



Taxes and credits in the health system reform law

The Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010, is paid for through taxes and fees on the health care sector and employers, as well as through additional taxes on upper-income individuals. These and other tax changes, including tax credits for small business owners, will affect physicians as employers and as individual taxpayers. Below is a snapshot of key provisions in the new law that may affect physicians and their practices.

Provisions affecting the health care sector

- **40 percent excise tax (“Cadillac” tax) on high-cost health plans**—Beginning in 2018, an excise tax will be imposed on the coverage provider (i.e., insurer, plan administrator or employer depending on the type of coverage) of high-cost employer-sponsored health plans with aggregate values exceeding \$10,200 for individual coverage and \$27,500 for family coverage. The tax is equal to 40 percent of the value of the plan that exceeds these threshold amounts. For insured plans, the coverage provider will be the health insurance issuer; for self-insured plans, the coverage provider will generally be the plan administrator. Employers that make contributions to a health savings account (HSA) or medical savings account (MSA) must pay the excise tax if those contributions exceed the thresholds. The tax is not imposed on the individual enrollee. The dollar thresholds are indexed to inflation.
- **Annual fee on health insurance providers**—Beginning in 2014, a fee will be applied on net premiums of all health insurers based on their market share. For non-profit insurers, only 50 percent of net premiums will be taken into account in calculating the fee. Exemptions are granted for: non-profit plans that receive more than 80 percent of their income from government programs targeting low-income or elderly populations, or people with disabilities; voluntary employees’ beneficiary associations (VEBAs) not established by an employer; certain nonprofit insurers with medical loss ratios within specific limits; and self-insured plans and federal, state or other government entities. (The fee does apply to companies that underwrite government-funded insurance, such as Medicaid managed care plans and the Federal Employee Health Benefits Program.)
- **Annual fee on pharmaceutical companies and medical device manufacturers**—New annual fees on certain manufacturers and importers of branded prescription drugs (including biological products, but excluding orphan drugs) would be imposed beginning in 2011 based on annual sales and set to reach a certain revenue target each year. Beginning in 2013, an annual excise tax of 2.3 percent will also be imposed on the sale of Class I medical devices by manufacturers, producers or importers. Class I includes the vast majority of orthotics and prosthetics, as well as durable medical equipment. Exemptions are provided for eyeglasses, contact lenses, hearing aids and any device that is generally purchased at retail for individual use.
- **Excise tax on indoor tanning services**—Effective July 1, 2010, an excise tax of 10 percent will be imposed on the amount paid for indoor tanning services.

Provisions affecting employers

Employer penalties and subsidies

- **Penalties on larger employers**—Employers with more than 50 full-time employees that do not offer coverage and have at least one full-time employee who obtains coverage through an exchange and qualifies for an individual premium tax credit or cost-sharing subsidy (e.g., individuals with income between 100 percent and 400 percent of the federal poverty level; the poverty level in 2010 is \$18,310 for a family of three) will be assessed penalties beginning in 2014. The penalty amounts to \$2,000 multiplied by the number of full-time employees in excess of 30. If an employer offers coverage but has at least one employee who is entitled to a premium tax credit because the employer's plan is too costly, the penalty is \$3,000 for each employee receiving a credit or \$2,000 for each full-time employee, whichever is less. **Employers of 50 or less, which include the vast majority of physician practices, are exempt from the requirement to provide coverage.**
- **Subsidies for small businesses**—Small business tax credits will be available to employers with 25 or fewer employees with average annual wages below \$50,000 if they purchase health insurance for their employees. (This tax credit is separate and distinct from the individual tax credit that low-income individuals may be eligible to receive if they purchase insurance through an exchange.) For tax years 2010 through 2013, the tax credit can be up to 35 percent of the employer's contribution toward the premium, provided the employer contributes at least 50 percent of the total premium cost. The full 35 percent credit will be available to employers of 10 or less with average annual wages below \$25,000. The credit phases out as firm size and average wage increase. In tax years 2014 and later, for eligible small businesses purchasing coverage through the state exchanges, the tax credit increases to 50 percent of the employer's contribution toward the premium, provided it is at least 50 percent of the total premium cost. The credit will be available for two years. The full credit will be available to employers of 10 or fewer with average annual wages of less than \$25,000. **According to the IRS, the wages and hours of physician business owners and partners will not be counted in calculating either the number of full-time employees or the average annual wages.**

Limitations on employer deductions

- **Expenses allocable to Medicare Part D subsidy**—Effective 2013, employers that currently sponsor retiree prescription drug plans will no longer be able to deduct amounts contributed to them. However, future Medicare Part D subsidies will continue to be tax-free to the employer.
- **Limitation on excessive health insurance company compensation**—Effective 2013, the deduction for executive and employee compensation for health insurance providers is limited to \$500,000 per applicable individual. The limit applies to all officers, employees, directors and other workers.

Provisions affecting individuals

- **Tax penalties for failure to obtain health insurance coverage**—Individuals must obtain minimum essential coverage for themselves and their dependents, effective 2014, with certain exemptions (i.e., hardship, religious reasons). Those without coverage will pay a tax penalty

Continued on page 3

of the greater of \$695 per year up to a maximum of three times that amount (\$2,085) per family, or 2.5 percent of household income. The penalty will be phased in according to the following schedule: \$95 in 2014, \$325 in 2015, and \$695 in 2016 for the flat fee; or 1.0 percent of taxable income in 2014, 2.0 percent in 2015, and 2.5 percent in 2016.

- **Medicare payroll tax**—Effective 2013, the hospital insurance (Medicare Part A) payroll tax will increase by 0.9 percent on high-income workers earning more than \$200,000 and joint filers earning more than \$250,000. In addition, a 3.8 percent Medicare tax will be imposed on net investment income from interest, dividends, annuities, royalties, rents and taxable net gain for these same individuals. This tax is not indexed for inflation.
- **Itemized deductions for medical expenses**—Effective 2013, the threshold for claiming the itemized tax deduction for unreimbursed medical expenses will increase from 7.5 percent to 10 percent for taxpayers under 65. The increased threshold applies to individuals 65 years and older in 2017.
- **Flexible savings accounts (FSAs)**—Effective 2013, contributions to FSAs are capped at \$2,500.
- **HSAs**—Effective 2011, the tax on distributions from an HSA or Archer MSA that are not used for qualified medical expenses is raised to 20 percent. Also effective 2011, the cost of over-the-counter medicines may not be reimbursed through an FSA, HSA, Archer MSA, or Health Reimbursement Arrangements, unless obtained with a prescription.
- **Health professionals state loan repayment tax relief**—Payments made under any state loan repayment or loan forgiveness program that is intended to provide for the increased availability of health care services in underserved or health professional shortage areas will be excluded from gross income.