HONIGMAN

Health Care Reform Alert

July 1, 2010

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New Taxes, Tax Credits/Subsidies and Other Tax Obligations - For Individuals

The recently enacted Affordable Care Act (ACA) imposes various new taxes and provides new tax credits/subsidies for both high and low income individuals. Employers will, however, need to be aware of how these work. These are:

Taxes

- An additional 0.9% Medicare tax will be imposed only on the employee's share of wages for employees whose wages exceed $200,000 per year (increasing the tax rate from 1.45% to 2.35%). This same rule applies to those who are self-employed. For joint returns, the increase will be imposed on combined incomes over $250,000. Though imposed only on the employee's share of this tax, the employer is obligated to withhold this additional amount, and if for joint returns, the withholding amount proves inadequate, the additional payment must be remitted with the taxpayer's Form 1040 (effective for tax years beginning on or after January 1, 2013).
- An additional 3.8% surtax will be imposed on the lesser of (i) net investment income, or (ii) the excess of the taxpayer's Form 1040 modified AGI over a threshold of $200,000 or $250,000 if married filing jointly. Net investment income includes interest, dividends, annuities, royalties and rents. Active business income, interest income and working capital income attributable to active business ownership, distributions from qualified retirement plans and IRAs, self-employed income, tax exempt income and other non-taxable gains are excluded from the definition of net investment income. Estate and trust income, however, is subject to this surtax (effective for tax years beginning on or after January 1, 2013).
- The penalty for withdrawals from HSAs and Archer MSAs that are not used to pay for medical expenses is increased from 10% to 20% (effective for expenses incurred on or after January 1, 2011).
- The threshold for claiming an itemized deduction for unreimbursed medical expenses increases from 7.5% of AGI to 10%. For taxpayers 65 or older or whose spouse is 65 or older, the threshold remains at 7.5% until 2017.
- Salary reduction contributions to health care FSAs are capped at $2,500 (effective for plan years beginning on or after January 1, 2012).

- Individuals who fail to maintain “minimum essential coverage,” or who have a family member who does not have such coverage, for one or more months during a taxable year will be subject to a tax penalty equal to the lesser of (i) the sum of the monthly penalty amounts for the months in which the failure occurred, and (ii) the national average premium for bronze-level qualified health plans available through a State Insurance Exchange.

  With some exception, the penalty will not be imposed for gaps in coverage lasting less than three months. The monthly penalty amount will be 1/12 of the greater of (i) the sum of the applicable dollar amounts for all individuals for whom failures occurred during the month (or 300% of the applicable dollar amount, if less), and (ii) 2% of household income (phases in beginning at 1% in 2014). The applicable dollar amount is $95 in 2014 and increasing to $695 in 2016, and indexed for inflation thereafter, but this amount is cut in half (except for purposes of calculating the 300% limit) for individuals who are under age 18. “Minimum essential coverage” is employer-provided coverage other than excepted benefits, individual health insurance coverage, grandfathered plans, coverage under Medicare, Medicaid, TRICARE, CHIP, other veterans coverage, Peace Corps coverage, or any other coverage recognized as minimum essential coverage by the Secretary of the DHHS in coordination with the Secretary of the Treasury (effective for tax years beginning on or after January 1, 2014).

- A 10% tax is imposed on indoor tanning services performed on or after July 1, 2010.

Tax Credits/Subsidies

- Tax-free coverage for adult children up to the last day of the calendar year in which they turn 26 (effective as of March 30, 2010).

- Employees whose household income is between 100% and 400% of the federal poverty level (FPL) are eligible for a refundable tax credit for coverage purchased for themselves and/or their family through a State Insurance Exchange. The amount of the credit is based on the cost of the second lowest cost silver plan available to them and/or their family on the Exchange. Individuals who are eligible for minimum essential coverage under a plan other than an individual plan are not eligible for the credit, provided this other coverage is (i) affordable (*i.e.*, the employee’s share of the premium cost does not exceed 9.5% of his/her household income), and (ii) the plan’s share of the costs of benefits is at last 60% (*i.e.*, equal to bronze level coverage on the Exchange), or the individual and any family member is actually covered under such plan.

- Insurers on the Exchange must reduce the out-of-pocket limit for an individual enrolled at the silver level of coverage, if their household income is between 100% and 400% of the FPL and they are eligible for a premium tax credit. The out-of-pocket subsidy is based on a sliding scale depending on the percentage of FPL the household income comes in at.
- For 2010 and 2011, the dollar limit for the adoption credit and income exclusion for employer-paid or employer-reimbursed adoption expenses through a qualified adoption assistance program is increased by $1,000 to $13,170 per child, including special needs children.

Other Tax-Related Items

- The IRS may report to the Secretary of the DHHS individual income tax information to determine the eligibility for premium credits, cost sharing reductions, and participation in state Medicaid and CHIP programs or coverage under an Exchange.

Action Steps

Employers must be aware of which of their employees might be eligible for the newly created insurance premium and out-of-pocket subsidies, as these may affect the extent to which the employers may be penalized should their employees qualify for and obtain coverage under State Insurance Exchanges.

Higher income individuals also must plan for potentially increased taxes, and should consult their financial planners about their impact and how to avoid or minimize their impact.

If you have any questions about these new taxes, and tax credits/subsidies or any of the other changes imposed by the ACA, please contact any of the Honigman attorneys listed on this Alert.