Changes Affecting Individuals in the 2010 Health Reform Law

On March 30, 2010 President Obama signed the Health Care and Education Reconciliation Act of 2010 (H.R. 4872) into law. The Reconciliation Act amends the Patient Protection and Affordable Care Act of 2010 (P.L. 111-148), which President Obama signed on March 23. The new law revamps the nation’s health care system and includes more than $400 billion in revenue raisers and new taxes on employers and individuals.

This Current Comment focuses on changes affecting individuals.

# Personal Responsibility Requirement—Individual Mandate

A centerpiece of the new law is an individual responsibility mandate. Beginning January, 2014, U.S. citizens and legal residents are required to maintain "minimum essential coverage" unless they are exempt from the mandate.

The "minimum essential coverage" requirement is met through participation in government sponsored programs (like Medicare and Medicaid), eligible employer-sponsored plans, plans in the individual market, and grandfathered group health plans. Individuals who currently have coverage, and wish to stick with that coverage, can do so under a "grandfather" provision in the new law that deems such coverage to meet the mandate. A similar grandfather provision applies to employers that currently offer coverage.

Minimum essential coverage does not include coverage that consists of certain HIPAA excepted benefits such as (1) coverage only for accident, or disability income insurance; (2) coverage issued as a supplement to liability insurance; (3) liability insurance, including general liability insurance and automobile liability insurance; (4) workers' compensation or similar insurance; (5) automobile medical payment insurance; (6) credit-only insurance; (7) coverage for on-site medical clinics; and (8) other similar insurance coverage, specified in regulations, under which benefits for medical care are secondary or incidental to other insurance benefits. [U.S.C. 42 sec. 300gg-91(c)(1); see also 42 U.S.C. 300gg-91(c)(2-4).]

. A family’s total penalty generally cannot exceed 300 percent of the per adult flat dollar penalty (for example, $285 for 2014, rising to $2,085 by 2016) or the national average annual premium for the “bronze” level of coverage through the insurance exchange. If

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an individual is a dependent (see Sec. 152) of another taxpayer, the other taxpayer is liable for any penalty payment with respect to the individual.

This per adult annual penalty is phased in as follows: $95 for 2014; $325 for 2015; and $695 in 2016. For years after 2016, the $695 amount is indexed to CPI-U, rounded to the next lowest $50. The percentage of income is phased in as follows: one percent for 2014; two percent in 2015; and 2.5 percent beginning after 2015.

Beginning after 2016, the penalty is subject to a cost-of-living adjustment. Exemptions from the penalty are available in the event of financial hardship, for certain religious objectors, American Indians, incarcerated individuals, or where the lowest cost plan option exceeds 8% of household income, or for those with incomes below the income tax filing threshold.

Individuals residing (see Sec. 911(d)(1)) outside of the United States are deemed to maintain minimum essential coverage.

# Premium Assistance Tax Credit

For tax years beginnning in 2014, the new law creates a refundable tax credit (the “premium assistance credit”) for eligible individuals and families who purchase health insurance through the newly established Insurance Exchanges. The tax credit is designed to assure that certain individuals will not spend more than a stated percentage of their incomes on health insurance premiums. The premium assistance credit will be available for individuals and families with incomes up to 400% of the federal poverty level ($43,320 for an individual or $88,200 for a family of four, using 2009 poverty level figures) that are not eligible for Medicaid, employer sponsored insurance, or other acceptable coverage. The credit will be available on a sliding scale basis. The amount of the credit will be based on the percentage of income the cost of premiums represents. [New Code Sec. 36B , 2010 Health Care Act Sec. 1401, 1411 and 1412, as amended by 2010 Health Care Act Secs. 10104, 10105, and 1017, and as further amended by 2010 Reconciliation Act Sec. 1001.]

The credit, which is refundable and payable in advance directly to the insurer, subsidizes the purchase of certain health insurance plans through an exchange. Under the provision, an eligible individual enrolls in a plan offered through an exchange and reports his or her income to the exchange. Based on the information provided to the exchange, the individual receives a premium assistance credit based on income and the Treasury pays the premium assistance credit amount directly to the insurance plan in which the individual is enrolled. The individual then pays to the plan in which he or she

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is enrolled the dollar difference between the premium tax credit amount and the total premium charged for the plan. Although the credit is generally payable in advance directly to the insurer, individuals may elect to purchase health insurance out-of-pocket and apply to the IRS for the credit at the end of the taxable year.

# Top Earners Will Pay Higher Medicare Taxes

Starting in 2013, the new health care law expands the Medicare tax base for top earners in two ways. First, by Imposing an additional Hospital Insurance (HI) tax rate of 0.9 percent on earned income in excess of $200,000 for individuals and $250,000 for married couples filing jointly; and second by creating a new 3.8 percent “unearned income Medicare contribution” tax on higher-income taxpayers.

# Medical Expenses Deduction Floor Raised

Under current law, taxpayers can take an itemized deduction for unreimbursed medical expenses for regular income tax purposes only to the extent that those expenses exceed 7.5% of the taxpayer's AGI. The new law raises the floor beneath itemized medical expense deductions from 7.5% of AGI to 10%, effective for tax years beginning after Dec. 31, 2012. The AGI floor for individuals age 65 and older (and their spouses) will remain unchanged at 7.5% through 2016.

# Reimbursement of Over-the-counter Meds from HSAs, FSAs, and MSAs Excluded

The new law excludes the cost of over-the-counter drugs not prescribed by a doctor from being reimbursed through a health reimbursement account (HRA) or a health flexible savings account (FSA) or from being reimbursed on a tax-free basis through a health savings account (HSA) or Archer Medical Savings Account (MSA), effective for tax years beginning after Dec. 31, 2010.

# Increased Penalties on Nonqualified Distributions from HSAs and Archer MSAs

# The new law increases the tax on distributions from a health savings account or an Archer MSA that are not used for qualified medical expenses to 20% (from 10% for HSAs and from 15% for Archer MSAs) of the disbursed amount, effective for distributions made after Dec. 31, 2010. Health Flexible Spending Arrangements Capped at $2,500 Per Year

Under the new law, contributions to health FSAs will capped at $2,500 per year, effective for tax years beginning after Dec. 31, 2012. The dollar amount will be indexed for inflation after 2013.

# Employer Health Plan - Dependent Coverage

Effective in 2010, the new law extends the income tax exclusion for reimbursements for medical care expenses under an employer-provided plan to children of an employee who have not attained age 27 as of the end of the tax year. This change also applies to the exclusion for employer-provided coverage under an accident or health plan for injuries or sickness for such a child. A similar change is made for VEBAs and 401(h) accounts.

(Note: Self-employed taxpayers can take a deduction for the health insurance costs of any child of the taxpayer who is under age 27 as of the end of the tax year.)

# Adoption Credit and Adoption Assistance Rules

For tax years beginning in 2010, the adoption tax credit is increased by $1,000, made refundable, and extended through 2011 The adoption assistance exclusion is increased by $1,000.