

# A Year-By-Year Look

## *Tax Credits, Increases, Penalties and Reporting Requirements Related to Health Care Reform and Jobs Creation*

As the reality of healthcare reform begins to sink in, business owners and individuals across the country are wondering what the law means to them. The Patient Protection Act is truly a landmark – perhaps the most far-reaching piece of legislation in a generation. However, many of its details have remained shrouded in questions as “the big picture” has played out in the media.

In the mind of many Americans, the Patient Protection Act is one huge, towering entity that is set to offer incentives and credits, and impose mandates, taxes, penalties and new regulations, all at once. In fact, only a few provisions of the bill will take effect in 2010. Several do not become effective until 2014. One will not officially be imposed until 2018.

Even as the full scope of health care reform reveals itself, there are other major taxes and tax credits on the horizon. Following is a brief look at several, along with major provisions of health care reform that will come into view over the next five years. They are listed by year to illustrate the importance of proactive planning for individuals and businesses.

### 2010

**Hiring Incentives to Restore Employment Act (HIRE Act)** – The HIRE Act is a \$17.6 billion package of temporary tax breaks designed to encourage employers to expand their workforce. The centerpiece is the \$13 billion “Hire Now Tax Cut,” which rewards employers that hire workers who have been unemployed or underemployed for at least 60 days. Relief comes in the form of an exemption from Social Security payroll taxes for qualified workers hired after Feb. 3, 2010, and before Jan. 1, 2011. There is also an additional \$1,000 credit for every new employee hired during this period that is retained for 52 weeks. Unlike many tax credits, which are claimed at the end of a tax year, HIRE provides immediate cash flow relief by exempting the employer from paying the 6.2 percent payroll tax on the qualified new employee. The employee must still pay their share of payroll taxes. Savings to the employer

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depend on the worker’s salary. Based on the maximum salary subject to Social Security withholding (\$106,800), the maximum value of the credit is \$6,621 for any individual qualified employee. Qualified individuals can be hired full-time or part-time, since the benefit to the employer is based only on a percentage of salary paid. New employees who are related to the employer, or who own 50 percent of the business, do not qualify for the credit.

**New Credit for Small Employers Providing Employee Health Insurance** – Qualified small employers with no more than 25 full time equivalent (FTE) employees may be entitled to up to a 35 percent tax credit on the cost of providing health insurance for employees, starting with the 2010 tax year. To qualify, the employees must have annual full-time equivalent wages that average no more than \$50,000. However, the full amount of the credit is available only to employers with 10 or fewer FTEs, and whose employees have average annual full-time equivalent wages from the employer of less than \$25,000. The employer must pay at least half of the cost of health insurance coverage.

This credit is initially available for any tax year beginning in 2010, 2011, 2012, or 2013. Qualifying health insurance for claiming the credit for this first phase of the credit is health insurance coverage purchased from an insurance company licensed under state law. For tax years beginning after 2013, the credit is only available to an eligible small employer that purchases health insurance coverage for its employees through a state health insurance exchange, and is only available for two years. The maximum two-year coverage period does not take into account any tax years beginning in years before 2014. Thus, an eligible employer could potentially

qualify for this credit for six tax years, four years under the first phase and two years under the second phase.

Self-employed individuals, including partners and sole proprietors, two percent shareholders of an S-corporation, and five percent owners of the employer are not treated as employees for purposes of this credit. There is also a special rule to prevent sole proprietorships from receiving the credit for the owner and their family members. As a result, no credit is available for any contribution to the purchase of health insurance for these individuals, and the individual is not taken into account in determining the number of full-time equivalent employees or average full-time equivalent wages.

### 2011

**Scheduled Increases in Income Tax Rates** – Unless Congress acts to change current law, federal income tax rates will increase in 2011. The highest individual rate on earned income will increase from 35 percent to 39.6 percent. For long-term capital gains, the highest rate more than doubles from 15 percent to 39.6 percent. There are also provisions that provide for the return of a phase-out of itemized deductions and personal exemptions for higher-income taxpayers. Effective income tax rates will actually be higher than statutory rates for these high earners.

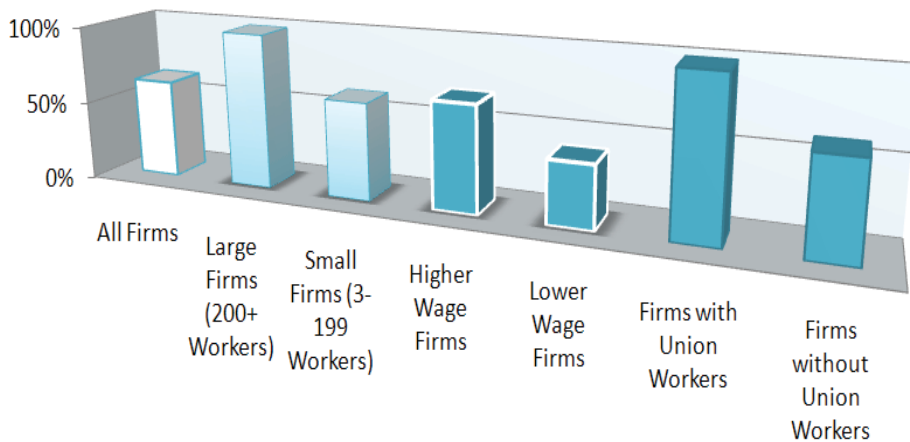
**Employer Reporting of Health Insurance Value on W-2s** – Beginning after the 2010 tax year, employers will be required to report the annual cost of health insurance coverage on employee W-2 forms. At this time, this is only a reporting requirement; there is no change in the tax-free treatment of employer-provided health coverage.

