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Staying Healthy, Wealthy & Wise: The Aftermath of the Fiscal Cliff

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2013 Tax Changes



- The Patient Protection and Affordable Care Act
- American Tax Relief Act of 2012

The Patient Protection and Affordable Care Act



- Signed into law on March 23, 2010
- Upheld by the Supreme Court on June 28, 2012
- Referred to as “ObamaCare”

ObamaCare



- 20 new taxes or tax hikes
- Expected to raise approximately \$800 billion in revenue over 10 years

Increased Taxes for 2013



- Marginal Tax Rates
- Capital Gain Tax Rates
- Medicare Surtax of 3.8% on Investment Income
- Additional Medicare Payroll Tax
- Payroll Tax Holiday
- Increased Threshold for Medical Expense Deduction
- Limit on Flexible Spending Accounts
- Medical Device Tax

Marginal Tax Rates



Addition of the 39.6% Tax Bracket

Filing Status	Taxable Income Above
Married Filing Jointly & Surviving Spouse	\$450,000
Single	\$400,000
Married Filing Separately	\$225,000
Head of Household	\$425,000

Marginal Tax Rates



What happened to the 35% tax bracket?



Filing Status	Taxable Income Range
Married Filing Jointly & Surviving Spouse	\$398,350 - \$449,999
Single	\$398,350 - \$399,999
Married Filing Separately	\$199,175 - \$224,999
Head of Household	\$398,350 - \$424,999

Capital Gains & Qualified Dividends



Tax Rates on Capital Gains & Qualified Dividends

- Continue at 0% and 15% levels
 - 0% rate applies if in the 15% bracket or less
 - 15% rate applies if in the 25% - 35% tax brackets
- Increased to 20% for taxpayers in the 39.6% tax bracket
- Additional 3.8% Medicare Surtax also applies

Medicare Surtax on Investment Income



Medicare Surtax of 3.8% on Investment Income

- Beginning in 2013
- Net Investment Income Tax (NIIT) is imposed on individuals and estates and trusts

Medicare Surtax on Investment Income



Net Investment Income Tax

- For individuals, the tax is imposed on the lesser of:
 - Net Investment Income for the tax year, or
 - Excess of modified adjusted gross income (MAGI) for the tax year over a threshold amount.

Medicare Surtax on Investment Income



Net Investment Income Tax Thresholds

Filing Status	MAGI Threshold
Married Filing Jointly & Surviving Spouse	\$250,000
Single	\$200,000
Married Filing Separately	\$125,000
Head of Household	\$200,000
Trusts and Estates	\$11,650

Medicare Surtax on Investment Income



Modified Adjusted Gross Income (MAGI)

- Adjusted gross income increased by otherwise excludable foreign earned income or foreign housing costs as reduced by any deduction, exclusion, or credits properly chargeable to such foreign earned income.

Medicare Surtax on Investment Income



Example 1

A married couple who files jointly has total earned income of \$265,000 and also has \$25,000 of net investment income in 2013.

MAGI = \$290,000

3.8% Tax is on the lesser of:

\$25,000 of NII, or

\$40,000 (\$290,000 MAGI - \$250,000 threshold)

3.8% Medicare Surtax = \$950

Medicare Surtax on Investment Income



Example 2

An unmarried individual lives strictly off of her \$1 million in “net investment income” from a stock and bond portfolio. Assuming a \$1 million MAGI, she will have to pay \$30,400 in NIIT in 2013.

3.8% Tax is on the lesser of:

\$1 million of NII, or

\$800,000 (\$1 million MAGI - \$200,000 threshold)

3.8% Medicare Surtax = \$30,400

Medicare Surtax on Investment Income



Net Investment Income Includes

- Dividends
- Capital gains
- Annuities
- Rents
- Royalties
- Passive activity income
- Income, gain, or loss attributable to an investment of working capital that is not derived in the ordinary course of a trade or business

Medicare Surtax on Investment Income



Net Investment Income Excludes

- Active trade or business income
- Distributions from IRAs or other qualified retirement plans
- Social Security benefits
- Self-employment income
- Tax-exempt interest
- The gain excluded from income on the sale of a principal residence

Medicare Surtax on Investment Income



Net Investment Income Exclusions and MAGI

- Although excluded from net investment income, the following are still included in MAGI in the tax calculations:
 - Pension income
 - Social Security income
 - Traditional IRA distributions

Medicare Surtax on Investment Income



Net Investment Income Tax Deductions

- Capital losses in excess of capital gains for a particular tax year can only offset up to \$3,000 of other net investment income
- Deductible investment fees
- Deductible investment interest
- State or local taxes attributable to the sources of net investment income
- Allowable passive activity loss carryovers

Medicare Surtax on Investment Income



Net Investment Income Tax Does Not Apply to:

- A non-resident alien
- Charitable trusts

Medicare Surtax on Investment Income



S Corporation Owners with Material Participation

- Flow-thru business income is not considered “unearned income” for purposes of the 3.8% Medicare tax.
- Flow-thru business income is not considered “earned income” for purposes of the .9% Medicare tax.

