Employee Benefits Committee and Business Entities Committee - The Impact of the Health Care Reform Law on Employers

Johanna M. Novak
Foster Swift Collins & Smith PC
Marquette

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I. Overview

A. The Law

The Patient Protection and Affordable Care Act ("PPACA") was signed into law on March 23, 2010. The Health Care and Education Reconciliation Act of 2010 ("HCERA"), signed one week later, both supplemented and amended (or "fixed") PPACA. The Acts are now collectively referred to as PPACA, the Affordable Care Act, ACA, Obamacare, or any number of other names. Regulations implementing PPACA have been and are still being issued on a fast and furious pace, making compliance with the law an ongoing battle.

B. The Cost of Reform

Gross Cost of Health Coverage Provisions. The Congressional Budget Office ("CBO") has estimated that the gross cost of direct governmental spending on PPACA's health coverage provisions between 2013–2022 to be $1.620 trillion. This includes spending on health insurance exchange subsidies, the small employer health care tax credit, Medicaid expansion, and other related items.

Revenues Related to Health Coverage Provisions. The CBO also estimated revenues related to health coverage provisions over that same time period at $455 billion. These revenues will consist of employer shared responsibility penalties, individual shared responsibility penalties, excise taxes on high-premium health insurance coverage, and savings from other coverage-related provisions.

Net Cost. This leaves the net cost of the health coverage related provisions at $1.165 trillion. That said, PPACA contains additional cost reductions and revenue increases that are unrelated to the health coverage provisions, which will further reduce the cost of reform. Cost reductions (primarily related to the Medicare program) are expected to exceed $700 billion. Revenue increases totaling $569 billion are expected from the addi-

tional Medicare payroll tax, the new net investment income tax, and from imposition of additional fees and taxes on certain manufacturers and insurers. In total, the CBO estimates that PPACA will reduce federal deficits over a ten-year period.

II. Employer Shared Responsibility Provisions

A. Applicability

PPACA's Employer Mandate, also referred to as the Shared Responsibility for Employers Regarding Health Coverage, requires large employers to offer health coverage that is affordable and of a minimum value to full-time employees and their dependents, or be subject to a penalty. A large employer is an employer that employed an average of at least 50 full-time employees (including full-time equivalents) during the preceding calendar year. The employer mandate becomes effective January 1, 2014. This means that an employer must review its 2013 staffing numbers to determine whether it will be considered a large employer in 2014.

B. No Offer of Coverage

Any large employer that does not offer health coverage to its full-time employees and their dependents may be subject to a penalty pursuant to 26 U.S.C. §4980H(a). This section provides that if (i) any large employer fails to offer to its full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage under an employer sponsored plan for any month, and (ii) at least one full-time employee enrolls in a qualified health plan offered through a Health Insurance Exchange for such month, with respect to which a premium tax credit or cost-sharing reduction was allowed or paid for such employee, then the employer shall be subject to a penalty equal to the product of 1/12 of $2,000 and the number of individuals employed as full-time employees during such month, reduced by 30.

As you can see, the penalty is "triggered" if at least one full-time employee enrolls in health insurance coverage through an Exchange and qualifies for a premium tax credit or cost-sharing subsidy. If this occurs, then the employer will be subject to a $166.67 monthly penalty (or, a $2,000 annual penalty if no coverage was offered for the entire year) for each full-time employee, regardless of the number of employees who actually triggered the penalty. When calculating this penalty, the large employer is permitted to disregard the first 30 of its full-time employees.

Example. Assume that a large employer has 100 full-time employees and does not offer employee health insurance coverage at any time for 2014. If at least one full-time employee obtains health coverage through the Exchange and qualifies for premium tax credit or cost-sharing subsidy, the penalty would be calculated as follows:
(100 - 30) x $2,000 = $140,000 penalty. The penalty is not tax deductible.

C. Some Coverage Offered

Large employers that do offer health coverage to full-time employees and their dependents may still face a penalty pursuant to 26 U.S.C. §4980H(b). If a large employer offers to its full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage under an employer sponsored plan for any month, but the coverage is either not affordable to an employee or does not provide minimum value, and a full-time employee enrolls in a qualified health plan through a Health Insurance Exchange for such month, with respect to which a premium tax credit or cost-sharing subsidy was

allowed or paid for such employee, then the employer shall be subject to a penalty of $250.00 per month for each such employee (or, $3,000 per year for each such employee).

