VENABLE LLP

Client Alerts

July 2012

What Do Healthcare Reform and the "Fiscal Cliff" Have In Common? Tax Increases

AUTHORS

Christopher E. Condeluci
Samuel Olchyk
The Honorable Bart Stupak
Brenda J. Tranchida
Ralph S. Tyler

RELATED PRACTICES

Healthcare
Tax and Wealth Planning
Employee Benefits and Executive Compensation

ARCHIVES

2012 2008 2004
2011 2007 2003
2010 2006 2002
2009 2005

On June 28th, the U.S. Supreme Court upheld the new healthcare reform law in part by ruling that (1) the individual mandate is a tax and (2) Congress has authority to impose the individual mandate under Congress's taxing power. As a result, all of the new healthcare reforms enacted under the law remain on the books. Also important is that all of the new tax provisions that were enacted to pay for the expansion of healthcare coverage remain in full-force.

Why Is This Important?

Every company – large or small, nonprofit or for-profit – is bracing for the projected "fiscal cliff" at the end of 2012. If Congress does not act by the end of this year, the scheduled spending cuts (known as "sequestration") take effect, along with the expiration of the reduced individual income tax rates, the $5 million estate and gift tax exemptions, and the favorable tax rates for capital gains and dividends (i.e., the Bush-era tax cuts). Now that the new healthcare reform law has been upheld, companies and individuals also must brace for new taxes on investments and wages that go into effect January 1, 2013.

What Are These New Taxes?

The most notable taxes that take effect on January 1, 2013, are (1) the additional Medicare payroll tax rate and (2) a "Medicare contribution" tax on investment income.

Additional Medicare Payroll Tax Rate

The new healthcare reform law increases the employee portion of the Hospital Insurance ("HI") payroll tax by 0.9% for individuals with wages in excess of $200,000 and for families with wages in excess of $250,000. These dollar thresholds are not indexed. It is important to emphasize that the 0.9% increase is not applicable to the employer's portion of the HI tax.

While the new tax will not have a direct economic impact on employers, it will create administrative challenges, as employers will have to modify and monitor the manner in which they withhold the HI payroll tax from employee paychecks. Under this new provision, an employer is required to withhold the additional 0.9 percent tax only for employees with wages in excess of $200,000 for the year. This means that if an employee earns wages less than $200,000, the employer is not required to withhold any additional amounts. Even if the combined wages of the employee and the employee's spouse exceed $250,000 for the year, the employer will not be required to withhold the additional 0.9 percent tax on those wages if the employee, himself or herself, earns less than $200,000 in wages. The employee and his or her spouse would be responsible for paying any portion of the additional payroll tax not withheld by the employer.

Medicare Tax on Investment Income

Under new Code section 1411, a 3.8 percent tax is imposed on net investment income (e.g., capital gains, dividends, annuities, rents, royalties, and interest (except tax-exempt interest)) for single taxpayers with a modified adjusted gross income ("MAGI") of $200,000 or more and joint filers with MAGI of $250,000 or more. The individual taxpayer is responsible for paying the investment tax.

This new tax is noteworthy because, for example, if the current capital gains and dividend tax rates expire, the capital gains rate could be as high as 23.8 percent and the dividend tax rate could jump to 43.4 percent for taxpayers in the top income tax bracket. This would likely have a chilling effect on investments and economic growth.

Are There Other Taxes?

The new healthcare reform law also enacted a number of taxes that take effect on January 1, 2014. The most notable taxes include:

- **Employer Mandate** – Employers with 50 or more employees are subject to a penalty tax if (1) they do not offer health insurance coverage to their employees or (2) they offer health coverage, but (a) the coverage is “unaffordable” or (b) the coverage does not pay for at least 60 percent of the medical benefits provided for under the plan. The amount of the penalty tax depends on whether an employer is offering healthcare coverage or not.
- **Penalties for Failing to Disclose Certain Information** – Penalties will apply for failing to meet certain new reporting and disclosure requirements, including furnishing an information return to (1) the IRS and (2) each of the employer’s full-time employees that sets forth certain information relating to the employer’s health plan.

Another significant tax that goes into effect on January 1, 2018, is the:

- High-Cost Plan Tax – Under this new provision, employer-sponsored health plans that exceed $10,200 for individuals and $27,500 for families will be subject to a 40 percent excise tax payable by insurance companies or administrators of a self-insured plan, a health Flexible Spending Arrangement (“FSA”), or a Health Reimbursement Arrangement (“HRA”).

What Do You Need To Do?

While there are a number of taxes that were enacted under the healthcare reform law that are already in effect, many observers agree that the taxes discussed above are the most significant. And, most would agree that the timing of when these taxes go into effect could not be worse. To avoid the application of penalty and/or excise taxes, it is highly advisable that tax professionals – particularly those working in company tax departments – fully grasp the technical aspects of these new tax provisions and coordinate with the company’s human resource and payroll departments. In addition, financial executives and analysts should pay close attention to what goes on in Washington, DC, at the end of this year, and even consider advocating for tax policy that promotes investment and economic growth.

Please contact any of the attorneys in our **Healthcare**, **Tax and Wealth Planning** and **Employee Benefits and Executive Compensation** Groups if you have any questions regarding this alert.