Outline of Tax Aspects of Health Care Reform Act (HCRA)

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I. Outline abbreviations:

A. Exchange – State-based health insurance exchange to allow small business and individual purchasers to get the same rates as large groups
B. MEC – Minimum Essential Coverage
C. PPA – Patient Protection Act
D. HCRA – Health Care Reform Act
E. HC – Health Coverage
F. FPL – Federal Poverty Level (Fam. of four = $22,050)
G. HI – Hospital Insurance also called “Medicare”
H. FTE – Full Time Employee(s)

II. Not provided in HCRA, but widely discussed:

A. Single Payer System

B. Government-Sponsored Health Care Insurance Co.

C. Abortion Coverage

D. Universal Coverage

III. Immediate 2010 changes.

A. Small Business Employer (defined later) possible Insurance Tax Credit

B. Temporary high risk pools for individuals with pre-existing conditions. [PPA § 1101, adding 42 USC § 1101] VA on “hold” for now, per VA Senator Barker comments on 5/7/10. Why?

1. No Fed. guidelines yet
2. No Fed. Funding
3. No VA funds

C. Temporary re-insurance for Employer plans that cover early retirees (not yet on Medicare). [PPA § 1102, 42 USC § 1102]

D. No discrimination re children with pre-existing conditions. Eventually extended to everyone. *See* IRC § 9815
(Joint Committee on Taxation Tech Exp. p. 49-50)

E. Ban on lifetime limits and recession of coverage on all existing health plans. Begins 6 months from signing – Sept. 2010. [PPA § 1001, adding 42 USC § 2711 & § 2712]

F. Coverage for adult-children under 27. Starts 6 months from signing – Sept. 2010. Some insurance companies already allowing coverage. [PPA § 1001, adding 42 USC § 2714] (More on this later.)

G. $250 rebate to Medicare beneficiaries affected by "donut hole." Phase-out of donut hole begins; fully closed by 2020.

H. The November 2010 elections and Republican repeal attempts.

I. Virginia's and other states' constitutional challenges. Per Sen. Barker and Del. Bob Marshall, only a challenge to the required purchase of health insurance by individuals.

IV. Small Business Credit – 25 Employees or less.

A. Starting in 2010, <u>THIS YEAR</u>, there will be a Small Business Employer tax credit. (Tech. Exp. p. 26-30) [IRC § 45R]

B. What is small? 25 Employees or less with average wages of no more than $50,000.

C. Small Employer must contribute at least <u>50% (one-half</u>) of health insurance premium costs for participating Employees.

D. 2010 to 2012 – credit of up to 35% of premium costs.

E. After 2013, possible 50% credit for 2 years if Employer offers insurance through an Exchange.

F. Amount of credit is 35% of the lesser of premiums paid by Employer or the premiums that would have been paid if each Employee premium equaled average premium for small business group market in state.

G. For tax-exempt employers, credit is up to 25%, unless payroll taxes are smaller, and is refundable to the entity.

H. 2% owners of S corporations and certain others not counted as "Employees."

V. Quite Small Employer – 10 Employees or less.

A. Full credit if average Employee annual wage is $25,000 or less.

B. If between 10 and 25 Employees and average annual wages $26,000 to $50,000, then credit pro-rated.

C. Example from IRS:

1. ABC, Inc. – For tax year 2010, ABC, Inc. a qualified Employer, has 9 Employees, with avg. annual wages of $23,000 per FTE. The Employer pays $72,000 (which does not exceed the avg. premium for the small group market in the Employer's state [what if the state has no small group market?]) and otherwise meets the requirements for the credit. The credit for 2010 equals $25,200 (35% x $72,000).

D. Credit Reduction:

1. If FTEs exceed 10, the reduction is determined by multiplying the otherwise available credit by a fraction, the numerator of which is the number of FTEs in excess of 10 and the denominator of which is 15.