Example. Suppose, for example, a large employer with 100 full-time employees offers health coverage to full-time employees and their dependents, but the coverage does not provide minimum value. If three of those full-time employees purchase their own health coverage through the Exchange and qualify for premium tax credits or cost-sharing subsidies, the employer would be penalized $3,000 x 3, or $9,000. This penalty is not tax deductible. In addition, any penalty under §4980H(b) is capped at whatever the penalty would have been under §4980H(a) had the employer offered no coverage.

Affordable Coverage. Health coverage is affordable for an employee if the employee's required contribution to premium for self-only coverage in the employer's lowest cost plan that provides minimum value does not exceed 9.5% of the:

- employee's annual household income
- employee's W-2 wages
- employee's monthly rate of pay, or
- federal poverty line for an individual.

Minimum Value. Health coverage provides minimum value if it covers at least 60% of medical costs. An employer may determine if coverage meets the minimum value standard by using a minimum value calculator, safe harbor checklists, or actuarial certification. The minimum value calculator is available at the following website: *cciio.cms.gov/resources/files/mv-calculator-final-2-20-2013.xlsm.*

D. Making a Penalty Payment

The IRS has stated that it will contact employers to inform them of their potential liability and provide them an opportunity to respond before any liability is assessed or notice and demand for payment is made. This contact will not occur until sometime after April 15th of the year following the year in question. If it is determined that an employer is liable for an Employer Shared Responsibility payment after the employer has responded to the initial IRS contact, the IRS will then send a notice and demand for payment. That notice will instruct the employer on how to make the payment. Employers will not be required to include the Employer Shared Responsibility payment on any tax return that they file.

E. Helpful Links

IRS Guidance: http://www.irs.gov/uac/Newsroom/Questions-and-Answers-on-Employer-Shared-Responsibility-Provisions-Under-the-Affordable-Care-Act

Proposed Regulations: http://www.irs.gov/pub/newsroom/reg-138006-12.pdf

III. Individual Shared Responsibility Provisions

A. Applicability

PPACA's individual shared responsibility provisions, also known as the Individual Mandate and found at 26 U.S.C. §5000A, require that a non-exempt individual maintain minimum essential health coverage starting in 2014, or be subject to a penalty.

Exempt Individuals. Certain individuals are exempt from the Individual Mandate, including the following:

- Religious conscience objectors
- Members of a health care sharing ministry
- A person who is a nonresident alien or not lawfully present in the United States
- Individuals incarcerated after being convicted of a crime
- Individuals who cannot afford coverage because the required contribution to coverage exceeds 8% of household income
- Individuals whose household income is below the applicable filing threshold
- Members of Indian tribes
- Individuals with hardship exemption certification
- Individuals with coverage gaps of less than 3 months

Minimum Essential Coverage. Non-exempt individuals must maintain minimum essential coverage for themselves and their tax dependents (generally referred to as the shared responsibility family) if they want to avoid the Individual Mandate penalty provisions. Minimum essential coverage includes coverage offered by a government program (such as Medicare or Medicaid, for example), coverage under most employer-sponsored plans, a plan purchased in the individual market, foreign health coverage, or self-funded student health coverage.

B. Penalty Provisions

The proposed regulations provide that the shared responsibility payment for a taxable year is the lesser of: (1) the sum of the monthly penalty amounts for each individual in the shared responsibility family, or (2) the sum of the monthly national average bronze plan premiums for the shared responsibility family. The shared responsibility family includes the taxpayer, the taxpayer's spouse (if filing a joint return) and any person for whom the taxpayer properly claims a deduction for a personal exemption under Code Section 151 for the taxable year.

Monthly Penalty Amount. The monthly penalty amount means 1/12 multiplied by the greater of: (1) the flat dollar amount, or (2) the excess income amount.

Flat Dollar Amount. The flat dollar amount is the sum of the "applicable dollar amounts" for all individuals included in the taxpayer's shared responsibility family. The applicable dollar amount for 2014 is $95. This amount increases to $325 in 2015 and $695 in 2016. Theoretically, for a family of 5, the flat dollar amount in 2014 could be the $95 applicable dollar amount x 5. However, the flat dollar amount is always capped at 300% of the applicable dollar amount. In addition, when calculating the flat dollar amount, the applicable dollar amount is halved for all individuals under the age of 18 in the shared responsibility family.

