Selected Tax Issues Under Patient Protection and Affordable Care Act (PPACA)

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Topics

- **Selected Current Provision in Effect**
  - W-2 Reporting Requirements
- **Selected Provisions Taking Effect in 2013**
  - Itemized Deductions for Medical Expenses
  - Flexible Spending Account Limits
  - Medicare Tax Increases
  - Employee Retiree Coverage Subsidy
  - Tax on Medical Devices
- **Selected Provisions Taking Effect in 2014**
  - Individual Mandate
  - Employer Shared Responsibility Payment

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New Health Care Law

Patient Protection and Affordable Care Act

(PPACA)

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Health Care and Education Reconciliation Act

(HCERA)

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W-2 Reporting Requirements

- Who is affected?
  - Employers
  - Employees
- In General:
  - Employers must report the value of healthcare benefits on employees' W-2 forms.
- Effective Date:
  - Originally slated to take begin TY2011, but delayed by the IRS.
  - Employers who file more than 250 W-2 forms:
    - Must report healthcare benefits beginning with TY2012.
  - Employers who file less than 250 W-2 forms:
    - Reporting is optional until the IRS issues further guidance.

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W-2 Reporting Requirements

- Report Aggregate Reportable Cost in box 12 on the W-2 Form, using code DD.
  - Include cost paid by employer and portion paid by employee.
  - Include cost of coverage for any covered relative under the plan.
- Amounts not Included in Aggregate Reportable Cost:
  - Contributions to any Archer MSA
  - Contributions to any Health Savings Account (HSA)
  - Salary reduction contributions to a Health Flexible Spending Arrangement (FSA)
- Reportable cost is the sum of reportable costs for each period during the year as determined by employer.
  - Must use the same method for every employee under a particular plan.

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W-2 Reporting Requirements

Acceptable ways to calculate cost of coverage:

1. COBRA applicable premium method.
   - Reportable Cost = COBRA applicable premium
   - Calculate according to I.R.C. § 4980B.
2. Premium charged method
   - Only available for employee covered under employer's insured group health plan.
   - Reportable Cost = Premium charged by insurer

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W-2 Reporting Requirements

Acceptable ways to calculate cost of coverage (con't):

3. Modified COBRA premium method.
   - Employer subsidizes the cost of COBRA:

     Reportable Cost = Reasonable good faith estimate of the COBRA applicable premium
   - Employer charges COBRA employees a COBRA applicable premium corresponding to a prior year:

     Reportable Cost = COBRA premium from that prior year
4. Composite rate method
   - If there is a single coverage class under the plan or
   - If there are different types of coverage and employees pay the same premium for each type of coverage.
   - Reportable Cost = reportable cost same for individuals in respective coverage group

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W-2 Reporting Requirements

- Applicable Employer-Sponsored Coverage
  - Coverage under any group health plan
    - Available to employees through employer
    - Excludable from employee's gross income
- Does not include
  - Long-term care coverage
  - On-site medical clinic coverage
  - Dental or eye coverage
  - Coverage for a specified illness or fixed indemnity (hospital) insurance
    - If payments not excludable from gross income and
    - Deduction not allowable

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Itemized Deductions for Medical Expenses

- Who is affected?
  - Individual Taxpayers.
- In General:
  - Deduction for medical expenses incurred by the taxpayer, taxpayer's spouse, or a dependent.
  - May not deduct expenses compensated by insurance or otherwise.
  - May only deduct expenses above the threshold
- For tax years starting after Dec. 31, 2012:
  - The threshold raises from 7.5% of AGI to 10% of AGI.

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Itemized Deductions for Medical Expenses

- Special Rule for years 2013–2016:
  - The threshold increase does not apply for taxpayers 65 and older.
  - The threshold increase does not apply for a taxpayer in any year in which the taxpayer, or the taxpayer's spouse, turns 65 before the end of the tax year.
- In 2017 the 10% threshold will apply to all taxpayers.

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Flexible Spending Account Limits

- Who is affected?
  - Individual Taxpayers
  - Employers
- In General
  - Health Flexible Spending Account (FSA): qualified benefit under a cafeteria plan, in which an employee chooses to reduce his/her cash compensation. These reductions are placed into the FSA as contributions, which are made available to reimburse the employee for medical expenses.
  - Contributions made to qualified benefits under an employer-sponsored cafeteria plan are not included in gross income for tax purposes.
  - A Health FSA provides an alternative method for employers to provide employees with tax-free health benefits.

