Much Ado About Nothing: The Impact of the Medical Device Excise Tax

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Critics of the new 2.3% medical device excise tax are hitting new heights with their claims of dire consequences:

- Conservative blogger and attorney Johnathan Emord blogged that the tax will "wipe out an entire industry," and further asserts that the tax is "one of the most draconian tax burdens in history."
- Stephen J. Ubl, president of the Advanced Medical Technology Association, called the tax "job-killing, innovation-destroying, and anti-competitive," while his counterpart, Gail Rodriquez of the Medical Imaging & Technology Alliance, claimed the tax threatened "lifesaving innovation."
- Dr. Maurice Ferre, founder and CEO of publicly traded Mako Surgical Corporation, stated that the tax will have an impact on companies such as Mako to do research and development and create jobs.
- Jeffrey Binder, CEO of Biomet with global sales greater than $2.8 billion, said the tax is "ill-conceived and counter-productive."
- Sean Fenske, a "medical design technology" blogger, stated that the tax is "already costing some employees of medical device OEMs their jobs as companies 'prepare' for the added expense of the tax before it's even being put into effect."

What are the facts? Is the industry overreacting?

Picking Your Battles

Students of military strategy learn quickly the advantages of choosing when and where to fight, rather than wasting resources on trivial issues. An impartial observer would wonder about the wisdom of the excessive rhetoric, over-the-top hyperbole, and political posturing surrounding the medical device excess tax.

Industry leaders should consider the following:

1. *The Medical Device Manufacturing Industry Is a Net Beneficiary of the ACA*—Most impartial analysts believe that the ACA will expand the use of medical devises through the addition of millions to the insured rolls. It is more likely that the additional revenues will benefit medical equipment manufacturers to a greater degree than the costs of the excise tax imposed on the industry.
2. *The Costs of Reform Are Bore by Citizens, Providers, and Suppliers Alike*—Citizens are required to pay higher health insurance premiums [1], co-pays, and deductibles; providers are seeing payments cut and being tied to favorable outcomes; and businesses with more than 50 employees are having to provide health insurance to their employees. A tax of 2.3% which may be passed on to purchasers in the form of higher prices is not a heavy burden when compared to other segments of healthcare businesses and individuals.
3. *The Tax Doesn't Affect the Competitive Landscape*—No single company benefits to a greater degree than its rival since it applies to all "manufacturers, producers, and importers." Companies with higher cost structures than their competitors will continue to be at a disadvantage, particularly those companies that produce low-margin products, such as trays, tables, scalpels, and furniture. High-tech manufacturers of stents, implantable devices, and diagnostic equipment will probably pass on the tax to purchasers, while low-margin manufacturers may elect to absorb the cost if they can gain a price advantage over the competition.
4. *The Negative Impacts of the Tax Are Exaggerated*—According to the Medical Device Manufacturers Association, the industry projects an estimated loss of 43,000 jobs as a result of the tax from more than 423,000 total jobs. Thus far, there have been an estimated 2,000 lost jobs blamed on the tax. However, industry analysts suggest that companies are likely to find themselves treated as "the boy who cried wolf" unnecessarily since many of the jobs were already scheduled to be outsourced. The requirement for smaller companies to provide healthcare coverage mandated by the Act is a more onerous financial burden than the tax itself.
5. *The Industry Outlook Remains Bright with Venture Capital*—Despite projections of doom and gloom, the investment community remains positive about the industry's future. According to a January 18, 2013 article at MassDevice.com, "There were 457 medtech angel- and seed-round 2012 deals worth a total of more than $187 million, with an average deal size of about $1.1 million." The year-over-year increase in the number of deals is a positive sign, easing away fears that early investors had fled the industry since the economic collapse of late 2008 and the passage of the ACA.
6. *The U.S. Healthcare System Needs Serious Reform*—Compared to other industrialized nations, healthcare in America is too expensive [2], over-utilized, and fails to cover a significant portion of the population. Without change, it will bankrupt the country within the next 50 years, as well as eliminate the largest existing market for medical device manufacturers. While not perfect, the ACA is an attempt to control costs with expanded coverage.

A Better Strategy

Rather than expend resources trying to eliminate the Medical Excise Tax, the industry would be better advised to focus their considerable financial and political muscle on the following areas:

Reform of the USDA 510k Product Approval Process
An Institute of Medicine report in July 2011 stated that the approval process was flawed and would increase approval time and expense, increasing the likelihood that medical device manufacturers would move away from the United States and expand abroad. The possibility of losing jobs overseas is a potent political message that can resonate with politicians, regulators, and the public alike.

Creation of New R&D Incentives and Grants
The medical device industry spends an estimated $10 billion annually for research, which it claims will suffer due to the tax. Innovation is the key to lowering overall healthcare costs [3] and improving patient outcomes. A case for increased R&D investment by the Federal Government is likely to be easier to achieve than a repeal of the excise tax.

Reform of the Corporate Income Tax
There is increasing momentum to reduce or eliminate U.S. corporate income taxes to allow U.S companies to be more competitive globally. Companies in all industries are united to reduce the tax burden that makes their products more expensive in the overseas markets and stimulates the transfer of financial resources and manufacturing offshore. Adding the industry's voice to the proponents of tax reform would have, if successful, a much more meaningful financial impact on companies in the medical device industry than the elimination of the excise tax.

Final Thoughts
Healthcare is one of the biggest industries in America. As with any industry, there are winners and losers, with competition on a variety of levels simultaneously. Profits to device manufacturers are costs to a hospital or physician, creating inter-industry and intra-segment competition as everyone fights for their share of the pie.

It is unlikely that efforts to eliminate the excise tax will be successful in the current political environment, particularly with the need to find revenues to implement the popular ACA. The industry would be better served by abandoning the excise tax repeal efforts and focusing its energy on projects that are more meaningful to the industry members (501k reform and R&D incentives) or likely to attract powerful allies (corporate tax reform).

What is your take on the excise tax? Should it be eliminated?

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