Tax Season News

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Understanding the Affordable Care Act

1) Introduction

The Affordable Care Act was passed in 2010. It overhauls the U.S. healthcare system and affects nearly all taxpayers, many employers and various elements of the healthcare industry. This represents the most significant change to our healthcare laws since the passage of Medicaid and Medicare in 1965.

The new law has been phased in over multiple years spanning from 2009 to 2018. As you'll read in the article, the new healthcare law utilizes the tax code and tax return in many respects to implement its measures. The following article summarizes the important aspects of the law and separates it out between the provisions impacting individuals and other provisions impacting small businesses.

2) Higher impact provisions for individuals

You need to carry insurance beginning in 2014 unless you meet an exception

Exemptions will be granted for:

- Financial hardship,
- Religious objections,
- American Indians,
- Individuals without coverage for less than 3 months,
- Aliens not lawfully present in the U.S.,
- Incarcerated individuals,
- Individuals whose lowest cost plan option exceeds 8% of household income, and
- Individuals with income below the tax filing threshold ($9,750 single; $19,500 married filing joint)

You have several options to get health insurance

- Job-based coverage: If your employer offers health insurance coverage, you may be eligible to receive it, including your spouse or dependents. Employers may decline or restrict coverage for certain reasons (e.g. part-time worker), but not for health reasons.
- Private policy: Beginning in 2014, these plans will cost the same whether acquired directly or through an insurance exchange. However, subsidies apply only if you're using an insurance exchange.

- Medicaid: Each state offers this program for lower income people, the elderly and people with disabilities.
- Health Insurance Marketplace (exchange): Beginning in 2014, this program helps you find health insurance that fits your budget. When you use an exchange, which is run by the state or federal government, it results in a private insurance policy.

If you can't afford health insurance, subsidies are provided

The centerpiece of the legislation is to provide a subsidy or tax credit to low and middle income individuals so they can better afford to buy health insurance. Beginning in 2014, people who purchase insurance through an exchange may be eligible for the Premium Assistance Credit.

The credit is refundable and payable in advance directly to the insurer. The individual then pays the difference between the total premium and the credit. For employed individuals, the premiums can be made through payroll deductions. Direct subsidies are also available.

To figure out if you're eligible for a subsidy, you need to determine your household size and household income and see where it falls within the federal poverty line. Subsidies are available up to 400% of the federal poverty line. Up to 133% of the federal poverty line, a family needs to devote 2% of its income towards the premium, with the balance subsidized by the government. The subsidy then decreases as income goes up.

Let's say Mary is a school teacher and is single with one child. She earns $45,000 per year, which is around 300% of the federal poverty line. Under the healthcare law, Mary needs to devote 9.5% of her income, or $4,275, towards health insurance. If the average annual premium is $5,160, the government would subsidize the balance of $885. In the end, Mary would pay 83% of the premium and the government subsidy would cover 17%.

How to calculate the penalty for not having insurance

Beginning in 2014, U.S. citizens and legal residents must carry health insurance or be subject to a penalty.

The penalty is the greater of:

- $695 per year ($2,085 maximum per family), or
- 2.5% of household income

For 2014, the penalty is the greater of $95 or 1% of household income. For 2015, the penalty is the greater of $325 or 2% of household income.

- Example 1: Family of 4 with household income of $50,000 in 2016, the penalty would be $2,085.
- Example 2: Family of 4 with household income of $100,000 in 2016, the penalty would be $2,500.

What you can do prior to 2014

- Your 2012 tax return will help determine your eligibility for an insurance subsidy from the government, which will help you purchase health insurance under the healthcare law. There is nothing special to do; your tax return determines your eligibility.
- Beginning in October 2013, uninsured Americans will be able to enroll in a health plan through state exchanges.

- In 2014, everyone, except for a few, will be required to purchase health insurance or face a tax penalty.

The exchanges are run by the government, but insurance is still handled by private industry

Some people believe that the exchange is where they can go to get enrolled into a new government run insurance plan, which will be offered along with the private health care insurance plans currently available in the market today. This is not the case.