Medicare Surtax on Investment Income



Real Estate Professionals who Materially Participate in Rental Activities

- Passive loss rules do not apply
- Rental income is not subject to the 3.8% NIIT
- Treated as a trade or business

Medicare Surtax on Investment Income



Tax Planning Considerations

- Tax-exempt investments
- Tax-deferred investments (real estate, life insurance, annuities, etc.)
- Roth IRA conversions
- Oil & gas investments (immediate depletion deduction)
- Installment sale
- Transfer interests in pass-through entities to family members
- Evaluate separate return filing

Medicare Surtax on Earned Income



Additional .9% Medicare Surtax

- Applies to wages and self-employment income that exceeds
 - \$200,000 for single, head-of-household, or surviving spouses
 - \$250,000 for married filing jointly
 - \$125,000 for married filing separately

Medicare Surtax on Earned Income



Additional .9% Medicare Surtax (cont.)

- Tax applies to the employee, not the employer
- Withheld by the employer at \$200,000 of wages
- Based on Medicare wages
- Filing status on Form W-4 does not matter

Medicare Surtax on Earned Income



Example 1

One spouse received \$220,000 of wages, while the other spouse earned \$25,000 of wages.

The employer of the first spouse is required to withhold the .9% tax on the last \$20,000 of taxable wages even though the couple will not owe the surtax since their earned income is under \$250,000.

Medicare Surtax on Earned Income



Example 2

One spouse received \$195,000 of wages, while the other spouse earned \$125,000 of wages.

The employers would not withhold the .9% tax since all wages are under \$200,000. However, the couple would owe \$630 $((\$195,000 + \$125,000 - \$250,000) * .9\%)$ in the Medicare Surtax when they file their 2013 Form 1040.

Medicare Surtax on Earned Income



Self-Employment Considerations

- Self-employed individuals do not receive an income tax deduction for one-half of the .9% Medicare surtax
- Self-employment loss cannot offset W-2 wages
- Consider the surtax when paying in taxes to avoid underpayment penalties

Medicare Surtax on Earned Income



Tax Planning Considerations

- Entity structure
 - Use S Corporations to avoid wages and self-employment income
- Use of separate returns by spouses in some cases

Payroll Taxes



2% Payroll Tax Cut

- Employee share of OASDI cut from 6.2% to 4.2% for 2011 and 2012
- Self-employment tax rate also cut (12.4% to 10.4%)
- This was not extended in 2013

Medical Expense Deduction



Increased Deduction Threshold for Medical Expenses

- 2012 and prior – 7.5% threshold
- 2013 – increased threshold to 10%
 - Remains at 7.5% for those over age 65 through 2016
 - Alternative Minimum Tax threshold remains at 10%

Flexible Spending Accounts



Limits Imposed on Flexible Spending Accounts

- Prior to 2013, unlimited contributions were allowed
 - Employer was allowed to impose a contribution limit
- Maximum of \$2,500 allowed as contributions
 - Reduces taxable wages (not subject to income tax or payroll taxes)

Flexible Spending Accounts



Impact of the FSA Limitation

- Results in a \$13 billion tax increase each year
- 30 – 35 million taxpayers make contributions
- Strong impact on families with special need children
 - FSA amounts can be used to pay for special needs education
 - Tuition rates for special needs children can exceed \$14,000 per year

Medical Device Tax



2.3% Excise Tax on Medical Devices

- Tax on sale of certain medical devices by the manufacturer or importer of the device
- Applies on sales after December 31, 2012

ObamaCare – Health Insurance Mandates



Goals

- Provide affordable health insurance to all US citizens and reduce the growth of health care spending
- Better preventive care coverage
- Better care for seniors
- Illegal to charge different rates to men and women
- No pre-existing conditions rejections by insurance companies
- No caps on annual or lifetime benefits

ObamaCare – Health Insurance Mandates



White House Announced Postponement

- On July 2, 2013 the White House announced a postponed start date of the employer and insurer mandate to January 1, 2015.
- One year delay gives employers with 50 or more full-time equivalent employee time to understand the regulations.
- The House should vote this week on the postponement of the individual mandate. Will it pass the Senate?

ObamaCare – Health Insurance Mandates



Individual Mandate

- Begins 2014 (unless changed by legislature)
- Individuals who cannot afford health insurance
 - Medicare/Medicaid
 - Assistance in the form of tax credits/tax breaks/subsidies
 - Health insurance exchanges

ObamaCare – Health Insurance Mandates



Health Insurance Exchanges

- State or federally run online marketplaces
- Small businesses can use the exchanges to purchase insurance for their employees
- Exchanges open in October 2013, coverage begins January 1, 2014

ObamaCare – Health Insurance Mandates



Health Insurance Exchanges (cont.)

