

## SUMMARY OF THE TAX PROVISIONS OF THE 2010 HEALTH CARE ACT THAT WILL AFFECT PRIVATE BUSINESSES

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The 2010 Health Care Act contains significant provisions that will affect the taxation and private businesses and their owners. These include tax credits and penalties associated with the purchase of health insurance, and a “Cadillac Tax” on high dollar health plans. Additionally, individual taxpayers will see increased Medicare taxes, and limits on flexible spending arrangements. These measures are summarized as follows:

**SMALL BUSINESS TAX CREDITS FOR PROVIDING INSURANCE:** The Health Care Act provides small employers with a tax credit (i.e.: a dollar-for-dollar reduction in tax) for non-elective contributions to purchase health insurance for their employees. The credit can offset an employer's regular tax or its alternative minimum tax (AMT) liability. To qualify, a business must offer health insurance to its employees as part of their compensation and contribute at least half the total premium cost.

**25 or Fewer Employees:** The business must have no more than 25 full-time equivalent employees (“FTEs”), and the employees must have annual full-time equivalent wages that average no more than \$50,000. However, the full amount of the credit is available only to an employer with 10 or fewer FTEs and whose employees have average annual full-time equivalent wages from the employer of less than \$25,000.

**Applicable Tax Years:** The credit is initially available for any tax year beginning in 2010, 2011, 2012, or 2013. For tax years beginning in 2010, 2011, 2012, or 2013, the credit is generally 35% (50% for tax years beginning after 2013) of the employer's nonelective contributions toward the employees' health insurance premiums. The credit phases out as firm-size and average wages increase.

**Payroll Tax Credits for Tax-Exempt Businesses:** Tax-exempt small businesses meeting these requirements are eligible for payroll tax credits of up to 25% for tax years beginning in 2010, 2011, 2012, or 2013 (35% in tax years beginning after 2013) of the employer's nonelective contributions toward the employees' health insurance premiums.

**Take the Credit, and Deduct the Rest:** The employer is entitled to an ordinary and necessary business expense deduction equal to the amount of the employer contribution minus the dollar amount of the credit. For example, if an eligible small employer pays 100% of the cost of its employees' health insurance coverage and the amount of the tax credit is 50% of that cost (i.e., in tax years beginning after 2013), the employer can claim a deduction for the other 50% of the premium cost.

Not Employees?: Self-employed individuals, including partners and sole proprietors, 2% shareholders of an S corporation, and 5% owners of the employer are not treated as employees for purposes of this credit. Any employee with respect to a self-employed individual is not an employee of the employer for purposes of this credit if the employee is not performing services in the trade or business of the employer.

**PENALTIES FOR NOT OFFERING HEALTH INSURANCE:** For businesses with at least 50 employees, the possible penalties vary depending on whether or not the employer offers health insurance to its employees. If it does not offer coverage and it has at least one full-time employee who receives a premium tax credit, the business will be assessed a fee of \$2,000 per full-time employee, excluding the first 30 employees from the assessment.

Example of Penalty: So, for example, an employer with 51 employees who doesn't offer health insurance to his employees will be subject to a penalty of \$42,000 (\$2,000 multiplied by 21). Employers with at least 50 employees that offer coverage but have at least one full-time employee receiving a premium tax credit (also allowed under the new law) will pay \$3,000 for each employee receiving a premium credit (capped at the amount of the penalty that the employer would have been assessed for a failure to provide coverage, or \$2,000 multiplied by the number of its full-time employees in excess of 30). These provisions take effect Jan. 1, 2014.

Small Businesses Exempted: Although the new law imposes penalties on certain businesses for not providing coverage to their employees (so-called "pay or play"), most small businesses won't have to worry about this provision because employers with fewer than 50 employees aren't subject to the "pay or play" penalty.

**"CADILLAC TAX" ON HIGH-COST HEALTH PLANS:** The new law places an excise tax on high-cost employer-sponsored health coverage (often referred to as "Cadillac" health plans). This is a 40% excise tax on insurance companies, based on premiums that exceed certain amounts. The tax is not on employers themselves unless they are self-funded (this typically occurs at larger firms). However, it is expected that employers and workers will ultimately bear this tax in the form of higher premiums passed on by insurers.

**INCREASE IN INDIVIDUAL MEDICARE TAXES:** Medicare taxes currently apply to the wages of employees at a rate of 2.9%. Going forward, for certain high-income taxpayers, Medicare taxes will increase to 3.8%, and apply to unearned income.

Payroll Taxes on Wages: Wages include any amounts earned from an employer (reported on a W-2), such as salary, or bonus. Beginning in 2013, certain taxpayers will see the percentage of Medicare taxes that they pay increase to 3.8%.

Current Rate: Medicare taxes currently apply to all wages at a rate of 2.9% (1.45% by employee, and 1.45% by employer). Self employed individuals pay the entire 2.9%.

**New Rate:** Most taxpayers will continue to pay 2.9%, but single people earning more than \$200,000 (or couples earning over \$250,000) will pay an additional 0.9% - for a total of 3.8% - on any wages in excess of \$200,000 (or \$250,000 for married couples).

**Payroll Taxes on Unearned Income:** Unearned income includes interest, dividends, royalties, rents, passive income, and capital gains. Beginning in 2013, Medicare taxes will apply to unearned income at a rate of 3.8% for certain high-income taxpayers.

**Current Law:** Medicare payroll taxes do not apply to unearned income under current law.

**New Rate:** Medicare taxes will apply to unearned income at a rate of 3.8%. This rate will apply to individuals with a modified adjusted gross income of over \$200,000, and married couples with a modified adjusted gross income in excess of \$250,000.

**Note:** The increase in Medicare taxes, in conjunction with the expiration of the Bush tax cuts will result in sharply increased capital gains rates –

Year	Federal LTCG Rate	Medicare Rate (applied to LTCG)	Colorado LTCG Rate	Total Combined LTCG Rate
2010	15%	0%	4.63%	19.63%
2011	20%	0%	4.63%	24.63%
2012	20%	0%	4.63%	24.63%
2013	20%	3.8%	4.63%	28.43%

**LIMITS ON FLEXIBLE SPENDING ARRANGEMENTS (HSAs, FSAs, AND MSAs):** The Health Care Act decreases the allowable contributions to a FSA to \$2,500 (currently there is no limit). In addition, the Health Care Act excludes the costs for over-the-counter drugs not prescribed by a doctor from being reimbursed through a FSA, effective for tax years beginning in 2011. There will also be an increased penalty for non-qualifying distributions from an FSA to 20% (currently the penalty is 10%).

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