

TAXOLUTIONS



►► *ideas on taxes*

PATIENT PROTECTION AND AFFORDABLE CARE ACT BECOMES LAW

On March 23, 2010, the Patient Protection and Affordable Care Act (Patient Protection Act) was signed into law by President Barack Obama. One week later, the President signed into law the Health Care and Education Reconciliation Act of 2010 (Reconciliation Act), completing reform of the nation's health insurance and delivery systems.

The core provisions of the Patient Protection Act, as amended by the Reconciliation Act, will go into effect over the next several years. Starting in 2010, small businesses with fewer than 25 employees that pay at least 50% of the health care premiums for their employees qualify for a tax credit of up to 35% of their premiums. This credit will increase to 50% after 2014 if insurance is purchased through an exchange. The amount of the credit for a specific business depends on the number of its employees and the average wage.

Starting in June 2010, individuals who have been unable to obtain insurance due to a pre-existing condition can join a high-risk insurance pool. Beginning this year, insurance providers may no longer deny coverage to children due to pre-existing conditions. This provision is expanded to include adults with pre-existing conditions beginning in 2014.

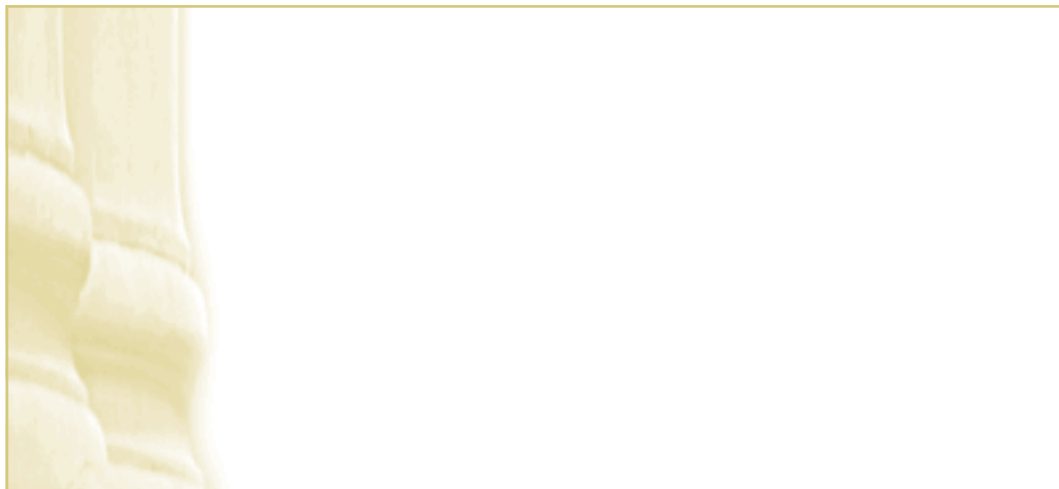
Also starting in 2010, uninsured adult children may remain on their parents' health care plans until the age of 26. Beginning in September 2010, insurance companies are prohibited from imposing lifetime maximum limits on policies and from rescinding policies, except in cases of fraud. Under the new law, the so-called "doughnut hole" in Medicare prescription drug coverage will be closed over the next several years, and beneficiaries who fall through this coverage gap qualify for a \$250 rebate in 2010.

Individual Coverage

Starting in 2014, all U.S. citizens and legal residents who are uninsured will

be required to obtain health care coverage, or pay a penalty. Those who already have insurance, individually or through their employers, will not need to make any changes, provided the coverage meets certain minimal requirements. Individuals who fail to purchase and maintain coverage will be required to pay tax penalties that will be phased in over time. An adult who fails to obtain health insurance by 2014 will be penalized \$95 or 1% of income, whichever is greater, provided the amount does not exceed the cost of a health care plan with basic coverage. In 2015, the penalty for not having insurance will increase to \$325 or 2% of income, and

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by 2016, the penalty will rise to \$695 for an adult or 2.5% of income, whichever is greater. A family's total penalty generally cannot exceed 300% of the adult flat-dollar penalty (\$285 for 2014, \$975 for 2015, or \$2,085 for 2016) or the cost of a basic health care plan. Exemptions to the penalty will be granted to individuals whose income is below the Federal income tax filing threshold; to individuals whose contributions to an employer-sponsored or basic plan through an insurance exchange would exceed 8% of household income; and to members of certain groups, including religious objectors, undocumented immigrants, incarcerated individuals, qualified members of Native American tribes, and certain hardship cases.

