirect benefit of “any individual’s health care?”
- What will the definition of “pharmaceuticals” be?

- Would individual providers, such as doctors, pharmacists, and hospitals be required to collect the sales tax when they bill insurers?
- Would these providers be responsible for remitting tax collections to the Department of Revenue?
- Would the insurer be the point of collection of the sales tax?
- What enforcement mechanisms will be created to ensure that such taxes will be collected and remitted? (The fiscal note response from the Department of Revenue indicated that pharmacies have trouble collecting sales tax from insurance companies.)
- Will insurers and health care providers be subject to expensive audits by the Department of Revenue?

This lack of specificity creates an uncertain business climate for companies in the health care industry and subjects them to unnecessary risk and exposure to legal challenges.

Conclusion

All of these questions will lead to more questions, compounding the uncertainty of the proposal. Based on the type of health care transactions that would be taxed under the petitions and the implications of administering the tax on health care, the sales tax proposals will result in an uncertain and unfair tax policy and will increase health care costs for thousands of businesses and millions of households.

About the Author

Brian Schmidt served as the executive director of the Missouri General Assembly's Joint Committee on Tax Policy from 2005 through 2011. He received his Bachelor of Political Science degree at Truman State University and his Master of Public Affairs- Public Policy degree at the University of Missouri-Columbia. He is currently the owner of Missouri Wonk, a Jefferson City-based public policy think tank that specializes in policy analysis, cost-benefit analysis, and forecasting. Missouri Wonk can be found online at www.mowonk.com.