Health Care

The Affordable Care Act: Tax Provisions on the Way

By Michael Hackman, Esq.

One major initiative of the Obama administration was the passage of a version of universal health coverage. In order to pay for the Affordable Care Act (known to some as Obamacare), the legislation made several critical tax changes. Some have already gone into effect.

We'll take a look at the changes scheduled to take effect in 2013, which may prompt you to make certain adjustments this year, before the tax changes take effect.

Surtax on Unearned Income

The Act hopes to raise $123.4 billion over ten years by placing a 3.8 percent tax on income from interest, dividends, capital gains, annuities, royalties and rents, unless that income is derived in the ordinary course of business and not treated as a passive activity. This is in addition to taxes already assessed on those items.

The new tax is applied to modified adjusted gross income in excess of the threshold amounts, not to exceed net investment income. The threshold amount is $200,000 for a taxpayer or $250,000 for a couple filing a joint return.

Increased Medicare Tax on Wages and Profits

Under present law, wages bear a Medicare tax of 2.9 percent, half deducted from the employee's salary and half borne by the employer. The Act would try to raise $86.8 billion over ten years by increasing the employee tax by .9 percent (to 2.35 percent) on wages in excess of the same thresholds ($200,000, or $250,000 for a couple filing a joint return).

There is no increase to the employer portion. The same tax is borne by self-employed persons.

While present law provides for withholding, there may be situations where the tax must be paid by the taxpayer directly. If both husband and wife earn $150,000, neither employer must withhold the excess amount because the $200,000 threshold is not met, but because the total salary is over $250,000 the additional tax must be paid.

Excise Tax on Medical Device Sales

The Act adds a new federal excise tax of 2.3 percent on all sales revenue of manufacturers of medical devices, unrelated to whether those manufacturers are showing a profit. Medical devices are not expected to include hearing aids, contact lenses, eyeglasses and similar items.

On the one hand, the companies involved will probably pass their increased costs to their consumers. On the other hand, the Act is expected to create an increased consumer base for medical devices and other medical services, resulting in increased business for these manufacturers.

Limits on the Medical Expense Deductions

Under present law, the medical expense deduction is limited to expenses in excess of 7.5 percent of a person's or married couple's adjusted gross income.

Under the Act, the floor is increased to ten percent of adjusted gross income. Taxpayers planning procedures which will require meaningful out of pocket payments may want to consider scheduling the procedure and paying for it in 2012. If either you or your spouse is 65 or older, the increase does not become effective until 2017.

Limits on Flexible Spending Accounts

Current law allows taxpayers to maintain Flexible Spending Accounts (FSAs), which lets the taxpayer deduct certain medical expensesnotwithstanding the 10 percent threshold. While the taxpayer may designate an amount without limit to use for this purpose, any unused amount is usually forfeited. However, the Act substantially limits the use of these accounts by establishing a $2,500 annual limit on FSAs, indexed for inflation.

The Act conformed items which could be purchased to the definition of tax deductible items, by preventing these accounts and Health Savings Accounts from being used to purchase over the counter medicines or related items not prescribed by a doctor. You will still be able to purchase medical devices, eyeglasses and contact lenses with your FSA.

Will This Ever Happen?

There is, of course, the substantial possibility that these changes will never take place. There are numerous challenges to all or parts of the Act, some of which, if successful, may prevent the tax changes from ever going into effect.

Further, the Presidential and Congressional elections will take place before the legislation is enacted, so that a new President and Congress may, either in later 2012 or early 2013, enact amendments to, or repeal the legislation altogether – preventing the new tax provisions from ever going into effect.

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