To assist those who cannot afford the full cost of premiums, the Federal government will expand the Medicaid program to enroll uninsured individuals with incomes below 133% of the Federal poverty level (FPL). Starting in 2014, subsidies will be provided on a sliding scale to individuals with lower to mid-level incomes who do not qualify for Medicaid. Families and individuals with incomes up to 400% of the FPL may be eligible for a premium assistance tax credit to help them purchase basic coverage through an exchange. These subsidies will not be available to individuals who are covered by employer-provided insurance, unless the workplace plan covers less than 60% of total allowed costs or the individual's contribution to the premium exceeds 9.5% of his or her income.

Employer Coverage

While employers will not be required to offer health care plans, starting in 2014, a business with 50 or more full-time employees (defined as working 30 or more hours per week) will be required to pay \$2,000 per worker per year for all workers if even one of the company's employees qualifies for and accepts a Federal health insurance premium subsidy. The first 30 employees are subtracted from the payment calculation. In addition, employers

face a potential tax penalty of \$3,000 per full-time worker per year for every full-time worker who qualifies for a health insurance coverage premium subsidy. Employers that offer health care coverage may in some cases be required to provide "free choice vouchers" to employees with incomes less than 400% of FPL whose share of the premium exceeds 8%, but is less than 9.8%, of their income and who choose to enroll in a plan in the exchange. Starting in 2011, employers and other entities providing minimum health coverage will be required to report the value of health benefits to the IRS, and this value will appear on employee W-2 forms.

Revenue-Raising Provisions

To help raise revenue to cover the costs of providing subsidies to the uninsured, the new law will broaden the Medicare tax base for higher-income taxpayers starting in 2013. This includes levying an additional Hospital Insurance tax rate of 0.9% on earned income in excess of \$200,000 for individuals and \$250,000 for married couples filing jointly, as well as a 3.8% unearned income Medicare contributions tax on higher-income taxpayers on the lesser of net investment income or the excess of modified adjusted gross income (AGI) over the same threshold amounts. Some trusts and estates will also be liable for this 3.8% tax.

An excise tax on high-cost, or "Cadillac," health plans, which was designed to raise revenue and reduce waste, will go into effect in 2018, which allows insurers time to adjust to the requirements. Starting in 2018, a 40% nondeductible excise tax will be imposed on health insurance providers or plan administrators for any health insurance plan with annual premiums in excess of \$10,200 for individual and \$27,500 for family coverage, with both amounts adjusted for inflation. For employees in certain high-risk professions and non-Medicare retirees age 55 and older, the thresholds increase to \$11,850 for individual and \$30,950 for family coverage. Insurance

providers and plan administrators are permitted to pass along the excise tax to consumers through higher premiums, as an alternative to or in combination with cost-cutting measures.

For taxpayers claiming the itemized medical expense deduction, the new law will increase the threshold to 10% of adjusted gross income (AGI), from the previous 7.5%, starting in 2013. Taxpayers age 65 and older and their spouses will be exempt from the higher threshold until 2017. The new law does not, however, adjust the allowable medical expense deduction floor for AMT purposes, which remains at 10%. Starting in 2011, provisions of the law will modify the definitions of qualified medical expenses for flexible spending accounts (FSAs), health savings accounts (HSAs), and health reimbursement arrangements (HRAs) to conform to the definition used for the medical expense itemized deduction, thereby excluding tax-free reimbursements for over-the-counter drugs not prescribed by a physician. The annual cap for contributions to FSAs will be set at \$2,500 starting in 2012, with the amount indexed for inflation in subsequent years.