Excess Income Amount. The excess income amount is the excess of the taxpayer's household income over the taxpayer's applicable filing threshold, multiplied by the income percentage. The income percentage is 1% in 2014, 2% in 2015, and 2.5% in 2016.

C. Example from Proposed Regulations

In 2016 Taxpayer G is an unmarried individual with no dependents. G does not have minimum essential coverage for any month in 2016. G's household income is $120,000. G's applicable filing threshold is $12,000. The annual national average bronze plan premium for G is $5,000.

For each month in 2016, G's applicable dollar amount is $695. As a single taxpayer, G's flat dollar amount is $695. G's excess income amount is $2,700 (($120,000 - $12,000) x 2.5%). Therefore, the monthly penalty amount is $225 (the greater of $58 ($695/12) or $225 ($2,700/12)). The sum of the monthly penalty amounts is $2,700 ($225 x 12). The sum of the monthly national average bronze plan premiums is $5,000 ($5,000/12 x 12). Therefore, the shared responsibility payment imposed on G for 2016 is $2,700 (the lesser of $2,700 or $5,000). *See Proposed Reg. 1.5000A-4(d)(Example 1).*

D. Making a Penalty Payment

The IRS has stated that taxpayers will have to account for coverage or make any payments when they file their 2014 federal income tax return in 2015. The IRS is planning to make additional information available at a later date about how the income tax return will take account of health coverage. Insurance companies will be required to provide everyone that they cover each year with information that will help them demonstrate that they had coverage. Note that the law prohibits the IRS from using liens or levies to collect payments owed related to the Individual Mandate.

E. Helpful Links

IRS Guidance: http://www.irs.gov/uac/Questions-and-Answers-on-the-Individual-Shared-Responsibility-Provision

Proposed Regulations: http://www.irs.gov/PUP/newsroom/REG-148500-12%20FR.pdf and http://www.gpo.gov/fdsys/pkg/FR-2013-02-01/pdf/2013-02139.pdf

IV. Additional Medicare Tax

A. Applicability and Effective Date

PPACA amended the hospital insurance provisions found in 26 U.S.C. §3101(b) to impose an additional 0.9% tax on wages (or self-employment income) received by every taxpayer (other than a corporation, estate, or trust) over a certain threshold during any taxable year beginning after December 31, 2012. This new tax is called the Additional Hospital Insurance Tax, or the Additional Medicare Tax ("AMT"). The AMT does not increase the employer portion of the hospital tax.

B. Threshold Wages

The AMT is imposed only on wages received with respect to employment which are in excess of the following thresholds.

Married/joint return	$250,000
Married/separate returns	$125,000
In any other case	$200,000

Example: B, a single filer, has $220,000 in wages. B is liable to pay AMT on $20,000, because that is the amount in excess of the applicable threshold for a single filer. B's AMT would be: $20,000 x .009 = $180.

C. Collection by Employer

An employer is required to collect the AMT from an employee only if the employer pays wages to the employee in excess of $200,000 in a calendar year. This is true regardless of the employee's actual filing status or any other income received by the employee. The employer has this withholding obligation even though the employee ultimately may not be liable for the AMT because, for example, the employee's wages together with the wages of his or her spouse do not exceed the $250,000 threshold for married persons filing a joint return. The employer should begin withholding the AMT in the pay period in which the employer pays wages to the employee in excess of $200,000.

Example: Employer pays wages to Employee A in the amount of $150,000 per calendar year and wages to Employee B in the amount of $150,000 per year. A and B are married to each other. Employer therefore knows that the combined wages of A and B will exceed the applicable threshold. However, Employer should not withhold AMT from A or B because Employer is not paying wages in excess of $200,000 to either one.

D. Reporting

A new line 5d has been added to Form 941 on which an employer must report any employee wages paid that are subject to the AMT and on which the employer will report its AMT withholding liability for those wages. The line used to report the regular Medicare tax on all wages remains the same. No changes will be made to the Form W-2 as the AMT withholding will be reported in combination with withholding for the regular Medicare tax in Box 6.

