

Summary of New Health Care Reform Law



Recently, two pieces of legislation, the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 were signed into law. Together, these pieces of legislation make the most significant reform to health care in the United States since the enactment of Medicare. The Congressional Budget Office estimates that by 2019, approximately 32 million currently uninsured

Americans will have health insurance, at a cost of about \$940 billion. A major component of the reform legislation is the creation of state-based American Health Benefit Exchanges and Small Business Health Options Program Exchanges to provide health insurance for low-income individuals and small businesses. The following is a brief description of some of the most important provisions of the health care reform legislation.

For individuals

- U.S. citizens and legal residents will be required to have health insurance by 2014, with some exceptions. Those without insurance will face a tax penalty of as much as 2.5% of taxable income.
- Existing employer-sponsored health insurance plans will be allowed to remain essentially the same except the plans will be required to extend dependent coverage to qualifying children through age 26, lifetime limits (and eventually, annual dollar limits) on coverage must be eliminated, waiting periods for coverage cannot extend beyond 90 days, and insurers will not be able to deny coverage or charge higher premiums to people based on their health status and gender.
- Medicaid eligibility will be expanded to include individuals under age 65 whose income is less than 133% of the Federal Poverty Level.
- For families with incomes up to 400% of the Federal Poverty Level, tax credits and subsidies will be available to purchase health insurance through state-run exchanges, and to offset out-of-pocket costs.
- Contributions to a health flexible spending account will be limited to \$2,500 per year. Reimbursements from health FSAs and HRAs for over-the-counter drugs will be restricted, and tax-free reimbursements from HSAs and Archer MSAs for over-the-counter drugs will not be allowed, while the tax on HSAs and Archer MSAs increases for distributions not used for qualified medical expenses.
- A rebate of \$250 will be available to Medicare Part D (drug coverage) beneficiaries who reach the coverage gap (donut hole) and the coinsurance rate for costs within this gap are gradually reduced to 25%.
- Adults with pre-existing conditions will be able to purchase coverage from temporary high-risk pools until 2014, when coverage cannot otherwise be denied for pre-existing conditions.
- A national program will be established to provide limited reimbursement for long-term care expenses for individuals who participate by contributing to the program's cost through voluntary payroll deductions.

For employers

- Employers with 50 or more employees that do not offer health insurance coverage will generally have to pay a premium tax of up to \$2,000 per full-time employee.
- Employers with more than 200 employees must automatically enroll employees in health insurance plans from which employees may opt out.
- Employers providing health insurance must offer a voucher to qualifying employees to purchase insurance through an exchange.
- Qualifying small employers may receive a tax credit for providing health insurance to employees.

Tax changes

- The threshold for itemized deductions for qualified medical expenses will be increased from 7.5% of adjusted gross income (AGI) to 10% of AGI, though a temporary exception will be maintained for those 65 and older.
- The tax for Medicare Part A (hospitalization coverage) is increased 0.9% for individuals with earnings exceeding \$200,000, and for couples with joint earnings greater than \$250,000. Also, high-income taxpayers will be subject to a surtax of 3.8% on unearned income, such as capital gains, dividends, annuities, and rental income.
- The law imposes a 10% tax on the amount paid for indoor tanning services.
- Some of these provisions are effective immediately while others will be implemented over the next several years. Consult with your financial professional to see how these laws may affect you.

Health-Care Reform: Tax Changes for Individuals

The health-care reform legislation that was recently signed into law contains a number of tax changes. Some of these changes take effect immediately; others won't have an impact for a few years. Here's a year-by-year breakdown of some of the changes worth taking note of.

Changes taking place in 2010

Bad news if you frequent tanning salons--after July 1, 2010, there will be a new 10% tax assessed on amounts paid for indoor tanning services.

Good news for adoptive parents, though--the maximum tax credit for qualified adoption expenses, and the maximum amount of employer-provided adoption assistance that can be excluded from income, each increase from \$12,170 to \$13,170. The tax credit is also made refundable. These changes are effective for 2010 and 2011, with an adjustment for inflation in 2011.

In addition, if you're covered by an employer health plan, the tax benefits (i.e., the ability to exclude the value of the benefits from income) associated with the health coverage and any reimbursements you receive for medical care expenses are extended to any children who have not reached age 27 by the end of the year. Similarly, self-employed individuals can deduct the costs associated with health-care coverage for any child who doesn't reach age 27 by year-end.

2011 through 2013

If you have a flexible spending arrangement (FSA), health reimbursement arrangement (HRA), health savings account (HSA), or Archer MSA, it's important to note that, beginning in 2011, over-the-counter medications (except for insulin and medications that are prescribed by a physician) will no longer be considered qualified medical expenses for purposes of reimbursement and tax-free distributions. And, starting in 2011, the additional tax that applies to HSA and Archer MSA distributions that aren't made for qualifying expenses increases to 20%. In 2013, health FSAs that are part of a cafeteria plan will be capped at a \$2,500 reimbursement limit.

Do you itemize your deductions on Schedule A? For many it's going to get a little more difficult in 2013, when unreimbursed medical expenses will be deductible on Schedule A only to the extent that they exceed 10% of adjusted gross income (AGI), instead of the 7.5% threshold that applies now. Until 2017, however, if you or your spouse turns age 65 before the end of the taxable year, the 7.5% AGI threshold will continue to apply. Beginning in 2017, the 10% AGI threshold will apply to individuals who have reached age 65 as well.

