



## Sensiba San Filippo: Healthcare Reform 2010

### *Summary of Reform Impact on Individuals and Employers*

The Patient Protection and Affordable Care Act signed into law by President Obama on March 23, 2010 coupled with the modifications in the Health Care and Education Reconciliation Act of 2010 signed into law on March 30, 2010 complete a massive overhaul of the U.S. health care system and have many significant new provisions affecting both individuals and employers. As the largest expansion of federal health care guarantees in more than four decades, these new requirements and tax impacts will go into effect as soon as mid-2010. To help gauge the impact of these changes, we've highlighted the new requirements and tax impacts to individuals (starting here on page 1) and employers (starting on page 4).

### Individuals

**Individual mandate.** The new law contains an "individual mandate"—a requirement that U.S. citizens and legal residents have qualifying health coverage or be subject to a tax penalty after 2013, by either electing coverage under their employer, or by purchasing an individual plan through a state run Health Benefit Exchange ("Exchange"), where individuals not covered by employers' plans can shop for health insurance at competitive rates. Under the new law, those without qualifying health coverage will pay a tax penalty amounting to the greater of:

- (a) \$695 per year, up to a maximum of three times that amount (\$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 between 2014 and 2016, and exemptions are granted for reasons including financial hardship, religious objections, short term non-compliance, American Indians, aliens not lawfully present in the U.S., incarcerated individuals and those residing outside of the U.S.

**Premium assistance tax credits for purchasing health insurance.** The health care legislation provides tax credits to low- and middle-income individuals and families for the purchase of health insurance. Specifically, for tax years ending after 2013, the new law creates a refundable tax credit (the "premium assistance credit") for eligible individuals and families who purchase health insurance through the Exchange. The premium assistance credit, which is refundable and payable in advance directly to the insurer, subsidizes the purchase of certain health insurance plans through the Exchange.

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) that are not eligible for Medicaid, employer sponsored insurance, or other acceptable coverage. The credits will be available on a sliding-scale basis.





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**Higher Medicare taxes for high-income taxpayers.** High-income taxpayers will be subject to a tax increase on wages and a new levy on investments.

*Higher Medicare payroll tax on wages.* The Medicare payroll tax is the primary source of financing for Medicare's hospital insurance trust fund, which pays hospital bills for beneficiaries 65 and older or who are disabled. Under current law, wages are subject to a 2.9% Medicare payroll tax - workers and employers each pay 1.45%. Under the new law, effective 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 taxed at an additional 0.9% (2.35% in total) on the excess over those base amounts. Self-employed persons will pay 3.8% on earnings over these thresholds.

*Medicare payroll tax extended to investments.* Under current law, the Medicare payroll tax only applies to wages. Beginning in 2013, the Medicare tax will, for the first time, be applied to investment income. A new 3.8% tax will be imposed on net investment income in excess \$200,000 for single filers and \$250,000 for taxpayers filing joint returns.

**Floor on medical expenses deduction raised from 7.5% of adjusted gross income (AGI) to 10%.** Under current law, taxpayers can take an itemized deduction for unreimbursed medical expenses for regular income tax purposes to the extent that those expenses exceed 7.5% of the taxpayer's AGI. The new law raises the floor beneath itemized medical expense deductions from 7.5% of AGI to 10%, effective January 1, 2013. The AGI floor for individuals age 65 and older (and their spouses) will remain unchanged at 7.5% through 2016.

**Limit reimbursement of over-the-counter medications from HSAs, FSAs, and MSAs.** The new law excludes the costs for over-the-counter drugs not prescribed by a doctor from being reimbursed through a health reimbursement account (HRA) or health flexible savings accounts (FSAs) and from being reimbursed on a tax-free basis through a health savings account (HSA) or Archer Medical Savings Account (MSA), effective in tax years beginning on or after January 1, 2011.

**Increased penalties on nonqualified distributions from HSAs and Archer MSAs.** The new law increases the tax on distributions from a health savings account or an Archer MSA that are not used for qualified medical expenses to 20% (from 10% for HSAs and from 15% for Archer MSAs) of the disbursed amount, effective for distributions made after Dec. 31, 2010.





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**Limit health flexible spending arrangements (FSAs) to \$2,500.** 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.

**Extended dependent coverage in employer health plans.** Effective Mar. 30, 2010, the new law extends 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 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.

**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 adoption assistance exclusion is also increased by \$1,000.





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### Employers

The recently enacted health overhaul legislation requires certain employers to offer and contribute to the health care insurance of their employees, or face paying a penalty. Under the new law, effective for months beginning after Dec. 31, 2013, a large employer (see definition below) that does not offer coverage for all of its full-time employees, offers minimum essential coverage that is unaffordable, or offers minimum essential coverage that consists of a plan under which the plan's share of the total allowed cost of benefits is less than 60%, is required to pay a penalty if any full-time employee is certified to the employer as having purchased health insurance through an Exchange with respect to which a tax credit or cost-sharing reduction is allowed or paid to the employee. Here are the details:

**Health insurance employer mandate – who is subject to it?** Only an “applicable large employer,” defined as having employed an average of at least 50 full-time employees during the preceding calendar year, is subject to the requirement to offer coverage. However, even an employer with 50 or more employees is not subject to the penalty for not offering coverage if the employer does not have any full-time employees who are certified to the employer as having purchased health insurance through an Exchange with respect to which a tax credit or cost-sharing reduction is allowed or paid to the employee.

