

## **New Health Care Law: Individual Tax Aspects**

The new health care law includes several significant tax-related provisions for individuals as well as monumental changes for employers (see Part I). This brief article summarizes some of the main provisions of interest to individual taxpayers.

**Medicare taxes:** Currently, the 1.45% Medicare tax portion of FICA applies to “earned income,” including all wages received by individuals. There is no tax due on “unearned income.” The new health care law imposes two additional Medicare taxes:

1. Joint filers must pay a 0.9% Medicare tax on earned income in excess of \$250,000. The tax applies to single filers with earned income above \$200,000.
2. Joint filers must pay a 3.8% Medicare tax on “net investment income” if their modified adjusted gross income (AGI) exceeds \$250,000.

For this purpose, net investment income includes interest, dividends, royalties, rents, gains from dispositions of property and passive activity income. However, distributions from qualified retirement plans and IRAs do not count. Effective date: January 1, 2013.

**Medical deductions:** Currently, unreimbursed medical expenses are deductible only to the extent the annual total exceeds 7.5% of AGI. The 7.5%-of-AGI threshold will be raised to 10% of AGI. Effective date: January 1, 2013. However, an individual (and his or her spouse) who is age 65 or older will be temporarily exempt from this increase for 2013 through 2016.

**Tax on health insurance plans:** An excise tax will be imposed on insurers of employer-sponsored health plans with aggregate values exceeding \$10,200 for individual coverage or \$27,500 for family coverage. Effective date: January 1, 2018. Note that individuals are not taxed directly, but costs under these “Cadillac plans” may be passed on in the form of higher premiums.

**Individual responsibilities:** Individuals are generally required to obtain health insurance coverage or pay a nondeductible tax penalty. The penalty for most taxpayers, which is phased in over three years, will eventually be equal to \$695 per person (up to a maximum of \$2,085) per month. However, exemptions are available for certain low-income taxpayers. Effective date: January 1, 2014.

**Premium assistance credits:** Tax credits will be available to certain low-income individuals and families. Eligibility for this refundable tax credit is based on household income. The credit is generally available to taxpayers with a household income between 100% and 400% of the federal poverty level. Effective date: January 1, 2014.

**Health care accounts:** Several provisions affect tax-favored health care accounts. For instance, the annual contribution limit for a flexible spending account (FSA) is capped at \$2,500 (with future adjustments for inflation). Effective date: January 1, 2013. Also, the

tax penalty for nonqualified distributions from health savings accounts (HSAs) is increased from 10% to 20%. Effective date: January 1, 2011.

Adoption credit: The adoption credit has been made refundable. Also, the new law raises the credit dollar limit for 2010 from \$12,170 to \$13,170 and enhances the tax benefits for adopting special needs children. Finally, the enhanced adoption credit, which was scheduled to be reduced after 2010, has been extended through 2011. Effective date: January 1, 2010.

Individuals are likely to be affected by both tax and nontax provisions in this far-reaching legislation. Consult a professional adviser concerning application of the new rules.