2. If avg. annual wages exceed $25,000 the reduction is determined by multiplying the otherwise available credit by a fraction, the numerator of which is avg. annual wages in excess of $25,000 and the denominator or which is $25,000.

E. Example of Credit Reduction.

1. XYZ, Inc. has 12 FTEs in 2010 and avg. wages of $30,000. It pays $96,000 in premiums. The credit reduction is computed as follows:

a. *Initial amount of credit determined before any reduction: (35% x $96,000) = $33,600.*

b. *Credit reduction for FTEs in excess of 10: ($33,600 x 2/15 [or 13.33%]) = $4,480.*

c. *Credit reduction for avg. annual wages over $25,000: ($33,600 x $5,000/$25,000 [or 20%]) = $6,720.*

d. *Total credit reduction: ($4,480 + $6,720) = $11,200.*

e. *Total 2010 tax credit: ($33,600 - $11,200) =* ***<u>$22,400.</u>***

F. Premiums paid before the HCRA passed in 2010 can by used to calculate the credit.

G. The credit (against income tax) can be carried forward for 20 years but not back.

H. Employer's deduction for insurance premiums is reduced by the amount of the credit.

VI. Adult Children Coverage.

A. Coverage allowed on parents policy under age 27.

B. Same for self-employed.

C. Per NPR on April 20, 2010, Two major insurers – Wellpoint (BC/BS, 33 million) and United Healthcare (24 million) – are starting immediately on this coverage instead of waiting until some future date. Per CCH, Par. 242, effective as of Mar. 30, 2010.

D. "Child" defined in IRC § 152(f)(1) as son, daughter, stepson or daughter, legally adopted, and some foster children.

E. Benefits from adult child coverage excluded from income of parents.

VII. Indoor Tanning Tax.

A. 10% excise tax on indoor tanning services after 7/1/2010; to be paid by customers and remitted to IRS by tanning salon. [IRC § 5000B]

B. The duty to collect and remit to the IRS will probably be similar to the duties of "responsible parties" for "trust fund" withholding taxes.

VIII. 2010 HRCA provisions not in this Outline.

A. Hire Act incentives for Employers to hire the unemployed.

B. Adoption Credit increased and is now refundable. As of 2010, the credit is $12,170 per year.

C. Student loan reforms – private lenders out; program will be administered by Fed. Dept. of Educ.

2011
Certain Provisions effective in 2011

IX. Remember 2001 and Pres. George W. Bush. The magic wand "10 year projections" expire at the end of 2010 and income tax and estate tax rates will increase unless Congress acts. Should income be accelerated into tax year 2010 if possible? Advice – do the numbers before acting.

X. Planning ahead – Should you die in 2010, the year of no estate tax? What if you die in 2010 and estate tax is made retroactively effective to Jan. 1, 2010? Should you then come back to haunt Congress?

XI. Over the Counter Drugs. (Tech Exp. p. 69)

A. FSAs, HSAs, HRAs, MSAs, RRAs
1. Flexible Spending Account (FSA)
2. Health Savings Account (HSA)
3. Health Reimbursement Account (HRA)
4. Archer Medical Savings Account (MSA)
5. Retiree Reimbursement Account (RRA)

B. Under some of the above plans (FSA, HSA, HRA, & MSA) purchases of over the counter (non-prescription) medicines were tax-free benefits. In 2011, such medicines are not tax-free benefits – unless – a physician prescribes them. Exception, insulin medicine.

XII. Penalty for FSA and MSA non-prescription distributions (i.e. patent medicines). [IRC § 105, § 106, § 220, § 223] (Tech Exp. p. 71-73)

A. Currently 10% HSA; 15% MSA unless owner 65 years of age or older.

B. In 2011, penalty increases to 20% for all plans if owner younger than 65.

C. Note, both the 20% penalty distributions for non-prescription medicines (except insulin) apply <u>plus</u> the additional tax.

