



Date: September 30, 2010
To: Clients
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We are submitting this material to supplement information presented in our August 31, 2010 Health Care Tax Provisions Seminar.

The Patient Protection and Affordable Care Act became law March 23, 2010 despite significant lack of public support. A few days thereafter the House and Senate passed the related Health Care and Education Reconciliation Act which, with the Patient Protection and Affordable Care Act, became known as the Health Care Legislation.

The Congressional Budget Office projects the Act will result in an average nationwide increase in annual health care premiums of \$2,100 for many families.

There will be much work to understand and to implement the Health Care Legislation. The following material presents the more significant changes resulting from the Legislation for years 2010 through 2018.

<u>ITEM</u>	<u>CHANGES FOR 2010</u>
New Health Insurance Tax Credit for Small Employers, Including Not-for-Profit Organizations	<p>Act Section 1421 created IRC Section 45R; IRS Notice 2010-44 - Small employers, employers (a) with 25 or fewer full-time-equivalent (FTE) workers; (b) paying an average FTE wage of less than \$50,000 annually; and (c) with a "qualifying health care arrangement" in place, can claim a new income tax credit up to 35 percent of the cost of providing health insurance to employees. Qualifying small employers that are tax-exempt non-profits can claim credit to 25 percent of employee health insurance costs.</p> <p>"Qualifying health care arrangement" means an employer (a) pays at least one-half of the cost of each enrolled employee's premiums; and (b) pays the same percentage for all employees, including employees with family coverage or self-plus-one coverage.</p> <p>For tax years beginning in 2010, a transition rule allows the credit when the employer doesn't pay the same percentage for each enrolled employee but pays at least one-half of the cost of single coverage, even if an employee has more expensive coverage.</p> <p>The credit commences to phase-out where the employer has (a) more than 10 FTE employees; and/or, (b) an average FTE wage in excess of \$25,000 - See Page 7.</p> <p>The income tax credit can be taken for eligible costs incurred in tax years beginning in 2010 including the period preceding enactment of the Health Care Legislation.</p>

ITEM	CHANGES FOR 2010 - CONTINUED
Healthcare Tax Benefits For Adult Children	<p>Reconciliation Bill Section 1004; IRC Sections 105(b) and 162(1); IRS Notice 2010-38 - Effective for plan years beginning after September 22, 2010, health plans that cover dependent children must cover children through age 26. Plans may provide for such coverage prior to September 22, 2010.</p> <p>The child is not required to qualify as the employee's dependent for the personal exemption deduction.</p> <p>Employer-provided health coverage for an employee's child is a tax-free benefit to the employee if the child hasn't reached age 27 by the end of the tax year.</p> <p>Reimbursements from an employer-provided cafeteria plan, healthcare flexible spending account (FSA) plan, or health reimbursement arrangement (HRA) to cover an under-age 27 child's qualified medical expenses are tax-free.</p> <p>Costs to a self-employed individual paying his/her own health insurance covering a child are eligible for the above-the-line deduction for self-employed health premiums provided the child hasn't reached age 27 by year end, regardless of whether the child is a dependent.</p>
Adoption Tax Benefits	<p>IRC Sections 36C and 137 - Increase the maximum annual tax-free employer adoption assistance payments from \$12,170 to \$13,170 and extend the program through 2011.</p> <p>Similarly, the Health Care Legislation increases the maximum annual adoption credit from \$12,170 to \$13,170 through 2011.</p> <p>The adoption credit is refundable for 2010 and 2011.</p>
New Rules for Not-for-Profit Hospitals	<p>Act Section 9007 amending IRC Sections 501(r) and 6033(b) - Establishes new rules for hospitals to qualify for tax-exempt nonprofit status; and imposes a \$50,000 excise tax on a hospital failing the Department of Human Services Regulations.</p>
No Tax Credit for "Black Liquor"	<p>Reconciliation Bill Section 1408; IRC Section 40(b)(6)(E) - Disallows the cellulosic biofuel producer credit at IRC Section 40(b) for unprocessed fuels as black liquor, the by-product of the paper milling process.</p>
New Loss Ratio Rule for Health Organizations	<p>Act Section 9016 amending IRC Section 833 - Requires a health organization have a medical loss ratio of at least 85 percent, use at least 85 percent of premium revenue for medical services reimbursement, to qualify for certain insurance company tax benefits.</p>
New Tanning Excise Tax	<p>Act Section 10907 created IRC Section 5000B - Imposes a 10 percent excise tax, collected from the customer by the provider, on indoor tanning services after June 2010.</p>

ITEM

Economic Substance Doctrine is Codified

CHANGES FOR 2010 - CONTINUED

Reconciliation Bill Section 1409; IRC Sections 7701(o), 6662(i), and 6676(c) - Provides for a 20 percent penalty on tax underpayments attributable to transactions entered into after March 30, 2010 disallowed for lack of "economic substance," 40 percent penalty for under disclosed economic substance transactions. Other penalties may also apply.

