Paul H. Burgess

Attorney at Law &
Certified Public Accountant
800 Park Centre, 525 South Main Street
Tulsa, OK 74103-4511

Tel (918) 599-7755/Fax (918) 599-7756
pburgess@barberbartz.com

April 23, 2010

Re: **The 2010 Health Care Act**

Dear Clients, Colleagues, and Friends:

The main part of the 2010 Health Care Act ("the Act") starts in 2014. Most U.S. citizens and legal residents will have to maintain "minimal essential coverage" for health insurance or pay a penalty tax on their 2014 Form 1040. More employers are likely to conclude it is in their best interest to at least offer health insurance that meets certain minimum standards. It is a push and pull piece of legislation between workers, employers and the government. It is designed to get practically everyone pitching in for health care services. To help fund the Act, starting in 2013, income taxes will increase on people earning over $200,000 (single) and $250,000 (married filing jointly). But, no matter what, one important goal remains to be seen: can this Act help our nation implement a system that more efficiently delivers health care? Time will tell, but at the risk of over simplification, the following is a brief summary of the Act and some of its provisions.

The Short Version of How the Act Works

Subject to certain exclusions, you must obtain health insurance in 2014 or pay a penalty tax. The amount of the penalty will be based on your income. But, where does one get insurance if their employer does not offer it or pay for it? The Act includes a program to make health care coverage available to all individuals; and the coverage must be "qualified." Qualified means the coverage meets certain minimum standards. In any case, what if you cannot afford the coverage? If you make less than a certain amount, you qualify for "premium assistance" tax credits which are used to buy coverage. Sounds easy enough, but how does this all relate to employers?

Employers with less than 50 employees aren't subject to the "pay or play" rules. For businesses with 50 or more employees, the penalties vary depending on whether or not the employer offers health insurance.

If the business does not offer coverage and it has at least one full-time employee who receives premium assistance, subject to some limitations, the business will be assessed a fee. Suffice to say, the fee will be enough to encourage the business to offer health care coverage.

If the business does offer coverage, but has at least one employee receiving a premium assistance credit, the company will also be assessed a penalty. Thus, the Act has a tendency to force employers to pay for health insurance for low income workers.

The theory behind the Act is if almost everyone is in the insurance pool, then insurance rates decrease. However, this is a government program interacting with an inefficient private enterprise delivery system for not exactly the healthiest group of folks. Accordingly, the cost will be high regardless. How is it going to be funded?

Higher Taxes Starting in 2013 to Pay for the Act

Higher income taxpayers will have a tax increase on wages and a new levy on investments. Single people earning more than $200,000 in wages and married couples with wages of more than $250,000 will be taxed at an additional 0.9% (almost 1%) on the earned income in excess of those thresholds. The employer will withhold the tax. Depending on your spouse's wages and your filing status, there will be many under and overpayments for the 0.9% tax that will be "even upped" on the Form 1040. Self-employed workers will have the same tax.

Here are a few examples of how the new labor tax works. If you and your spouse each make $125,000 on your W-2s, you will not be subject to the tax. If you both make $200,000 at work, none of it will be withheld from your paycheck, yet you will pay an extra $1,350 when filing your tax return. If you make $250,000 and your spouse does not work, you will have a $450 credit on your tax return for amounts withheld by your employer.

Next, there will be a 3.8% tax on net investment income of single taxpayers who have incomes above $200,000 and joint filers with incomes above $250,000. Net investment income is interest, capital gains, annuities, dividends, royalties, rental income, and profits from a passive trade or business. Notice that retirement distributions and municipal interest income escape the tax. ***Tax Planning Tip!*** It appears that earnings from S corporations whose owners are active in the business also avoid the investment income tax. However, before the investment income surtax even applies, you must have total income over those $200,000 or $250,000 thresholds.

Here are a few examples of how the investment surtax works. Suppose you make $200,000 at work and your spouse does not work outside the home and you have $50,000 dividends and interest. You will not owe the tax. Same example, but you had a $100,000 capital gain also. Now your net investment income is $150,000 and your total income is $350,000. You owe $3,800 for the tax.

The tax also applies to trusts' and estates' undistributed net investment income. Those entities will have threshold amounts based on the highest tax brackets for trusts and estates. The surtax on net investment income will not apply to corporations. Individuals have a few years to plan for this new tax as it does not take effect until 2013.

The following section of the newsletter discusses some of the key aspects of the Act which begin this year.

