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HEALTH CARE REFORM INFORMATION FOR INDIVIDUALS

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The 2010 health care reform legislation that was upheld by the Supreme Court was landmark legislation that will affect all individuals in some way over the next few years. Besides the obvious effect this massive legislation will have on health care, there are many significant provisions of the legislation that affect an individual's income taxes. Some provisions of this law were effective immediately, while others are not effective for several years. In fact, the full range of provisions will not take effect until 2018. This overview is a brief look at the major provisions that will affect individuals by 2014. Our firm is ready to assist you with any questions you may have, and help you understand how this legislation will affect your taxes and finances. Please give us a call if you want additional information on any aspect of the new law.

Following are other provisions, listed in the order in which they are effective.

Expanded Dependent Coverage In Health Plans. Effective for plan years beginning on or after September 23, 2010, health insurance plans that offer coverage for dependent children must continue to offer that coverage until the child reaches age 26. Since most health plans use the calendar year as a plan year, this means that beginning in 2011 (for most individuals), an adult child can continue to be covered under a parent's health insurance until age 26. The adult child does not have to qualify as a dependent for income tax purposes to be covered under the health insurance. However, for plan years beginning before 2014, grandfathered plans do not have to offer the coverage if the adult child is eligible for coverage through an employer-sponsored plan that is not a parent's plan. Additionally, health insurance coverage for an adult child who has not turned age 27 as of the end of the parent's tax year (generally, a calendar year) is not taxable to the parent. These provisions apply to self-employed individuals also, so they can take an above-the-line deduction for the health insurance costs of qualifying adult children.

Reimbursement of Over-the-counter Medication Costs. Prior to the health care legislation, certain over-the-counter medications not prescribed by a doctor qualified as reimbursable medical expenses through a health reimbursement account (HRA) or a health flexible spending arrangement (health FSA). Additionally, Health Savings Accounts (HSAs) and Archer Medical Savings Accounts (Archer MSAs) could provide tax-free distributions for certain over-the-counter medications not prescribed by a doctor. For reimbursements of expenses incurred after December 31, 2010, the cost of over-the-counter drugs not prescribed by a doctor are no longer qualifying medical expenses for HSAs and health FSAs. Likewise, distributions from HSAs and Archer MSAs for over-the-counter drugs not prescribed by a doctor are nonqualified distributions. However, insulin and doctor-prescribed over-the-counter medications continue to be qualified medical expenses.

Increased Penalties on Distributions from HSAs and Archer MSAs Used for Nonmedical Purposes. For distributions made after December 31, 2010, distributions from an HSA or Archer MSA that are used for nonmedical purposes are subject to regular income tax and an additional penalty tax of 20%.

Threshold on Medical Expenses Deduction Increased to 10% of AdJusted Gross Income (AGI). Currently, for regular income tax purposes, taxpayers can take an itemized deduction for unreimbursed medical expenses only to the extent that those expenses exceed 7.5% of the taxpayer's AGI. Generally, this threshold increases to 10% of AGI, effective for tax years beginning after December 31, 2012. However, if an individual is age 65 or older, the increased threshold does not apply until tax years beginning after December 31, 2016.

Limit on Contributions to Health FSAs. A health FSA is one of a number of tax-advantaged arrangements that can be set up through an employer's cafeteria plan. A health FSA allows an individual to set aside a portion of his or her wages on a pre-tax basis to pay for qualified medical expenses as defined in the cafeteria plan. Through 2012, there is no limit in the tax law on an employee's salary reduction contribution amount to a health FSA (although some plans may have a limit). However, effective for plan years beginning after December 31, 2012, employee salary reduction contributions are limited to no more than $2,500 per year. The dollar amount will be indexed for inflation for plan years beginning after 2013.