"Economic substance" is deemed to exist if the transaction (a) changes the taxpayer's economic position in a meaningful way exclusive of taxes; and, (b) is entered into for a substantial non-tax purpose.

ITEM

Employers Report Healthcare Costs on Forms W-2

CHANGES FOR 2011

IRC Section 6051(a)(14) - Requires employers to report the value of employer - provided health insurance coverage, exclusive of salary - reduction amounts contributed to healthcare flexible spending accounts, on employees' annual Form W-2, Wage and Tax Statement.

No More Tax-Free Reimbursements for Non-Prescription Drugs

Act Section 9003; IRC Sections 160(f), 220(d) and 223(d) - Currently a participant in an employer-sponsored healthcare FSA or HRA or an individual with his/her own health savings account (HSA) or medical savings account (MSA) can take tax-free withdrawals for non-prescription drugs as pain and allergy relief medications. Starting 2011, tax-favored withdrawals are limited to prescription drugs, insulin, and doctor-prescribed over-the-counter medications.

Stiffer Penalty on Nonqualified HSA and MSA Withdrawals

Act Section 9004; IRC Sections 220(f) and 223(f) - Currently withdrawals from a HSA or MSA for any reason other than for qualified medical expenses are subject to federal income tax plus a 10 percent penalty tax, 15 percent penalty tax for a MSA. Effective 2011 the penalty tax rate increases to 15 and 20 percent for nonqualified withdrawals.

New Simple Cafeteria Plans for Small Employers

IRC Section 125(j) - Provides Section 125 cafeteria benefit plans for employers with 100 or fewer employees are deemed to satisfy all applicable cafeteria benefit plan nondiscrimination rules if the plan satisfies minimum standards for eligibility, participation, and contributions.

New Tax on Drug Companies

Section 9008 of the Patient Protection Act as amended by Act Section 1404 - Imposes a \$2.5 billion nondeductible fee for 2011 on targeted manufacturers and importers of branded prescription drugs; apportioned among targeted companies based on each company's share of sales the preceding year.

Long-Term Capital Gain Tax Rates

The maximum federal income tax rate on long-term capital gains, gains on assets held more than 12 months, generally 15 percent for 2010, is scheduled to increase for 2011 as shown below.

ITEM

CHANGES FOR 2011 - CONTINUED

Maximum Federal Individual Income Tax Rates on Long-Term Capital Gains

	<u>Capital Gain Tax Rates</u>		
	<u>2008 Through</u> <u>2010</u>	<u>After 2010</u>	<u>After 2010 with</u> <u>3.8 Percent</u> <u>Medicare</u> <u>Contribution Tax</u>
General	<u>15%</u>	<u>20%</u>	<u>23.8%</u>
Taxpayer in 10%/15% income tax bracket - capital asset held more than 1 year but less than 5 years	<u>0%</u>	<u>10%</u>	<u>13.8%</u>
Taxpayer in 10%/15% income tax bracket - capital assets held more than 5 years	<u>0%</u>	<u>8%</u>	<u>11.8%</u>
Taxpayer income tax bracket greater than 15% - capital assets held more than 5 years	<u>15%</u>	<u>18%</u>	<u>21.8%</u>
Recapture straight-line depreciation on real property held more than 1 year	<u>25%</u>	<u>25%</u>	<u>28.8%</u>
Collectibles held more than 1 year	<u>28%</u>	<u>28%</u>	<u>31.8%</u>

ITEM

CHANGES FOR 2012

New Form 1099 Reporting Requirement for Business Payments to Corporations

Act Section 9006 amends IRC Section 6041(a) and (h) - Requires a business that pays \$600 or more in a calendar year to a corporation to supply the corporation a Form 1099 and file a copy with the IRS. Prior law exempted most payments to corporations from 1099 reporting requirements. The new requirement does not apply to corporations that are tax-exempt organizations.

New 1099 Reporting Requirement for Business Payments for Property

Act Section 9006 amends IRC Section 6041(a) - Requires a business that pays \$600 or more in a calendar year to a single payee, including an individual, for property and/or services generally to supply the payee a Form 1099 and file a copy with the IRS. Prior law generally exempted payments by businesses for property from 1099 reporting.

New Tax on Health Insurance Policies

IRC Sections 4375, 4376 and 4377 - Requires health insurers and sponsors of applicable self-insured health plans to pay an annual fee of \$2 per covered life for policy years ending after September 30, 2012; \$1 per life for affected policy or plan years ending during 2013.

