What You Need to Know About the Tax Provisions in the Health Care Bill

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There are several tax provisions in the Patient Protection and Affordable Care Act, often referred to as "Obamacare," that will begin to take effect in 2013. I will discuss a few of the major tax provisions and how they will affect you.

Beginning in 2013 there will be a new 3.8% Medicare surcharge on investment income for all taxpayers whose income exceeds the "threshold amount." This tax will be imposed on interest, dividends, capital gains, passive business investment income, royalties, annuities and rents. The threshold amount for single filers is a modified adjusted gross income (MAGI) above $200,000 and the threshold amount for married taxpayers is a MAGI over $250,000. Therefore, if the Bush Era tax cuts expire as scheduled at the end of 2012, the maximum tax rate on qualified dividends will increase from 15% to 43.4% and the maximum tax on long-term capital gains will increase from 15% to 23.8%. Now let's address a few questions you will likely have about the impact of these changes on you.

What can you do about the new Medicare tax on investment income?

- Tax exempt bonds, tax deferred annuities, rental real estate and life insurance are a few options to consider. However, careful tax planning is required to determine if it is really worth changing your investments.
- Investment income does not include distributions from tax favored retirement plans such as qualified employer plans and IRAs, social security benefits, and unemployment compensation. While these items themselves are not investment income subject to the additional 3.8% tax, they are included in MAGI and may therefore drive your MAGI over the threshold amount. Similarly, it is important to consider that while ROTH IRA distributions do not increase your MAGI, Roth IRA conversions do increase MAGI.

What can you do about the Medicare tax on long-term capital gains?

- If you have gains to harvest on investments that you intend to hold for a long time, the best advice is to do nothing different right now. The benefit of deferring taxes on that gain is probably greater than the benefit of paying taxes now at a lower rate. If your plan is to harvest these gains in a short time period, you may consider selling them in 2012 since the tax deferral benefit will be small in these cases.
- If you have capital losses that have been carried over from prior years, they would be better used to offset gains in future years when the long-term capital gains rates are higher. Assets that are sold to produce gains could be repurchased, but the Health Care and Education Reconciliation of 2010 added a code section that could inflict a penalty on repurchases that

are immediate. Therefore, it is better to let time pass after the sale or to reinvest in different assets.

It is important to remember the general rule: tax rates alone should not drive your investment decisions. The increasing tax rates are one factor to consider as you work with your investment advisor to evaluate your portfolio decisions.

There is also going to be an increased Medicare surcharge on wages and other earned income. Currently the Medicare surcharge on wages is 1.45% paid by the wage earner and an additional 1.45% paid by the employer. A self-employed person pays 2.9%. For single taxpayers with salary and/or self-employment income greater than $200,000 there will be an additional 0.9% Medicare tax. For joint-filers this tax will apply if the combined wage and self-employment income is greater than $250,000. This new tax only applies to the employee portion of the Medicare tax. If it is obvious that wages will exceed these levels then the employer will withhold the extra tax. If the threshold amount is reached after combining earned income sources on the tax return, this tax will be paid with the tax return.

What can you do about the new Medicare tax on earned income?

- Watch out for compensatory stock options. Timing of when the income is recognized is now very important. Talk to your employer and to us to make sure that you thoroughly understand the income tax consequences of your specific type of option.
- Consider putting the maximum allowed into a qualified retirement plan. Employees and self- employed individuals have this option.

What other Obamacare provisions will impact me?

- For many years medical expenses could be deducted as an itemized deduction if they were greater than 7.5% of modified adjusted gross income (AGI). Beginning in 2013 this hurdle will increase to 10% of AGI.
- In addition, the Healthcare Flexible Spending Account (FSA) that allows employees to make tax-free contributions to a plan and deduct those contributions from taxable wage will also be affected. These salary reduction contributions, which can then be used to pay for qualified medical expenses, tax-free, will now be limited to $2,500. This limit does not apply to certain employer non-elective contributions, health savings accounts, or health reimbursement arrangements.
- A new 2.3% excise tax on sales of medical devices will indirectly affect taxpayers through an increase in consumer costs as manufacturers pass-through this additional cost. This tax will not apply to eyeglasses, contact lenses or hearing aids. Unfortunately, there is nothing that you, the taxpayer can do to avoid this increase.

We will continue following the Congressional discussions on the Affordable Care Act and the Bush Era Tax cuts and will keep you informed of any changes. If the Bush Era tax cuts are not extended, we will work with you to project your MAGI and earned income for 2013 in order to consider whether any income acceleration or expense deferral strategies should be implemented to minimize your overall tax liability.

As always, if you have any questions, or want to do some early tax planning, please contact one of us directly by calling our office at: 781.449.5825 or by sending an email to advice@waldronrand.com or your specific contact at our firm.

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