Some Main Provisions for 2010

√ Effective January 1, 2010, small employers that meet certain wage and number of employee criteria and who pay for at least 50% of their employees' health insurance get up to a 35% tax credit (i.e., a dollar-for-dollar reduction in tax) for premiums they pay. The employer must employ less than 25 people to get any credits. To get the full 35% credit, in addition to certain wage limitations, the company must employ 10 or fewer people. To further qualify for the credit, the average annual wages must be less than \$50,000. To get the full 35% credit, in addition to the 10 or fewer employees, the average wages must be less than \$25,000. Businesses in between the employee (11 to 24) and average wage (\$25,000 to \$50,000) thresholds will be in the phase out zone.

√ Starting July 1, 2010, there is a 10% excise tax on indoor tanning services. The person receiving a payment for the tanning services is required to collect this tax from their customers and then remit it to the IRS every quarter. My opinion is if the Act becomes more expensive than what the government has projected, there will be more excise taxes to discourage unhealthy behaviors. For example, there is already talk of a soda pop tax.

√ Starting September 23, 2010, any group health plan or health insurance issuer that offers group or individual health insurance coverage which provides coverage for dependent children must continue to make dependent coverage available for an adult child until the child turns 26 year of age. Nothing in the Act requires making coverage available to a child's child.

√ The adoption credit is expanded under the Act for tax years 2010 to 2012. The credit increases from \$12,170 to a maximum of \$13,170 and said amount is adjusted for inflation. Under the Act and prior tax law, the credit is phased out when income is between \$182,520 and \$222,520. But, under the Act, the credit is refundable, unlike the old tax law. A refundable credit means a taxpayer does not have to have a tax liability to use the credit, but rather the taxpayer can get cash back for the credit if their tax liability has been reduced to zero.

√ Effective March 23, 2010, the Act establishes the "Patient-Centered Outcome Research Trust Fund" (PCORTF) to perform research with respect to the outcomes, effectiveness, and appropriateness of health care services and procedures. The research is first funded by the government and then a tax in 2014 on insurance providers. The Act seems to be void of substantive changes that actually reduce costs versus spreading them out. Perhaps the PCORTF can identify some real cost saving approaches in the next few years.

The following section highlights a few provisions in the Act that are on the near horizon.

Some Items in the Act for 2011 to 2013

√ Beginning in 2011, employers must disclose the value of the benefit provided by them for each employee's health insurance coverage on the employee's annual Form W-2. This is a burden on small businesses. Employers will have an additional record keeping requirement. All health insurance premiums will be required to be detailed out and assigned to an employee.

√ Pharmaceutical manufacturers and importers will have to pay an annual flat fee beginning in 2011 allocated across the industry according to market share. The schedule for the flat fee is: 2011, $2.5 billion increasing to $4.1 billion in 2018 and then dropping to $2.8 billion. My opinion is the tax should be allocated based upon the number of commercials the company puts on TV. ☺

√ Starting in 2012, Form 1099 reporting will be required for many sales of personal property. The same rules already apply to intangibles such as salaries, wages, interest, dividends, etc and most real estate transactions. Now, the 1099 reporting will apply to tangible personal property as follows: if you are in a trade or business and purchase tangible personal property (from paper clips to machinery) and pay over $600 to a recipient, then you have to issue a 1099. There will be quite a few exceptions coming out. But, one example is if you are in the business of selling used cars and you purchase a car from an individual for resale, and that car cost you over $600, then you will be required to issue the seller a 1099.

√ Starting in 2013, there will be a manufacturer's excise tax of 2.3% on the sale of certain medical devices by the manufacturer, producer, or importer. A taxable medical device is any device intended for humans, except as otherwise provided. The exceptions are eyeglasses, contact lenses, hearing aids, and any other medical device determined by the IRS to be of a type that is generally purchased by the public at retail for individual use.

Conclusion - the Act and this Newsletter

This newsletter is designed to provide you a general working knowledge of the 2010 Health Care Act. The Act contains many other important provisions not mentioned in this newsletter. For example, there is a high risk pool starting in 2010. In a few years, if your employer provides health insurance, you will have an option to purchase insurance from the "Exchange" instead. There are also new business credits available for drug development.

This newsletter does not explain the many detailed computations for taxes that will be effective in a few years. As the enactment dates get closer, we will provide specific examples of their importance. We will continue studying the Act and its developments in order to keep you up to date. In the interim, if you or your business would like to know more about the Act, please contact our offices via email at **pburgess@barberbartz.com** or via telephone at **918.599.7755.**