

# Deconstructing the 2010 Health Care Act

## Part I of II: Individuals

When the 2010 Health Care Act was passed by Congress on March 23, I was probably in the dark as much as anyone. From 'death panels' to health care rationing, internet blogs and Facebook pages were abuzz with warnings and predictions – or excitement (depending upon the political persuasion). Now that the Act has been signed into law and emotions are (some-what) settled, I've had time to study key provisions of the bill. When you learn more about it, you'll see why some accountants refer to it as the "Job Security Act for CPAs". Otherwise, I'm here to present the facts and I'll keep my opinions to myself.

This article covers how the Health Care Act will affect individuals. Next month, we will focus on changes that are coming for small businesses. Since most of the changes don't take place until future years, the dates that provisions go into effect are italicized where applicable.

**Individual Mandate** The new law requires U.S. citizens and legal residents to have qualifying health coverage or be subject to a tax penalty. Those without qualifying health coverage will pay a tax penalty of the greater of: (a) \$695 per year, up to a maximum of \$2,085 per family, or (b) 2.5% of household income over the threshold amount of income required for income tax return filing. The penalty will be phased in *beginning in 2014* and will gradually increase to 2.5% of taxable income in 2016. *Beginning after 2016*, the penalty will be increased annually by a cost-of-living adjustment. Exemptions will be granted for financial hardship, religious objections, American Indians, those without coverage for less than three months, aliens not lawfully present in the U.S., incarcerated individuals, those below certain income thresholds, and those residing outside of the U.S.

**Tax credits for purchasing health insurance** *Beginning in 2014*, certain low and middle income taxpayers are eligible for tax credits when they purchase health insurance through an "Exchange." Eligibility is based upon income levels and other factors. A qualified person will enroll in a plan offered through the Exchange and will report his/her income to the Exchange. Based upon this information, the IRS will pay the applicable "premium assistance credit" to the insurance company. The individual pays the insurer the difference in the IRS credit and the total premium. If employed, the payment must be made through payroll deductions.

The premium assistance credit will be available for individuals and families with income up to 400% of the federal poverty level (\$43,320 for an individual or \$88,200 for a family of four, using 2009 poverty level figures) that are not eligible for Medicaid, employer sponsored insurance, or other acceptable coverage. The credits will be available on a sliding scale basis.

**Higher Medicare taxes on high-income taxpayers** High-income taxpayers will be hit with a double whammy: a tax increase on wages and a new levy on investments. The Medicare payroll tax is the primary source of financing for Medicare's hospital insurance trust fund, which pays hospital bills for beneficiaries who are 65 and older or disabled. Under current law, wages are subject to a 2.9% Medicare payroll tax. Employees and employers pay 1.45% each. Self-employed people pay both halves of the tax and deduct half of this amount for income tax purposes. Unlike the payroll tax for Social Security, which applies to earnings up to an annual ceiling (\$106,800 for 2010), the Medicare tax is levied on all of an employee's wages without limit.

Under the provisions of the new law *taking effect in 2013*, most taxpayers will continue to pay the 1.45% Medicare hospital insurance tax, but single people earning more than \$200,000 and married couples earning more than \$250,000 will be hit with an additional 0.9% tax (a total of 2.35% including the 1.45% Medicare tax) on the excess over those amounts. Employers will collect the extra 0.9% on wages exceeding \$200,000 just as they withhold Medicare taxes and remit them to the IRS. However, because this is levied

on a "per couple" basis for married couples, those with combined incomes approaching \$250,000 will have to keep tabs on both spouses' pay to avoid an unexpected tax bill on April 15.

**Medicare payroll tax extended to investments** *Beginning in 2013*, Medicare tax will be levied on investment income for the first time in our history. Single taxpayers with adjusted gross income (AGI) above \$200,000 and joint filers with AGI over \$250,000 will pay an additional 3.8% tax on their net investment income. Net investment income for these purposes is defined as interest, dividends, royalties, rents, gross income from a trade or business involving passive activities, and net gain from disposition of property (other than property held in a trade or business). The new tax will apply only to the income that is in excess of the \$200,000/\$250,000 thresholds.

#### **In brief**

- The floor on the **medical expense deduction** has been raised from 7.5% of AGI to 10% (*beg. 2013*) for taxpayers under the age of 65.
- *Beginning 3/30/10*, employees' children under the age of 27 (as of the end of the tax year) will now be able to qualify for **dependent coverage** under the employer's accident or health plan.
- **Self-employed individuals** can take a deduction if they pay for health insurance for any child(ren) under the age of 27 at the end of the tax year.
- You will no longer be able to use your HRA, HSA, FSA, or MSA to reimburse for the cost of **over-the-counter drugs** (*beg. 2011*).
- **Contributions to FSAs will be capped** at \$2,500 per year (*beg. 2013*).
- Indoor **tanning salons** must charge tanners a 10% excise tax (*beg. 7/1/10*).
- **Penalties** on non-qualified distributions from HSAs and MSAs go up to 20% (*beg. 2011*).
- **Adoption tax credits** are increased and liberalized (*beg. 2010*)

Whether or not you like the bill, there is something for everyone. Be sure to read next month's article where we will bravely attempt to condense the business-related health care changes into one short, easily digestible article. And, as always, if you need advice on your specific situation, please give me a call.