XIII. Reporting of Health Benefits.

A. Starting for tax years beginning after 2010, that is 2011, Employers must show on the Employees W-2, the value of health benefits. [IRC § 6051]

B. First W-2s affected will be the ones issued in Jan. 2012 it is believed. Tax-free treatment of health benefits to Employees will remain the same.

XIV. SIMPLE Cafeteria Plans.

A. Because of non-discrimination rules smaller Employers have been reluctant to offer cafeteria plans because highly compensated Employees and key Employees (often the owners of the business) can't participate.

B. Beginning in 2011, rules will be relaxed to encourage small Employer (one to 100 FTEs) to offer cafeteria plans. Non-discrimination rules relaxed. [IRC § 125(j)]

C. Must cover all Employees with 1,000 hours of service in the prior year. Employees must have the choice of all benefits offered under the plan.

D. New relaxed Cafeteria Plans can exclude:

1. Employees less than 21 yrs of age;

2. Less than 1-yr. of service;

3. Employees covered under collective bargaining; and

4. Non-resident Employees working outside the U.S.

2012

XV. Information Reporting after Dec. 31, 2011.

A. Payments in excess of $600 to corporate and non-corporate providers of <u>property</u> and services requires an info report to IRS. [IRC § 6041]

B. Previously, payments to corporations, and for property, generally did not have to be reported on a 1099.

2013

XVI. Additional Hospital Insurance “HI” or Medicare .9% Payroll Tax on high earners in 2013.

A. Payroll tax on Social Security remains the same – capped at $106,800 in 2010 with Employer paying 6.2% on base and Employee paying 6.2%. Combined 13.4% for self employed.

B. HI or Medicare tax 1.45% Employer, 1.45% Employee, (combined 2.9%) is not capped. If self employed and you earn $5,000,000 the Medicare tax is $145,000 (5 mil. x 2.9%).

C. Starting 2013 – additional HI tax of .9% on earned income in excess of $200,000 individual and $250,000 for joint, plus. [IRC § 3101(b)]

D. Same individual earns $5,000,000 in 2014 would be subject to HI tax of $188,200 ($200,000 x 2.9% = $5,800, plus $4,800,000 x 3.8% = $182,400) HI tax will be $43,200 more in 2014 on same $5 mil. (182,400 - 145,000).

XVII. New 3.8% Medicare Surtax.

A. Additional 3.8% on “Unearned Income Medicare Contributions” – New complicated concept. [IRC § 1411]

B. The 3.8% Unearned Income tax is imposed on the lesser of:

1. Net investment income, or

2. Excess of modified AGI (Adjusted Gross Income) over threshold amounts of $200,000 for individuals or $250,000 for joint or $125,000 for married filing separately.

C. Projected Impact – 3.8% and .9% to raise $210.2 billion from 2013 to 2019 per CCH on March 26, 2010 brochure.

1. Example: Tom has modified AGI of $220,000 and net investment income of $40,000. The tax applies to the lesser of (i) net investment income ($40,000) or (ii) modified AGI ($220,000) over the threshold amount for a single person ($200,000) or $20,000. The tax is 3.8% of $20,000 or $760. The tax in this case is not applied to the entire $40,000 of investment income, which tax would have been $1,520 (3.8% x $40,000).

XVIII. Net Investment Income Defined.

A. Includes:

1. Interest
2. Dividends
3. Royalties
4. Rents
5. Gain from selling property of a passive activity
6. Income from passive activity

B. Expenses related to 1 through 6 above reduce "Net Investment Income."

C. Net Investment Income does not include distributions from retirement plans, IRA's, etc.

D. Estates and Trusts retained earnings – subject to 3.8% tax on unearned income.

XIX. Medical Expense Deduction Limit Raised. (Tech Exp. p. 95)

A. Under current law unreimbursed medical deductions which exceed 7.5% of the AGI may create an itemized deduction. [IRC § 213]

B. The threshold of 7.5% of the AGI is raised to 10% of the AGI after December 2012. If 65 or older, the increase (to 10%) doesn't start until 2017.

