How Health Care Reform Affects Your Tax Bill
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The Internal Revenue Service (IRS) announced a proposal to require business taxpayers with assets of On March 23, 2010, President Obama signed the Patient Protection and Affordable Care Act, representing a sweeping overhaul of the U.S. health care system. The act expands individuals' access to health coverage and includes tax provisions affecting individuals and businesses. Following is an overview of the 2,400-page act and its major tax-related provisions.

On March 21, the House of Representatives actually passed two bills: the Patient Protection Act, which had previously been approved by the Senate and is what the President signed into law, and a "sidecar" bill — the Health Care and Education Tax Credits Reconciliation Act — which makes several changes to the Senate-approved bill. If the Senate passes the Reconciliation Act (which requires only 51 votes under budget reconciliation rules), those changes will be incorporated into the Patient Protection Act.

This article describes the law *as amended* by the Reconciliation Act. If the Senate doesn't approve the amendments or it makes additional changes, we'll provide another update.

Overview of Reforms

The Patient Protection Act expands access to health coverage by:

- Requiring most Americans to have a basic level of health insurance by 2014 (or pay a penalty);
- Establishing state-based insurance exchanges, starting in 2014, through which individuals can purchase coverage at a competitive price, as well as separate exchanges for small businesses to purchase coverage;
- Expanding Medicaid to families with income up to 133% of the federal poverty level (FPL), starting in 2014;
- Providing premium assistance to individuals and families with income between 133% and 400% of the FPL who purchase coverage through the exchanges, starting in 2014;
- Providing tax credits to small businesses that purchase health insurance for employees, starting in 2011;
- Prohibiting insurers from denying coverage based on pre-existing conditions, starting later this year for children and in 2014 for adults;
- Prohibiting insurers from imposing lifetime limits on the dollar value of coverage and, beginning in 2014, from imposing annual limits;
- Limiting waiting periods for coverage under an individual or group policy to 90 days, starting in 2014;
- Requiring insurers to provide dependent coverage for children up to age 26, starting later this year, and;
- Gradually closing the "donut hole" which creates a gap in Medicare prescription drug benefits, starting this year.

These are just some of the many changes the act makes in an effort to expand health coverage, improve the quality of health care and contain costs.

Tax Provisions for Individuals

A variety of tax provisions will affect individuals, generally not until 2013 or later:

Penalties for the uninsured. Beginning in 2014, most individuals who aren't eligible for Medicaid, Medicare or other government-provided coverage will have to purchase minimum essential health coverage. Those who fail to do so will be hit with a penalty (with exceptions for the poor and certain others).

In 2014, the penalty will be the greater of $95 per person or 1% of household income. Those amounts increase to $325 or 2% of income in 2015 and $695 or 2.5% of income in 2016. Flat dollar penalty amounts are cut in half for children who are under 18 or in college. Also, your total liability for all individuals for whom you're liable — generally family members — is limited to three times the applicable dollar amount.

Premium assistance for those with lower incomes. Beginning in 2014, people with income between 133% and 400% of the FPL are eligible for tax credits or cost-sharing subsidies on a sliding scale to help pay insurance premiums. For example, based on current FPL figures, premium assistance would be available to a single person with income between around $14,400 and $43,300 or to a family of four with income between around $29,300 and $88,200. The credits are designed to ensure that qualifying individuals don't spend more than a certain percentage of their income (ranging from 3% to 9.5%) on health insurance premiums.

Higher taxes on the affluent. To help offset the act's cost, affluent taxpayers will face higher taxes. Beginning in 2013, taxpayers with more than $200,000 in earned income ($250,000 for families) will pay an additional 0.9% Medicare tax on the excess. In addition, those with an adjusted gross income (AGI) over $200,000 ($250,000 for joint filers) will pay a new, 3.8% Medicare tax on *unearned* income, such as interest, dividends, rents, royalties and certain capital gains. The tax doesn't apply to retirement plan distributions.

