



## Looking Ahead: Health Care Reform and Resulting Tax Implications

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In late March, the long debated Health Care and Education Reconciliation Act of 2010 became law. The controversial bill's intent is to contain soaring medical costs and cover more uninsured Americans. In fact, beginning in 2014, individuals who do not maintain a minimum level of health care coverage will face a penalty tax. Health care reform comes with an array of complex rules; phase-ins and phase-outs and non-compliance penalties, depending on your income and medical coverage. It also comes with tax increases.

This new law includes over \$250 billion in new taxes, the majority of which will impact higher income taxpayers. Starting in 2013, high-income investors and wage earners will see their federal taxes increase, in some cases significantly. On January 1, 2013, a new tax on investment income will be assessed on high-income investors. The new Medicare Contribution Tax, which will be used to fund health care expansion, is a 3.8% flat rate and applies to an individual's eligible investment income. Investment income encompasses capital gains, dividends, interest, royalty and rental income.

The tax is levied on the lesser of net investment income or the amount by which your adjusted gross income exceeds \$200,000 for single filers, or \$250,000 for married couples filing a joint return. For example, consider a married couple with adjusted gross income of \$275,000, including net investment in-

come of \$30,000. The calculation is made by taking the lesser of investment income, in the amount of \$30,000, or the amount by which the adjusted gross income exceeds \$250,000. The resulting \$25,000 is subject to a 3.8% tax, or \$950.

High-income taxpayers who have investment income and wage earnings or self-employment income are doubly impacted. Starting in 2013, there is an additional Hospital Insurance Tax of .9% on wages, and or self-employment income over \$250,000 for married couples filing jointly or \$200,000 for single filers. This tax is in addition to the 1.45% Medicare Tax currently assessed on wages and earned income. Employers are responsible for withholding this additional tax from employee wages. Unlike the 1.45% Medicare Tax currently being charged, the employer is not required to pay in an equal amount as this tax affects the employee only.

Here's where it gets more complicated. Suppose both spouses are employed and neither earns wages over the applicable threshold. If each spouse's wages are \$200,000, under the \$250,000 limit, their respective employers are not required to withhold the additional .9% tax. However, when their joint tax return is filed, the wages total \$400,000, \$150,000 over the \$250,000 joint filing threshold. As a result, an additional \$1,350 of Hospital Insurance Tax is owed.

It is important to note that both the Medicare Contribution Tax and the Hospi-

tal Insurance Tax will be subject to Federal Income Tax withholding rules. They will count as taxes for determining any underpayment penalties, meaning these taxes must be paid through additional payroll withholdings or quarterly estimated tax payments.

In anticipation of these tax increases, high-income investors may want to recognize large capital gains in a particular stock before the law goes into effect in 2013. If warranted, the taxpayer can buy the stock back and pay the capital gains before the additional taxes kick in. The taxpayer also receives an increase in the cost basis. Municipal bonds may be another option for high-income taxpayers to minimize additional taxes, as municipal income is not counted toward the taxpayer's adjusted gross income. Employees expecting a large bonus in 2013 should consider accelerating payment into 2012.

At Pennsylvania Trust, our experienced staff of tax professionals closely follows tax legislation and works diligently to keep our clients aware of the implications they, as individuals, might experience as a result of changes in old laws or new legislation. It is not too early to initiate a discussion with us to review your portfolio, ensuring that you remain well positioned to achieve your financial goals.

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