Patient Protection and 2010 Reconciliation Acts: Law, Explanation and Analysis, ¶27,010 , CLIENT LETTER #2: Patient Protection and Affordable Care Act: Individuals

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Re: Patient Protection and Affordable Care Act: Individuals

Dear Client:

The Patient Protection and Affordable Care (PPAC) Act, as amended by the Health Care and Education Reconciliation Act of 2010 (Reconciliation Act), was enacted to provide quality, affordable health care for all Americans. Although the primary thrust of the PPAC Act is health insurance reform, the tax law plays a key role in implementing that goal. Individuals both receive benefits and are subject to responsibilities under the PPAC Act. The following are highlights of the tax provisions of the PPAC Act that affect individuals. Several of these provisions take effect in 2010, but others are not effective until later years.

Penalty for failing to carry health insurance. Beginning in 2014, the PPAC Act imposes a penalty on “applicable individuals” who fail to ensure that they and their dependents have minimum essential health coverage by obtaining insurance either from a private insurer or through one of the new American Health Benefit Exchanges (AHBEs) to be established by each state by January 1, 2014. This penalty is also called a “shared responsibility payment.” The penalty is equal to the lesser of the sum of the monthly penalty amounts for the tax year, or the amount of the national average premium for qualified health plans that offer a specified minimum level of coverage; provide coverage for families the size of the taxpayer’s family; and are offered through AHBEs.

The nonprofit AHBEs are responsible for certifying that an “applicable individual” is exempt from the penalty because no affordable qualified health plan is available through the individual’s AHBE or employer, or because the individual meets the requirements for any other exemption from the penalty.

Medical benefits for children under age 27. The exclusion from gross income for reimbursements made under an employer-provided accident or health insurance plan for medical care expenses of an employee, employee’s spouse, or employee’s dependents, is extended to apply to any child of the employee who is not age 27 as of the end of the tax year. The child does not have to be a dependent of the employee for this exclusion to apply. Therefore, the exclusion applies even if the child provides more than one-half of his or her own support, earns more income than the exemption amount, or does not live with the parents. The provision is effective on the date of enactment of the 2010 Reconciliation Act.

Health insurance premium assistance refundable credit. Those individuals who cannot afford coverage may be eligible for a refundable health insurance premium assistance credit (PAC). For those purchasing coverage within an AHBE, an advanceable and refundable PAC can limit the out-of-pocket expense for silver health plan premiums. Those purchasing silver-level coverage may also qualify for cost-sharing subsidies to help pay for deductibles, copayments, etc.

The PAC operates on a sliding scale that begins at two percent of income for taxpayers at 100 percent of the federal poverty level (FPL) and phases out at 9.5 percent of income for those at 300-400 percent of the FPL. This credit applies to tax years ending after December 31, 2013.

Free choice voucher. Under the PPAC Act, individuals who cannot afford the plans provided by their employers may be eligible for a free choice voucher to help them purchase insurance through their state’s AHBE. If the amount of the free choice voucher exceeds the amount of the premium of the qualified health plan in which the qualified employee is enrolled for the month, the excess is paid to the employee. The amount of any free choice voucher provided is excluded from the employee’s gross income to the extent that the amount of the voucher does not exceed the amount paid for a qualified health plan. This exclusion applies to vouchers issued after December 31, 2013.

Itemized deduction for medical expenses. The PPAC Act increases the threshold for the itemized deduction for unreimbursed medical expenses from 7.5% to 10% of adjusted gross income (AGI) for tax years beginning after December 31, 2012. A temporary waiver of the increased threshold applies to tax years beginning after 2012 and before 2017 for individuals who are age 65 and older before the close of the tax year.

Distributions and reimbursements limited to prescribed medicines and insulin. The definition of qualified medical expense for purposes of Health Savings Accounts, Archer Medical Savings Accounts, Health Flexible Spending Arrangements, Health Reimbursement Arrangements, and other accident and health plans does not include any amounts paid for over-the counter medications. This applies to distributions from such accounts after December 31, 2010.