Also starting in 2013, the act raises the threshold for deducting unreimbursed medical expenses from 7.5% to 10% of AGI and limits contributions to flexible spending accounts for medical expenses to $2,500 per year.

Tax Provisions for Businesses

Several tax provisions also affect businesses:

Employer reporting requirement. For tax years beginning after Dec. 31, 2010, employers must disclose the value of the benefit provided for each employee's health insurance coverage on the annual Form W-2.

Penalties for failure to provide coverage. The Patient Protection Act doesn't require employers to provide insurance coverage, but starting in 2014 it imposes tax penalties on certain employers that don't provide it. Employers with 50 or more full-time-equivalent workers (FTEs) that don't offer coverage and have at least one full-time employee who receives a premium tax credit are subject to an annual fee of $2,000 per FTE. The first 30 FTEs aren't counted, so, for example, a company with 51 full-time employees that doesn't offer coverage would pay a fee of 21 × $2,000, or $42,000 per year.

Employers who offer coverage may still be hit with penalties if the coverage is deemed unaffordable (based on employee eligibility for premium credits). If an employer offers coverage but has at least one full-time employee receiving a premium tax credit, it will be liable for a penalty equal to the lesser of $3,000 for each employee receiving a credit or $2,000 for each full-time employee.

Tax credits for small businesses. Starting next year, small businesses are entitled to tax credits for purchasing group health coverage. For tax years 2011 to 2013, the maximum credit is 35%, provided the employer contributes at least 50% of the total premium or 50% of a benchmark premium. Starting in 2014, a maximum credit of 50% is available for two years for employers that purchase coverage through a state exchange and contribute at least 50% of the total premium. Smaller credits are available for tax-exempt businesses.

The full credit is available for employers with 10 or fewer employees and average annual wages of less than $20,000. Partial credits are available on a sliding scale to businesses with up to 25 employees and average annual wages of less than $40,000.

Excise tax on "Cadillac" plans. Starting in 2018, high-cost group plans will be subject to a 40% nonrefundable excise tax. The tax applies to annual premiums in excess of $10,200 for individual coverage and $27,500 for family coverage (excluding stand-alone dental and vision plans). The thresholds are higher ($11,850 and $30,950, respectively) for retirees and employees in certain high-risk professions. These amounts will be indexed for inflation.

The excise tax will be imposed on insurance carriers, which will likely pass the cost along to employers or employees in the form of higher premiums. For self-funded plans, the tax is paid by the employer or other plan administrator.

Industry-specific changes. Beginning in 2011, pharmaceutical manufacturers and importers will pay an annual flat fee allocated according to market share. The flat-fee schedule is: 2011, $2.5 billion; 2012 – 2016, $3 billion; 2017, $4 billion; 2018, $4.1 billion; 2019 and later, $2.8 billion. The fee will not apply to companies with sales of branded pharmaceuticals of $5 million or less.

Manufacturers or importers of medical devices will pay an excise tax of 2.3% of the sale price of any taxable medical device sold by the manufacturer, producer, or importer of the device. A taxable medical device is any device intended for humans. The excise tax will not apply to eyeglasses, contact lenses, hearing aids, or any other medical device determined by the IRS to be generally purchased at retail for individual use.

Health insurance providers will have an annual flat fee effective for calendar years beginning after Dec. 31, 2013. The fee will be allocated based on market share of net premiums written for a U.S. health risk for calendar years beginning after Dec. 31, 2012. The flat fee schedule is as follows: 2014, $8 billion; 2015 and 2016, $11.5 billion; 2017, $13.5 billion; 2018, $14.3 billion. The fee does not apply to companies whose net premiums written are $25 million or less.

Get a Financial Checkup

The Patient Protection Act will affect virtually everyone in the country, both insured and uninsured and at all income levels. To find out more about how the new law may affect you or your business, please contact Gloria McDonnell, CPA, gmcdonnell@hlbtr.com.