E. Helpful Links

IRS Guidance: http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Questions-and-Answers-for-the-Additional-Medicare-Tax

Proposed Regulations: www.gpo.gov/fdsys/pkg/FR-2012-12-05/pdf/2012-29237.pdf

V. Net Investment Income Tax

A. Applicability and Effective Date

PPACA added new section 1411 to the Internal Revenue Code which imposes a 3.8% tax on certain net investment income (the "Net Investment Income Tax", or "NIIT") of individuals, estates and trusts. The NIIT is effective for tax years beginning after December 31, 2012.

B. Net Investment Income

Investment income generally includes interest, dividends, capital gains, rental income, royalty income, non-qualified annuities, income from businesses involved in trading of financial instruments or commodities, and businesses that are passive activities to the taxpayer. To calculate net investment income, gross investment income should be reduced by deductions that are properly allocable to such gross investment income. See Prop. Treas. Reg. 26 C.F.R. §1.1411-4. Net investment income does not include wages, unemployment compensation, operating income from a non-passive business, Social

Security benefits, alimony, tax-exempt interest, self-employment income, and certain qualified plan distributions. In addition, the NIIT will not apply to any amount of gain that is excluded from gross income for regular income tax purposes, such as certain gain realized with the sale of a primary residence at 26 U.S.C. §121.

C. Individuals

An individual will owe the tax if they have net investment income and also have modified adjusted gross income ("MAGI") over the following thresholds:

Married/joint return	$250,000
Married/separate returns	$125,000
In any other case	$200,000

Such an individual would be liable for the 3.8% NIIT on the lesser of: (1) net investment income for the taxable year, or (2) the excess (if any) of modified adjusted gross income ("MAGI") for the taxable year over the applicable threshold.

Example 1: Jane, a single filer, has wages of $150,000 in 2013. She also received $40,000 of net investment income in the form of dividends and capital gains. Her MAGI is therefore $190,000. Because her MAGI is less than the $200,000 threshold for individuals, she is not subject to any NIIT.

Example 2: John, a single filer, has $190,000 in wages and $75,000 in net investment income from a passive business activity. John's MAGI is therefore $265,000, which is higher than the $200,000 threshold applicable to single filers. This means that John is subject to the NIIT. The NIIT is 3.8% of the lesser of (1) his net investment income of $75,000, or (2) the excess of his $265,000 MAGI over the $200,000 threshold, which is $65,000. His NIIT is therefore $65,000 x .038 = $2,470.

D. Estates and Trusts

An estate or trust is subject to the NIIT if it has undistributed net investment income and also has adjusted gross income over the dollar amount at which the highest tax bracket for an estate or trust begins for that taxable year. The IRS has stated that for tax year 2012, this threshold amount is $11,650. An estate or trust with undistributed net investment income and adjusted gross income above that threshold amount must pay a tax equal to 3.8% of the lesser of: (1) undistributed net investment income for the taxable year, or (2) the excess (if any) of adjusted gross income over the dollar amount at which the highest tax bracket begins (at 26 USC §1(e)) for the taxable year.

Exemptions. Charitable trusts, qualified retirement plan trusts, and grantor trusts are generally exempt from the NIIT. Proposed Treasury Regulation 26 C.F.R. §1.1411-3(b) contains a full list of exempt trusts.

E. Reporting

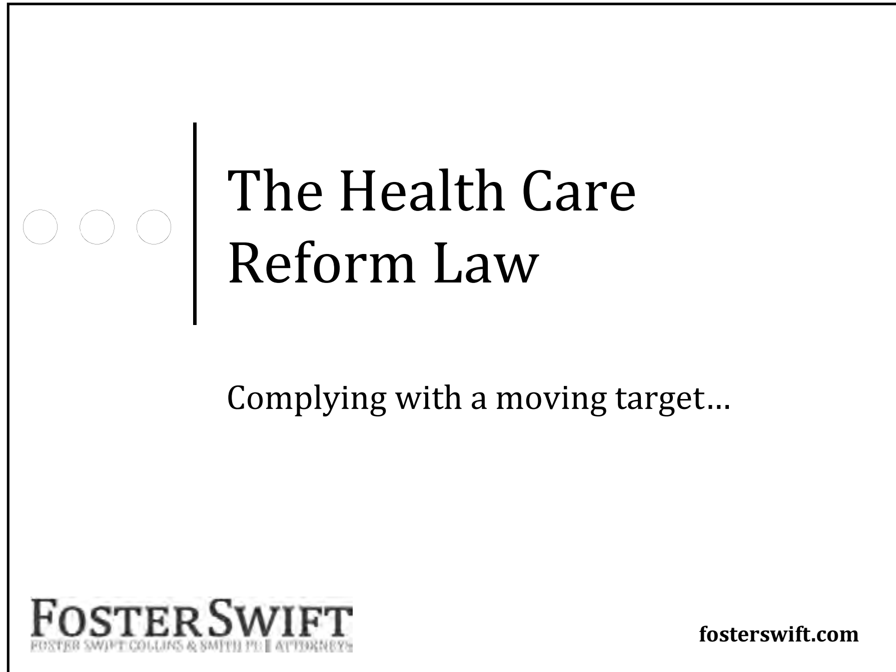
Individuals should report and pay any NIIT on Form 1040. Estates and trusts should report and pay any NIIT on Form 1041.

