COWAN BOLDUC DOHERTY
CPAs & Advisors

Key Changes in the New Health Care Law

The new *Patient Protection and Affordable Care Act of 2010,* and its accompanying reconciliation law, provide broad-based changes for employers as well as many individuals. In addition to virtually mandating health insurance coverage for all U.S. citizens, this massive health care reform legislation includes several other far-reaching tax provisions.

The changes generally take effect over time -- in some cases, you won't see them for two to four years. But advance planning can maximize tax advantages for some and minimize tax disadvantages for others.

Here's a brief summary of some of the provisions.

Individual coverage - This is one of the foundations of the health care legislation. For tax years beginning after 2013, any individual who is not eligible for Medicare or Medicaid must obtain "minimum essential coverage" through an employer-sponsored plan or one of the other options, such as a government-sponsored plan or a private plan. If you fail to do so, you will be assessed a nondeductible tax penalty based on the greater of a flat dollar amount (cut in half for children under age 18 or full-time students) or a percentage of household income (see chart below).

These figures will be phased in over three years and then adjusted for inflation for tax years beginning after 2016.

If the tax year begins in:	The flat dollar penalty* is:	Or you must pay this % of household income, if greater than the flat penalty:
2014	$ 95	1%
2015	$325	2%
2016	$695	2.5%
	* Total household penalty can't exceed 300% of the per-adult penalty	

Premium assistance credits - For tax years beginning after 2013, the new law provides "premium assistance credits" that certain taxpayers can use to help purchase health insurance through a state-run exchange. Eligibility for this refundable tax credit will be based on household income in the tax year ending two years before the enrollment period.

The credit is generally available to taxpayers with a household income between 100 percent and 400 percent of the federal poverty level who aren't receiving health insurance through an employer (or spouse's employer). This credit is coordinated with reduced cost-sharing for qualified individuals.

Employer responsibilities - For tax years beginning after 2013, an employer may have to pay a tax penalty if it fails to offer minimum essential coverage to an eligible employee. The penalty for each month is equal to the number of full-time employees multiplied by one-twelfth of $2,000.

This rule applies to any employer with at least 50 full-time employees during the prior calendar year. *Note:* The penalty is based on <u>all</u> full-time employees, not just employees who aren't receiving minimal essential coverage. But an employer can subtract the first 30 employees from the calculation. For instance, the penalty for an employer with 100 full-time employees is based on 70 employees.

Small business credits - The new requirements for employers may be costly, but qualified small business owners can benefit from a special tax credit.

For tax years beginning in 2010 through 2013, an eligible small business can receive a credit of up to 35 percent of the contribution for employee health insurance premiums. In 2014 and later years, an eligible business can receive an increased credit of 50 percent of the contribution for a two-year period. The credit is available for small employers with less than 25 full-time equivalent employees.

Medicare tax - The new law includes a fundamentally different tax treatment in the imposition of the 1.45 percent Medicare tax paid by individuals (2.9 percent for self-employed individuals). Previously, this payroll tax only applied to "earned income" such as wages and bonuses. No part of the Social Security tax, including the Medicare tax, was ever due on "unearned income" received from investments. For tax years beginning after 2012, certain high-income taxpayers may be assessed an additional tax on earned income and an unprecedented Medicare tax on unearned income.

New Reporting Requirements

For tax years beginning after 2011, the new law requires employers to report the value of the employer-sponsored health insurance coverage on employees' W-2 forms. It also requires businesses to file information returns for all payments totaling $600 or more in a calendar year to a single recipient, including corporations (other than tax-exempt entities). Additional details on these requirements will be issued in the future by the IRS.

Two New "Payroll" Taxes for High-Income Earners

The *Patient Protection Act* imposes two new extra Medicare taxes on high-income individuals beginning in 2013:

1. You must pay an additional 0.9 percent Medicare tax on earned income if you're a single tax filer with earned income above $200,000 or a joint filer with earned income above $250,000.

2. You must pay an additional 3.8 percent Medicare tax on net investment income if you're a single tax filer with a modified adjusted gross income (MAGI) above $200,000 or a joint filer with a MAGI of more than $250,000.

The second tax applies to "net investment income." For this purpose, net investment income includes interest, dividends, royalties, rents, gains from dispositions of property and passive activity income (from, for example, certain rentals). However, it does not include distributions from qualified retirement plans, such as 401(k), 403(b) and 457 plans, and IRAs.

The tax on net investment income is assessed on the lesser of the net investment income or the amount by which your net investment income exceeds the MAGI threshold.

Example: Let's say in 2013, you receive $220,000 in wages, $70,000 in capital gains and $10,000 in IRA distributions, for an MAGI of $300,000. Because you're a joint filer and your MAGI exceeds the threshold by $50,000, you must pay the additional Medicare tax on $50,000 of your capital gains, or an extra $1,900 ($50,000 times 3.8 percent). However, you don't owe the extra 0.9 percent tax because your earned income doesn't exceed the $250,000 threshold.

There are numerous other tax provisions in the new health care law, including changes for cafeteria plans, flexible spending accounts and other tax-favored health care accounts; and fees on insurers for high-cost insurance plans. Other special rules and "grandfather" exceptions for health plans may apply.

New Provisions That May Affect You and Your Children

These two provisions take effect six months from the date of enactment:

Pre-existing conditions - The *Patient Protection Act* prohibits health plans from denying coverage to children who have pre-existing conditions.

Coverage for young adults - The law generally requires health plans to allow parents to keep their children on their insurance policies through age 26.

Increased Tax Break For Adoptions

The tax credit for adoption expenses is increased $1,000 to $13,170 for 2010. The credit is also now refundable. That means that an eligible taxpayer can collect all or part of any leftover credit after his or her federal income tax has been reduced to zero.

Medical Expense Deductions Will Be Harder to Obtain

As many taxpayers know, it is currently difficult to claim a deduction for medical expenses because of the limits imposed under the tax code. The *Patient Protection Act* will make it even more difficult.

Under current law: You can deduct unreimbursed medical expenses in excess of 7.5 percent of your AGI.

Under the new law: For tax years beginning after 2012, the new law increases this threshold to 10 percent of your AGI.

Exception: An individual who is age 65 or older (and spouse, if married) is temporarily exempt from the increase in the medical deduction threshold for tax years beginning after 2012 and before 2017.

The deduction threshold for alternative minimum tax (AMT) purposes remains at its previous level of 10 percent of AGI.

Tip: As the end of each year approaches, take a look at your medical expenses. If you are close to -or exceed the 7.5 percent threshold in any year before 2013 -- you may want to get as many expenses as possible into that particular year. This might involve getting qualified elective medical care.

When adding up medical costs, don't forget the cost of traveling to your doctor or medical facility for treatment. If you go by car, you can deduct a flat rate, adjusted by the IRS annually, or you can keep track of actual expenses for gas, oil and repairs. The flat medical rate for 2010 is 16.5 cents per mile (down from 24 cents per mile for 2009).
With either method, you can add in amounts paid for parking and tolls. If you must travel out of town for medical treatment, you may also qualify to write off some costs.

This information should not be acted upon without further details and/or professional assistance. Call our office for assistance, 978.620.2000.