Affordable Care Act – What to expect in 2013 and 2014

In June 2012, the U.S. Supreme Court ruled in favor of the constitutionality of the Patient Protection and Affordable Care Act, often called Obamacare, clearing the way for the law's implementation.

The Affordable Care Act, along with the Healthcare and Education Reconciliation Act, represents the most significant regulatory overhaul of the U.S. healthcare system since the passage of Medicare and Medicaid in 1965. Aimed at reducing the number of uninsured Americans and reducing the overall cost of health care, the act provides a combination of mandates, subsidies, taxes and credits to both employers and individuals to increase the insurance coverage rate.

Although the major non-tax-related changes of the act are yet to come, a few significant tax provisions will take place in 2013 and 2014.

Many people are aware of the Medicare payroll tax and the surtax on net investment income, but there are additional provisions that may affect taxpayers. These taxes are meant to alleviate the Medicare system's financial difficulties as well as offset the cost of healthcare legislation.

Effective Jan. 1, 2013

Medical device tax

This excise tax of 2.3 percent is levied on medical device manufacturers or importers on the sale of any taxable medical device. Generally, it doesn't apply to over-the-counter medical devices, such as eyeglasses, contact lenses, hearing aids and some prosthetics.

The tax mostly applies to medical devices used and implanted by medical professionals. The manufacturer or importer of the device is responsible for paying the tax using Form 720, Quarterly Federal Excise Tax Return, which is due at the end of the month following the last month of the calendar quarter. The first quarter 2013 return is due April 30, 2013. Semimonthly tax deposits may be due if the tax exceeds $2,500 for the quarter.

Medicare payroll tax increase and surtax

The Medicare Part A (hospital insurance) tax rate on wages will be increased by 0.9 percent (from 1.45 percent to 2.35 percent) on earnings over $200,000 for individual taxpayers and $250,000 for married couples filing jointly. The increased tax will be withheld by employers, similar to the existing Medicare tax.

In addition, a 3.8 percent surtax will be imposed on net investment income if the taxpayer's modified adjusted gross income exceeds $200,000 for individual taxpayers and $250,000 for married couples filing jointly. Net investment income includes interest, dividends, annuities, royalties, rents and capital gain income.

Capital gain includes the gain from sale of a principal residence but only for that portion of the gain above the existing exclusion. Capital gains associated with an asset used in a business are not included in the definition of investment income.

Net investment income also includes trade or business income from a "passive activity" as defined in Internal Revenue Code Section 469 (and related regulations). Although some rental activities engaged in by a real estate professional are not passive activities, they may still be subject to the surtax. More guidance is needed in this area.

Net investment income is defined as gross investment income less deductions allocable to that income. Typically, investment-related deductions are certain itemized deductions subject to a number of thresholds and limits for regular income tax purposes, including the investment interest deduction, which has its own separate limitations. It appears these

see **Affordable care act** *on the back*

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Affordable care act *continued from other side*

thresholds and limitations will apply in calculating net investment income.

The 3.8 percent surtax also applies to trusts and estates on income in excess of approximately $12,000.

Limit on flexible spending contribution

A new cap of $2,500 will apply to contributions by employees to a flexible spending account. The annual $2,500 cap will be indexed for cost-of-living adjustments for plan years beginning after Dec. 31, 2013. Under previous law, no limit applied to an employee's contribution amount unless the employer imposed one.

Loss of employer retiree drug subsidy deduction

The federal tax deduction for employers who receive the Medicare Part D retiree drug subsidy coverage is eliminated. The retiree drug subsidy was established by the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 to encourage employers to continue offering prescription drug benefits to their retirees.

Employers who received the subsidy also were allowed to deduct the entire cost of the benefits. The healthcare act retains the drug subsidy but eliminates the employer's ability to deduct the amount of the subsidy.

Medical itemized deduction threshold increased

The adjusted gross income (AGI) threshold for claiming medical expenses increases from 7.5 percent to 10 percent of AGI for taxpayers 64 and under. Taxpayers 65 and older can continue to use the 7.5 percent threshold through 2016.

Effective Jan. 1, 2014

Penalty for not having medical insurance

For individuals who do not have health insurance coverage, a penalty will be assessed at the greater of $95 a year or up to 1 percent of income. The penalty increases to the greater of $325 or 2 percent of income by 2015, and the greater of $695 or 2.5 percent of income by 2016.

For families, the penalty will be capped at 300 percent of the annual flat dollar amount.

The requirement can be waived for several reasons, including financial hardship or religious beliefs. If the tax would exceed 8 percent of your income (in 2014), you are exempt. Some religious groups are also exempt. The tax cannot exceed the cost of a "bronze plan" bought on the exchange.

While some states, including Alabama, Wyoming and Montana, have passed laws to block the requirement to carry health insurance, those provisions do not override federal law.

For businesses with more than 50 full-time employees who do not offer health insurance coverage to all employees, a penalty of $2,000 per employee will be assessed. The first 30 employees are not counted in the calculation of this penalty.

Enhanced Small Business Health Insurance Credit

For businesses with fewer than 25 employees that pay an average wage to their employees of less than $50,000 per year and pay for more than 50 percent of the employees' health insurance premiums, a credit is currently allowed equal to 35 percent of the cost of the health insurance. Starting in 2014, the credit jumps to 50 percent for employers who participate in a health exchange.