In other revenue-raising provisions, the legislation levies a 10% tax on indoor tanning services starting in July 2010 and limits the deductibility of compensation for executives of health insurance companies if at least 25% of the insurer's premium fails to meet minimum essential coverage requirements. In addition, annual fees will be imposed on pharmaceutical manufacturers and importers starting in 2011 and health insurance providers starting in 2014. An excise tax of 2.3% will be levied on medical devices, excluding those routinely purchased by consumers, such as eyeglasses and hearing aids.

For more information on the Patient Protection and Affordable Care Act of 2010, as amended by the Health Care and Education Reconciliation Act of 2010, contact one of our qualified tax professionals. ■

HEALTH CARE REFORM LEGISLATION INCLUDES CLASS ACT

In addition to provisions affecting health care, the newly enacted health care reform legislation, the Patient Protection Act as amended by the Reconciliation Act, includes the CLASS Act, which establishes a Federal program designed to help Americans meet the costs of long term care (LTC). While this program is being developed over the next several years, individuals can take advantage of existing Federal tax deductions on benefits and premiums for qualified LTC insurance policies.

The Community Living Assistance Services and Supports Act (CLASS Act) creates a self-funded, voluntary program through which individuals pay a monthly premium in exchange for future cash benefits to purchase non-medical services and support necessary to maintain independent living. Enrollees become eligible for benefits after at least five years of participation.

While the CLASS Act provision goes into effect in 2011, the details of the program are expected to be developed by the U.S. Department of Health and Human Services (HHS) over the next several years. The exact amount of premiums and benefits must still be determined. Benefits will vary according

to need, but the cash amount will be no less than \$50 per day. When the program is in place and employers have signed up, workers will have the option of participating through payroll deduction. While CLASS Act benefits aren't meant to cover the entire cost of LTC, they may be an important supplement to savings, LTC insurance, or other methods of funding.

LTC insurance can cover LTC expenses before you or a loved one becomes eligible for public programs, like Medicaid. Policies vary, but in general, they provide a daily, set amount of coverage that can help cover the expenses of nursing homes, assisted living facilities, adult day care centers, and/or home health care. Under the Health Insurance Portability and Accountability Act of 1996 (HIPAA), any benefits received from a qualified LTC insurance policy are generally tax free.

Premiums for qualified LTC policies can be deducted as a medical expense, subject to the 7.5% of adjusted gross income (AGI) floor. The amount that qualifies is limited according to the age of the insured. In 2010, the qualified deduction for LTC insurance premiums is limited to \$330 for those age 40 and under, \$620

for those age 41 to 50, \$1,230 for those age 51 to 60, \$3,290 for those age 61 to 70, and \$4,110 for those over age 70.

For business owners and the self-employed, the potential tax deductions for LTC insurance are higher. Self-employed individuals or sole proprietors are entitled to deduct 100% of their out-of-pocket LTC insurance premiums, up to the eligible premium limits. While not required to meet the 7.5% AGI threshold to claim this deduction, they are not allowed to deduct LTC insurance premiums during any calendar month in which they or their spouse are eligible to participate in an employer-subsidized LTC insurance plan. In most cases, partnerships, LLCs, and S corporations are entitled to the same deduction as the self-employed. When a C corporation provides a tax-qualified LTC insurance plan as a benefit to any of its employees, the corporation is permitted to take a 100% deduction as a business expense on the total premium paid. The deduction is not limited to the aged-based eligible premiums.

For more information on the CLASS Act and other deductions for LTC insurance, consult one of our qualified tax professionals. ■

HIRE ACT PROVIDES INCENTIVES FOR HIRING AND RETAINING WORKERS

On March 18, 2010, President Barack Obama signed into law the Hiring Incentives to Restore Employment (HIRE) Act, which was designed to encourage employers to hire and retain workers. The legislation includes an exemption on payroll taxes through the end of 2010, a tax credit for hiring workers who have been unemployed, and a one-year extension of

enhanced Section 179 expensing rules for small businesses.