Reduction of Part D premium subsidy for high-income beneficiaries. Starting in 2011, the Medicare portion or premium subsidy amount has been reduced for certain beneficiaries of the Voluntary Prescription Drug Benefit Program under Medicare Part D whose modified adjusted gross income (AGI) exceeds the thresholds used under Part B. The PPAC provides the Social Security Administration with access to certain Internal Revenue Service information about taxpayers which helps in determining these reductions. This information-sharing provision is considered effective on March 23, 2010.

Additional tax on HSA and Archer MSA distributions. The PPAC Act increases the additional tax on distributions made from HSAs not used for qualified medical expenses from 10 percent to 20 percent of the amount includible in gross income. Similarly, the additional tax on distributions made from Archer MSAs not used for qualified medical expenses is increased from 15 percent to 20 percent of the amount includible in gross income. These provisions apply to distributions made after December 31, 2010.

Health FSAs offered in cafeteria plans. For tax years beginning after December 31, 2012, a Health FSA is not a qualified benefit under a cafeteria plan unless the plan provides for a $2,500 maximum salary reduction contribution to the FSA. If the plan does allow salary reductions in excess of $2,500, then an employee is subject to tax on Health FSA distributions.

Additional hospital insurance (Medicare) taxes for high-income taxpayers. In addition to the 1.45 percent employee portion of the hospital and hospital service insurance (HI) tax imposed on wages, 0.9 percent tax will be imposed on individuals who receive wages or self-employment income in excess of $200,000 ($250,000 for married joint filers, and $125,000 for married separate filers). These excess wages are subject to a total HI rate (combined employer and employee portions) of 3.8 percent. If the additional HI tax is not withheld by the employer, the employee is responsible for paying the tax. This additional HI tax does not qualify for the one-half of self-employment taxes above-the-line deduction from income. These provisions apply with respect to remuneration received, and tax years beginning, after December 31, 2012.

Medicare tax on unearned income. The 2010 Reconciliation Act imposes a 3.8 percent unearned income Medicare contribution tax on the lesser of an individual’s net investment income, or any excess of modified AGI for the tax year over a threshold amount. The unearned income Medicare contribution tax is subject to the failure to pay estimated tax penalty. The new Medicare tax applies to tax years beginning after December 31, 2012.

Excise tax on tanning salons. The PPAC Act adds a 10 percent excise tax on the cost of “indoor tanning services.” The excise tax is imposed on the full amount of the charge for the service and is imposed regardless of who pays the ultimate cost of the service, whether insurance or otherwise. Although the tax is imposed on the patron of the tanning salon, the salon owner is required to collect the taxes and remit them to the IRS on a quarterly basis. This provision applies to tanning services performed on or after July 1, 2010.

Expansion of adoption credit and adoption assistance programs. The adoption credit for qualified adoption expenses for each eligible child has been increased by $1,000 to $13,170, and is made refundable. These amounts are still indexed for inflation. An employee’s gross income does not include amounts paid or expenses incurred by an employer for the employee’s qualified adoption expenses pursuant to an adoption assistance program. The adoption credit and adoption assistance program amendments apply to tax years beginning after December 31, 2009. In addition, the previous sunset provision, which would have reduced the amount of the credit and exclusion allowable to previous levels, is extended through December 31, 2011.

Gross income exclusion for repayments under state loan programs for health care professionals. In addition to repayments under the National Health Service Corps Loan Program and state repayment programs under the Public Health Service Act, the PPAC Act excludes from gross income those repayments under other state loan repayment or forgiveness programs that are intended to provide for the increased availability of health care services in underserved or health professional shortage areas (as determined by the state). This incentive is available for amounts received by health care professionals in tax years beginning after 2008.

Qualified health care benefits of Indian tribe members. Qualified health care benefits provided after March 23, 2010 to the member of an Indian tribe, the member's spouse, or the member's dependents are excluded from the recipient's gross income. To deny a double tax benefit, this exclusion does not apply to the amount of a qualified Indian health care benefit that is not includible in the gross income of the beneficiary under another tax law provision. Similarly, the exclusion does not apply to the amount of a qualified benefit for which the beneficiary may claim a deduction under another provision.

If you have any questions regarding these health care provisions, please call our office at your earliest convenience.

Sincerely yours,