Additional Medicare Tax on Wages. Currently, wages are subject to a 2.9% Medicare payroll tax. Workers and employers pay 1.45% each. The Medicare tax is levied on all of an employee's wages subject to FICA taxes (i.e., there is no wage limit). Under the new law, effective in 2013, individuals earning more than $200,000 ($250,000 if married, filing a joint return; $125,000 if married, filing separately) must pay an additional 0.9% Medicare tax on their wages exceeding those base amounts. An employer will be required to withhold and remit the additional tax for any employee to whom it pays at least $200,000. Therefore, many individuals (especially those who are married and each earn less than $200,000, but earn more than $250,000 combined) will need to adjust their federal income tax withholding (FITW) or make quarterly estimated tax payments to be sure they are not hit with an underpayment penalty when filing their income tax return each year.

Self-employed individuals pay both halves of the Medicare tax (2.9%), but are allowed to deduct half of this amount for income tax purposes. Under the new law, self-employed persons earning more than the threshold amounts will pay the additional 0.9% tax on amounts above the thresholds. The additional tax will not be deductible for income tax purposes. Self-employed individuals will need to adjust their quarterly estimated income tax payments to account for this additional tax.

Medicare Contribution Tax on Investments. Under current law, the Medicare payroll tax only applies to wages. Beginning in 2013, a new 3.8% Medicare tax (i.e., the Medicare contribution tax) will apply to some (or all) of the net investment income of taxpayers with an AGI above $200,000 (over $250,000 for married filing jointly and surviving spouses; $125,000 for married filing separately). Net investment income generally includes gross income from interest, dividends, royalties, and rents; passive activities trade or business gross income; and net gain from the disposition of property; reduced by deductions properly allocable to such income. The additional tax will not apply to distributions from tax-deferred retirement accounts [e.g., 401(k) plans and IRAs]. The tax will be calculated on the individual's income tax return and due with his or her federal income tax. Affected individuals will need to either adjust their FITW or make quarterly estimated income tax payments to be sure they are not hit with an underpayment penalty when filing their income tax return each year.

Individual Mandate for Health Coverage. The health care reform legislation requires most U.S. citizens and legal residents (i.e., applicable individuals) to have minimum essential health insurance coverage every month beginning on or after January 1, 2014. Those who do not have such health insurance will be subject to a penalty for each month they do not have minimum essential coverage. The penalty will be the greater of a flat fee amount (for each individual not covered by health insurance) or a percentage of household income over a threshold amount.

Certain low-income individuals and individuals who meet certain financial hardship criteria are exempt from the mandate. In addition, members of an Indian tribe and individuals who either meet a religious conscience exception or are members of certain health care sharing ministries are exempt from the mandate.

Premium Assistance Credits and Cost-sharing-reduction Subsidies. To assist individuals in meeting the mandate for having minimum essential health insurance coverage, the legislation also provides for premium assistance credits and cost-sharing-reduction subsidies. Beginning in 2014, some medium-income and low-income individuals will qualify for a premium assistance credit to help them pay the premiums on health insurance purchased in the individual market through the state insurance exchanges that will be operational by 2014. Individuals can elect to have this credit payable in advance directly to the insurer.

The premium assistance credit will be available (on a sliding scale basis) for individuals and families with incomes up to 400% of the federal poverty level ($44,680 for an individual or $92,200 for a family of four, using 2012 poverty level figures) who are not eligible for Medicaid, CHIP, a state or local public health program, employer-sponsored insurance that is both affordable and provides a certain minimum value, or other acceptable coverage.

Additionally, many of these individuals will be eligible for a cost-sharing-reduction subsidy that will assist them in paying any deductibles or other cost-sharing payments required under their health insurance coverage.

That is a brief highlight of the major provisions of the health care legislation that will affect individuals. Of course, with legislation this expansive, additional guidance from the IRS, Department of Labor (DOL), and Department of Health and Human Services (HHS) is being issued on a regular basis. We will keep you informed of major announcements from these agencies.

If you would like more details about any of these provisions or have questions about the effects of these provisions to you and your family, please do not hesitate to call the KKAJ tax and accounting professionals at 818.848.5585, 661.705.4222 or toll free at 888.837.9321.