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New Health Care Law — Tax Impact

By: David Carroll. ***This was posted Thursday, March 25th, 2010***

New Healthcare Law — Tax Impact

According to reporting by Bloomberg's Ryan J. Donmoyer (www.bloomberg.com) if the final version of the healthcare legislation passes the Senate, high-income investors will pay higher Medicare taxes, tax breaks for out-of-pocket medical deductions, such as flexible spending accounts, will be limited, and it will cost insurance companies more to pay executives higher salaries. These expanded taxes will help fund the expansion of Medicaid services for the low income citizens and subsidize health insurance to cover millions who don't currently have health insurance.

In all, the bill would generate $409.2 billion in additional taxes by 2019, according to an analysis by the congressional Joint Committee on Taxation, a nonpartisan agency. According to the Congressional Budget Office, another non-partisan agency that tracks the costs of legislation, says the healthcare bill will impose about $69 billion more in penalties for individuals and businesses who don't meet mandates to buy health insurance.

Bloomberg's Donmoyer reports that most of the revenue would come from higher Medicare taxes on about 1 million individuals earning more than $200,000 and about 4 million couples filing jointly who make more than $250,000. The new legislation would, for the first time, apply Medicare taxes to investment income received by these households, beginning in 2013. The 3.8 percent Medicare tax rate would apply to unearned income such as realized net capital gains, dividends, interest, rents and royalties. It wouldn't apply to other income subject to income taxes, such as interest from municipal bonds and retirement accounts such as 401(k) plans until funds are withdrawn.

Bloomberg also reports that Obama's budget will raise the present 15 percent tax rate on dividends and capital gains to 20 percent in 2011 for the same high-income tax payers. Adding in 3.8 percent Medicare tax on top of that would mean a new top rate on dividends and capital gains of 23.8 percent. The top tax rates on interest and rental income would rise to as high as about 44 percent, assuming other Obama tax increases on high-earners are enacted. The tax increases are centered on investment income such as capital gains and dividends. These are the categories of income generated by the investors and private business owners who comprise most of our small and medium sized businesses, for example the "Accredited Investors" (as defined by the Securities Act of 1933); those high-net worth individuals who invest in small to medium private investment opportunities.

Some of the other provisions likely to affect individual taxpayers involve the scaling back of tax preferences associated with paying out-of- pocket medical expenses. Starting in 2013, Americans under 65 won't be able to deduct medical expenses until they exceed 10 percent of income, up from 7.5 percent now; retirees would keep the lower threshold. In addition, the bill would place new restrictions on what can be purchased using special savings accounts funded with pre-tax dollars including HSAs (Health Savings Accounts) starting in 2011. Improper withdrawals from the accounts also would be hit with a new 20 percent tax.

And the legislation for the first time would place a $2,500 limit on what can be contributed to employer-sponsored flexible spending accounts, another type of account funded with pre-tax dollars that can be used to pay for medicines, co-payments, and other health care related expenses. Employers now set their own limits, typically between $3,000 and $5,000 in the absence of a government cap. according to Wage Works, Inc., a San Mateo, California, company that administers 1.5 million accounts, this change would cost an average worker about $625 in tax savings.

The affect of these tax increases will likely make capital gains and dividend income less attractive from a tax perspective and place additional tax burdens on benefits to employees. In addition, any penalties on those businesses that cannot provide health insurance for employees will cause marginally profitable businesses to struggle to maintain profitability. The unintended consequences for small to mid-sized private businesses would be to choke off investment capital and raise mandated expenses and possible penalties. That is a toxic mix for private enterprises coming at a time when those businesses are trying to pull out of the recession.