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July 31, 2012

Mr. Smith

Supreme Court: Affordable Care Act Mandate Is a Tax

Dear Mr. Smith:

Last month, the U.S. Supreme Court held that the Affordable Care Act's individual mandate, which requires all Americans to purchase health care insurance, was constitutional. The Court upheld the mandate not under the Commerce Clause of the Constitution, but under Congress's authority to impose taxes.

The likelihood of repeal by Congress is considered remote, implementation of the Affordable Care Act will continue as scheduled through 2014. There are many aspects of this complex law that will have a major impact on the delivery of health care in this country, and ultimately affect all businesses and individuals.

Overview of Tax Provisions:

- **A 3.8% surtax on "investment income" when modified adjusted gross income is more than $200,000 ($250,000 for joint-filers).** "Investment income" includes dividends, interest, rent, capital gains, annuities, house sales, partnerships, etc. Thus, taxes on dividends will rise from 15% to 18.8% next year **–** ***if Congress extends the Bush-era tax cuts***. If Congress does not extend the Bush-era tax cuts, dividends will be taxed as ordinary income at rates ***as high as 43.8%***, compared with the current rate of 15%.

- **A 0.9% surtax on Medicare taxes for employees making $200,000 or more ($250,000 joint).** Individuals currently pay Medicare tax of 1.45%, and employers pay another 1.45% for each employee. Self-employed taxpayers pay the entire 2.9%. Next year, taxpayers with earned income over $200,000 ($250,000 if filing jointly) will pay a higher Medicare tax of 2.35% (or 3.8% for self-employed taxpayers).

- **Flexible Spending Account (FSA) contributions will be capped at $2,500.** There is no tax-related limit on how much you can set aside pre-tax to pay for medical expenses. However, beginning next year, individuals will only be able to put $2,500 in a pre-tax health care FSA to pay for qualifying medical expenses. As of January 2011, FSA funds could no longer be used for over-the-counter medicines (absent a prescription). Legislation aimed at once again allowing reimbursement with pre-tax FSA funds for over-the-counter medicines is currently under consideration in Congress.

- **The itemized-deduction threshold for medical expenses is increasing to 10%.** Right now, medical expenses over 7.5% of a taxpayer's annual adjusted gross income are deductible as itemized deductions. Next year, that threshold will rise to 10%.

- **The penalty on non-medical withdrawals from Healthcare Savings Accounts is 20% instead of 10%.** This change is already in effect. The increased penalty is twice as high as the penalty that applies to annuities, IRAs, and other tax-free vehicles.

- **A tax of 10% on indoor tanning services.** This tax has been in place since the summer of 2010.

- **A 40% tax on "Cadillac Health Care Plans" starting in 2018.** Those taxpayers whose employers pay for all or most of the cost of a comprehensive health care plan (e.g., one that costs at least $10,200 for an individual or $27,500 for families) will have to pay a 40% tax on the amount of the employer premium. The 2018 start date is said to have been a concession to the major labor unions, which often have such plans.

- **A "penalty" tax for those who don't buy health insurance.** This is perhaps the most controversial aspect of the Affordable Care Act since it will require many taxpayers to purchase health care insurance. The minimum penalty/tax will start at $95 per person beginning in 2014, but this amount will increase in stages so that in 2016 the penalty will be at least $695, but could be as high as 2.5% of the taxpayer's income over a specified base amount.

- **A Premium Assistance Tax Credit for lower income individuals.** Starting in 2014, a premium assistance tax credit is available to lower income individuals who obtain qualified coverage through an insurance exchange.

- **An additional tax on businesses that do not offer minimum essential health care insurance coverage.** Starting in 2014, a tax, called the "Employer Mandate," equal to the number of full-time employees in excess of 30 multiplied by up to $2,000 per employee, will be imposed on employers that have more than 49 employees but do not offer minimum essential coverage.

- **Small Employer Health Insurance Tax Credit.** For tax years 2010-2013, small businesses with 25 or fewer employees will be eligible for a maximum tax credit of 35% of their health insurance premium expense when the average annual wages of employees is less than $50,000 per full-time equivalent employee. This credit equals 25% in the case of tax-exempt employers.

- **Health care insurance for dependent children until age 26.** This is a requirement for group health plans and insurance issued for plan years beginning after September 23, 2010.

- **A tax on medical devices costing more than $100.** Starting in 2013, medical device manufacturers will have to pay a 2.3% excise tax on medical equipment, which will likely raise the cost of medical procedures.

- **Economic Substance Doctrine codified.** A transaction will only be treated as having economic substance if: a) the transaction changes the taxpayer's economic position in a meaningful way; and b) the taxpayer has a substantial business purpose for entering into the transaction. Transactions entered into after March 29, 2010 that do not satisfy these tests are subject to a penalty of either 20% or 40%.

If you have any questions on these topics, we would be happy to personally go over all of these rules with you or other tax-savings strategies that your financial situation may suggest – will work for you. PIASCIK provides premier tax, business, and financial services to a broad range of clients throughout the United States, Canada, UK, Germany and abroad. For more information, please visit www.piascik.com, or call Ryan L. Losi directly at (804) 228-4179.

Very truly yours,
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