

## **Dealing with Health Care's New Tax Laws**

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March 2010 saw the enactment of a sweeping overhaul of the nation's health care system with the passage of the *Patient Protection and Affordable Care Act* and the *Health Care and Education Reconciliation Act*. The Congressional Budget Office has determined that the bills can provide health care coverage to nearly 32 million, resulting in 95 percent of Americans having access to affordable health care. Highlights of the health care reform bills include barring of health insurance discrimination based upon pre-existing conditions, creating competitive marketplaces for individuals & businesses to purchase health care coverage, and offering tax credits to small businesses for providing employees with health care coverage. The Budget Office estimates the cost of this legislation to be \$940 billion over the next ten years. This amount will be offset by \$438 billion in new taxes and more than \$500 billion in spending reductions.

The fear of catastrophic illness combined with loss of health insurance coverage has been a concern for many American families. The legislation includes measures to prevent insurance providers from setting lifetime limits on coverage, setting unreasonable annual limits, and rescinding insurance coverage from current enrollees when claims are filed, except in cases of fraud or intentional misrepresentation of facts.

While clearly the result of this legislative process is health care related, the revenue-raising provisions will largely be implemented and controlled through tax law. The Internal Revenue Service's Tax Code is front and center as the means to ensure compliance with the penalties, fees and surtaxes designed to provide the tax credits and health cost-sharing assistance.

There will be immediate effects with benefits and tax credits beginning in 2010. The majority of the provisions have delayed effective dates. It is important when reviewing the health care reform package from the standpoint of the Tax Code, to be mindful of the implementation timeline for tax planning.

### **Immediate enactment – 2010**

Employers continuing to pay at least half of their employee's health insurance premiums may be entitled to receive a general tax credit on federal income taxes up to an equivalent of 35 percent of their contribution. The credit is limited to companies with less than 25 employees and average wages of less than \$50,000. The credit is reduced proportionately when the number of employees is over ten and the average annual wages paid to all employees exceeds \$25,000.

The credit is claimed on the annual income tax return, and can be reflected in determining estimated payments through the year. General business credits are not refundable, so if the company does not have any current regular tax liability, the credits can be carried forward 20 years.

Qualified employers may also be organizations that are organizations described under the Internal Revenue Code 501(c) exempt under Code 501(a). Governmental employers are not qualified unless they meet the description of Code 501 (c) exempt under Code 501(a). For tax-exempt employers, the credits are refundable.

Parents with employer-provided health plans may continue to cover their unmarried children, up to age 27.

## **2011**

It will be easier for employers to provide additional tax-free benefits to their employees with the use of a Simple Cafeteria Plan. This is designed to ease the administrative burden of sponsoring a cafeteria plan. It will exempt employers who make contributions for employees under a simple cafeteria plan from the pension plan nondiscrimination requirements applicable to highly compensated and key employees.

Health Savings Account (HSA) holders making withdrawals from their accounts prior to age 65 and not using those funds for qualified medical expenses will have the additional tax paid on withdrawals increase from 10 to 20 percent. Similar withdrawals from an Archer MSA will see an increase in additional tax from 15 to 20 percent.

There will be an annual fee assessed on the pharmaceutical manufacturing industry based on market share.

## **2013**

Individuals with earned income of more than \$200,000 for the year (\$250,000 for married couples) will see an increase in the amount that they contribute to the Medicare program. This payroll tax will increase from the current 1.45 percent to 2.35 percent. They will also begin to pay 3.8 percent into the Medicare program on their net investment income.

Some tax breaks designed around medical costs will be reduced. The Flexible Spending Arrangement plans (FSAs) pre-tax contribution limit will be reduced to \$2,500 but will be indexed by the consumer price index in subsequent years.

Taxpayers, who have been including their medical costs as itemized deductions on their federal tax returns, will see the threshold of eligible costs increase from 7.5 to 10 percent of their adjusted gross income. However, individuals over 65 would be able to claim the itemized deduction for medical expenses at the 7.5 percent rate through 2016.

A 2.3 percent excise tax on first sales for use of medical devices with the exception of the types that are generally purchased by the public for personal use, such as eyeglasses, contact lenses and hearing aids.

## **2014**

The states will be charged with the responsibility of acting as the national health insurance enrollment vehicles. The health care reform package requires each state to establish an American Health Benefit Exchange by 2014 to bring help to the individual health insurance market. The exchanges will provide assistance to people in need of individual health insurance options by screening for the Children's Health Insurance Program and Medicaid programs, and if eligible, will assist with enrollment. Eligibility for cost-sharing reductions or premium assistance tax credits for individuals will also be available. The group (employer) market will be served by state exchanges to be known as Small Business Health Options Programs (SHOP). Qualified employers will be able to use the exchanges to comparison shop for health insurance coverage for their employees. The exchanges are to utilize standardized formats for presenting the benefit options of participating health insurance programs.

The small employer's tax credit will increase to 50 percent of the premiums paid for employees for two years after 2013, if the employer participates in an insurance exchange.

Employers with more than 50 workers who do not offer insurance, and any of its full-time workers obtain subsidized coverage through the states' insurance exchanges, will be required to pay annual fees of \$2,000 for each full-time employee, excluding the first 30 employees from the calculation.

Individuals with earnings up to 400 percent of the poverty level (a family of four making less than \$88,000 annually in today's dollars) will be eligible to receive subsidies to purchase insurance from the state-run health insurance exchanges, in the event that their

employers do not provide coverage. The income level will be taken into account when determining if the individual qualifies for premium assistance through tax credits, cost-sharing or vouchers.

Individuals not covered by a qualified employer plan will be required to obtain acceptable health insurance coverage or pay a penalty of \$95 in 2014, with increases up to a cap of 2.5 percent of income in 2016. After 2016, the dollar amounts will be indexed.

People can apply for a hardship waiver for not carrying health insurance coverage. If affordable coverage remains unavailable to an individual, they will not be penalized.

Health insurance providers will be assessed a new fee on their net premiums. The aggregate fee imposed on all entities will be \$8 billion in 2014, increasing annually to \$14.3 billion by 2018 and thereafter, indexed to the rate of premium growth. The fee will be apportioned annually, based upon an insurer's market share.

## **2018**

The employer-sponsored health coverage insurance offering the highest level of benefits, often referred to as "Cadillac policies" will now have a 40 percent excise tax imposed upon their cost. Employers may seek to either pass the tax through to the employee or lower the amount of benefits in the plan below the high-value plan limits. The threshold for imposing the tax is \$10,200 in annual premiums for self-only plans and \$27,500 for family coverage.

Over the course of the next few months, the IRS and other federal agencies will be filling in details on how to comply with all the provisions under the massive health care reform package. The IRS is expected to issue guidance soon on the provisions with effective dates in 2010 and 2011. We will be staying on top of all developments, please visit the newsletter section of our website at [www.bssf.com](http://www.bssf.com).

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