F. Helpful Links

IRS Guidance: http://www.irs.gov/uac/Newsroom/Net-Investment-Income-Tax-FAQs

Proposed Regulations: https://www.federalregister.gov/articles/2012/12/05/2012-29238/net-investment-income-tax

Exhibit A
PowerPoint Presentation



Health Insurance Marketplace

- An online market where individuals and small businesses can go to easily compare and purchase insurance policies from different carriers.
- 5 minutes or less!
- Open enrollment begins in October, 2013.
- Michigan will not operate its own Marketplace in 2014.

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The Marketplace

- Plans offered through the Marketplace will be organized into metal tiers and will pay for the specified percentage of costs as follows:
  - Bronze: 60 percent
  - Silver: 70 percent
  - Gold: 80 percent
  - Platinum: 90 percent
- Each policy must provide at least an "essential health benefits" package. Essential health benefits include: (i) ambulatory and emergency, (ii) hospitalization, (iii) maternity and newborn care, (iv) mental health and substance disorders, etc.
- There is an exception for catastrophic plans, which may only be offered to individuals who are less than 30 years old or who are otherwise exempt from maintaining minimum essential coverage.

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Premium Assistance Tax Credit

- Provided to lower the amount of premium that the individual or family must pay for their coverage purchased through the Marketplace.
- Only individuals or families with income from 100% to 400% of the federal poverty level ("FPL") will be eligible for the credit.
- Spending 2014-2023: $767 billion (CBO 2013 Estimate)

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Premium Assistance Tax Credit

Income Level %	Income in Dollars (single person)	Income in Dollars (two person household)	Percentage of Income that must be Contributed Towards Premiums
100 - 133% FPL	$11,490 - $15,281	$15,510 - $20,628	2% of income
133 - 150% FPL	$15,281 - $17,235	$20,628 - $23,265	3 – 4% of income
150 - 200% FPL	$17,235 - $22,980	$23,265 - $31,020	4 – 6.3% of income
200 - 250% FPL	$22,980 - $28,725	$31,020 - $38,775	6.3 – 8.05% of income
250 – 300% FPL	$28,725 - $34,470	$38,775 - $46,530	8.05 – 9.5% of income
300 - 400% FPL	$34,470 - $45,960	$46,530 - $62,040	9.5% of income

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Example

- Bob purchases a plan from the Exchange. Bob is 35 years old and his annual household income is $17,240, or 150% of the FPL. He purchases a silver plan through the Marketplace. The annual premium cost for this plan is $3,962. Bob will be expected to contribute 4% of his household income towards this premium cost, or $689 ($17,240 x .04). The remaining premium cost ($3,273) will be paid through the premium assistance tax credit.

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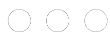
Cost-Sharing Subsidies

- Income ranging from 100% - 250% of the FPL: Increases the actuarial value of the policy.
- Income ranging from 100% - 400% of the FPL: Reduces the out-of-pocket maximum cost associated with the policy.
- Spending 2014-2023: $180 billion



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Employer Mandate

- Also known as the "Employer Shared Responsibility Provisions."
- Starting in 2014, an employer with 50 or more full-time employees (including full-time equivalents) must offer <u>affordable</u> health coverage of a <u>minimum value</u> to full-time employees and their <u>dependents</u> or be subject to a penalty. See 26 U.S.C. § 4980H.

