Tax Law Changes in PPACA, Providing Clarity

By Matthew P. McLaughlin

On March 23, 2010, President Obama signed into law the landmark Patient Protection and Affordable Care Act of 2010 ("PPACA"). PPACA contains a number of significant tax law changes, some of which have not been properly addressed by the media in the numerous articles that have been written on the subject. This article attempts to clear up any confusion that may exist related to the tax law changes contained in PPACA.

1. Tax Law Changes Impacting Businesses under PPACA

Tax Credit for Small Employers
PPACA provides small employers with a tax credit for nonelective contributions to purchase health insurance for their employees. The tax credit can be used to offset the regular tax or the alternative minimum tax of the employer. In order to qualify for this tax credit, the employer must offer health insurance to its employees as part of their compensation and contribute at least half of the total premium cost. The employer cannot have more than 25 full-time equivalent employees and the employees must have annual full-time equivalent wages that average no more than $50,000. However, to qualify for the full amount of the credit, an employer must have fewer than 10 full-time equivalent employees that make less than $25,000 in average annual full-time equivalent wages.

For tax years 2010 through 2013, the credit is generally 35% (50% for tax years beginning after 2013) of the employer's nonelective contributions toward the employees' health insurance premiums. Tax-exempt small businesses meeting these requirements are eligible for payroll tax credits of up to 25% for tax years 2010 through 2013 (35% in tax years beginning after 2013) of the employer's nonelective contributions toward the employees' health insurance premiums.

Self-employed individuals, including partners and sole proprietors, 2% shareholders of an S corporation, and 5% owners of the employer are not treated as employees for purposes of this credit.

Employers Exempt from Offering Coverage
Effective January 1, 2014, PPACA imposes penalties on certain businesses for not providing health insurance coverage to their employees; however, most businesses will not have to worry about this particular pay or play mandate because employers with fewer than 50 employees are not subject to any of the penalties. For businesses with at least 50 employees, the possible penalties vary depending on whether or not the employer offers health insurance to its employees. If it does not offer coverage and it has at least one full-time employee who receives a premium tax credit, the business will be assessed a fee of $2,000 per full-time employee, excluding the first 30 employees from the assessment. Employers with at least 50 employees that offer coverage but have at least one full-time employee receiving a premium tax credit will pay $3,000 for each employee receiving a premium credit (capped at the amount of the penalty that the employer would have been assessed for a failure to provide coverage, or $2,000 multiplied by the number of its full-time employees in excess of 30).

Excise Tax on High-Cost Employer Sponsored Health Coverage
Under PPACA and for tax years beginning after December 31, 2017, there is an excise tax of 40% on insurance companies and plan administrators for any health coverage plan to the extent that the annual premium exceeds $10,200 for single coverage and $27,500 for family coverage. An additional threshold amount of $1,650 for single coverage and $3,450 for family coverage will apply for retired individuals age 55 and older and for plans that cover employees engaged in high risk professions. The tax will apply to self-insured plans and plans sold in the group market, but not to plans sold in the individual market. The dollar amount thresholds will be automatically increased if the inflation rate for group medical premiums between 2010 and 2018 is higher than the Congressional Budget Office estimates in 2010. Employers with age and gender demographics that result in higher premiums can value the coverage provided to employees using the rates that would apply using a national risk pool. The excise tax will be levied at the insurer level. Employers will be required to aggregate the coverage subject to the limit and issue information returns for insurers indicating the amount subject to the excise tax.

Simple Cafeteria Plans
For years beginning after 2010, a new employee benefit cafeteria plan known as a Simple Cafeteria Plan will be available. This plan will be subject to eased participation restrictions so that small businesses can provide tax-free benefits to their employees.

New Deduction Limit on Executive Compensation for Insurance Providers
A new deduction limit on executive compensation applies to insurance providers. If at least 25% of the insurance provider's gross premium income is derived from health insurance plans that meet the minimum essential coverage requirements in the new health reform law, an annual $500,000 per tax year compensation deduction limit will apply for all officers, employees, directors, and other workers or service providers performing services for or on behalf of a covered health insurance provider. The limit applies to remuneration paid in tax years beginning after 2012 for services performed after 2009.

Pharmaceutical Manufacturers Fee
Effective January 1, 2011, pharmaceutical manufacturers and importers must pay an annual flat fee allocated across the industry according to market share. The schedule for the flat fee is: 2011, $2.5 billion; 2012 to 2013, $2.8 billion; 2014 to 2016, $3 billion; 2017, $4 billion; 2018, $4.1 billion; 2019 and later, $2.8 billion. The fee will not apply to companies with sales of branded pharmaceuticals of $5 million or less.

Health Insurance Providers Fee
Effective January 1, 2013, health insurance providers will face an annual flat fee on the health insurance sector. The fee will be allocated based on market share of net premiums written for a United States health risk. The aggregate annual flat fee for the industry will be: $8 billion for 2014; $11.3 billion for 2015 and 2016; $13.9 billion for 2017; and $14.3 billion for 2018. The fee will be indexed to the rate of premium growth for later years. The fee will not apply to companies whose net premiums written are $25 million or less.

