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Congratulations – It's a Tax

How Will Individual Americans Pay for Health Care Reform? What "Obamacare" Means to You

By Eric Gurgold, Esq.

The Supreme Court has upheld key provisions of the 2010 legislation that implemented the health care reform that President Obama sought, commonly known as The Health Care Reform Act. Unless repealed or modified by Congress, health care reform creates tax effects for both individuals and businesses. Certain portions of the Act are already in place, while other sections continue to be phased in.

Dependents

Beginning March 30, 2010, children under the age of 27 will generally be treated as a dependent of a parent for medically related deductions. A child 26 years and younger will be treated as a dependent:

i. for purposes of the general exclusion for reimbursements of medical expenses of an employee, spouse or a dependent under an employer provided health plan;

ii. for purposes of deducting health insurance costs of a self-employed person for himself, spouse and dependent;

iii. for allowing qualified retirement plans to provide benefits for medical expenses to retired employees and their dependents; and,

iv. for voluntary employee benefit associations providing health benefits to its members and their dependents.

Reimbursed Expenses

Items that can be deducted and the amounts that may be contributed to health savings accounts, flexible spending arrangements and other health reimbursement arrangements are more limited. The reimbursable expenses are limited to itemized medical deductions allowed a taxpayer. Over-the-counter medications and other non-prescription items are no longer reimbursable expenses. However, if over-the-counter medications are prescribed by a doctor, they will be reimbursable. The new limitations on reimbursable expenses began in 2011. The penalty for distributions for non-qualified expenses will increase to twenty percent (20%).

2013 Changes

In 2013, the tax effects of the health care reform kick into high gear. Contributions to flexible spending accounts will be limited to a maximum of $2,500.00. Employers will no longer be able to set their own limits. The $2,500.00 amount will be indexed for inflation. For individual taxpayers itemizing expenses on their income tax return, the threshold for itemized medical expenses will rise from 7.5% floor to a 10% floor. Therefore, taxpayers will have to have medical expenses exceeding 10% of their adjusted gross income in order to receive a deduction for such expenses. One exception exists for taxpayers who were 65 years or older before the end of 2010. For those taxpayers, the 7.5% floor will remain in effect through 2016.

Medicare Tax

A new additional 0.9% Medicare tax on wages and self-employment income comes into effect in 2013. This will affect taxpayers with earnings exceeding $200,000 for individual taxpayers, and exceeding $250,000 for joint filers. The tax will be imposed on the combined earnings of both spouses, which is not currently the case on the Medicare tax. Because the Medicare surtax will be imposed on earnings of both spouses, and because employers will not be aware of the combined earnings of both spouses, there is a very real risk that there will be under-withholding of Medicare taxes on married persons filing joint returns. The employee will be personally liable for the additional Medicare tax and must take the tax into account in figuring the taxpayer's estimated taxes for the year. Although the employer portion of the Medicare tax does not increase, self-employed individuals will not be able to deduct the additional Medicare tax. Only the employer portion of the self-employment tax is deductible from gross income.

A surtax of 3.8% will be imposed on taxpayers with modified adjusted gross income (MAGI) in excess of $200,000 for individuals, and $250,000 for joint filers. Modified adjusted gross income is deemed to be the taxpayer's adjusted gross income increased by any foreign earned income or foreign housing costs excluded under IRC Section 911. The tax will be imposed on the lesser of the taxpayer's net investment income or modified adjusted gross income exceeding the $200,000 and $250,000 levels. Investment income for these purposes will include interest, dividends, annuities, realties, certain rents, passive income from a trade or business and net gain attributable to the disposition of property. Investment income does not include distributions from retirement or IRA accounts, interest on tax exempt bonds, veterans benefits, nor gain on the sale of a principal residence.