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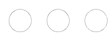

Affordability

- Coverage will be considered affordable if the employee's required contribution to the <u>self-only premium</u> for the employer's lowest-cost coverage (that provides minimum value) does not exceed 9.5% of:
  - the employee's household income;
  - the employee's W-2 wages;
  - the employee's monthly rate of pay; or
  - the annual federal poverty line for individuals.

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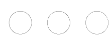
Minimum Value

- Health coverage provides a minimum value if the plan's share of total medical costs is at least 60%.
- The Department of Health and Human Services has created a minimum value calculator for employers to use to determine if their plan provides minimum value.
- *cciio.cms.gov/resources/files/mv-calculator-final-2-20-2013.xlsm*
- Safe harbor checklists will also be created, which will allow an employer to compare its plan to the safe harbor plans. If the employer's plan is consistent with or more generous than any one of the safe harbor checklists, then the employer's plan would be treated as providing minimum value.
- Actuarial certification is also permissible.



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Penalty – No Coverage Offered

- If the employer offers no health coverage, and at least one full-time employee qualifies for a premium assistance tax credit or cost-sharing subsidy when purchasing through the Health Insurance Marketplace, then the penalty provisions under **§4980H(a)** apply.

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Section 4980H(a) Penalty

- The §4980H(a) penalty provides that for this employer, the penalty will be equal to $2,000 per year per full-time employee (reduced by 30 full-time employees).
- This penalty will actually be calculated on a monthly basis, with the penalty being the product of the # of full-time employees for that month (reduced by 30 full-time employees) and 1/12 of $2,000.

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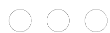

Example

- Employer offered no coverage to full-time employees and their dependents for any month in 2014. Employer has 100 full-time employees. One goes to Marketplace and qualifies for subsidies. Penalty calculation: (100-30) x $2,000 = $140,000
- Penalty amount is not tax deductible.

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Penalty – Some Coverage Offered

- If the employer offers health coverage to its full-time employees and their dependents that is either not affordable to the employee or does not provide minimum value, and a full-time employee qualifies for a premium assistance tax credit or cost-sharing subsidy in the Marketplace, then the penalty provisions under **§4980H(b)** apply.

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Section 4980H(b) Penalty

- The §4980H(b) penalty provides that for this employer, the penalty will be equal to $3,000 per year per full-time employee who qualified for the Marketplace subsidies.
- This penalty will actually be calculated on a monthly basis, with the penalty being the product of the # of full-time employees qualifying for the Marketplace subsidies for that month and 1/12 of $3,000.

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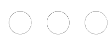

Example

- Employer offered coverage to full-time employees and their dependents for all of 2014 but the coverage did not provide minimum value. Employer has 100 full-time employees. One goes to Marketplace and qualifies for subsidies. Penalty calculation: 1 x $3,000 = $3,000
- Penalty amount is not tax deductible.

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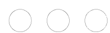

Penalty Payments

- http://www.irs.gov/uac/Affordable-Care-Act-Tax-Provisions
- The IRS will contact employers in 2015 to inform them of their potential liability and provide an opportunity to respond. If, after this opportunity to respond, it is determined that the employer is liable for a Shared Responsibility payment, the IRS will send the employer a notice and demand for payment. The notice will instruct the employer on how to make the payment. An employer will not have to include the payment on any tax return the employer files.
- 2014-2023 collections: $150 billion (CBO 2013 estimate)

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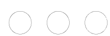
Individual Mandate

- Shared responsibility payment for not maintaining minimum essential coverage.
- Starting in 2014, non-exempt individuals will have a choice: maintain minimum essential coverage for themselves and their non-exempt family members, or report a shared responsibility payment on their federal income tax return. See 26 USC § 5000A.
- 2014-2023 collections: $52 billion (CBO 2013 estimate)



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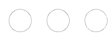
Who is Exempt?

- Religious conscience objectors ; members of health care sharing ministries
- Not a citizen or national of the United States
- Not lawfully present in the United States
- Incarcerated because of conviction of a crime
- Member of an Indian tribe
- Unable to afford coverage because they would have to pay more than 8% of their family income towards premiums
- A person with household income below the income tax filing threshold (generally, $9,750 for an individual under age 65 or $19,500 for a married couple under age 65 in 2012)
- A person experiencing a gap in coverage of generally less than 3 months

(See 26 USC § 5000A(d) and (e)).



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What is Minimum Essential Coverage?