Blue Cross/Blue Shield Medical Loss Ratio and Certain Deductions
Effective January 1, 2010, Blue Cross/Blue Shield organizations must maintain a medical loss ratio of 85% or higher in order to take advantage of certain tax benefits provided to them, including the deduction for 25% of claims and expenses and the 100% deduction for unearned premium reserves.

Medical Device Manufacturer and Importer Tax
Starting January 1, 2013, manufacturers or importers of medical devices will have to pay a 2.3% excise tax on the sale of any taxable medical device by the manufacturer, producer, or importer of the device. A taxable medical device is any device defined in section 201(h) of the Federal Food, Drug, and Cosmetic Act intended for humans. The excise tax will not apply to eyeglasses, contact lenses, hearing aids, and any other medical device determined by the Internal Revenue Service to be of a type that is generally purchased by the general public at retail for individual use.

Tax on Indoor Tanning Services
For services provided on or after July 1, 2010, businesses operating indoor tanning parlors will pay a 10% excise tax on indoor tanning services.

Investment Tax Credit
For expenses paid or incurred after December 31, 2008, a two-year temporary investment tax credit applies, subject to an overall cap of $1 billion, to encourage investments in new therapies to prevent, diagnose, and treat acute and chronic diseases.

2. Tax Law Changes Impacting Individuals under PPACA

The Mandate
PPACA requires that United States citizens and legal residents have qualifying health coverage or be subject to a penalty. Those individuals without qualifying health coverage will pay a 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 according to the following schedule: $95 in

2014, $325 in 2015, and $695 in 2016 for the flat fee or 1.0% of taxable income in 2014, 2.0% of taxable income in 2015, and 2.5% of taxable income in 2016. Beginning after 2016, the penalty will be increased annually by a cost-of-living adjustment. Exemptions will be granted for financial hardship, religious objections, American Indians, those without coverage for less than three months, aliens not lawfully present in the United States, incarcerated individuals, those for whom the lowest cost plan option exceeds 8% of household income, those with incomes below the tax filing threshold (in 2010 the threshold for taxpayers under age 65 is $9,350 for singles and $18,700 for couples), and those residing outside of the United States.

Premium Assistance Tax Credits
For tax years ending after 2013, PPACA provides a refundable tax credit for eligible individuals and families who purchase health insurance through an exchange program. The premium assistance credit, which is refundable and payable in advance directly to the insurer, subsidizes the purchase of certain health insurance plans. An eligible individual enrolls in a plan offered through an exchange plan and reports his or her income. The taxpayer receives a premium assistance credit based on income and the Internal Revenue Service pays the premium assistance credit amount directly to the insurance plan in which the individual is enrolled. The individual then pays to the plan in which he or she is enrolled the dollar difference between the premium assistance credit amount and the total premium charged for the plan. For employed individuals who purchase health insurance through an exchange program, the premium payments are made through payroll deductions.

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 is 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.

Increased Medicare Payroll Taxes
Effective January 1, 2013, the Medicare hospital insurance tax rate is increased by 0.9% on individual taxpayers earning over $200,000. ($250,000 for married couples filing jointly.) Employers will collect the extra 0.9% on wages exceeding $200,000 just as they would withhold Medicare taxes and remit them to the Internal Revenue Service.

Surtax on Unearned Income
A new 3.8% surtax will be imposed on net investment income of single taxpayers with adjusted gross income (AGI) above $200,000 and joint filers with AGI 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. The new tax will not apply to income in tax-deferred retirement accounts such as 401(k) plans.

Modified Medical Expense Deduction Threshold
Generally, 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. However, PPACA raises the floor beneath itemized medical expense deductions from 7.5% of AGI 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.

Limitation on Reimbursement for Over-the-Counter Medications from HRAs, FSAs and MSAs
PPACA 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 Tax on Nonqualifying MSA or Archer MSA Distributions
PPACA increases the tax on distributions from an HSA 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.

BALCH
& BINGHAM LLP

Limit on FSA Contributions
Currently, there is no limit on the amount of contributions to an FSA. Under PPACA, however, allowable contributions to health FSAs will be capped at $2,500 per year, effective for tax years beginning after December 31, 2012.

Exclusion from Gross Income for Health Professionals
Effective for amounts received by an individual in tax years beginning after December 31, 2008, payments made under any state loan repayment or loan forgiveness program that is intended to provide for the increased availability of health care services in underserved or health professional shortage areas are excluded from gross income.

For more information contact:
Matthew P. McLaughlin
Balch & Bingham LLP
t: (601) 965-8162
e: mmclaughlin@balch.com
website bio: www.balch.com/mmclaughlin

This is an informational resource for clients and friends of Balch & Bingham LLP. It does not contain legal advice, and is not a solicitation to perform legal services. No representation is made that the quality of legal services performed by Balch & Bingham LLP is greater than the quality of legal services performed by other lawyers. Design, logo, and content © 2012 Balch & Bingham LLP.