- Offers various types of plans with same essential benefits with differential co-pays and deductible amounts
 - Bronze (60% coverage)
 - Silver (70% coverage)
 - Gold (80% coverage)
 - Platinum (90% coverage)

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Individual Penalties if Coverage is Foregone

- Monthly penalty
 - 1/12 of the greater of:
 - The flat dollar amount, or
 - The applicable percentage of income
- Actual annual penalty is the lesser of the above penalty on an annual basis, or the average national annual premium for qualified health plans that offer bronze coverage

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Individual Penalties if Coverage is Foregone (cont.)

- Flat Dollar Amount – sum of the applicable dollar amounts for each applicable individual who lacks minimum essential coverage, and whom the taxpayer is required to insure
 - The flat dollar amount cannot exceed 300% of the applicable dollar amount
 - Applicable dollar amount = \$95 for 2014; \$325 for 2015; \$695 for 2016
 - Halved for those under the age of 18

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Individual Penalties if Coverage is Foregone (cont.)

- Applicable Percentage of Income – an amount equal to the following percentage of the taxpayer's household income over the taxpayer's filing threshold
 - 1.0% for 2014
 - 2.0% for 2015
 - 2.5% after 2015

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Exclusion from Individual Penalties

- The individual cannot afford coverage because cost exceeds 8% of income
 - Cost is based on the required contribution for employer sponsored coverage, or the lowest cost “bronze plan”

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Employer Mandate

- Large employers must offer minimum essential coverage to full-time equivalent employees or pay a penalty
- Applies to employers with an average of at least 50 full-time equivalent employees on business days during the preceding calendar year.
 - Companies with common owner are combined
 - Employer uses any six consecutive month period in 2013

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Full-time Equivalent Employee

- Employed on average at least 30 hours per week
- A combination of employees working 120 hours per month count as one full-time equivalent employee
- Exemption applies if
 - Workforce exceeds 50 full-time equivalent employees for 120 days or less during the calendar year, and
 - The employees in excess of 50 employed during the 120 day period were seasonal workers.

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Employer Penalties Apply if:

- 50 or more full-time employees or equivalents,
and
- One or more of its full-time employees receive premium credits to help purchase coverage in the exchange
 - Coverage must be affordable and provide the minimum essential coverage

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Affordable & Minimum Coverage

- Employee premium for self-only coverage cannot exceed 9.5% of the employee's household income
- Plan must pay, on average, for 60% or more of the covered health care expenses

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Employee Eligible for Premium Subsidy if:

- Employee's household income must be less than 400% of the Federal Poverty Level, which varies by family size
 - Household income includes the income of the employee's spouse and other dependent members of the household
- Employee's portion of premium must exceed 9.5% of their household income
 - The employer can use the employee's W-2 for this calculation

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Employer Penalties

- Large employers that do not offer health insurance
 - \$2,000 for every full-time employee after excluding the first 30 full-time employees (\$166.67 per month per employee)
- Large employers that do offer health insurance, penalty is the lesser of:
 - \$2,000 for every full-time employee after excluding the first 30 full-time employees (\$166.67 per month per employee), or
 - \$3,000 for every employee receiving a subsidy

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Implications of the Employer Mandate

- Companies choose to pay the penalty and drop the coverage
- Expensive to cross the 50 employee threshold due to \$40,000 penalty
- Scaling back full-time workers to part-time
- Discourages business growth and development
- Hiring more contractors, or outsourcing in lieu of hiring employees
- Strong incentives to avoid hiring workers from low-income households

ObamaCare – Health Insurance Mandates



Exchange Notice Requirements to Employees

- Employers must provide a notice to employees of coverage options available through Exchange by October 1, 2013.
 - Applies to employers with at least one worker and at least \$500,000 in annual revenues
- Department of Labor provides guidance on communication

ObamaCare – Health Insurance Mandate



Small Employer Health Insurance Credit

- 35% credit for the cost of premiums paid
- Credit is available in 2010 through 2013
- Small employer must pay at least 50% of the premium cost
- Credit is reduced to 25% for tax-exempt eligible small employers

ObamaCare – Health Insurance Mandate



Small Employer Health Insurance Credit

- After 2013, a 50% credit is only available to an eligible small employer that purchases coverage through a state Exchange.
- 50% credit is only available for two consecutive years beginning with the first year the employer offers a qualified plan through an Exchange.
- An employer could have credits from 2010 through 2015 for health insurance premiums.

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Who is a Small Employer for the Credit?

- 25 or fewer employees
 - Credit phases out after 10 employees
 - Credit reduced by 6.667% for each full-time employee in excess of 10
- Average annual wages of less than \$50,000
 - Credit phases out after \$25,000
 - Credit reduced by 4% of each \$1,000 that average compensation exceeds \$25,000

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Who is a Small Employer for the Credit?

- Seasonal employees are excluded
- Business owners and their family members are generally excluded
- Number of full-time equivalent employees =
Total hours worked by all employees

2,080

ObamaCare – Health Insurance Mandate



The Federal government has acknowledged the complexity of the health care mandates.

Prepare now for 2014 and 2015.



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