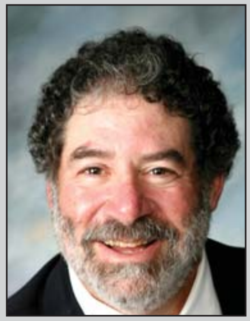
The 2010 Health Care Mandate

Understand the Many Ways It Can Impact Your Bottom Line

By BRUCE M. FOGEL, Esq.

Everybody knows that the government is out of money and needs to raise cash. However, do you understand the financial impact that the 2010 health care legislation will have on your family?

This isn't just about everybody being required to carry health insurance. It is much more. The government is using this legislation as a revenue builder, and you will be paying the bill. So what will your cost be?



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Individual Mandate

The new federal law requires that non-exempt individuals must maintain qualifying health-insurance coverage for themselves and their dependents or face a tax penalty after 2013. Similar to Massachusetts law, those without qualifying health coverage will be required to pay a tax penalty. The federal penalty will be the greater of: (a) $695 per year, up to a maximum of three times that amount, or $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 according to the following schedule: $95 in 2014, $325 in 2015, and $695 in 2016 for the flat fee; or 1.0% of taxable income in 2014, 2.0% of taxable income in 2015, and 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 available for a variety of reasons, including but not limited to, financial hardship, those without coverage for less than three months, illegal aliens, prisoners, those for whom the lowest cost plan option exceeds 8% of household income, and those with incomes below the tax-filing threshold (in 2011 the threshold for taxpayers under age 65 is $9,500 for singles and $19,000 for couples).

Premium Assistance Tax Credits for Purchasing Health Insurance

A refundable tax credit is available to certain individuals who are not eligible for Medicaid, employer-subsidized health insurance, or other acceptable health coverage, and who get health insurance by enrolling in a qualified health plan through a state-run insurance exchange for tax years after 2013. While the credit generally will be payable directly to the insurer, individuals can elect to purchase health insurance out of pocket and then claim the credit on their Form 1040.

Based on the information provided to the exchange, the individual receives a premium-assistance credit based on income, and IRS pays the premium-assistance credit amount directly to the insurance plan in which the individual is enrolled. The individual then pays to the plan in which he or she is enrolled the dollar difference between the premium-assistance credit amount and the total premium charged for the plan. For employed individuals who purchase health insurance through an exchange, the premium payments are made through payroll deductions.

The premium-assistance credit will be available for individuals and families with incomes 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) who are not eligible for Medicaid, employer-sponsored insurance, or other acceptable coverage.

Higher Medicare Taxes on High-income Taxpayers

High-income taxpayers will be subject to a tax increase on wages and a new levy on investments as well.

Higher Medicare Payroll Tax on Wages

Under current law, wages are subject to a 2.9% Medicare payroll tax with employees and employers paying 1.45% each. Self-employed people pay both halves of the tax, but are allowed to deduct half of this amount for income-tax purposes. While the payroll tax for Social Security applies to earnings up to an annual ceiling ($106,800 for 2011 and increasing to $110,100 for 2012), the Medicare tax is levied on all earnings without limit.

Under the provisions of the new law, which goes into 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 required to pay an additional 0.9% (2.35% in total) on the excess over those base amounts. Self-employed individuals will pay 3.8% on earnings over the threshold.

Medicare Payroll Tax Extended to Investments

As part of the revenue-generation aspect of the new laws, beginning in 2013, a Medicare tax will, for the first time, be applied to net investment income. A new 3.8% tax will be imposed on such income of single taxpayers with adjusted gross income above $200,000, and joint filers over $250,000. Net investment income includes interest, dividends, royalties, rents, gross income from a trade or business involving passive activities, and net gain from disposition of property (other than most property held in a trade or business) reduced by properly allocable deductions to such income.

The new tax is intended to apply only to income in excess of the $200,000/$250,000 thresholds. For example, if a couple earns $200,000 in wages and $100,000 in capital gains, $50,000 will be subject to the new tax ($300,000 minus $250,000).

Additionally, while not directly applicable to individuals, this new tax is also applicable to estates and trusts. In such situations, the tax is 3.8% of the lesser of (a) undistributed net investment income, or (b) the excess of AGI over the dollar amount at which the highest estate- and income-tax bracket begins.

Threshold for Medical-expenses Deduction Raised

Under current law, taxpayers can include in their itemized deductions unreimbursed medical expenses for regular income-tax purposes (not AMT) only to the extent that those expenses exceed 7.5% of the taxpayer's AGI.

As noted, the new law raises the threshold for itemized medical expense deductions from 7.5% of AGI to 10%, effective for tax years beginning after Dec. 31, 2012. However, it should be noted that the threshold for individuals age 65 and older (and their spouses) will remain unchanged at 7.5% through 2016.

Reimbursement Limited for Some OTC Medications

Qualified medical expenses, which are expenses that can be reimbursed tax-free through a health reimbursement account (HRA), health flexible savings account (FSA), health savings account (HAS), or Archer Medical Savings Account (MSA), no longer include over-the-counter medicines (except for insulin, which continues to qualify), unless prescribed by a doctor, effective for tax years beginning after Dec. 31, 2010.

Increased Penalties on Non-qualified Distributions from HSAs and Archer MSAs

The penalty tax on distributions from a health savings account or an Archer MSA that are not used for qualified medical expenses has been increased to 20% (from 10% for HSAs and from 15% for Archer MSAs) of the disbursed amount, effective for distributions made after Dec. 31, 2010.

FSAs Limited to $2,500

An FSA is one of a number of tax-advantaged financial accounts that can be set up through a cafeteria plan of an employer. It allows an employee to set aside a portion of his or her earnings to pay for qualified expenses as established in the cafeteria plan, most commonly for medical expenses, but often for dependent care or other expenses. Under current law, there is no limit on the amount of contributions to an FSA. Under the new law, however, allowable contributions to health FSAs will be capped at $2,500 per year, effective for tax years beginning after Dec. 31, 2012. The dollar amount will be indexed for inflation after 2013.

Dependent Coverage in Employer Health Plans

Effective as of March 30, 2010, the new law extended the general exclusion for reimbursements for medical-care expenses under an employer-provided accident or health plan to any child of an employee who has not attained age 27 (whether they qualify as a dependent or not) as of the end of the tax year.

This change is also intended to apply to the exclusion for employer-provided coverage under an accident or health plan for injuries or sickness for such a child. A parallel change is made for voluntary employee benefit associations (VEBAs) and 401(h) accounts. Also, self-employed individuals are permitted to take a deduction for the health insurance costs of any child of the taxpayer who has not attained age 27 as of the end of the tax year.

Excise Tax on Tanning Services

The new law imposes a 10% excise tax on indoor tanning services. The tax, which will be paid by the individual on whom the tanning services are performed, but collected and remitted by the person receiving payment for the tanning services, will take effect July 1, 2010.

Liberalized Adoption-credit and Adoption-assistance Rules

For tax years beginning after Dec. 31, 2009, the adoption tax credit is increased by $1,000, made refundable, and extended through 2011. The employer-provided adoption-assistance exclusion is also increased by $1,000.

Bottom Line

These are some of the highlights of the 55-page health care legislation that was signed into law by President Obama on March 30, 2010. It affects every American citizen to varying financial degrees and phases, in different aspects, at various timeframes. If you have questions about how it will affect your family, it would be wise to consult with your tax advisor. ■

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