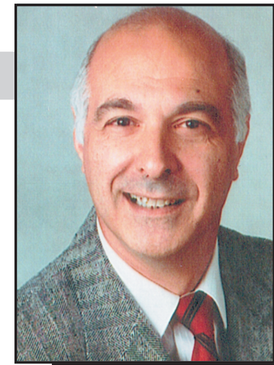
About the Authors/BART BASI, CPA; MARCUS S. RENWICK

Dr. Bart A. Basi is an expert on closely-held enterprises. He is an attorney, a Certified Public Accountant, and President of The Center for Financial, Legal & Tax Planning, Inc. He is a member of the American Bar Association's Tax Committee on Closely-Held Businesses.

Marcus Renwick is an attorney and the Director of Research and Publications with the firm.

With four specific services, The Center provides complete unbiased planning. The Center does not sell any products; its main purpose is to provide advice. Local experts are retained to implement the plans developed by the Center. The Center for Financial, Legal & Tax Planning is located at 4501 W. DeYoung Street, Suite 200, Marion, Illinois 62959. Phone 618-997-3436; Fax 618-997-8370.



Bart Basi

SPECIAL REPORT

The Patient Protection and Affordable Health Care Act

It is official. The Patient Protection and Affordable Health Care Act has passed Congress and has been signed by the President on March 23, 2010. The law changes the entire paradigm behind healthcare and even changes some tax rules. While the law has passed and is now the rule of the land, The Center graciously reminds those reading this special report that we do not take a position of endorsing the rule, nor opposing it. We write this special report to inform the business community of what has changed in both healthcare and the tax consequences that will now affect closely-held business owners.

Changes in Healthcare

Rules on Pre-existing Conditions

Starting in 2014, insurance companies will no longer be able to deny coverage for pre-existing conditions to adults. Children under the age of 27, whose parents are purchasing insurance for them, will no longer be denied health coverage within the next six months. Those with health considerations (or have children with) ailments such as epilepsy, cystic fibrosis, and a whole range of genetic and age-related diseases, will gain the right to be covered.

Healthcare Exchanges

Currently, healthcare insurers and consumers are limited as to where and how they can buy and sell health insurance. Under the new law, "healthcare exchanges" will be created, allowing more flexibility as to how, who, and the means in which healthcare insurance can be purchased. While the exact mechanics of the healthcare exchanges remains to be seen, they are predicted to increase competition in the insurance marketplace and make healthcare insurance more affordable to consumers.

Changes in the Tax Laws

Individual Mandate

With the new law comes an obligation for all individuals to be insured. Those individuals who refuse to get coverage will face a fine of up to $694 per year to a maximum of $2,085 per family per year or 2.5% of the household income over the amount subject to income tax, whichever is greater. The penalty is being phased in as follows: 2014: $95 or 1%, 2015: $325 or 2%, 2016: $695 or 2.5%. The penalty then increases after 2016 based on a cost of living adjustment. For some, it may be less expensive to pay the fine as opposed to purchasing health insurance. However, be aware that the $695 penalty is a penalty by means of The Internal Revenue Code. In other words, the penalty must be paid or such individuals will face the IRS.

Government Tax Credits

In order to help the individual pay for the mandated insurance, the federal government is offering tax credits to individuals that are not eligible for Medicare, Medicaid, or are not covered by their employers for health insurance. The tax credits do not become effective until 2014 and are available for individuals and families making between 100% and 400% of the federal poverty guidelines. The current federal poverty level for an individual is $22,050 and for a family of four is $88,200.

This credit works as follows:

1. The individual purchases insurance from an insurance exchange;
2. The individual tells the insurance exchange what their income is;
3. The IRS issues a credit and pays the insurance exchange a fee; and, finally
4. The individual pays the insurance exchange the difference.

Employers With Over 50 Employees

In the new law, there is no mandate or requirement that employers provide insurance to employees. There is however, a dichotomy between employers employing 50 employees or more and those employing 49 employees or less. Those employing 50 or more face penalties if their employees elect the government credits

for their health insurance purchases. The penalty is $2,000 per employee who elects the government credits; however, the first 30 employees who do so do not count against the company. Small businesses employing 49 employees or less are under no such penalties.

