



HEALTH CARE *and you*

The New Health Care Law: Tax Implications for Individuals

The new health care law makes several changes to taxes that mostly affect families with incomes over \$200,000. Some of the changes will take effect in 2011; others will be phased in over several years.

The most noticeable tax change for the vast majority of Americans under the new health law will be on your W-2 Form. The law requires your employer to disclose the cost of health insurance benefits provided to you beginning in 2011. This new reporting requirement **will not** affect the taxes you pay. The value of health insurance benefits reported on your W-2 should not be included in your income when you file your taxes. You will also not have to pay any FICA taxes on this amount.

Medicare Taxes

For those earning less than \$200,000 (or \$250,000 for a couple) your Medicare taxes **will not** increase. If you earn more than \$200,000 as an individual taxpayer, or if you earn more than \$250,000 and file a joint tax return with your spouse, you will see an increase in part of your Medicare Part A tax rate beginning in 2013. The tax rate will go from its current level of 1.45% to 2.35%. However, you will pay the 2.35% rate only on the portion of your earnings that is over \$200,000 for individuals or over \$250,000 for a couple. This means that your earnings

that are less than \$200,000 (or \$250,000 for a couple) will continue to be taxed at 1.45%. Also, the 1.45% Medicare tax that your employer pays on your behalf will not change. The change in the tax rate will increase the amount withheld from your salary or wages, or the tax you pay on self-employment income only if you earn over \$200,000.

Flexible Spending Accounts

Some employers offer flexible spending accounts that allow you to set aside part of your salary before it is taxed to help pay for some of your medical expenses. If you have one, the most you will be able to contribute to a flexible spending account will be \$2,500 starting in 2013. The \$2,500 limit will be increased in future years with increases in the cost of living. Also, starting in 2011 you will not be able to get reimbursement from your flexible spending account for over-the-counter medications, such as aspirin or cough and cold medications, unless they are prescribed by your doctor.

Medical Expense Deductions

You can deduct some medical expenses from your taxable income. Currently you can deduct the

amount of medical expenses that exceeds 7.5% of your taxable income. Beginning in 2013 you will be able to deduct only those medical expenses that exceed 10% of your adjusted gross income. For example, if your adjusted gross income is \$100,000 and your medical expenses are \$11,000, you could deduct \$3,500 under the old law ($\$11,000 - [\$100,000 \times 7.5\% \text{ or } \$7,500] = \$3,500$). Starting in 2013 you will be able to deduct \$1,000 in medical expenses $\$11,000 - [\$100,000 \times 10\% \text{ or } \$10,000] = \$1,000$). The percentage will remain at 7.5% for persons 65 and older until 2016.

New Tax on “Cadillac” Health Plans

Starting in 2018, if your health benefits are worth more than \$10,200 for individual plans and \$27,500 for family plans, your **insurers** will pay a new tax. They will have to pay a 40% tax on the amount that your benefits exceed these threshold levels. These levels are increased to \$11,850 and \$30,950 for some retirees who are 55 or older and not eligible for Medicare, as well as people in high-risk occupations. They will also increase for companies that pay higher premiums due because of the age and gender of their workers. All threshold levels will be indexed for the cost of living after 2018. If you are self-employed and are covered through a group health plan, the insurer of your plan will also have to pay the tax.

You won't directly pay this so-called “Cadillac tax” since the tax is on your insurer. For the purposes of this law, an insurer could be an insurance company, your employer, or a third party that handles your employer's self-insured plan, flexible spending account, or health savings account. It will be up to your insurer to determine if it will pass the cost of the tax on to you or your employer.

Investment Income Tax

Taxpayers earning less than \$200,000 (or \$250,000 for a couple) **will not** pay higher taxes on their investment income. Starting in 2013, if you earn more than \$200,000 as an individual taxpayer, or if you earn more than \$250,000 and file a joint tax return with your spouse, you will pay a 3.8% tax on your net investment income. Net investment income includes interest, dividends, annuities, royalties, rents, and capital gains. It does not include income from Social Security, pensions, or IRA distributions. Payments from qualified IRA annuities are also not counted as net investment income.

Not all investment income is taxed. To figure out the amount of the tax, subtract \$200,000 (for an individual) or \$250,000 (for married couples filing jointly) from your taxable income. Then compare the result with your net investment income. Multiply the **lesser** amount by 3.8% to get the amount of the tax.

For example, a married couple with a modified adjusted gross income of \$275,000 and a net investment income of \$10,000 would pay \$380 in taxes on their net investments income:

$\$275,000 - \$250,000 = \$25,000$ which is larger than \$10,000 for a tax of $\$10,000 \times 3.8\% = \380

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