Health care reform act: Brace for tax onslaught

The U.S. Supreme Court has spoken: It has generally upheld the constitutionality of the Patient Protection and Affordable Care Act of 2010 (PPACA), the controversial health care law that is often called Obamacare.

**Alert:** This means that the tax-related provisions in the PPACA will stand. Therefore, the tax bill for some taxpayers, especially those with higher incomes, will increase, starting next year.

Here are several key tax law changes that you will have to contend with unless something changes.

1. **Medicare surtaxes:** Beginning in 2013, high-income taxpayers will face two new Medicare tax burdens:
   - A 0.9% Medicare tax is imposed on wages of single filers with earned income above $200,000 and $250,000 for joint filers.
   - A 3.8% Medicare tax applies to all or part of the “net investment income” received by single filers with a modified adjusted gross income (MAGI) above $200,000 and $250,000 for joint filers.

   Net investment income includes capital gains, interest, dividends, royalties, rents, and income from passive activities. Distributions from qualified retirement plans and IRAs don’t count.

2. **Flexible spending accounts:** Currently, there is no limit on pretax contributions to flexible spending accounts (FSAs) used to pay qualified medical expenses. (A $5,000 limit applies to FSAs used for dependent care expenses.) Beginning in 2013, the PPACA caps the annual amount of health care FSA contributions at $2,500 (indexed for inflation thereafter).

3. **Medical deductions:** Under current law, you may deduct only qualified medical expenses in excess of 7.5% of your adjusted gross income (AGI). Beginning in 2013, the law generally raises this “deduction floor” to 10% of your AGI.

   However, an individual (and spouse) who is age 65 or older is temporarily exempt from this increase for tax years beginning after 2012 and before 2017.

   **Note:** The PPACA doesn’t make any adjustment in the allowable medical expense deduction for computing alternative minimum tax (AMT) liability. Thus, the medical deduction floor for AMT purposes, which was already at 10% of AGI, remains the same.

4. **Individual mandate:** After 2013, any individual not eligible for Medicare or Medicaid must obtain minimum
essential health care coverage or pay a nondeductible penalty based on a flat dollar amount or a percentage of household income.

The maximum penalty will increase from $95 in 2014 to $695 (thereafter indexed for inflation). But the flat dollar penalty is cut in half for individuals under age 18 or college students. Also, the flat dollar penalty for a family can’t exceed 300% of the applicable dollar amount for the year.

The PPACA also provides coverage subsidies to qualified lower-income individuals through premium assistance tax credits. The IRS will be responsible for determining eligibility.

5. Employer mandate: Beginning in 2014, an employer failing to offer minimum essential coverage in any month for an eligible full-time employee will be assessed a tax equal to 1/12th of $2,000 × the number of all full-time employees. This penalty applies to employers with 50 or more workers, but the first 30 workers are subtracted from the calculation.

Tip: Undoubtedly, we haven’t heard the last word on health care reform. Stay tuned.

Silver tax lining for small biz owners

One favorable PPACA tax provision for small business owners is already in effect.

Strategy: A qualified small business can use a special tax credit to offset the cost of health insurance coverage for employees. For this purpose, a “small business” is one with fewer than 25 employees and average annual wages of less than $50,000 per employee.

For 2010 through 2013, a small business may qualify for a credit up to 35% of the company’s contribution toward employee health insurance premiums. After 2013 and beyond, a credit of up to 50% for a two-year period is available to employers that purchase coverage through a state-run exchange.

As with the other tax-related provisions in the PPACA, the credit for qualified small businesses emerges intact from the Supreme Court ruling.