Also in 2013, two new Medicare-related taxes will affect high-income individuals. Those with wages over \$200,000 (married couples filing jointly with wages over \$250,000) will be subject to an additional 0.9% hospital insurance (Medicare) payroll tax. A new 3.8% Medicare contribution tax will also be imposed on the unearned income of individuals with AGI over \$200,000, or married couples filing jointly with AGI over \$250,000.

2014

This is the year of the carrot and the stick. A new premium assistance tax credit will help eligible individuals purchase health-care insurance through one of the newly established state exchanges. If you qualify for the credit, it will be paid directly to the exchange insurance plan that you join. Who qualifies? Individuals with household income between 100% and 400% of the federal poverty level will qualify, with the exact amount of the credit based on income level. Generally, individuals who are offered coverage through an employer health plan won't qualify for the credit unless the employer health plan doesn't cover an adequate share of benefits (60%), or it's considered "unaffordable" (the employee portion of the premium is 9.5% or more of the employee's household income).

In addition to a premium assistance tax credit, those with household income between 100% and 400% of the federal poverty level may qualify for a cost-sharing subsidy to help cover out-of-pocket costs like co-payments and deductibles, when they buy health insurance through an exchange. Like the tax credit, the subsidy will be paid directly to the plan.

And then there's the stick. Beginning in 2014, if you're a U.S. citizen or legal resident, you're generally required to have adequate health-care coverage. If you don't, you'll face a penalty tax. In 2014, the tax will equal the greater of 1% of the amount of your household income that exceeds a specific amount (generally, the standard deduction plus personal exemption amounts you're entitled to for the year), or \$95 per uninsured adult (half that for uninsured family members under age 18), with a maximum household penalty of \$285. By 2016 the percentage rate increases to 2.5%, the dollar amount per uninsured adult increases to \$695, and the maximum household penalty increases to \$2,085.

Health-Care Reform: Tax Issues for Businesses

The health-care reform legislation that was recently enacted includes new taxes, but there are also some tax breaks available to help small businesses pay for health insurance. Two of the changes getting a lot of attention: a tax credit available to small businesses that offer health-care coverage to employees, and a tax to penalize employers who do not offer coverage.

Small business tax credit

The new health-care reform legislation provides a tax credit to small businesses that offer health insurance coverage to their employees. The credit is available in two phases. For the years 2010 through 2013, the maximum credit is 35% of the employer's premium expenses. For tax years 2014 and later, the maximum credit increases to 50%.

To be eligible for the tax credit, the following conditions must be met:

- An employer must have the equivalent of fewer than 25 full-time employees for the tax year. Generally, this is determined by dividing the total hours for which wages were paid for all eligible employees during the year by 2,080.
- Average annual wages must be less than \$50,000 (to calculate, total wages paid during the tax year are divided by the number of full-time employees, and rounded down to the nearest \$1,000).
- The employer must contribute at least 50% of the premium cost of a qualifying health plan offered to employees.

Special rules apply to seasonal employees and to tax-exempt employers. Also, sole proprietors, partners, 2% shareholders of an S corporation, and 5% owners of an employer generally are not considered employees for purposes of the credit. In addition, family members of ineligible employees are not counted as employees.

The maximum credit is available to qualifying employers with 10 or fewer full-time employees with average annual wages not exceeding \$25,000. The credit is phased out for employers with between 10 and 25 full-time employees, and for employers who have full-time employees with average annual wages between \$25,000 and \$50,000.

Businesses applying for the credit in 2010 can include premium payments made prior to March 23, 2010, the date of enactment of the new health-care reform legislation. However, the total premium paid by the employer that's eligible for the credit cannot exceed the average premium for the small-group market in the state where the employer offers health coverage. The average premium for each state is published by the IRS. The credit is claimed on the employer's annual tax return as a general business credit.

Beginning in 2014, the maximum credit will increase to 50%; however, qualifying arrangements are restricted to health insurance purchased by the employer through a state-run health exchange. Additionally, starting in 2014, the credit can be claimed by the employer for only two years.

Penalty taxes encourage employers to offer coverage

While employers aren't required to provide health-care coverage to employees, a new excise tax will encourage them to do so. Beginning in 2014, a penalty tax will be assessed on employers who do not offer health-care coverage to employees if:

- The employer has 50 or more full-time employees (more specifically, an average of at least 50 full-time employees in the prior year, and part-time employees are factored into the calculation), and
- At least 1 full-time employee purchases health insurance coverage through a state exchange, and is entitled to a tax credit or cost-sharing reduction.

The tax is assessed on a monthly basis, and is equal to the number of full-time employees exceeding 30 multiplied by \$166.67 (\$2,000 divided by 12).

Even employers (those with at least 50 full-time employees) that do offer health-care coverage to employees may still face a tax penalty if at least 1 full-time employee purchases health insurance coverage through a state exchange, and is entitled to a tax credit or cost-sharing reduction as a result of:

- An employer's coverage consisting of a plan that pays less than 60% of the total allowed cost of benefits.
- An employer's coverage being considered "unaffordable" for an employee (generally, coverage would be considered unaffordable if an employee's portion of the premium exceeds 9.5% of the employee's household income).

In this case the tax, assessed on a monthly basis, equals \$250 (one-twelfth of \$3,000) for each full-time employee receiving a premium tax credit or cost-sharing subsidy through a state exchange. The tax is capped, however, at the amount that would be due if an employer did not offer health-care coverage to employees (i.e., the number of full-time employees exceeding 30 multiplied by \$166.67).