Health Care Legislation Update

September 2010

Rachel Sherman, *Director, Client Service*
Susan Doud, *Tax Manager/BSA-AML Internal Auditor*

Overview

Recent health care legislation has generated mountains of press coverage, ranging from vehement criticism to lofty praise. There are substantial benefits to many people, but also substantial tax increases to some.

But what do the new laws mean for Market Street clients? The answer depends on many factors, including your age, employment status, and income level; your current health status; whether you run a small business; and whether you are covered by Medicare. This client update provides a general overview, but any individual queries can be addressed with your Wealth Advisor or Market Street's Tax Department.

Although a number of provisions of the health care laws take place in 2010, others are phased in over time.

The timeline to the right compiles the effective dates of salient features of the legislation.

The stated objectives of the law are commendable: cracking down on waste, fraud, and abuse, and improving affordability of and access to health care for most Americans. Opponents charge that the laws' costs far exceed their benefits and place health insurance in the hands of an ineffective government bureaucracy. Only time will tell, however, whether the goals of the legislation can actually be achieved, or whether the entire effort proves disastrous.

2010	• Adult child coverage • Small employer tax credit
2011	• Health savings account changes • W2 reporting of the value of health benefits • Medicare Part D donut hole 50% discount on prescription drugs
2012	• Expanded 1099 reporting
2013	• Medicare tax increase for high wage earners • Tax on investment income on certain tax payers • Itemized medical expense deduction floor increases from 7.5% to 10%, with some exceptions
2014	• Individual mandate penalty • "Play or pay" mandate for large employer • Coverage subsidies
2018	• "Cadillac" insurance plan excise tax
2020	• Medicare Part D donut hole closed

Major Features of the Recent Legislation

Adult Child Coverage

Certain health plans must now provide for coverage of an adult child of a covered individual until the child turns 26.

The eligible adult child must be offered all of the benefits available to similarly situated individuals at the same price. Coverage may be extended whether or not the child lives with the parent, is a dependent for tax purposes, or is a student. The new law applies only to policies that provide dependent coverage. This provision goes into effect for plan or policy years beginning on or after September 23, 2010, but some insurers have already extended coverage voluntarily. If your insurer is required to provide this coverage under your health plan, it must notify you during open enrollment. If you have an adult child in need of coverage, however, you should contact your insurer to ask whether the insurer has voluntarily provided coverage earlier than the implementation date.

The Internal Revenue Code was amended so that the value of the coverage of an employee's child under an employer sponsored plan should no longer be imputed as income to the employee.

Small Business Tax Credits and Large Business Fees

Small business tax credits are available for firms that qualify and elect to offer coverage.

From 2010 to 2013, the credit is up to 35% of the employer's contribution toward the employee's health insurance premium. Beginning in 2014, for employers who purchase coverage through the Exchange (a marketplace for health insurance policies meeting certain minimum coverage criteria overseen by the federal government), the credit will be up to 50% of their contributions. This credit does not apply to health insurance coverage that an employer provides for a domestic employee. Market Street does not qualify as a small business under this provision.

A fee on businesses with 50 or more employees will be charged (equal to $750 multiplied by employee for the number of employees over 30) if the firm does not offer adequate coverage. This is referenced in the press as the "play or pay" mandate.

Medicare's "Donut Hole" Filled

Medicare Part D prescription drug program beneficiaries suffer a gap in prescription drug coverage, once they reach an initial coverage limit. ($2,830 in 2010).

At this point, the full cost of their drugs are out of pocket until the beneficiary's total out-of-pocket expenses reach a limit ($4,550 in 2010), after which prescription drug coverage kicks back in. This coverage gap is known as the "donut hole." The health care legislation begins to fill that hole: in 2010, a $250 rebate is provided; in 2011, a 50% discount on certain prescription drugs in the donut hole is provided; the donut hole is then slowly phased out until 2020, when prescription drug coverage closes it completely.

End to Preexisting Condition Limitations and Lifetime Limits

Except with respect to certain "grandfathered" plans, a new patients' bill of rights under the health insurance legislation prohibits insurance companies from imposing pre-existing condition exclusions on children (under 19) and setting lifetime limits on coverage.
It also restricts insurance companies' use of annual limits. These rules apply to plan or policy years beginning on or after September 23, 2010, although the annual limit restrictions are phased in over the next several years.

Beginning in 2014 an absolute ban on refusing to cover adults with pre-existing conditions becomes effective. In the meantime, adults unable to buy insurance due to pre-existing conditions can begin enrolling in the "Pre-existing Condition Insurance Plan." For more information, refer to www.healthcare.gov/law/provisions/preexisting/index.html.

1099 and W-2 Reporting Changes

For employee tax years beginning after December 31, 2010, employers are required to report the value of company provided health care coverage on an employee's W-2's.

Although the value of company provided health care benefits are not currently taxable as income to employees, there is speculation that W-2 reporting is the first step in that direction.

Under previous reporting rules, payments made for services over $600 had to be reported on a 1099. Payments for merchandise or payments made to a corporation were exempt from the reporting requirements. In an effort to close the "tax gap," effective January 1, 2012, new requirements expand those rules to all payments made by businesses. Businesses will have to report payments for services and merchandise in excess of $600 on a 1099.

(Note, this provision is under repeal pressure due to the significant burden to comply.)

HSA Changes

A takeaway is in the form of limits to the use of Health Savings Account funds.

HSAs are tax-advantaged medical savings accounts for individuals enrolled in high-deductible health plans. Contributions to these funds are not taxable as income. The money in the account can be used to cover qualified medical expenses. Beginning next year HSAs can no longer be used to pay for over-thecounter medications, and the penalty for unauthorized distributions is increased, from 10% to 20%. Further, employees will be limited in their contributions to HSAs to $2,500 a year beginning in 2013.

Increased Taxes

Beginning in 2013, the Medicare tax base is increased as follows:

- 0.9% increase for amounts over $200,000 for individuals and $250,000 for married couples filing jointly

- 3.8% tax on unearned income of "High Income" taxpayers who are defined as people whose gross income exceeds the $200,000 threshold for individuals and $250,000 for couples. This tax will be levied on the lesser of net investment income or any excess of Modified Adjusted Gross Income over $200,000 for individuals and $250,000 for married filing jointly.

Beginning in 2018, there will be a 40% excise tax levied on high-cost health plans (so-called "Cadillac" plans).

Individual Mandate

If an individual is not covered by insurance through an employer or Medicare, he or she will be required to purchase it on an exchange or else pay a tax penalty.

Beginning in 2014, a penalty will be imposed, rising to a maximum of $695 for each uninsured family member, up to a certain maximum amount per family (approximately $2,000), or percentage of gross household income (2.5%) is reached, whichever is greater.

For more information feel free to contact:

Susan Doud,
Tax Manager/BSA-AML Internal Auditor,
or your Market Street Wealth Advisor

80 E. Market Street, Suite 300
Corning, New York 14830
800.962.6876
www.marketstreettrust.com

MARKET STREET
TRUST COMPANY