ITEM

CHANGES FOR 2013

Additional 0.90 Percent Medicare Tax on Salaries and Self-Employment Income Earned by Higher Income Taxpayers

Act Section 9015, adding IRC Section 3101(b); amended by Act Section 10906(a); Act Section 9015(b)(1) adding IRC Section 1401(b)(2)(A), amended by Act Section 10906(b) - Currently medicare tax on salary and/or self-employment income is 2.90 percent; 1.45 percent withheld from employees and 1.45 percent paid by the employer. Self-employed individuals pay 2.90 percent medicare tax.

ITEM

CHANGES FOR 2013 - CONTINUED

Starting 2013 the employees' portion of the medicare tax, the hospital insurance portion of FICA, will increase to 2.35 percent for salaries and self-employment income in excess of:

- \$125,000 for married filing separately taxpayers;
- \$200,000 for single taxpayers; and
- \$250,000 for married filing jointly taxpayers.

The above thresholds are not adjusted for inflation. The additional .90 percent Medicare tax will increase SE tax for self-employed individuals, however, the additional .90 percent (a) does not qualify for the above-the-line deduction for 50 percent of SE tax; and, (b) must be taken into account for estimated tax purposes.

Additional 3.8 Percent Medicare Tax on Net Investment Income For High Income Individuals and Trusts

Reconciliation Bill Section 1042; IRC Sections 1411 and 6654 - Commencing 2013, net investment income is subject to a 3.80 percent medicare contribution tax.

The 3.80 percent medicare tax applies to the lesser of (a) net investment income; or, (b) modified adjusted gross income in excess of the following thresholds.

	<u>MAGI</u>
Married filing jointly	<u>\$ 250,000</u>
Married filing separately	<u>\$ 125,000</u>
Single	<u>\$ 200,000</u>

Net investment income, unearned income, includes interest, dividends, royalties, annuities, rents, gross income from passive business activities, gross income from trading in financial instruments or commodities, and long-term capital gains/net gain from property held for investment, reduced by deductions allocated to such income.

The 3.80 percent Medicare Contribution Tax is to be considered in making estimated tax payments.

For trusts, the 3.80 percent Medicare Contribution Tax will apply to the lesser of (a) undistributed net investment income; or, (b) AGI in excess of the threshold for the top trust federal tax bracket.

\$2,500 Cap on Healthcare FSA Contributions

Act Section 9005 amending IRC Section 125 - Currently there is no tax-law limit on salary-reduction contributions to an employer healthcare FSA unless the plan imposes limits. Starting 2013, the maximum annual FSA contribution by an employee will be \$2,500, indexed for inflation commencing 2014.

Higher Threshold for Itemized Medical Expense Deductions

Act Section 9013 amending IRC Section 213(a) and (f) - Current law allows an itemized deduction for medical expenses exceeding 7.5 percent of AGI. Starting 2013, the threshold is 10 percent of AGI, 2017 for a taxpayer or his/her spouse who is age 65 or older at year end. The medical deduction threshold is 10 percent of AGI for AMT.

ITEM

CHANGES FOR 2013 - CONTINUED

Eliminates Deduction for Retiree Drug Plan Subsidies

Act Section 9012 amending IRC Section 139A - Currently employers sponsoring qualified retiree prescription drug plans deduct the full cost of retiree drug plans without reduction for tax-free federal subsidies. The Health Care Legislation reduces deductions by the amount of tax-free federal subsidies.

New Excise Tax on Medical Device Manufacturers

Reconciliation Bill Section 1405; IRC Section 4191 - Sales of medical devices by manufacturers are subject to a 2.30 percent excise tax. Devices retailed to the general public as eyeglasses, contact lenses, hearing aids, etc. are exempt.

New Deductible Compensation Limit for Health Insurers

Act Section 9014 amending IRC Section 162(m)(6)(A) - Health insurance providers are limited to a \$500,000 per-person deduction annually, exclusive of deferred compensation, for compensation paid officers, employees, directors, and to certain other service providers as consultants, for services performed after December 31, 2009.

ITEM

CHANGES FOR 2014

New Penalties on Individuals Without "Adequate" Coverage

Act Section 1501 creating Reconciliation Bill Section 1002; IRC Section 5000A - In general, U.S. citizens and legal residents will be required to pay penalties if they don't obtain "adequate" health insurance coverage.

The tentative penalty equals the greater of: (a) the "applicable percentage" of household income above the threshold for filing a federal income tax return; or (b) the "applicable dollar amount" times the number of uninsured individuals in the household.

The "applicable income percentage" is 1 percent for 2014, 2 percent for 2015, and 2.5 percent for 2016 and beyond.

The "applicable dollar amount" is \$95 for 2014, \$325 for 2015, and \$695 for 2016. The \$695 is adjusted for inflation commencing 2017. "Applicable dollar amounts" for household members under age 18 are one-half the above household amounts.