C. Note – for computing AMT (Alternative Minimum Tax) no change; remains at 10%. The current difference of 2.5% (10% -7.5%) is subject to the complicated AMT, for seniors until 2017, it appears.

XX. Annual contributions to Flexible Saving Accounts (FSAs) capped at $2,500 in 2013. (Tech Exp. p. 72-77)

A. Health FSAs have become popular and they allow unlimited contribution to be used for common medical expenses, copayments, etc. without paying tax on the income contributed to such plans.

B. Starting in 2013 such contribution to FSAs will be limited to $2,500. [IRC § 125(i)]

XXI. If the Employer subsidizes Medicare Part D for retirees there may be reductions in the Employer deductions for such plans.

XXII. Health Insurance Companies (New concept).

A. At least 25% of insurer's premium income must be used for Minimum Essential Care (MEC), if not, compensation in excess of $500,000 will be denied under Sec. 162(m).

2014 and Beyond

XXIII. Basic Concepts – Regarding Health Coverage under HCRA.

A. Technically, Employer not forced to provide health coverage (HC). But the "Play-or-Pay" concept will force some Employers to pay a penalty (called a "shared responsibility payment") if MEC is not provided.

B. Similarly individuals are not forced to buy health insurance. But if such coverage not purchased then there are penalties that will apply to some.

XXIV. Premium Assistance Tax Credits & Employer Vouchers.

A. In 2014, all individuals not covered by Medicare or Medicaid must obtain coverage – or – pay a penalty, unless exempt. (Exemptions shown below.) [IRC § 5000A]

B. Some, or many, Employer plans may generally satisfy the MEC requirements.

C. Starting in 2014, some low-income families and some middle income families may qualify for:

1. Premium assistance tax credits [IRC § 36B]

2. Vouchers to help pay costs [IRC § 139E]

D. In 2014, Premium Assistance Tax Credits – Credit for health insurance if household income is between 100% to 400% of FPL.

E. How Premium Assistance Tax Credit works: (Tech Exp. p. 10-17)

1. U.S. Treasury will pay the credit to the insurance company directly. The difference between the regular premium for the plan chosen by individual and credit, is paid to the insurance by the insured.

2. Applicants must provide U.S. tax returns for two prior years. Credit to be determined by Sec. of HHS. Family size and all family income taken into account for purposes of determining eligibility for credit and size of credit.

3. A chart (p. 14 Tech. Exp.) shows household income as a percentage of FPL. As income and family size increase the credit increases. This is difficult to explain and will be difficult to implement.

F. Cost Sharing Subsidy (p. 20 Tech Exp.)

1. In addition to the Premium Assistance Tax Credit, just discussed above, for those receiving such credit, some may get a further reduction in out of pocket payments based upon the applicants relationship to FPL.

2. This subsidy is to be administered by HHS, IRS, Soc. Security Admin, Homeland Security Admin, and the U.S. Treasury (Tech. Exp. p. 21). Any volunteers to write the regulations????

G. Free Choice Vouchers (2014) – An Employer which provides MEC to Employees through a plan must provide Free Choice Vouchers to Employees if:

1. Any Employee not covered by Employer plan.

2. An Employee whose required contribution for MEC is between 8% to 9.8% of household income.

3. An Employee whose income is not greater than 400% of FPL.

4. Such monthly vouchers are excluded from the Employee(s) income **<u>only</u>** if used for qualified health insurance coverage. Voucher cost deductible by Employer.

5. Benefits and Credits received under the HCRA are not considered additional income to the recipient. (Tech. Exp. p. 25)

XXV. Individual Penalty if no Health Coverage.
[IRC § 5000A] (Tech Exp. p. 31-34)

A. Starting in 2014, the Patient Protection Act (PPA), as amended by the Reconciliation Act, requires most individuals (not eligible for Medicaid, Medicare, or other government sponsored plans or otherwise exempt from MEC) to have coverage.