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Flexible Spending Account Limits

- Qualified Benefits
  - A cafeteria plan may only offer qualified benefits as defined in I.R.C. § 125.
  - § 125(i), added by PPACA, provides that a Health FSA that allows contributions in excess of $2,500 is not a qualified benefit.
  - To comply with § 125, the cafeteria plan must be amended to comply with the limit, and must also comply with the limit in operation.
  - The limitation applies separately to each individual qualified employee.
    - Two spouses working for the same employer may each elect to make contributions up to the limit.
    - An employee working for two separate employers may elect to make contributions up to the limit at each position.
- Effective Dates
  - The limitation applies to all plan years beginning after Dec. 31, 2012.
  - For plan years beginning after Dec. 31, 2013, the limitation value will be increased annually to reflect increases in cost of living.

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Flexible Spending Account Limits

- Other Considerations
  - Short Plan Years: for plan years with a coverage period less than 12 months, the limitation should be prorated according to the length of the plan-year.
  - Grace Period: typically Health FSA funds are subject to the "use it or lose it rule," in which funds not used during a plan year are lost.
    - Plans may grant employees a grace period of not more than 2 ½ months in which to spend funds not used during the previous plan year.
    - Prior year funds available during a grace period do not count against an employee's $2,500 limitation for the current year.
  - Contributions not subject to the limit: The new limitation only applies to Health Flexible Spending Accounts; it does not apply to:
    - Employer non-elective contributions (flex credits), other types of FSAs (such as dependant care assistance), health savings accounts, health reimbursement arrangements, and contributions to cafeteria plans that are used to pay an employee's share of health coverage premiums.

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Flexible Spending Account Limits

- Relief for contributions exceeding the limit made by reasonable mistake
  - The employer should refund the excess amount to the employee and correct the employee's reportable wages for the applicable tax year.
  - Requirements for Correction
    - employer complied with the written plan requirements of § 125,
    - the error was due to reasonable mistake and not willful neglect, and
    - the employer's plan is not under examination for the plan year in which the erroneous contributions occurred.
  - Reporting Error:
    - Employer reports excess salary reduction contributions as taxable wages on employee's W-2 for the employee's taxable year that coincides with the plan year in which the correction is made

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Medicare Tax Increase

- Who is affected?
  - Employers
  - High Income Individuals
  - Self-Employed
- In General: 2 Changes
  - Payroll Tax Increase – 0.9%
  - Unearned Income Medicare Contribution – 3.8% tax on unearned income
- Effective Date
  - Both provisions apply to taxable years beginning after Dec. 31, 2012.

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Medicare Tax Increase – Payroll Tax

- Payroll Tax Increase: Additional 0.9% Tax Imposed
  - Collectable only on wages earned in excess of threshold amount.
- High Income Individual Threshold Amounts:
  - High Income Employees
    - Married filing jointly
      - $250,000 in annual wages
    - Married filing separately
      - $125,000 in annual wages
    - All other Employees
      - $200,000 in annual wages
  - High Income Self-employed persons
    - Married filing jointly
      - $250,000 in self-employment income
    - Married filing separately
      - $125,000 in self-employment income
    - All other Employees
      - $200,000 in self-employment income

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Medicare Tax Increase – Investment Income

- Additional 3.8 % Tax applied to high-income individuals
- Tax applies to the lesser of the following:
  - Taxpayer:
    - Net Investment Income or Excess Modified Adjusted Gross Income over the threshold amount.
  - Trust or Estate:
    - Undistributed Net Investment Income or Adjusted Gross Income (as defined in section 67(e)).

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Medicare Tax Increase – Investment Income

- High Income Individual: Threshold Amounts of Income
  - Modified Adjusted Gross Income*
    - $250,000 for Married couple filing jointly or surviving spouse
    - $125,000 for married individual filing separately
    - $200,000 for single individual and for a head of household
  - Adjusted Gross Income (§67(e))
    - $11,650 (highest tax bracket in §1(e)) for estates and trusts
  - Note: Currently, no inflation-adjusting provision

* "Modified adjusted gross income" is adjusted gross income increased by certain amounts of foreign earned income excluded from taxpayer's gross income.

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Medicare Tax Increase – Investment Income

- Net investment income is defined as the following types of income:
  - (a) gross income from interest, dividends, annuities, royalties and rents;
  - (b) net gains (e.g. capital gains) excluding gains from trade or business property (e.g. §1231 gains);
  - (c) trade or business income from a passive activity; and,
  - (d) trade or business income of trading in financial instruments or commodities (see §475(e)(2)).
- Net investment income does not include distributions from retirement plans, income already subject to self-employment tax, or certain active interests in partnerships and S-corporations
- In addition, deduction is allowed for expenses properly allocated to the income items.

