

HEALTH CARE REFORM

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REPORT FROM COUNSEL

TAX CHANGES AFFECTING INDIVIDUALS IN THE HEALTH REFORM LEGISLATION

On March 30, 2010, President Obama signed into law H.R. 4872, the Health Care and Education Reconciliation Act of 2010 (Reconciliation Act, RL. 111-152), thus completing a massive overhaul of the U.S. health care system affecting nearly all taxpayers, many employers, and many elements of the health care industry. The Reconciliation Act modifies legislation signed into law on March 23 that contains the bulk of the health reform law, H.R. 3590, the Patient Protection and Affordable Care Act (Health Care Act, RL. 111-148).

This newsletter gives you a brief overview of the key tax changes affecting individuals in the recently enacted health reform legislation. Please contact our office for details of how the new changes may affect your specific situation.

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 after 2013. 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 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 U.S., 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 U.S.

Premium assistance tax credits for purchasing health insurance. The health care legislation provides tax credits to low and middle income individuals and families for the purchase of health insurance. Specifically, 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, which is refundable and payable in advance directly to the insurer, 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 and IRS 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, 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 credits will be available on a sliding scale basis.

Higher Medicare taxes on high-income taxpayers. High-income taxpayers will be subject to a tax increase on wages and a new levy on investments.

Higher Medicare payroll tax on wages. The Medicare payroll tax is the primary source of financing for Medicare’s hospital insurance trust fund, which pays hospital bills for beneficiaries, who are 65 and older or disabled. 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 the provisions of the new law, which take 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. Self-employed persons will pay 3.8% on earnings over the threshold.

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. 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 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.

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 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 but often for dependent care or other 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 March 30, 2010, 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. This change is also intended to apply to the exclusion for employer-provided coverage under an accident or health plan for injuries or sickness for such a child. A parallel change is made for VEBA and 401(h) accounts. 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.

I hope this information is helpful. If you would like more details about these provisions or any other aspect of the new law, please do not hesitate to contact us.

Please visit our website: www.pozzuolo.com

UPCOMING SEMINARS

CONTINUING LEGAL EDUCATION/CONTINUING PROFESSIONAL EDUCATION (CLE/CPA)
SEMINARS FOR ATTORNEYS AND CERTIFIED PUBLIC ACCOUNTANTS

“A GRAYING POPULATION: ESTATE PLANNING FOR THE AGING MIDDLE CLASS SUBURBAN CLIENT” presented by ***JOSEPH R. POZZUOLO, ESQUIRE AND LISA A. LEGGIERI, ESQUIRE*** on ***FRIDAY, MAY 7, 2010 AT NEUMANN UNIVERSITY***

“CURRENT TRENDS IN EMPLOYMENT LAW: DISCRIMINATION THROUGH THE FAMILY MEDICAL LEAVE ACT” presented by ***JUDITH P. RODDEN, ESQUIRE AND LESLEY M. IBANEZ, ESQUIRE*** on ***FRIDAY, MAY 13, 2010 AT NEUMANN UNIVERSITY.***

“HOW TO INTEGRATE AN ESTATE PLAN FOR SUCCESSION PLANNING FOR A SUBURBAN CLOSELY HELD BUSINESS INCLUDING ETHICS” presented by ***JOSEPH R. POZZUOLO, ESQUIRE AND JEFFREY H. SMITH, ESQUIRE*** on ***FRIDAY, MAY 21, 2010 AT NEUMANN UNIVERSITY***

More info can be found at: <http://www.pozzuolo.com/Seminars.shtml>

Publications

All of the following professional publications and past newsletters written by attorneys of this office are available by clicking here: http://pozzuolo.com/Pubs_Articles.shtml

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Money Purchase Pension Plan Falls Out Of Favor

Why An Employment Contract Is Mandatory

What Type of Qualified Corporate Retirement Plan Best Serves Your Business, Tax And Retirement Needs

Structuring Loans From Qualified Plans – How To Handle The Strict Tax Rules

How An S Corporation Avoids The Double Taxation Incurred When Excessive Compensation Is Treated As A Dividend

Bankruptcy – How To Prevent It And How To Cope With It Should It Happen To Your Business

How To Look, Act And Sound Like A Professional Corporation

How Mortgage Lenders Should Draft Broker Agreements To Avoid RESPA Violations

How to Structure a Suitable Buy-Sell Agreement

Estate Planning

The Limited Liability Company – A Sophisticated Tool For Estate Planning

Diversify Strategies For An Effective Estate Plan

Use Wills To Maximize Family Protection And Minimize Tax

Six Proven Estate Planning Techniques

Divorce Raises The Need For Performing An Estate Planning Review

Divorce and Estate Planning

Remarriage Situations Can Raise Special Estate Planning Considerations

College Funding Tool Offers Estate Planning Advantage

Drafting The Durable Power Of Attorney For Wealth Protection Purposes

Why Living Wills – Advance Directives Are An Essential Part Of Estate Planning

Special Needs Trust – An Estate Planning Tool For The Disabled

Adapt Estate Planning Strategies to Fit the Needs of Same-Sex Couples

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