

# 2010 HEALTH CARE REFORM: TAX PROVISIONS

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# How to pay for Health Care Reform?

THE ECONOMIST

THE OBAMA HEALTH CARE PLAN  
IN A NUTSHELL



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# How to pay for Health Care Reform?





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# Today's Agenda

- Timeline of Tax Provisions
- Tax Incentives
- Penalties
- Transparency
- Funding Health Care Reform

# Timeline of Tax Provisions

2010:

- Tax credit becomes available for some small businesses to help provide coverage for workers
- Imposes a 10% excise tax on individuals using tanning services
- Adds provision to disqualify unprocessed fuels, including so-called black liquor, from the section 40(b) cellulosic biofuel credit starting in 2010
- Codifies the economic substance doctrine and imposes penalties for transactions that lack economic substance

# Timeline of Tax Provisions

2010:

- New 2-year tax credit for investments in new health care therapies
- Adoption credit extended and increased for 2010 and 2011

# Timeline of Tax Provisions

2011:

- Imposes non-deductible annual flat fees on pharmaceutical manufacturers and importers based on relative market share
- Conforms the definition of qualified medical expenses for HSAs and FSAs to the definition used for medical expense itemized deductions – thus, starting in 2011, OTC drugs will no longer be eligible to be reimbursed through these vehicles
- Increases the penalty for distributions from HSAs prior to age 65 not used for qualified medical expenses from 10% to 20%
- Employers are required to disclose the value of health benefits on W-2s

# Timeline of Tax Provisions

2012:

- Requires information reporting for businesses that pay corporate providers of property and services any amount more than \$600

# Timeline of Tax Provisions

2013:

- Increases the Medicare payroll tax from 1.45% to 2.35% for individuals with wages of more than \$200,000 and \$250,000 for joint filers
- Imposes a new 3.8% tax on investment income referred to as “unearned income” for individuals with wages of more than \$200,000 and \$250,000 for joint filers
- Imposes a 2.3% excise tax on sales of most medical devices by manufacturers, producers or importers
- Limits the amount of contributions to health flexible spending accounts to \$2,500 per year
- Eliminates the deduction for the Medicare Part D subsidy for employers who maintain prescription drug plans for eligible retirees
- Increases the floor for deductible medical expenses from 7.5% of AGI to 10%
- Caps the amount of deductible executive compensation for health insurance companies at \$500,000

# Timeline of Tax Provisions

2014:

- Imposes non-deductible annual flat fees on health insurance providers and clinical labs based upon relative market share
- Increases the estimated corporate tax payments for firms owing at least \$1 billion in payments due in July, August and September 2014 by 15.75 percentage points
- Healthcare tax credits become available to help people with incomes up to 400 percent of poverty purchase coverage
- Correspondingly, employer penalties begin for not providing affordable coverage
- Employers must report health coverage information

# Timeline of Tax Provisions

2018:

- Imposes a 40% excise tax on insurance companies and plan administrators for health insurance plans above the threshold of \$10,200 for individual coverage and \$27,500 for family coverage



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# General Thoughts on New Tax Provisions

- Provide tax incentives to channel behavior
- Provide penalties to channel behavior
- Help promote the transparency of health care costs
- Most importantly, serve as a vehicle to help fund the health care reform

# Tax Incentives

- In 2010, a tax credit becomes available for some small businesses to help provide coverage for workers
  - 35% of costs paid in Phase I (2010-2013)
  - 50% of costs paid in Phase II (2014-2015)
  - Affects only very small employers
    - Full credit only available if 10 or fewer employees AND average wages of \$25,000 or less
    - Sliding scale reduction of credit between 10 and 25 employees and average wages between \$25k and \$50k (indexed for inflation)
    - Coverage must be qualifying coverage on which employer pays at least 50% of premium
    - Employee count determined based on 2,080 hour FTE standard
    - Seasonal employees and owners generally do not factor into calculation

# Tax Incentives

- Credit can be claimed by non-profits as an offset to payroll taxes but at 25% in Phase I and 35% in Phase II
- Credit only available if the small business:
  - Pays  $\geq$  50% of total cost of plan (single)
  - For years 2014 and beyond, the small business must purchase insurance coverage from the state exchange program to be eligible for the credit
  - Credit is only available for a total of 6 years
  - For 2010, total costs for the entire year are eligible for the credit, even costs paid prior to enactment

# Tax Incentives

- New two-year temporary tax credit available for investments in new therapeutic discovery projects in 2009 and 2010 (50% tax credit to encourage investments in new breakthrough medical therapies to prevent, diagnose and treat acute and chronic diseases) - \$1 billion allocated for 2 years
- Credit for child adoption increased to \$13,170 in 2010, indexed for inflation in 2011 (refundable in 2010 and 2011)

# Tax Incentives

- Individual health care tax credits become available in 2014 to help people with incomes up to 400 percent of poverty purchase coverage from the exchange:
  - Credit is available if taxpayer income is 100% to 400% of poverty level and employer does not offer coverage, or
  - Employer offers coverage but cost to employee is 9.5% of income or more or plan's share of benefits is under 60% (deemed inadequate)
  - Credit can be paid directly to insurer or claimed as a refundable tax credit on a tax return
  - Sliding scale from 100% to 400% of poverty level
  - If an employee gets assistance, the employer is generally subject to penalties



