

Rosen Seymour Shapss Martin & Company LLP

Certified Public Accountants & Profitability Consultants

Tax Alert

2010 Health Care Reform Provisions

Part 1 - Individuals

Dear Clients and Friends of the Firm:

Below is a summary of the major tax changes affecting individuals in the recently enacted 2010 health reform legislation.

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. Under the new law, those without qualifying health coverage will pay a tax penalty of 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 *beginning in 2014*. Exemptions will be granted including financial hardship.

Premium assistance tax credits for purchasing health insurance - The centerpiece of the health care legislation is its provision of tax credits to low and middle income individuals and families for the purchase of health insurance. *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 an exchange. The premium assistance credit subsidizes the purchase of certain health insurance plans through an exchange. Under the provision, an eligible individual enrolls in a plan offered through an exchange and reports his or her income to the exchange. Based on the information provided to the exchange, the individual receives a premium assistance credit based on income.

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 amount of the credit will be based on the percentage of income the cost of premiums represents, rising from 2% of income for those at 100% of the federal poverty level for the family size involved to 9.5% of income for those at 400% of the federal poverty level for the family size involved.

Higher Medicare taxes on high-income taxpayers - High-income taxpayers will be hit with a double whammy: a tax increase on wages and a new levy on investments.

Higher Medicare payroll tax on wages - Under current law, wages are subject to a 2.9%

Medicare payroll tax. Workers and employers pay 1.45% each. Self-employed people pay both halves of the tax (but are allowed to deduct half of this amount for income tax purposes). Unlike the payroll tax for Social Security, which applies to earnings up to an annual ceiling (\$106,800 for 2010), the Medicare tax is levied on all of a worker's wages without limit.

Under this provision, *which takes effect 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. Employers will collect the extra 0.9% on wages exceeding \$200,000 just as they would withhold Medicare taxes and remit them to the IRS. Companies wouldn't be responsible for determining whether a worker's combined income with his or her spouse made them subject to the tax. Instead, some employees will have to remit additional Medicare taxes when they file income tax returns, and some will get a tax credit for amounts overpaid. Self-employed persons will pay 3.8% on earnings over the threshold. Married couples with combined incomes approaching \$250,000 will have to keep tabs on their spouses' pay to avoid an unexpected tax bill. It should also be noted that the \$200,000/\$250,000 thresholds are not indexed for inflation, so it is likely that more and more people will be subject to the higher taxes in coming years.

Medicare payroll tax extended to investments - Under current law, the Medicare payroll tax only applies to wages. **Beginning in 2013**, a Medicare tax will, for the first time, be applied to investment income. A new 3.8% tax will be imposed on net investment income of single taxpayers with AGI above \$200,000 and joint filers over \$250,000 (unindexed). Net investment income is interest, dividends, royalties, rents, gross income from a trade or business involving passive activities, and net gain from disposition of property (other than property held in a trade or business). Net investment income is reduced by properly allocable deductions to such income. However, the new tax won't apply to income in tax-deferred retirement accounts such as 401(k) plans. Also, the new tax will apply only to income in excess of the \$200,000/\$250,000 thresholds. So if a couple earns \$200,000 in wages and \$100,000 in capital gains, \$50,000 will be subject to the new tax.

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 only to the extent that those expenses exceed 7.5% of the taxpayer's AGI. The new law raises the floor to 10%, effective *for tax years beginning after December 31, 2012*. 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 for tax years beginning after December 31, 2010*.

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 December 31, 2010*.

Limit health flexible spending arrangements (FSAs) to \$2,500 - An FSA is one of a number of tax-advantaged financial accounts that can be set up through a cafeteria plan of an employer. An FSA allows an employee to set aside a portion of his or her earnings to pay for qualified expenses as established in the cafeteria plan, most commonly for medical expenses. 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 December 31, 2012*. The dollar amount will be indexed for inflation after 2013.

Dependent coverage in employer health plans - *Effective on the enactment date*, 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. Also, self-employed individuals are permitted to take a deduction for the health insurance costs of any child of the taxpayer who has not attained age 27 as of the end of the tax year.

Excise tax on indoor tanning services - The new law imposes a 10% excise tax on indoor tanning services. The tax, which will be paid by the individual on whom the tanning services are performed but collected and remitted by the person receiving payment for the tanning services, *will take effect July 1, 2010*.

Liberalized adoption credit and adoption assistance rules - *For tax years beginning after December 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.

Because many of the above provisions will not take effect until future years, we can expect refinements and clarifications between now and actual effective dates.

If you would like more details about any of the aspects of these 2010 health care reform provisions, please do not hesitate to contact us at (212) 303-1800 or email us at info@rsmcpa.com. Visit our website at www.rsmcpa.com.

Sincerely,

Rosen Seymour Shapss Martin & Company LLP

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Rosen Seymour Shapss Martin & Company LLP | 757 Third Avenue | New York | NY | 10017