

An open letter to President Joe Biden, Xavier Becerra, Secretary of Health and Human Services, Rep. Mike Johnson, Speaker of the United States House of Representatives, and Sen. Chuck Schumer, Majority Leader of the United States Senate:

## **Scrap the Punitive, Unworkable, and Indefensible Excise Tax on Prescription Drugs**

We, the undersigned economists, attorneys, and other expert professionals in the fields of tax and health policy and administration, write to express concern over a provision in the Inflation Reduction Act (IRA) of 2022 to levy a 95 percent excise tax on the sales of prescription medicines if their manufacturers do not accede to below-market federal price caps. We know of few other examples from U.S. history of a tax that would be as punitive, unworkable, and ultimately indefensible.

Much criticism has been leveled at Subtitle B of the IRA, which provided the Secretary of Health and Human Services with the authority to conduct negotiations directly between the government and drug manufacturers supplying the private insurance plans participating in Medicare Part D (later expanding to Part B). Far less attention, however, has been given to the coercive mechanism that effectively forces those manufacturers to pay whatever price the government dictates: a 95 percent excise tax for those who choose not to participate in this ploy. The flaws of this approach, now embodied in Section 5000D of the Internal Revenue Code, are numerous:

- **If the Tax Were Ever Levied, Taxpayers Would Lose Twice.** Normally, most excise tax increases are either passed along directly to consumers or are reflected in higher prices. Yet, Section 5000D is not normal policy; rather, it was created to enforce price controls. Imposing price controls on one part of Medicare would lead to higher costs for beneficiaries elsewhere, whether through higher premiums or increased costs in other parts of Medicare. In general, enforcing prices set at below-market rates leads to shortages, squeezes the cost bubble toward some other portion of the economy, and imposes a deadweight loss on society.

Nonetheless, it is axiomatic that taxing a product or service at exorbitant rates tends to reduce its availability. The very existence of a 95 percent excise tax could therefore lead to shortages in the prescription drugs that patients need, as well as less innovation toward future cures as manufacturers are deterred from engaging in R&D that could carry a new 95 percent premium. Taxpayers could no longer count on as many future drug breakthroughs to bend the cost curve of more expensive treatments such as surgeries and hospital stays in government healthcare programs. The policy goal should be to encourage life-saving treatments that benefit seniors in Medicare, and ultimately, all taxpayers. This tax scheme will do the opposite.

- **Section 5000D Defies All Definitions of an Excise Tax.** Generally, excise taxes are exactions on manufacturing, sales, or consumption of a given product designed to raise revenue for a related or specific purpose. As the National Taxpayers Union recently stated, however, Section 5000D contradicts this principle: there is no pretense of a given product being routinely sold between a private sector business and customer, and therefore a flow of commerce. Nor is the tax designed at a level to specifically offset the cost of providing government service. Nor is the tax firmly linked to a quantifiable externality, such as providing routine law enforcement or funding harm reduction.
- **The Tax Is Not Only Unserious, It Is Under Several Legal Challenges.** The budgetary impact estimates of Congress's Joint Committee on Taxation (JCT) assume that Section 5000D won't raise any revenue, because the Committee believes the tax will never be invoked. Congress's scorekeepers assume what the architects of this provision knew all along: far from being a mere cudgel to guide the behavior of taxpayers, Section 5000D is effectively designed to secure compliance with federal price controls. As professionals in the policy, legal, and economics communities, we believe that tax laws should be crafted with serious, rather than spurious, purposes in mind.

Doubts over Section 5000D's legal pedigree and practical function are among several arguments that various parties, from affected manufacturers to the U.S. Chamber of Commerce, have raised in litigation currently underway against the new drug negotiation process. Unless Section 5000D is repealed or substantially modified, the federal government will continue to expend considerable tax dollars in the courts on an uncertain outcome.

Whether characterized as a massive tax with little precedent in U.S. experience, or a punitive artifice crafted to achieve price controls on prescription drugs, Section 5000D risks further damaging the integrity of the U.S. tax system. Policymakers would be wise to change course now, and jettison this ill-conceived law.

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