An individual taxpayer who has modified adjusted gross income of $180,000 in 2013 of which $70,000 consists of net investment income will not pay a surtax. Because the surtax is only charged on the lesser of net investment income or modified adjusted gross income in excess of $200,000, the surtax will not apply. If the same individual had $210,000 of MAGI, including investment income of $20,000 , the MAGI would exceed $200,000 and the 3.8% Medicare tax would apply to the $10,000 of MAGI above $200,000 threshold. The taxpayer will pay a surtax of $380. Taxpayers must take the 3.8% surtax into account in estimating taxes and paying their estimated taxes.

2014 Changes

In 2014 life becomes complicated. The Health Care Reform Act mandates individuals to obtain minimum essential health insurance for themselves and their dependents. Failure to do so will result in a penalty (now ruled to be a tax by the Supreme Court) on the individual for each month the individual is without mandated coverage. Prisoners, non-citizens, illegal aliens, healthcare sharing ministry members and those of religious conscience are excluded from the mandate. There are certain exceptions where the penalty will not be imposed, especially on those who can prove hardship.

Penalties

Although a formula exists for calculating the penalty, the penalty cannot be currently calculated because a premium has not yet been set for the national exchange. Once a national exchange premium is established, the penalty will be equal to the lesser of either: (1) the monthly penalty amount for the year, or (2) the amount of the national exchange premiums offered at the bronze level for the taxpayer's family size. The monthly penalty is equal to 1/12th of the greater of either: (1) a flat dollar amount, or (2) the applicable percentage of income. The flat dollar amount will be a fixed amount for each person the taxpayer is required to insure, including each dependent (remember dependents will now be children up to 27 years of age). The monthly penalty may not be more than 300% of the flat dollar amount. In 2014, the flat dollar amount will be $95, in 2015 the flat dollar amount will be $325, and in 2016 the flat dollar amount will be $695. If the individual's dependents are under the age of 18 years old, the flat dollar amounts will be cut in half. In calculating the applicable percentage of income, the penalty would be based on a percentage of excess household income over a threshold filing requirement.

As stated earlier, life becomes complicated in 2014. An example might help. In 2014, a couple with two minor dependents has household income of $45,000 on a filing threshold of $23,900. The flat dollar amount would be $285.00 [($95 x 2) + (1/2 x 95) x2)]. Because the flat dollar amount may not exceed 300% of the applicable dollar amount less amounts included for children under 18, the flat dollar amount would actually be $190 ($95 x 2). Because the household income exceeds their filing threshold by $21,100, and in 2014 the applicable percentage is 1% of the excess above the threshold, a monthly penalty of $211 is incurred. Because the penalty is based upon the greater of the flat dollar amount or the excess over the threshold amount, $211 will be the penalty. However, if this is greater than the average national premium of qualified health plans at the bronze level, the penalty will be reduced to the average national premium amount.

Although the Supreme Court upheld the penalty provision of the Act, it struck down the provisions requiring states to participate by offering insurance to state residents or lose Medicaid funding. Thus states may choose not to participate. This raises many questions, including how a resident of a nonparticipating state can access affordable insurance and will the resident be "penalized" for not having mandated coverage.

Bottom Line

In order to get the minimal essential coverage, individuals will have to have coverage under a government sponsored plan such as Medicare or Medicaid, coverage under an eligible employer sponsored plan, an individual market plan, a grandfathered plan, or certain other coverage. Certain other coverage would include state-sponsored health insurance exchanges, which are mandated to be set up by the states by 2014. Individuals and businesses with 100 or fewer employees are to be able to obtain affordable health coverage under these plans. Individuals whose household income is between 100% and 400% of the federal poverty line may be eligible to receive health insurance premium assistance credit if they participate in insurance through the state exchange.

Eric Gurgold is a Florida Board Certified in Wills, Trusts & Estates lawyer. He assists clients in the preparation of wills, trusts, family limited partnerships, inventories, inheritance and estate tax returns, as well as providing counsel to minimize income and estate taxes. Eric also handles elder law, probate litigation, title insurance claims related to probate issues, business law and tax matters. He can be reached at 239.344.1162 or via email at eric.gurgold@henlaw.com.