B. If not exempt and no MEC then a penalty. What is the individual penalty?

1.

Year	Penalty “or”	% of Income
2014	$95.00	1%
2015	$325.00	2%
2016	$695.00	2.5%

2. Formula = Monthly penalty payment is 1/12 of the “greater” of flat dollar amount or percentage of income. (1/12 x Flat $ or % of income)

C. Why monthly? The beginning date, because of age (under 18), or ending date, i.e. death, may vary.

D. After 2016 “Flat Dollar” amount indexed for inflation.

E. Under 18 yrs of age, flat dollar amount reduced to 50% of the above amounts.

F. Married filing jointly – penalty liability is joint.

XXVI. Exemptions from individual coverage in 2014.

A. Certain individual who contributes to Employer plan “Bronze level,” if contribution exceeds 8% of household income;

B. Individuals whose income is below the federal poverty level;

C. Religious objectors;

D. Undocumented resident aliens;

E. People in jail;

F. Qualified Native American tribes;

G. Certain hardship cases; and

H. Health care sharing ministry members.

XXVII. Long Term Care.

A. Voluntary insurance program for long term “community assistance services and support.”

B. Premium paid thru payroll deductions if Employer decides to participate.

XXVIII. Early Retirees.

A. HCRA creates a temporary reinsurance program for Employer sponsored early retirement.

B. Payments made by Employer excluded from income.

C. American Indian health payments, excluded from income.

XXIX. Employers Penalty. [IRC § 480H] (Tech Exp p. 37-42) (Euphemistically, sometimes called the “Shared Responsibility Payment”)

A. HCRA does not require Employer to provide health insurance.

B. Large Employer (50 or more Employees) will be subject to “Play-or-Pay” rules after 2013 (beginning in 2014).

C. Employee defined – 30 or more hours per week is considered full time. (Tech Exp p. 39)

XXX. Employer “Employer” Penalty = 50+ Employees.

Conditions:

A. Employer <u>fails</u> to offer full time Employees and dependents the chance to enroll in MEC under Employer plan if at least <u>one</u> full time employee is enrolled in an insurance exchange and receives a premium assistance tax credit or cost sharing; or

B. Employer offers (not fails to offer) full time Employees and dependents chance to enroll in MEC under Employer plan and any full time Employee is in an Insurance Exchange and receives premium assistance tax credit or cost sharing.

XXXI. Amount of <u>nondeductible</u> Employer Penalty per Employee. (Tech Exp. p. 37-42)

A. Applicable Penalty #1: In the case of XXX(A) immediately above – the penalty is 1/12 of $2,000 ($166.67 per month) times the number of full time Employees for the month.

B. Supplemental Penalty #2: In the case of XXX(B) immediately above – the penalty is the number of Employees receiving premium assistance (or cost sharing for health insurance thru an exchange) for the month in an amount equal to 1/12 of $3,000 ($250 per month).

C. Note: the second penalty (Supplemental Penalty #2) is limited and cannot exceed the Applicable Penalty #1 (1/12 of $2,000 per month times number of EEs).

XXXII. Calculation of Employer Penalty.

A. If 50 or more Employees – subtract first 30 Employees. Example: ABC, Inc. has 65 Employees. Penalty would apply to 35 Employees (65 - 30 = 35 x Applicable Pen. #1 or Supplemental Pen. #2).

B. Observation: Penalty is lower for Employer that offers nothing, it seems. If Supplemental Penalty #2 cannot exceed Applicable Penalty #1, then it appears that it will be necessary to compute both penalties always.

XXXIII. Free Choice Vouchers.

A. Beginning in 2014, an Employer that offers MEC and pays any portion of the plans costs is required to provide a "FREE CHOICE VOUCHER" for an Employee that does not participate in the plan if: (1) the Employee's income does not exceed 400% of FPL or (2) whose contribution to Employer plan exceeds 9.5% of the individuals household income.