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Medicare Tax Increase – Investment Income

- Real Estate Note
- Tax may apply to individuals who sold houses or other real estate
  - If real estate sale becomes investment income and individual's investment income fits the trigger for the tax.
- Principal Residences
  - The tax may apply to the sale of a principal residence if two conditions are met.
    - 1. The taxpayer(s) must qualify as a High Income Individual.
    - 2. The sale of the residence must result in a gain of over $250,000 (single taxpayer) or $500,000 (joint taxpayers).
  - The taxable gain is only the amount by which the gain exceeds the threshold.
  - Only the taxable gain will be added into Net Investment Income for purposes of calculating the Medicare Tax.

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Employee Retiree Coverage Subsidy

- Who is affected?
  - Employers
  - Retired Employees
- In General:
  - Where an employer provides coverage for retiree drug expenses for retirees who would otherwise qualify for Medicare Part D;
  - The employer may receive a “qualified retiree prescription drug plan subsidy” from the Department of Health and Human Services, which is equal to 28% of the allowable retiree costs paid by the plan sponsor on behalf of the retiree that exceed the cost threshold but not the cost limit.
- PPACA Change:
  - The employer may no longer include that portion of the plan’s expense which is offset by the subsidy as a part of its general business expense deductions.
- Effective Date
  - Applies to taxable years beginning after Dec. 31, 2012.

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Employee Retiree Coverage Subsidy

- Qualified Retiree:
  - Medicare Part D eligible individual who is not enrolled in a prescription drug plan or a Medicare Part D plan, but is enrolled in a qualified prescription drug plan.
- Allowable Retiree Costs:
  - The actual costs paid by the plan sponsor or by or on behalf of the qualified retiree under the plan. The subsidy only applies to the amount of allowable costs exceeding the cost threshold, but not exceeding the cost limit.
- Cost Threshold and Cost Limit – TY2006:
  - Threshold: $250.
  - Limit: $5,000.
- Cost Threshold and Cost Limit – After TY2006:
  - The threshold and limit amounts are indexed in the same manner as the annual deductible and out of pocket threshold as provided in 42 U.S.C. § 1395w-102.

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Tax on Medical Devices

- Who is affected?
  - Medical device manufacturers, producers, and importers.
- In General
  - Imposes an excise tax on the sale of taxable medical devices equal to 2.3% of the sale price.
  - A taxable medical device is any device defined in section 201(h) of the Federal Food, Drug, and Cosmetic Act, 21 U.S.C. 321, intended for humans
  - Excluded devices include those determined by the Secretary of the Treasury to be of a type generally sold at retail establishments to individuals for their personal use. For example: eyeglasses, contact lenses, and hearing aids.
- Effective Date
  - Applies to all sales made after Dec. 31, 2012.

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Tax on Medical Devices

- Manufacturer or Importer Pays and Reports Tax
  - Reported on Form 720, Quarterly Federal Excise Tax Return.
  - No action needed from individual consumers.
- IRS has issued proposed regulations
  - 26 C.F.R. §§ 48.4191-1 and 48.4191-2

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Requirement To Maintain Individual Coverage

- Who is affected?
  - "Applicable Individuals"
- In General:
  - All non-exempt, applicable individuals are required to maintain "minimum essential coverage;" failure to maintain coverage will result in a penalty.
  - The penalties are assessed on a per-month basis, and may begin accruing after Dec. 31, 2012.
- Penalty Effective Dates:
  - TY 2014 – Individual mandate takes effect, failure to maintain coverage results in a penalty of the greater of $95 or 1% of income.
  - TY 2015 – Penalty increases to $325 or 2% of income.
  - TY 2016 – Penalty increases to $695 or 2.5% of income.
  - The fee for an uninsured individual under age 18 is half the adult fee for the year in question provided that the total household penalty may not exceed 300% of the adult penalty.
  - TY After 2016 – Dollar amounts increase by annual cost of living adjustment.

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Requirement to Maintain Individual Coverage

- Exempted Individuals:
  - Religious objectors
  - Health care sharing ministry participants
  - Individuals not lawfully present
  - Incarcerated individuals
  - Individuals who cannot afford coverage
  - Taxpayers with income below the filing threshold
  - Members of Indian tribes
  - Individuals with short-term coverage gaps – less than 3 continuous months
  - Individuals who have received a hardship waiver
- Individuals without coverage for less than 12 months:
  - The penalty is pro-rated by the number of months without coverage.
  - No penalty for a single gap in coverage that is less than 3 months.

