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E-Newsletter Article

Selected Highlights of the 2010 Health Care Act and Health Care Reconciliation Act

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After significant debate and months of negotiations and deal-making, Congress passed and the President signed into law a new health care reform law in late March. The new health care reform law (Health Care Act 3/23/2010 and Health Care Reconciliation Act 3/30/2010) includes a mandate for most residents of the U.S. to obtain health insurance and with it a host of new tax rules, tax credits, and penalties. In this article we will discuss only three of the many major tax related law changes that came out of this new health care reform law. The first area deals with penalties for individuals who have no health insurance after 2013. The second area briefly covers the small employer health insurance credit. And finally we will discuss the changes to the deductible floor regarding medical expenses.

Individuals who have no health insurance after 2013 face a tax penalty

Until the Health Care Act the federal government had never before mandated that individuals purchase health insurance coverage. That will change for tax years ending after 2013, when certain taxpayers will be penalized if they do not maintain minimum health coverage. The mandate will not be universal, as certain individuals will be exempt from the health insurance mandate. Taxpayers with incomes below the income tax filing threshold, taxpayers exempt for religious reasons, individuals residing outside the U.S., incarcerated individuals, members of Indian tribes, and certain others will all be eligible for the exemption.

The penalty calculation utilizes a complicated formula that is calculated on a monthly basis. The monthly penalty amount for a taxpayer for any month during which a failure to maintain minimum coverage occurred will be an amount equal to 1/12 of the greater of a flat dollar amount or a percentage of income. The actual penalty calculations are very detailed and beyond the scope of this article, please contact our firm should you want the details behind the penalty.

If a taxpayer files a joint return, the individual and spouse are jointly liable for any penalty payment. No penalty is assessed for individuals who do not maintain health insurance for a period of three months or less during the tax year. If an individual exceeds the three month maximum during the taxable year, the penalty for the full duration of the gap during the year is applied.

Small employer health insurance credit

For tax years beginning after 2009, a tax credit is provided for an eligible small employer for certain contributions to purchase health insurance for its employees. An eligible small employer for this purpose generally is an employer with no more than 25 full-time equivalent employees

employed during its tax year, and whose employees have annual full-time equivalent wages that average no more than \$50,000. Again Congress has made these calculations complicated and sometimes difficult to define.

The credit is only available to offset actual tax liability and is claimed on the employer's income tax return. The credit is neither payable in advance to the taxpayer nor refundable. Thus, the employer must pay the employees' premiums during the year and claim the credit at the end of the year on its income tax return. The credit is a general business credit, and can be carried back for one year and carried forward for 20 years.

The credit is initially available for any tax year beginning in 2010, 2011, 2012, or 2013. Qualifying health insurance for claiming the credit for this first phase of the credit is generally 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 a State exchange and is only available for a maximum coverage period of two consecutive tax years beginning with the first year in which the employer or any predecessor first offers one or more qualified plans to its employees through an exchange.

The credit is equal to the applicable percentage, which is 35% for tax years beginning after 2009 and before 2014 and is 50% for tax years beginning after 2013. The credit also reduces the employer's deduction for contributions.

Caution: Self-employed individuals, including partners and sole proprietors, 2% shareholders of an S Corporation, and 5% owners of the employer are not treated as employees for purposes of this credit. Any employee with respect to a self-employed individual is not an employee of the employer for purposes of this credit if the employee is not performing services in the trade or business of the employer. Thus, the credit is not available for a domestic employee of a sole proprietor of a business. There is also a special rule to prevent sole proprietorships from receiving the credit for the owner and their family members.

Increase in Medical Expense Floor After 2010

For tax years beginning after 2012, the floor beneath the itemized deduction for medical expenses is increased from 7.5% of adjusted gross income to 10% of adjusted gross income. Thus, an individual's unreimbursed medical expenses will be deductible only to the extent they exceed 10% of the individual's adjusted gross income for the tax year.

For certain seniors this new law will not take effect until after 2016. For tax years beginning after 2012 and ending before 2017—i.e., for 2013, 2014, 2015, and 2016—the 7.5% floor will apply if the taxpayer or his or her spouse has reached age 65 before the close of the tax year. Thus the 7.5% floor will apply to a married taxpayer for 2013 through 2016 if either the taxpayer or the taxpayer's spouse is 65, whether they file a joint return or separate returns.