Insurance Companies

A special penalty applies to insurance companies and self insured companies if the premiums they charge exceed $10,200 per person or $27,500 per family. The penalty is an excise tax of 40% of the excess premium charged.

Medicare

Taxpayers earning in excess of $250,000 (for families) or $200,000 (individuals) will pay an additional 0.9% in Medicare taxes on their excess income. The law is effective in 2013.

In addition to the above, a Medicare tax of 3.8% will now be applied to any net investment income that exceeds the $200,000 and $250,000 threshold. This includes income from the sales of a business.

Dividends

Income from dividends has seen its share of changes in the past 10 years. Once again the dividend rate has been altered by means of the legislation. For those families making above $250,000, dividends will be subject to an additional 3.8% tax. This tax begins in 2012. To those who own closely-held C Corporations, a review of their tax strategy is appropriate, especially if unpaid retained earnings are present. The current dividend tax rate is 15%.

Interest

While interest is taxable as ordinary income, there will be a 3.8% surcharge assessed to interest earnings for those families making over $250,000 per year, starting in 2012.

Capital Gains

Capital gains income has enjoyed favorable treatment for quite some time. Currently, capital gains are taxed at 0% for low income bracket payers and 15% for high tax bracket payers. For those making about $250,000, the tax rate will increase by an additional 3.8%, starting in 2012 as well.

Credit for Small Businesses

Employers with 1) 25 or less full-time employees, 2) average compensation of $50,000 or less, and 3) pay at least half of the health insurance coverage, are eligible for a tax credit.

During tax years 2010, 2011, 2012, and 2013, employers will receive a 35% tax credit (in addition to a tax deduction for the premiums paid less the tax credit). In 2014 and 2015, the tax credit increases to 50%., After 2013, the credit is only available for two more years and only if the insurance is purchased from an insurance exchange.

On the other hand, if the employer has 10 or fewer employees, their average compensation must be less than $25,000 in order for the employer to qualify for the credit. Furthermore, the credit is 25% for 2010, 2011, 2012, and 2013. For 2014 and 2015, the credit increases to 35%.

Medical Expenses

Under the old law, individuals (if they itemized), could only deduct medical expenses in excess of 7.5% of their adjusted gross income. Effective January 1, 2013, the floor raises to 10% for all individuals except those 65 years of age and older. This is expected to result in a decrease of the deduction for medical expenses; thus raising taxes.

Health Reimbursement Plans

Effective 2011, there will no longer be reimbursements allowed for any over-the-counter drugs. So anyone with a flexible savings account plan, a health savings account, etcetera, will not be able to use tax deductible dollars to pay for over-the-counter drugs or medications. Only prescription items from a doctor will be allowed to be paid from such plans.

In addition, a penalty of 20% will be imposed on all health reimbursement plans for any funds not used for qualified medical expenses. The new penalty is effective January 1, 2011.

Individuals will now only be allowed to put a maximum of $2,500 per year into health savings plans. This limit goes into effect January 1, 2013. After 2013, the maximum amount will be indexed per inflation. Effective March 2010, children under the age of 27 can be included in such healthcare savings plans.

Tanning Services

In a surprise move, the new law creates an excise tax on all indoor tanning services. The individual that receives the service must pay the tax to the operator, who will collect the tax and remit it to the federal government. The tax is 10%.

Adoptions

Presently, there exists a credit for adoption costs incurred by families. The new law increases the current credit of $12,150 by $1,000. This law is retroactive to January 1, 2010 and extends only until December 31, 2011.

Conclusion

The healthcare bill has now become law. Not only are there incentives for small businesses to cover employees and new opportunities for individuals to obtain health insurance, a whole host of tax issues have surfaced. Just to name a few, business succession and exit planning will be affected because of the new capital gains rates. C Corporations with retained earnings should at least consider accelerating their payouts to avoid the increased taxes on dividends (2012). Along with these issues, many others exist in the tax world as a result of this law.

The Center routinely advises and acts as a consultant for those engaging in succession and exit planning. Please call the professionals at the Center for all of your tax needs regarding the tax law changes and challenges that it presents.