CLIENT MEMO: How will health care reform affect you and your taxes?

It's massive, and it's complicated. At more than 2,000 pages, the *Affordable Care Act* (ACA for short) has left businesses and individuals confused about what the law contains and how it affects them.

The aim of the law is to provide affordable, quality health care for all Americans. To reach that goal, the law requires large companies to provide health insurance for their employees starting in 2015. Medium-sized companies have until 2016 to provide health insurance to employees. Uninsured individuals must generally get their own health insurance starting in 2014. Those who fail to do so face penalties.

Insurance companies must also deal with new requirements. For example, they cannot refuse coverage due to pre-existing conditions, preventive services must be covered with no out-of-pocket costs, young adults can stay on parents' policies until age 26, and lifetime dollar limits on health benefits are not permitted.

The law mandates health insurance coverage, but not every business or individual will be affected by this requirement. Here's an overview of who will be affected.

FOR BUSINESSES – It's all in the numbers

- **Fewer than 50 employees**

  Companies with fewer than 50 employees are encouraged to provide insurance for their employees, but there are no penalties for failing to do so. A special marketplace is available for businesses with 50 or fewer employees, allowing them to buy health insurance through the Small Business Health Options Program (SHOP).

- **Fewer than 25 employees**

  For 2010 through 2013, small companies that paid at least 50% of the health insurance premiums for their employees could be eligible for a tax credit for as much as 35% of the cost of the premiums. To qualify, the business had to employ fewer than 25 full-time people with average wages of less than $50,000.

  For years that begin after 2013, the maximum credit is 50% of the premiums the company pays, though to qualify for the credit, the insurance must be purchased through SHOP. (Special rules apply where SHOP is not available.) The credit may only be claimed in two consecutive tax years that begin after 2013.

- **50 to 99 employees**

  Businesses with 50 to 99 employees have until January 1, 2016, to meet the requirement of providing minimum, affordable health insurance to workers or face penalties. To qualify for this transitional relief, employers must certify that they have not laid off workers in order to come under the 100 employee threshold.

- **100 or more employees**

  For companies with 100 or more full-time employees, the requirement to provide "affordable, minimum essential coverage" to employees is effective January 1, 2015.

- **The business play or pay penalty**

  Effective in 2015, companies with 100 or more employees that don't offer minimum essential health insurance face an annual penalty of $2,000 times the number of full-time employees over a 30-employee threshold. If the insurance that is offered is considered unaffordable (it exceeds 9.5% of family income), the company may be assessed a $3,000 per-employee penalty. These penalties apply only if one or more of the company's employees buy insurance from an exchange and qualify for a federal credit to offset the cost of the premiums.

FOR INDIVIDUALS – It's all about coverage

A great deal of attention has been focused on the health insurance exchanges or "Marketplace" that opened for business on October 1, 2013. Confusion about the *Affordable Care Act* left many people thinking everyone had to deal with the exchanges. The fact is that if you are covered by Medicare, Medicaid, or an employer-provided plan, you don't need to do anything.

Also, if you buy your health insurance on your own, you can keep your coverage if your plan is still offered by the insurance company. You can keep insurance that doesn't meet the law's minimum coverage requirements through October 2017 if your state permits it. However, the only way to get any premium-lowering tax credits based on your income is to buy a plan through the Marketplace.

- **The exchanges (Marketplace)**

  Each state either developed an insurance exchange (Marketplace) or uses one provided by the federal government. The Marketplace allows those seeking coverage to comparison shop for health plans from private insurance companies.

  There are four types of insurance plans to choose from: Bronze, Silver, Gold, and Platinum. The more expensive the plan, the greater the portion of medical costs that will be covered. The price of each plan depends on several factors including your age, whether you smoke, and where you live.

  Individuals may qualify for federal tax credits that will reduce the premiums they actually pay. Each state's Marketplace has a calculator to assist individuals in determining the amount, if any, of their federal tax credit.

- **The individual play or pay penalty**

  Individuals generally need to have had coverage for 2014 or pay a penalty of $95 or 1% of their income, whichever is greater. Under certain circumstances, individuals may qualify for an exemption from the requirement to have health insurance. Low-income individuals may qualify for subsidies and/or tax credits to help pay the cost of insurance.

  The penalty for 2015 is $325 or 2% of income; for 2016 it is scheduled to be $695 or 2.5% of income. For 2017 and later years, the penalty is inflation-adjusted. Those who choose not to be insured and to pay the penalty instead will still be liable for 100% of their medical bills.

MORE ABOUT THE LAW AND YOUR TAXES

In addition to the penalties required by the *Affordable Care Act*, the law made other tax changes that could affect you. Among them are the following:

- Annual contributions to flexible spending accounts are limited to $2,500 (indexed for inflation).
- The 7.5% adjusted gross income threshold for deducting unreimbursed medical expenses is now 10% for those under age 65. Those 65 and older can use the 7.5% threshold through 2016.
- The additional tax on nonqualified distributions from health savings accounts (HSAs) is 20%, an increase from the previous 10% penalty.
- The payroll Medicare tax increased from 1.45% of wages and self-employment income to 2.35% on amounts above $200,000 earned by individuals and above $250,000 earned by married couples filing joint returns. This rate increase applies only to the employee portion, not to the employer portion.
- A 3.8% Medicare surtax is imposed on unearned income (examples: interest, dividends, most capital gains) for single taxpayers with income over $200,000 and married couples with income over $250,000.

• Employer Reimbursement of Employees' Health Insurance Premiums

Employers who reimburse employees for their individual health insurance policies may find themselves in violation of the "market reform" restrictions in the ACA. The penalty for noncompliance with these restrictions is $100 per day, per employee. It's important to note that these reimbursement rules apply to all employers, regardless of size, and for health care plans effective beginning on or after January 1, 2014.

In February 2015, the IRS issued a notice temporarily delaying the penalty until June 30, 2015, for employers with fewer than 50 full-time employees. The relief includes the 2014 tax year. The underlying rules, explained below, remain in place, and employers who are not in compliance may be liable for the penalty after June 30, 2015.

Generally speaking, the ACA market reform requirements do not permit employers to subsidize or reimburse employees for individual health insurance policies on either a pre-tax or after-tax basis. It appears that employers may be allowed to increase an employee's taxable wages to provide funds that the employee may use to purchase an individual insurance policy. However, the employer may not require that the additional wages be used to pay for insurance; the employee must be allowed to decide whether to use the funds for that purpose or not.

Be aware that the IRS may issue further guidance on this issue. Because the penalties for noncompliance with the rules governing employer reimbursement arrangements are so severe, all employers should carefully review their situation to be sure they will meet the ACA requirements.

NOTE: This Memo is intended to provide you with an informative summary of the tax issues connected with the *Affordable Care Act*. This massive package of legislation contains varying effective dates, definitions, limitations, and exceptions that cannot be summarized easily. Also be aware that in the political environment surrounding this law, changes to the law have already been made and more changes could be made at any time. For details and guidance in applying the tax provisions of this law to your situation, seek professional assistance.

(Last updated 2/23/15)