

The Job-Killing Medical Device Tax

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Americans consume nearly \$100 billion dollar's worth of medical devices annually.¹ Medical devices include simple things, such as cotton swabs, as well as complex instruments, such as pacemakers and artificial joints.



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In 2010, Congress passed a tax on medical devices to offset a portion of the \$1 trillion cost of the Patient Protection and Affordable Care Act (ACA). Beginning in 2013, a 2.3 percent tax will be imposed on the manufacture and importation of medical devices. Devices typically sold by retailers to consumers — including toothbrushes and bandages — are exempt from the tax, whereas devices purchased from wholesalers by health care providers, such as tongue depressors and ultrasound equipment, will be taxed.

Though seemingly small, if this tax is implemented it will destroy jobs and stifle innovation.

What Is a Medical Device? A medical device can be “an instrument, apparatus, implement, machine, contrivance, implant, in vitro reagent, or other similar or related article, including a component part,” according to the U.S. Food and Drug Administration (FDA).²

Medical devices fall into one of three regulatory classes based on the level of risk they pose to patients:

- Class I devices have the least risk and thus require the least regulatory control; indeed, most of the items found in local pharmacies are Class I medical devices.
- Class II devices are more closely scrutinized by the FDA and include such things as patient monitors, diagnostic imaging machines and laboratory equipment.
- Class III medical devices — the most highly regulated — include life-sustaining devices, such as pacemakers and drug-coated arterial stents, as well as orthopedic implants, such as artificial hips and knees.

Medical Device Tax. The 2.3 percent tax will be imposed on revenue, not profits. This means the tax will be paid even on devices sold at a loss. Further, the increased tax burden represents a significant portion of the profit margin on each dollar of medical device sales:³

- In 2006 the medical device industry paid corporate income taxes of \$3.1 billion on taxable income of \$13.7 billion.⁴

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- The medical device tax would add approximately \$3 billion annually to the taxes paid by medical device firms — a 100 percent increase.⁵

Medical device firms in the United States are relatively small — about 95 percent have annual sales of less than \$100 million.⁶ Over the 2013 to 2019 period, these firms would pay a projected \$20 billion in additional taxes — imposing one of the highest effective corporate tax rates in the world.

Effect of Tax on Industry. How firms respond to the new tax will vary. To the extent they can, medical device makers will have an incentive to raise prices across the board to cover the cost of the tax. Although the industry is highly competitive, the fact that the tax applies to all firms could easily prompt industry-wide price increases.

Characteristics, profit margins and business practices vary within each segment of the industry, but those firms with relatively high profit margins will likely fare better than firms with thin margins. Thus, the tax will impact some firms more than others. For instance, device maker Zoll could see its profits fall by 40 percent, whereas Abiomed would see its losses pushed

further into the red by 19 percent. [See the table.]

Medical device makers have already been adversely affected by the downturn in the economy, as patients postpone elective procedures like hip and knee replacements due to cost-sharing requirements.⁷ In addition, the recession has produced a more risk-averse investment environment, prompting more medical device firms to turn to Europe for their new product launches.⁸ Indeed, a Northwestern University study found that about three-fourths of medical device makers initially launch new products overseas, where device approval takes less time and the regulatory environment is more predictable.⁹

Changes in profitability for U.S.-based operations could ultimately encourage producers to look for lower-cost options abroad.¹⁰ Moving more of the industry offshore could potentially result in supply disruptions or shortages of certain devices.

Effect of Tax on Workers. The U.S. medical device industry employs more than 423,000 workers across the United States, who collectively earn about \$25 billion annually.¹¹ According to the Lewin Group, a consulting firm that studies the impact of public policy, workers

Impact of the Medical Device Tax on 2010 Profits* (in millions of dollars)

| Company | U.S. Sales | Profit (-loss) | Device Tax | Net Profit (-loss) | Percent Change |
|--------------------|-------------|----------------|------------|--------------------|----------------|
| Abiomed | \$93.10 | -\$11.60 | \$2.10 | -\$13.70 | -18.50% |
| SonoSite | \$133.00 | \$10.00 | \$3.10 | \$6.90 | -30.70% |
| Zoll | \$329.00 | \$18.90 | \$7.60 | \$11.40 | -40.00% |
| Intuitive Surgical | \$1,130.40 | \$381.80 | \$26.00 | \$355.80 | -6.80% |
| Covidien | \$5,152.00 | -\$1,065.00 | \$118.50 | -\$1,183.50 | -11.10% |
| Medtronic | \$15,933.00 | \$3,096.00 | \$366.50 | \$2,729.50 | -11.80% |

* Had the tax scheduled for 2013 been in effect in 2010.

Source: "The Medical Device Tax is a Bad Idea," MassDevice.com, October 13, 2011. Available at <http://www.massdevice.com/blogs/massdevice-staff/medical-device-tax-bad-idea>.

in this sector earn an average of \$58,188 per year — about 40 percent more than average U.S. pay. In many states the medical device industry pays a wage premium of nearly 50 percent or more compared to the average wage.¹²

High-paying middle class jobs benefit local economies as well as the individuals who receive the paychecks. Communities benefit from the demand for other goods and services these positions create. For example, the state median job multiplier in the medical device industry is 2.5, meaning for every one job in the medical device industry an additional 1.5 jobs are indirectly created to provide additional services such as housing and groceries.¹³

The medical device tax will result in the loss of high-paying manufacturing jobs. Indeed, firms have already begun preparing for the tax by reducing payrolls:¹⁴

- In November 2011, device maker Stryker Corporation announced its intention to layoff 1,000 workers in order to cut costs in advance of the tax.¹⁵
- Another firm, Covidien Plc, announced the layoff of 200 U.S. workers and plans to offshore production to Mexico and Costa Rica.¹⁶
- The tax will prompt the loss of about 45,661 jobs across the medical device industry, according to Diana Furchtgott-Roth, former chief Labor Department economist.¹⁷

Effect of Tax on Health Care Costs. The medical device tax will ultimately increase national health expenditures, according to the Office of the Actuary for the Centers for Medicare and Medicaid Services.¹⁸ Health care providers, hospitals, doctors and patients, as well as insurers, will bear much of the additional cost of the tax. To the extent that device makers are unable to pass on their additional costs, innovation and medical device workers will suffer.¹⁹

Conclusion. Congress would be wise to repeal the impending medical device tax. It is a blow to an industry that provides goods essential to the health of Americans. The tax will boost the nation’s medical bills while causing the loss of high-paying manufacturing jobs, and the potential tax revenue is relatively small compared to the costs.

Endnotes

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