B. Such vouchers are not taxable to the Employee recipient if used for medical coverage. Any excess not so used is taxable. [IRC § 139E]

C. If an Employee gets a Free Choice Voucher, then no "premium assistance tax credit" or cost sharing is required.

XXXIV. Reporting.

A. Employers and others providing MEC will be required to file info returns with IRS. Penalties are imposed for not filing. [IRC § 6056] Perhaps similar to Form 5500 for retirement plans. (Tech. Exp. 35-36)

XXXV. “Cadillac Plans,” beginning in 2018, 40% Excise taxes on certain health care plans if – Annual Premiums for individual exceeds $10,200 or joint return $27,500. [IRC § 4980I]

A. Non-deductible tax against insurance companies.

B. Probably designed to force insurers to charge less than limits shown above.

C. Insurer – can increase premiums, but this would increase the 40%, it seems.

D. Thresholds ($10,200 and $27,500) are to be indexed for inflation.

E. High risk professions (not defined yet) and retirees 55 and older have higher limits before penalty applies.

1. Example: Dan, age 40, elects family coverage under an employer-provided fully-insured health care policy covering major medical with a value of $37,000. The amount subject to the excise tax would be $9,500 ($37,000 - $27,500 (the threshold for family coverage)). Dan’s employer would report $9,500 as taxable to the insurer. The insurer calculates and pays the tax to the IRS.

XXXVI. Medicare Part D.

A. Deduction for Employer coverage for retirees (a subsidy) is eliminated starting in 2013.

XXXVII. Large Employer (assets over $1 billion).

A. Estimated payments for July, August and September increase to 17.5%.

XXXVIII. State Exchanges (sometimes abbrevated “AHBE”).

A. Starting in 2014, each state is required to establish an “American Health Benefit Exchange & Small Business Health Option Program” (Shop Exchange). States may have one or more plans for their state and states may band together and have one program for multiple states. (Tech. Exp. p. 9)

B. Purpose – to provide qualified individuals and small businesses with access to health plans.

C. Four levels of benefits with percentages equal to an actuarial equivalent (I guess to be determined later). These are referred to as:

1. Bronze 60%
2. Silver 70%
3. Gold 80%
4. Platinum 90%

Key Non-Health Care Related Provisions

XXXIX. Economic Substance Doctrine. [IRC § 7701(o)]

A. The doctrine is codified in the HCRA, effective for years after March 18, 2010.

B. If no purpose, other than creating a tax break -- deduction may be denied.

C. Expanded penalties for underpayments attributable to transactions lacking economic substance. [IRC § 6662(I)]

XL. Foreign Asset and Transaction Reporting.

A. Expanded reporting and penalties relating to foreign financial asset ownership (e.g., stock in foreign entities) in addition to Financial Bank Account Reports (FBAR), effective for years after March 18, 2010 . [IRC § 6038D]

B. Expanded penalties for underpayments attributable to undisclosed foreign financial assets. [IRC § 6662(j)]

C. Expanded penalties, reporting, and statute of limitations for certain for foreign trust transfers and new rules for foreign trusts with US beneficiaries. [IRC § 679, §6048, § 6667]

Condensed Time line of Effective Dates

2010

- Smaller Employer Tax Credit
- Dependent Adult Child Coverage
- Indoor Tanning Tax

2011

- Only Doctor Prescribed Medicines Covered by FSAs/HSAs
- Employer reports on W-2 Value of Health Benefits
- Codified Economic Substance Doctrine
- Enhanced foreign transaction provisions

2012

- Reporting of $600 or more for services or to corporation.

2013

- Hospital Insurance (HI) 0.9% Increase for $200K/$250K+ Wages
- 3.8% Tax on Net Investment Income of High Income Taxpayers
- 10% of AGI Floor on Itemized Medical Expenses
- $2,500 cap on FSAs

2014

- Individual Shared Responsibility Penalty
- Coverage Subsidies
- Large Employer Mandate “Play-or-Pay”

2018

- 40% excise tax on high-cost insurance