# Penalties

- As previously discussed, if an employee qualifies for the individual health care tax credit (starting in 2014), the employer is generally penalized because the employer is either not offering insurance or not offering affordable insurance coverage
  - If health coverage is not offered, the employer pays a monthly penalty of \$167 times the number of full-time employees in excess of 30 (free pass on first 30 employees)
  - If health coverage is inadequate, the employer pays a monthly penalty of the lesser of:
    - \$250 times the number of full-time employees who receive a tax credit, or
    - \$167 times the number of full-time employees in excess of 30



# Penalties

- Starting in 2018, a 40% excise tax is imposed on insurance companies and plan administrators for health insurance plans above the threshold of \$10,200 for individual coverage and \$27,500 for family coverage
  - These amounts will be indexed for inflation and may even change before 2018
  - The tax is on the excess of the annual total cost of coverage over the threshold amount
  - The annual total cost of a coverage is to be computed similarly to the current COBRA calculations
  - There are certain classes that will be allowed higher thresholds, including high-risk retirees

# Transparency

- Starting in 2011, employers are required to disclose the value of health benefits on employee's W-2s. This is informational only and will not impact the employer's or employee's tax burden
- Starting in 2014, employers must file returns with the IRS including information about employer, waiting period, employees, coverage plans, and premiums (penalties for non-compliance)



# Funding Health Care Reform

- New 10% excise tax starting July 1, 2010 on indoor tanning services (spray tans are not taxed) – expected to raise \$2.7 billion
- Starting in 2010, excludes unprocessed fuels from the Section 40(b) biofuel credit
- Starting in 2010, codifies the economic substance doctrine and imposes stiff penalties for transactions that lack economic substance



# Funding Health Care Reform

- In 2011, a non-deductible annual flat fee is imposed on pharmaceutical manufacturers and importers based on relative market share. Initial fee of \$2.5 billion. Companies with sales under \$5 million are excluded.
- In 2011, the definition of qualified medical expenses for HSAs and FSAs is conformed to the definition for medical itemized deductions. OTC drugs will no longer be reimbursable unless prescribed by a physician.
- In 2011, the penalty for distributions from HSAs prior to age 65 not used for qualified medical expenses increases from 10% to 20%.



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# Funding Health Care Reform

- Starting in 2012, businesses that pay corporate providers of property and services any amount more than \$600 are required to report such payments to the IRS. This is akin to the current 1099 reporting which requires reporting of payments to individuals and non-corporate entities but currently exempts payments to corporations. This will provide the IRS with more information-matching opportunities and more penalty potential for those who do not comply.



# Funding Health Care Reform

- Starting in 2013, the Medicare payroll tax is increased from 1.45% to 2.35% for individuals with wages of more than \$200,000 and \$250,000 for joint filers.
  - Employer share remains 1.45% for a total of 3.8%
  - Employer is to assume that the employee's only income is the income they are paid by the company and that the individual is single even if both spouses are employed by the same company
  - There will be a mechanism on the 1040 to receive a refund of any over-withheld Medicare tax



# Funding Health Care Reform

- Starting in 2013, a new 3.8% tax on “unearned” dividends, interest, rents, royalties and income and gains from passive activities
  - This tax is on the lesser of:
    - Net investment income or
    - The excess of modified AGI over the threshold amount (\$200k for single or \$250k for joint taxpayers)
  - Individuals will be responsible for estimated tax payments on this income as this income will not be covered by withholding
  - IRA and pension withdrawals from a qualified plan are not subject to this tax
  - Estates and trusts will also be subject to this tax



# Funding Health Care Reform

- Starting in 2013, the tax deduction for the Medicare Part D subsidy for employers who maintain prescription drug plans for retirees is eliminated
  - This has received a lot of immediate press since public companies were required to report the impact of this change in the quarter the tax law change took effect (March 31, 2010)
    - Boeing anticipates a charge of roughly \$150 million and AT&T anticipates a charge of about \$1 billion
  - This effectively ends what was seen as a loophole from the 2003 Medicare prescription drug program which granted employers a 28% tax-free subsidy (up to \$1,330 per retiree) for prescription drug costs but also allowed employers to deduct this subsidy as well. The subsidy is still tax-free but the deduction will be eliminated



# Funding Health Care Reform

- Starting in 2013, a new 2.3% excise tax will be imposed on sales of most medical devices by manufacturers, producers and importers. Excluded are certain “medical devices” routinely purchased by consumers such as eyeglasses, contact lens, hearing aids and other items for individual use.
- Starting in 2013, limits the amount of contributions to health flexible spending accounts to \$2,500 per year.
- Starting in 2013, the floor for deductible medical expenses is increased from 7.5% of AGI to 10%.
- Starting in 2013, the amount of deductible executive compensation for health insurance companies is capped at \$500,000 if at least 25% of the insurer’s premium income does not meet minimum government standards



# Funding Health Care Reform

- Starting in 2014, a non-deductible annual flat fee is imposed on health care providers and clinical labs based on relative market share (\$8 billion in initial year)
- The required corporate estimated tax payments factor for corporations with assets at least \$1 billion for payments due in July, August and September 2014 are increased by 15.75 percentage points
- Starting in 2018, a 40% excise tax is imposed on insurance companies and plan administrators for health insurance plans above the threshold of \$10,200 for individual coverage and \$27,500 for family coverage (Cadillac plans)

# Opportunities

- Take advantage of new tax incentives
- Avoid new penalties
- Find how to comply at the least possible cost
- Align yourself with consultants who understand and keep current with the new law and continuing developments

# Questions





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