Tax Impact of Health Care Reform Act

In this tax update for small businesses and high net worth individuals, we focus on the tax impacts of health care reform. The Patient Protection and Affordable Care Act of 2010 included three major provisions which will impact our clients in the near term: the 3.8% Medicare surtax on net investment income; the additional 0.9% tax on the Medicare portion of payroll and self-employment taxes in excess of $200,000, or $250,000 if married filing jointly; and the impact on businesses and owners of the health insurance minimum coverage mandate that will be effective January 1, 2014.

The Medicare surtax, effective January 1, 2013, is designed to affect "high-income" taxpayers, who are defined as individuals with modified adjusted gross income (MAGI) of more than $200,000, or $250,000 if married filing jointly. The Medicare surtax is imposed on the lesser of net investment income or the excess (if any) of MAGI over the threshold amounts above. The Medicare surtax also applies to estates and trusts. It is important to note that even though certain items are not considered net investment income, they still can trigger the Medicare surtax by increasing your MAGI above the threshold amounts.

<u>Year</u>	<u>Changes in Effect</u>
Now	Small business health care tax credit
	New simplified cafeteria plan for small businesses
	Dependent coverage to child under 27
	Increased penalty on non-qualified distributions from HSA/MSA
	No FSA/HSA OTC drug reimbursement
	W-2 reporting of health insurance
2013	**Medicare tax on high earned income**
	Medicare tax on investment income
	Medical itemized deduction threshold increased to 10% (under age 65)
	$2,500 annual limit on health FSA contributions
2014	**Individual health insurance minimum essential coverage mandate**
	Employer penalties
	Free choice vouchers
	State exchanges
2017	Medical itemized deduction threshold increased to 10% (all taxpayers)
2018	Excise tax on high cost health plans

Investment income:

- Interest, dividends, royalties, annuities and rents
- Income derived from passive activities
- Income derived from trading financial instruments and commodities
- Net capital gains derived from the disposition of property (other than property held in an active trade or business)

NOT investment income:

- Active trade or business income
- Gain on sale of an active interest in a partnership or S corp
- Distributions from IRAs or qualified retirement plans
- Income from tax-exempt municipal bonds
- Tax deferred non-qualified annuities
- Income taken into account for self-employment purposes
- Portion of capital gain on the sale of a principal residence that is excluded from income under IRC Section 121

SWEENEY CONRAD, P.S.
certified public accountants
and business advisors

Tax Impact of Health Care Reform Act

Key Provisions of Health Care Reform

Individuals

- Individuals not otherwise eligible for Medicaid or Medicare or other government-sponsored coverage will be subject to penalties if they do not maintain qualifying medical insurance beginning in 2014. The penalty will phase in, reaching the greater of $695 or 2.5% of income in 2016.
- Premium assistance tax credits and reduced cost sharing will be available to qualified individuals on a sliding scale after 2013.
- Individuals are subject to an additional 0.9% Medicare tax on earned income in excess of $200,000 ($250,000 for families) beginning in 2013.
- Individuals with adjusted gross income (AGI) above $200,000 ($250,000 for families) are subject to a new 3.8% Medicare tax on investment income beginning in 2013. Investment income includes dividends, interest, royalties, rents, gains, and passive activity income, but excludes distributions from retirement plans. The $200,000/$250,000 amounts are not indexed for inflation.
- Spending limits for flexible spending accounts (FSA) are reduced to $2,500 (indexed for inflation) after 2012.
- Penalties on disqualified medical expense withdrawals from health savings accounts (HSA) after December 31, 2010, are increased to 20%.
- Nontaxable over-the-counter drug reimbursements from medical spending accounts are eliminated, after December 31, 2010, unless prescribed by a physician.
- The threshold for medical expense deductions is increased from 7.5% of AGI to 10% after 2012 (after 2016 for individuals age 65 or older).
- The age of unmarried children who qualify for dependent coverage increases to 26 beginning after March 30, 2010.
- Medicaid eligibility is expanded, beginning in 2014.

Businesses

- Large and mid-size employers (i.e., employers with 50 or more employees) that fail to offer qualifying medical insurance to a full-time employee who has enrolled in a subsidized plan using the premium assistance tax credit or cost-sharing reductions will be subject to a tax of $2,000 per employee. Additional penalties may apply if waiting-period restrictions are imposed. Applies for months beginning after December 31, 2013.
- Certain small employers with less than 25 employees and an average annual wage of less than $50,000 will be eligible for a tax credit for nonelective contributions to purchase health insurance for their employees, beginning after December 31, 2009.
- Certain small businesses can provide a new employee benefit cafeteria plan (SIMPLE Cafeteria Plan) that provides tax-free benefits to employees, including self-employed individuals, beginning after 2010.
- Employer-sponsored health insurance coverage must be reported on the employees' W-2s beginning in 2011.
- Qualified small businesses will be able to buy insurance through state-based Web portals to be known as Small Business Health Options Programs (SHOP) after 2013.
- The deduction for the subsidy for employers who maintain prescription drug plans for their Medicare Part D-eligible retirees will be eliminated after 2012.
- If essential coverage requirements are not met, a new $500,000 deduction limit on executive compensation applies to payments to insurance providers after 2012.