The penalty for each household is limited to 300 percent of the "applicable dollar amount." For example, the maximum 2016 penalty will be \$2,085, 3 times \$695. However, if the national average cost of "bronze coverage" a new term, for the household is less, the maximum penalty will be limited to the cost of bronze coverage.

The penalty is calculated monthly using pro-rated annual amounts, if an affected individual is uninsured for only part of the year.

New Penalties on Employers

Act Section 1513 adds IRC Section 4980H - Employers with 50 or more full-time employees are required to provide employees health coverage meeting certain minimum standards or pay a \$167 per month penalty, \$2,000 per year, for each employee who is not provided "adequate" coverage for that month even if he/she purchases government subsidized coverage through a state exchange. No penalty is charged for the first 30 employees.

Government-subsidized coverage means coverage for which a federal cost-sharing subsidy is available.

An employer is also subject to a \$250 per month penalty tax for each full-time employee offered a plan providing "adequate" coverage, choosing subsidized coverage through a state exchange, provided the total penalty is limited to the penalty for outright failure to offer "adequate" coverage.

These penalties are not a deductible business expense.

New Cost-Sharing Subsidizes for Eligible Individuals

Act Section 1401 creating IRC Section 36B - Government "cost-sharing subsidies" are to help individuals ineligible for Medicare, employer-provided coverage, or other "adequate" coverage. An individual can be eligible for the "premium assistance tax credit" with income up to 400 percent of the federal poverty level, \$43,320 for one person, \$88,200 for a family of four, for 2009.

The cost-sharing subsidy, "premium assistance tax credit," is to be paid to the insurer; alternatively, the subsidy is claimed as a refundable tax credit on the eligible individual's federal income tax return.

Health Insurance Tax Credit for Small Employers

IRC Section 45R and Section 1421 of the Healthcare Legislation - Employers (a) with 25 or fewer full-time employees; (b) paying an average annual wage less than \$50,000; (c) offering health insurance provided by a state exchange to its employees; and, (d) paying at least one-half of employee's premiums, can claim a new tax credit to help pay the cost of employee health coverage.

Tax Credit as Percent of Non-Elective Costs to Employers for
Employees Health Insurance Premiums

	<u>For Profit Employers</u>	<u>Not for Profit/ Tax-Exempt Employers</u>
2010 through 2013	<u>35%</u>	<u>25%</u>
2014 through 2015	<u>50%</u>	<u>35%</u>

The FTE wage caps for credit qualification and calculation purchases are indexed for inflation starting 2014.

The credit commences to phase-out as (a) the number of full-time employees increases from 10 to 25; and/or, (b) the average annual wage increases from \$25,000 to \$50,000 - See Page 1.

For tax years beginning after 2013, the credit is available for two consecutive tax years commencing the tax year the employer offers one or more qualified health plans to its employees through a state exchange.

Employer Provided Free Choice Vouchers

Section 10108 of the Health Care Legislation - An affected employer must give a "free choice voucher" to eligible employees choosing to buy his or her own coverage instead of participating in the employer's plan. The voucher equals what the employer would have contributed on behalf of the employee if he/she participated in the employers plan.

The voucher is tax-free to the employee if he/she spends at least the voucher amount on qualified health coverage. An employee using the voucher system is ineligible for a cost-sharing subsidy for buying coverage from a state exchange.

New Excise Tax on Health Insurance Providers

Section 9010 of the Patient Protection Act as amended by Act Section 1406 - Assesses a \$8 billion fee for 2014 on targeted health insurance providers, apportioned to targeted companies based on each company's share of applicable net premiums.

New Coverage Reporting

Act Section 1502 - Requires insurers including employers that self-insure, to report information concerning an employee's coverage during a calendar year to the employee and to the Internal Revenue Service.

- * Name and address of the primary insured
- * Name, Social Security number of each other person covered under the policy
- * Dates of coverage
- * Whether coverage is through a government mandated exchange
- * Amount of any premium tax credit or cost-sharing reduction the person received
- * Other information sought by the Secretary

ITEM

CHANGES FOR 2018

New Excise Tax on "Cadillac Health Plans"

Act Section 9001 amending IRC Section 49801 - Requires (a) health insurance companies that service the group market; and, (b) administrators of employer-sponsored health plans, pay a 40 percent excise tax on premiums exceeding \$10,200 annually for self-only coverage, \$27,500 annually for family coverage; \$11,850 and \$30,950, respectively, for retired individuals and plans for employees in high-risk professions.

These thresholds may be increased for higher-than-expected inflation in health premiums. Plans sold in the individual market will be exempt, except for coverage eligible for the above-the-line deduction, self-employed health premiums.

The 2010 Health Care Legislation is said to be the most significant social legislation enacted in decades with over \$400 billion in tax increases potentially affecting all individuals and business in the United States.

Let us know if you would like to discuss this legislation as it pertains to you.