There is no government run insurance plan or single payer system established under the Affordable Care Act. The government will only run the exchanges and the insurance industry will still be run by private companies.

Public exchanges will be available in all 50 states and four levels of health insurance will be offered (platinum, gold, silver and bronze). Each insurance plan will offer “minimum essential coverage”, which is needed to avoid paying a penalty. Private exchanges will be available as an alternative to the public exchanges.

Increased Medicare taxes on high-income taxpayers

- Wages. Currently, wages are subject to a 2.9% Medicare payroll tax with the worker and employer each paying 1.45%. There is no limit to the amount of wages that are subject to the tax. Self-employed people pay both halves. Under the new law beginning in 2013, there is an additional 0.9% (2.35% in total) hospital insurance tax that applies to wages received in excess of $250,000 for joint filers and $200,000 for single filers.
- Investment income. Currently, the Medicare payroll tax only applies to wages. Under the new law beginning in 2013, the tax will also to apply to investment income, such as interest and dividends. The 3.8% surtax is levied on the lesser of net investment income or the excess of modified adjusted gross income over $250,000 for joint filers and $200,000 for single filers.

3) Higher impact provisions for small businesses

Only large employers will face penalties for not providing insurance to employees

Under the new law, small businesses with less than 50 employees are exempt from the penalty for not offering coverage to their employees. Small businesses that do offer insurance to its employees may qualify for a tax credit as an incentive.

For companies with at least 50 employees, there are penalties involved if the business does not offer health insurance.

Affordable alternatives are available, such as Health Reimbursement Arrangements and Health Savings Accounts, which allow the employer to define the contribution.

Tax credit for small employers that provide insurance for employees

In order to qualify, the small business must contribute at least one half of the cost of the premium. The business also must not employ more than 25 annual full-time equivalent employees (FTEs) and their wages cannot average more than $50,000.

The full amount of the credit is only available to a business with 10 or fewer full-time employees and their annual wages must average less than $25,000. This credit has been available beginning in 2010.

Beginning in 2014, the credit will only be available if the business purchases health insurance through a state exchange and is only available for a maximum of two years. There is no limit to the number of years that the business can take the credit for years prior to 2014.

The credit percentage is 35% from 2010 through 2013 and 50% after 2013. To arrive at the credit amount, the percentage is multiplied by the employer's non-elective contributions towards the employee's health insurance premiums. The credit phases out as the size of the business and the average wage increase.

"Cadillac tax" on high-cost health plans

Beginning in 2018, there will be a 40% excise tax levied on insurance companies when insurance premiums exceed certain amounts. This new tax won't be levied on the employer unless they provide self-funded plans. The tax applies to the extent that annual premiums exceed $10,200 for single coverage and $27,500 for family coverage.

A Few Thoughts on the ACA ("Obamacare")

Q: What do I do about the sign up problems with the health insurance exchanges?

Cover Oregon is dead on arrival, and the telephone line is long for the federal health insurance exchange. Keep checking with the insurance company you signed up with to ensure they receive your paperwork from the federal health insurance exchange if you signed up there.

Q: Would it be better to forgo health insurance coverage and pay the penalty?

There are those who simply cannot afford to pay for health insurance regardless of the government subsidy. In some cases, taxpayers can qualify for reduced or no-cost health insurance coverage (Medicare subsidy) through their state agency rather than signing up via the health insurance exchange web site. Ultimately, the decision to carry health insurance is a personal one, and there are circumstances where it may be more cost-effective to pay the penalty in lieu of higher insurance premiums.

Q: How is the government paying for subsidizing health insurance for taxpayers?

The ACA enacted the penalty tax and Medicare tax increases to offset the cost of subsidizing taxpayer health premiums. Whether or not the new taxes will offset the expense of Obamacare remains to be seen.

At the very least, the US Government should be accountable to its citizens by providing a full report of the social and economic impacts of this legislation.