A large portion of the \$18 billion HIRE Act provides incentives for businesses to hire unemployed workers by offering payroll tax forgiveness through the end of the year and an additional \$1,000 credit for each qualified retained worker. Under the new legislation, a

qualified employer's 6.2% Social Security tax liability is waived for wages paid to previously unemployed new hires for any period starting after March 18, 2010 through December 31, 2010. Both full- and part-time employees can qualify employers for payroll tax forgiveness.

Generally, all private sector employers are eligible for this incentive. A

Independent Contractor or Employee?

While companies outsource jobs to independent contractors for a variety of reasons, a primary motivation is often to save money. For employees, companies are obligated to withhold Federal, state, and Social Security (FICA) taxes, and pay unemployment and workers' compensation insurance. Because these taxes and other benefits can add 20% to 30% to the cost of hiring an employee, a company may prefer to classify a worker as an independent contractor.

Business owners should be aware, however, that the IRS and other Federal agencies have strict rules to differentiate an employee from an independent contractor. According to the IRS, a hiring firm has the right to control or direct only the result of the work performed by an independent contractor, but not the means and methods of accomplishing

the job. Independent contractors may not be given extensive instructions by the hiring firm about what hours they should keep, where they should perform the work, what tools or equipment they should use, whom they may hire as assistants, or from whom they may buy supplies or services.



The IRS also views favorably evidence that the contractor has a significant investment in his or her own tools and equipment, charges flat fees, covers his or her own business expenses, and has the opportunity for both profits and losses. Independent contractors often work for a number of clients simultaneously and may publicly advertise their services.

If the IRS determines that a worker classified as an independent contractor is actually an employee, a firm will be required to pay back taxes, as well as a penalty that could amount to as much as 35% of the taxes owed. A failure to classify workers properly can also lead to charges of labor law violations. One of our qualified tax professionals can provide advice on how best to structure relationships with the people who work for your company.

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qualified employee must begin work anytime after February 3, 2010 and before January 1, 2011, and he or she may not have been employed for more than 40 hours during the 60-day period that ends on the day the worker begins employment. A qualified worker is not permitted to take the place of a current employee, unless the employee was separated from employment voluntarily or for cause, and a worker who is related to the employer or who directly or indirectly owns more than 50% of the business does not qualify. However, the incentive may apply if a business rehires a worker who was previously laid off.

In addition, businesses that hire new employees who qualify for payroll tax forgiveness and keep them on the payroll for at least 52 consecutive weeks

may qualify for an income tax credit of \$1,000 for each qualifying worker. This new incentive is provided through the Code Section 38(b) business tax credit, which is increased, with respect to each qualified retained worker, by the lesser of \$1,000 or 6.2% of wages paid by the taxpayer to the qualified retained worker during a 52-consecutive week period. Thus, given the 6.2% cap, employers would be eligible to collect the full \$1,000 credit for any newly hired employee who earns more than \$16,129 during the 52-week period.

Extending a provision originally included in 2008 stimulus legislation, the HIRE Act permits small businesses to expense up to \$250,000 of Section 179 property purchased through December 31, 2010. This is equal to the deduction amounts permitted in

2008 and 2009, and up from \$125,000 in 2007. The amount that may be expensed is reduced once the qualifying purchases exceed \$800,000 in 2010. No extension of bonus depreciation, however, was included in the bill.

The Build America Bonds program, created by the American Recovery and Reinvestment Act of 2009, is also enhanced under the HIRE Act. The program provides subsidies to municipalities issuing taxable debt. Among the tax credit bonds covered under this provision are qualified renewable energy bonds, energy conservation bonds, and school construction bonds.

For more information about the Hiring Incentives to Restore Employment (HIRE) Act of 2010, consult one of our qualified tax professionals. ■