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Requirement to Maintain Individual Coverage

- Sources that may satisfy the requirement – "minimum essential coverage:"
  - Medicare, Medicaid, Children's Health Insurance Program, TRICARE, veteran's health program, plan offered by an employer, individual insurance that meets the Bronze level standard, a grandfathered health plan in existence before the health reform law was enacted
- Levels of Coverage
  - Bronze: designed to cover 60% of the full actuarial value of the plan benefits.
  - Silver: designed to cover 70% of the full actuarial value of the plan benefits.
  - Gold: designed to cover 80% of the full actuarial value of the plan benefits.
  - Platinum: designed to cover 90% of the full actuarial value of the plan benefits.

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Shared Responsibility for Employers

- Who is affected?
  - Large Employers: Employers with an average of 50 full time equivalent employees (FTE) for more than 120 days during the calendar year.
- In General:
  - A large employer who does not offer coverage, and who has at least one employee receiving a premium assistance tax credit will be required to make a shared responsibility tax payment.
    - This payment is $2,000 per full time employee, not including the first 30 full time employees.
  - A large employer who offers coverage, but this coverage either lacks minimum required value or is unaffordable, and as a result at least one full time employee receives a premium assistance tax credit to purchase insurance from the exchange, will be assessed a shared responsibility tax payment.
    - This payment is the lesser of $3,000 per full time employee receiving a tax credit, or $2,000 for each full time employee, not including the first 30 full time employees.

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Shared Responsibility for Employers

- Effective Date:
  - All months after Dec. 31, 2012.
- Full Time Equivalent (FTE) = Full-Time + Equivalent Part-Time
  - Full-Time Employee:
    - Employee who works at least 30 hours a week.
  - Equivalent Part-Time Employees:
    - Equivalent Number of Full-Time Employees =
      - Monthly hours worked by all part-time employees / 120.
    - Example: 12 part-timers who work 20 hrs. a month = 2 full-timers.
- FTE is used to classify an employer as a large employer, but only actual full-time employees count for purposes of satisfying the mandate.
  - Employers are not required to provide coverage for part-time employees.

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Shared Responsibility for Employers

- Two criteria to ensure that the coverage offered by an employer is adequate.
- Affordability Test – I.R.C. § 36B(c)(2)(C)(i)(II)
  - The employee's required contribution for the annual premium under the plan must be equal to or less than 9.5% of employee's household income.
    - The 9.5% figure will be indexed to reflect the extent that insurance premiums rise faster than income and consumer prices.
- Minimum Value Test - I.R.C. § 36B(c)(2)(C)(ii)
  - Employer-provided coverage provides minimum value
    - If the plan's share of the total allowed costs of benefits provided under the plan is at least 60% of such costs, for a single plan.
- Even if an employer's plan fails these tests, the employer will not have to pay a tax assessment unless one or more full time employees receive a premium assistance tax credit.

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Shared Responsibility for Employers

- Return Requirement
  - Beginning the year 2014, applicable large employers must file an annual report with IRS (first filing in 2015).
- Annual Report Requirements:
  - Employer Information
    - Name
    - Employer Identification Number (EIN)
  - Date the return is filed
  - Certification of Medical Coverage Offering
    - Certify whether the applicable large employer offers its full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage under an eligible employer-sponsored plan (as defined in § 5000A(f)(2)) and, if so, certify
      - (1) The duration of any waiting period (as defined in § 6056(b)(2)(C)) with respect to such coverage;
      - (2) The months during the calendar year when coverage under the plan was available;
      - (3) The monthly premium for the lowest cost option in each enrollment category under the plan; and
      - (4) The employer's share of the total allowed costs of benefits provided under the plan.
  - Employee Information
    - Number of full-time employees for each month of the calendar year
    - For each full-time employee, the name, address, and taxpayer identification number (TIN) of the employee and the months (if any) during which the full-time employee (or any dependents) were covered under the eligible employer-sponsored plan; and

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Potential Penalties for Large Employers

Not a large employer: Less than 50 full-time equivalent employees	Large employer: 50 or more full-time equivalent employees			
	Does not offer coverage		Offers coverage	
	No full time employees receive credits for exchange coverage	1 or more full-time employees receive credits for exchange coverage	No full time employees receive credits for exchange coverage	1 or more full-time employees receive credits for exchange coverage
No Penalty	No penalty	Number of full-time employees minus 30 multiplied by $2,000. (penalty is $0 if employer has 30 or fewer full-time employees	No penalty	Lesser of: • Number of full-time employees minus 30, multiplied by $2,000. • Number of full-time employees who receive credits or exchange coverage multiplied by $3,000. (Penalty is $0 if employer has 30 or fewer full-time employees – because penalty is based on the lesser of the two calculations)

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Questions?

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