*Penalty for employers not offering coverage.* An applicable large employer who fails to offer its full-time employees and their dependents the opportunity to enroll in minimum essential coverage under an employer-sponsored plan for any month is subject to a penalty if at least one of its full-time employees is certified to the employer as having enrolled in health insurance coverage purchased through an Exchange with respect to which a premium tax credit or cost-sharing reduction is allowed or paid to the employee. The penalty, assessed monthly, is an excise tax equal to the number of full-time employees over a 30-employee threshold during the applicable month (regardless of how many employees are receiving a premium tax credit or cost-sharing reduction) multiplied by one-twelfth of \$2,000.

*Penalty for employers that offer coverage but have at least one employee receiving a premium tax credit.* An applicable large employer who offers coverage but has at least one full-time employee receiving a premium tax credit or cost-sharing reduction is subject to a penalty - an excise tax is imposed for each of the above aforementioned employees. For each full-time employee receiving a premium tax credit or cost-sharing subsidy through an Exchange for any month, the employer is required to pay an amount equal to one-twelfth of \$3,000. The penalty for each employer for any month is capped at an amount equal to the number of full-time employees during the month (regardless of how many employees are receiving a premium tax credit or cost-sharing reduction) in excess of 30, multiplied by one-twelfth of \$2,000.





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**Requirement to offer “free choice vouchers.”** After 2013, employers offering minimum essential coverage through an eligible employer-sponsored plan and paying a portion of that coverage will have to provide qualified employees with a voucher whose value could be applied to purchase a health plan through the Exchange. Qualified employees would be those employees:

- (a) who do not participate in the employer's health plan;
- (b) whose required contribution for employer sponsored minimum essential coverage exceeds 8%, but does not exceed 9.8% of household income; and
- (c) whose total household income does not exceed 400% of the poverty line for the family.

The value of the voucher would be equal to the dollar value of the employer contribution to the employer offered health plan. **Employers providing free choice vouchers will not be subject to penalties for employees that receive a voucher.**

**Tax credits to certain small employers that provide insurance.** The new law provides small employers with a tax credit (i.e., a dollar-for-dollar reduction in tax) for nonelective contributions to purchase health insurance for their employees. The credit can offset an employer's regular tax or its alternative minimum tax (AMT) liability.

*Small business employers eligible for the credit.* To qualify, a business must offer health insurance to its employees as part of their compensation and **contribute at least half the total premium cost.** The business must have no more than 25 full-time equivalent employees (“FTEs”), and the employees must have annual full-time equivalent wages that average no more than \$50,000. The full amount of the credit is available only to an employer with 10 or fewer FTEs and whose employees have average annual full-time equivalent wages from the employer of less than \$25,000.

*Years the credit is available.* The credit is initially available for any tax year beginning in 2010 through 2013. Qualifying health insurance for claiming the credit for this first phase of the credit is health insurance coverage purchased from an insurance company licensed under state law. For tax years beginning after 2013, the credit is only available to an eligible small employer that purchases health insurance coverage for its employees through an Exchange and is only available for two years. The maximum two-year coverage period does not take into account any tax years beginning before 2014. Thus, an eligible small employer could potentially qualify for this credit for six tax years - four years under the first phase and two years under the second phase.





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*Calculating the amount of the credit.* For tax years beginning in 2010 through 2013, the credit is generally 35% (50% for tax years beginning after 2013) of the employer's nonelective contributions toward the employees' health insurance premiums. The credit phases out as firm size and average wages increase.

*Special rules.* The employer is entitled to an ordinary and necessary business expense deduction equal to the amount of the employer contribution minus the dollar amount of the credit. For example, if an eligible small employer pays 100% of the cost of its employees' health insurance coverage and the amount of the tax credit is 50% of that cost (i.e., in tax years beginning after 2013), the employer can claim a deduction for the other 50% of the premium cost.

Self-employed individuals, including partners and sole proprietors, two percent shareholders of an S corporation and five percent owners of the employer are not treated as employees for purposes of this credit.

**Most small businesses exempted from penalties for not offering coverage to their employees.** Although the new law imposes penalties on certain businesses for not providing coverage to their employees, most small businesses won't have to worry about this provision because employers with fewer than 50 employees aren't subject to the penalty.

**The "Cadillac tax" on high-cost health plans.** The new law also places an excise tax on high-cost employer-sponsored health coverage (often referred to as "Cadillac" health plans). This tax comes in the form of a 40% excise tax on the insurance companies, based on premiums that exceed certain amounts. **The tax is not on employers themselves** unless they are self-funded (this typically occurs at larger firms). However, it is expected that employers and employees will ultimately bear this tax in the form of higher premiums passed on by insurers. The tax, which applies for tax years beginning after January 1, 2018, is placed on insurance companies and plan administrators for any health coverage plans whose annual premiums exceed \$10,200 for single coverage and \$27,500 for family coverage.

For more information and detail about how these new provisions may affect you or your business, please contact your SSF partner or email us at [info@ssfilp.com](mailto:info@ssfilp.com).