### 2012

**Expanded Form 1099 Filing Requirements** – Under current law, any business that makes payments to an individual of \$600 or more in compensation, interest, rent, royalties or income, is required to report those payments to the IRS and the recipient of the payments, using Form

### Health Insurance Offer Rates by Firm Characteristics, 2008

Percent of firms offering health benefits:



SOURCE: Kaiser/HRET Survey of Employer-Sponsored Health Benefits, 2008

1099. Effective with payments beginning in 2012, the reporting requirement will apply to payments made to corporations as well. Also effective after 2011, persons engaged in a trade or business must file a Form 1099 for payments made for the purchase of property if the gross payments exceed \$600. Copies of Form 1099 must be filed with the IRS and with the person from whom the property was purchased.

## 2013

**Medicare Surtax on Earned Income** – Currently, earnings reported on Form W-2 are subject to a Social Security tax and a separate Medicare tax. The current, overall Medicare tax rate is 2.9 percent (half paid by the employer, and half by the employee). Effective for wages earned after 2012, and additional 0.9 percent Medicare surtax will be added to amounts exceeding \$250,000 in annual income for married couples. The threshold for singles is \$200,000, and \$125,000 for married persons filing separately. The surtax applies to persons who are employees, and those who are self-employed.

**3.8 Percent Medicare Surtax on Investment Income** – In the past, the Medicare tax has only been imposed on an employee's wages or a self-employed person's earned income. Beginning in 2013, the tax will also be imposed on all or part of the net investment income (interest, dividends, annuities, royalties, rents) of married couples with modified adjusted gross income (MAGI) of \$250,000 or more, or singles with MAGI of \$200,000 or more.

## 2014

**Penalties for Failing to Carry Health Insurance** – Starting in 2014, individuals who do not have “minimum essential health coverage” will be subject to a penalty, which will be paid when an income tax return is filed. For that year, the maximum annual penalty is generally the greater of \$95 per uninsured adult in the household, or 1 percent of household income in excess of a threshold. An increase would take effect in 2015, with a maximum penalty of \$695 or 2.5 percent of household income taking effect in 2016.

**Premium Assistance for Low and Middle Income Taxpayers** – To assist low and middle income taxpayers in purchasing health care insurance, a refundable tax credit is available to qualified individuals who purchase coverage through a state-run health insurance exchange. To qualify, the individual would enroll in the state plan and report their income to the health insurance exchange. Based on this information, the premium assistance credit will be paid by the IRS. The individual will be required to pay the difference between the credit amount and the premium charged by the insurance plan.

**Penalties for Failing to Pay for Employee Health Insurance** – Most small businesses are exempt from penalties for not offering coverage to their employees. Although the new law imposes penalties on certain businesses for not providing coverage to their employees (so-called “pay or play”), most small businesses will not have to worry about this provision because employers with fewer than 50

employees are not subject to the “pay or play” penalty. For businesses with at least 50 employees, the possible penalties vary depending on whether or not the employer offers health insurance to its employees. If no coverage is offered and at least one full-time employee receives a premium tax credit, the business will be assessed a fee of \$2,000 per full-time employee, excluding the first 30 employees from the assessment. For example, an employer with 51 employees who does not offer health insurance to their employees will be subject to a penalty of \$42,000 (\$2,000 multiplied by 21). Employers with at least 50 employees that offer coverage, but have at least one full-time employee receiving a premium tax credit, will pay \$3,000 for each employee receiving a premium credit. The penalty is capped at the amount of the penalty that the employer would have been assessed for a failure to provide coverage, or \$2,000, multiplied by the number of its full-time employees in excess of 30). These provisions take effect Jan. 1, 2014.

## 2018

**Excise Tax on “Cadillac Plans”** – Beginning in 2018, a 40 percent nonrefundable excise tax will be imposed on group insurers if annual premium payments for so-called “Cadillac plans” exceed an inflation-adjusted \$10,200 for individual coverage and \$27,500 for family coverage. By this time, employers will be reporting the value of employer-provided health insurance on each employee's annual Form W-2. The tax is not on employers unless they are self-funded (which is typically seen at larger companies). It is expected that employers and employees will ultimately bear this tax in the form of higher premiums passed on by the insurer.

**Details to come** – The IRS and other federal agencies continue to fill in details on how to comply with all the provisions under the massive health care reform package. Clifton Gunderson will stay informed of any new developments, with an eye toward how to best maximize results under the new law for our clients. We are prepared to advise our clients on all compliance rules and tax-reduction opportunities that will undoubtedly arise.

**For additional information about this and other tax legislation, please visit [www.cliftoncpa.com/Resources/Tax\\_Legislation](http://www.cliftoncpa.com/Resources/Tax_Legislation).**