- Medicare
- Medicaid
- CHIP (Children's Health Insurance Program)
- TRICARE (for military service members and retirees and their families)
- Employer-provided health coverage
- Veteran's health coverage
- An individual health policy
- Health care as a peace corps volunteer

(See 26 USC § 5000A(f))

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Shared Responsibility Payment

- The payment for the taxable year is <u>the lesser of</u>:
  - the sum of the monthly penalty amounts for each individual in the shared responsibility family, or
  - the sum of the monthly national average bronze plan premiums for the shared responsibility family.

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Monthly Penalty Amount

The monthly penalty amount is 1/12 multiplied by <u>the greater of</u> the flat dollar amount or the excess income amount.

- <u>Flat dollar amount</u>: $95 for taxpayer plus $95 for each person in TP family
  - 2014: $95; 2015: $325; 2016: $695
  - Capped at 300% and halved for individuals under age 18
- <u>Excess income amount</u>: the product of 1% and the excess of TP household income over the TP filing threshold.
  - 2014: 1%; 2015: 2%; 2016: 2.5%

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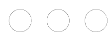

Example

- Assume you have a taxpayer, a spouse, and three children under 18 years of age, and none had coverage at any time in 2014. The flat dollar amount in 2014 would be $95 for the taxpayer, plus $95 for the spouse, plus $47.50 for each of the three children, for a total of $332.50. But the limit on the flat dollar amount is three times the base flat dollar amount for that year ($95 x 3 = $285). Then, determine whether the $285 flat dollar amount is greater than 1% of the excess of the taxpayer's household income over the taxpayer's filing threshold. Assume that the taxpayer's household income is $45,000, and the filing threshold is $23,900. This would mean that the household income exceeds the filing threshold by $21,100. 1% of $21,100 is $211. $285 is greater than $211, so the penalty for 2014 would be $285.

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Additional Medicare Tax on Wages

- 26 USC § 3101(b)(2), added by PPACA, increases the employee portion of the Medicare tax by an additional .9% on wages received which are in excess of certain threshold amounts.
- Effective for wages received after 12-31-2012.
- The AMT differs from the traditional Medicare Tax in that the AMT is not imposed until wages exceed the threshold amount. Also, the AMT does not increase the employer portion of the Medicare Tax.

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Applicable Tax Amounts

- Employer Medicare Tax for all wages: 1.45%.
- Employee Medicare Tax for all wages: 1.45%.
- Employee Additional Medicare Tax for wages above threshold: 0.9%.

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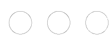
Filing Status and Threshold

Filing Status	Threshold
Married filing a joint return	$250,000
Married filing a separate return	$125,000
Any other case	$200,000



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Withholding – Employer Issues

- The employer must withhold AMT from wages it pays to an individual in excess of $200,000 in a calendar year, without regard to the individual's filing status or wages paid by another employer.
- The employer must withhold this AMT on wages in excess of $200,000 even if informed by the employee that the employee will not actually owe the tax because he files a joint return with his spouse and they will not meet the $250,000 threshold for joint filers.

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Withholding – Employer Issues

- If an employee's Medicare wages are expected to be above $200,000 for the year, the employer should not withhold the AMT starting at the beginning of the year. Instead, the employer must begin withholding the AMT in the pay period in which it pays wages in excess of $200,000 to the employee.

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Withholding – Employer Issues

- If the employer employs a husband and wife that both earn $150,000 per year, the employer should not withhold AMT from either employee, even though the employer knows that together, their wages exceed the threshold for married couples filing jointly.
- A new line 5d has been added to Form 941 on which an employer must report any wages paid during the quarter in excess of $200,000, and on which the employer must report its AMT withholding liability for those wages. The existing line used to report liability for regular Medicare Tax on all wages remains unchanged.
- No change to W-2. Include any AMT withholding in Box 6 "Medicare Tax Withheld".

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Withholding – Employee Issues

- The individual may owe more than the amount withheld by the employer, depending on the individual's filing status, wages, and self-employment income. If so, the individual should make estimated tax payments and/or request additional income tax withholding by the employer using Form W-4, Employee's Withholding Allowance Certificate.
- Example: Individual may hold two jobs, neither of which pays compensation above the threshold (meaning neither employer is withholding AMT), but the sum of wages does exceed the threshold.
- http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Questions-and-Answers-for-the-Additional-Medicare-Tax

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Net Investment Income Tax

- Net Investment Income Tax ("NIIT") Provisions: 26 USC § 1411.
- Effective 1-1-2013, the NIIT is a 3.8% tax on certain net investment income of individuals, estates, and trusts that have income above certain thresholds.
- Originally referred to as "unearned income Medicare contribution tax", but no provision has been made to move amounts collected as NIIT to the Medicare Trust Fund.

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Net Investment Income

Net investment income is the excess of the sum of the following items, less any deductions allocable to such items:

(1) Gross income from dividends, annuities, royalties and rents, unless derived from a trade or business (trade or business will not include a trade or business that is a passive activity of the taxpayer or that involves trading in financial instruments or commodities);

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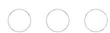

Net Investment Income, Cont.

(2) Other gross income from any passive trade or business; and

(3) Net gain included in computing taxable income that is attributable to the disposition of property other than property held in any trade or business that is not a passive trade or business.

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Passive Activity

- Per Code § 469, a passive activity is any activity which involves the conduct of any trade or business <u>and</u> in which the taxpayer does not materially participate. Material participation includes involvement on a regular, continuous and substantial basis.

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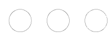

Example

- Taxpayer B, a single filer, rents a boat to Fred for $100,000 in year 1. B's rental activity is not a § 162 trade or business but instead a passive activity. In year 2, B sells the boat to Fred and recognizes taxable gain attributable to the boat of $500,000. This gain is net investment income (disposition of property from a passive activity).

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What is not Net Investment Income?

- Wages, unemployment compensation, Social Security benefits, alimony, tax-exempt interest, self-employment income, distributions from qualified plans.
- The NIIT will not apply to any amount of gain that is excluded from gross income for regular income tax purposes (ex. certain gains from sale of personal residence).

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NIIT - Individuals

- Individuals will owe the NIIT if they have:
  - net investment income **and**
  - modified adjusted gross income over the following thresholds:

Filing Status	Threshold Amount
Married filing jointly	$250,000
Married filing separately	$125,000
All others	$200,000

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Application of Tax - Individuals

- A 3.8% tax is imposed on the lesser of: (1) an individual's net investment income for the tax year, or (2) any excess (if any) of modified adjusted gross income (MAGI) for the tax year over the applicable threshold amount.

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Example

- Taxpayer, a single filer, has wages of $180,000 and $15,000 of dividends and capital gains. Taxpayer's MAGI is $195,000, which is less than the $200,000 threshold for individuals. Taxpayer is therefore not subject to the NIIT.

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Example

- Taxpayer, a single filer, has wages of $180,000 and also received $90,000 from a passive partnership interest. TP's MAGI is $270,000. The NIIT is based on the lesser of: (a) the amount that TP's MAGI exceeds the $200,000 threshold amount for single filers ($70,000) or (b) TP's actual net investment income ($90,000).
- $70,000 x 3.8% = $2,660 NIIT
- For individuals, the NIIT will be reported on and paid with the Form 1040.

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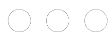
NIIT – Estates and Trusts

- Estates and trusts are subject to the NIIT if they have:
  - undistributed net investment income, and
  - adjusted gross income over the dollar amount at which the highest tax bracket for an estate or trust begins for such taxable year (for tax year 2012, this amount is $11,650).



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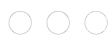

NIIT – Estates and Trusts

- Certain trusts will not be subject to the NIIT:
  - any trust not classified as a trust for federal income tax purposes (such as a real estate investment trust)
  - grantor trusts
  - charitable trusts
  - qualified retirement plan trusts

  See 26 CFR 1.1411-3(b) for additional exempt trusts.

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Application of Tax – Estates and Trusts

- Estates and trusts must pay a 3.8% tax on <u>the lesser of</u>: (1) their undistributed net investment income for the tax year, or (2) the excess (if any) of adjusted gross income over the dollar amount at which the highest tax bracket for estates and trusts begins for the applicable tax year.

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AMT and NIIT Collections?

- The Heritage Foundation estimated in 2010 that the AMT and NIIT together will raise $210 billion in revenue through 2019.

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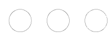

Questions?

Johanna M. Novak
Foster Swift Collins & Smith, PC
205 S. Front Street, Suite 2D
Marquette, MI 49855
(906) 226-5501 or (517) 371-8231
jnovak@fosterswift.com

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