

HEALTH CARE REFORM AND THE MULTI FAMILY HOUSING INDUSTRY

In March 2010, President Obama signed into law the *Patient Protection and Affordable Care Act* (P.L. 111-148) and the *Health Care and Education Reconciliation Act* (P.L. 111-152), sweeping health care reform legislation that included tax provisions that will significantly impact members of the multi family housing industry and their employees. NMHC has prepared the following list of tax law changes included in these measures:

Payroll Tax Increases on Both Earned and Net Investment Income

Beginning in 2013, the health care bill would raise Medicare payroll taxes on earned income and, for the first time, impose a payroll tax on net investment income.

- *Payroll Tax Increase on Wage Income:* Under current law, a 2.9 percent Medicare payroll tax is imposed on all wage income (the employer and employee are each responsible for remitting half the tax with the self-employed having to pay both halves). The health care reform bill would increase by 0.9 percentage points the Medicare tax on wages for individuals earning over \$200,000 and married couples earning over \$250,000. Impacted individuals and the self-employed (as opposed to employers) would be responsible for remitting the tax.
- *Payroll Tax Imposed on Net Investment Income:* Under current law, no Medicare tax is imposed on net investment income, including annuities, capital gains, interest, dividends, royalties, and rents. The health care reform legislation will generally impose a 3.8 percent tax on such income for individuals with total incomes over \$200,000 and married couples with total incomes over \$250,000. Notably, the provision does not apply to annuity, capital gain, interest, dividend, royalty, and rental income derived in the ordinary course of a trade or business but would apply if the income inures from a passive activity. Also, excluded are any distributions from qualified retirement plans, including a 401(k), 403(b), or 457 plan. Finally, in the case of the disposition of a partnership interest or stock in an S corporation, only net gain or loss attributable to property held by the entity that is not property attributable to an active trade or business is taken into account.

Employer Fines for Failure to Provide Insurance

- Although health care reform legislation does not mandate that employers provide health insurance, it will beginning in 2014 impose fines on firms with more than 50 employees that fail to do so. Specifically, a fine would be imposed if even a single employee obtains subsidized health insurance through the new exchanges (health insurance marketplaces). The penalty would total \$2,000 for each full time worker (not just those who obtained insurance in the exchanges), but would exempt the first 30 employees while calculating the penalty. Thus, an employer with 60 workers would pay the penalty for 30 workers for a total of \$60,000.

Notably, employers, even those offering insurance, may also have to take additional actions to benefit workers earning under 400 percent of poverty (\$88,200 for a family of

four) who seek to purchase insurance on their own through the new exchanges. Such workers who are eligible for employer coverage may opt to purchase insurance on subsidized exchanges if the cost of employer-provided coverage totals at least 8 percent of income (but no more than 9.8 of income). Should an employee decide to purchase coverage on an exchange, the employer would have to provide a voucher equal to the firm's contribution for employer-provided coverage. Firms making such payments would not be responsible for remitting the fines described above.

Individual Insurance Mandate

- The health care legislation mandates that beginning in 2014 most Americans must purchase health insurance or pay a penalty. Individuals below the tax filing threshold (\$9,350 for individuals and \$18,700 for married couples in 2009) and those who cannot find a policy that costs less than 8 percent of income will be exempted. Penalty amounts will be phased-in for failure to comply. In 2014, uninsured Americans will be fined the greater of \$95 or 1 percent of income. In 2015, this amount will rise to the greater of \$325 or 2 percent of income. In 2016 and thereafter, the penalty will total the greater of \$695 or 2.5 percent of income. Penalties apply to all members of a family, including children, to a maximum of \$2,085 per family.

Small Business Tax Credit

- The health care reform legislation provides a tax credit for small businesses to provide coverage to employees. The maximum credit is worth 35 percent of health care costs in 2010 through 2013 and 50 percent of health care costs in 2014 and thereafter. The full credit would be available to small businesses with 10 or fewer full-time employees with average wages of \$25,000 or less. The credit is phased out as a firm's number of full-time employees rises to 25 and as average wages increase to \$50,000. Small businesses may take the credit in each year through 2013 but only for two years following 2014.

Other Employee Benefit Changes

- *Cafeteria Plans for Small Employers:* Under present law, larger employers can establish so-called cafeteria plans to offer benefits (e.g., health insurance) to their employees on a tax-free basis. Smaller employees often cannot do so due to so-called non-discrimination rules designed to prevent employers from providing excessive benefit dollars to highly compensated employees. The health care reform bill would beginning in 2011 loosen non-discrimination rules for employers with 100 or fewer employees.
- *Flexible Spending Accounts (FSAs):* Under current law, employees may use FSAs to pay for medical services on a pre-tax basis. There is no limit regarding how much employers can allow employees to set aside in an FSA. Beginning in 2013, health care reform legislation limits to \$2,500 the amount that may annually be placed into an FSA. Furthermore, beginning in 2011, over-the-counter medication may no longer be purchased with FSA funds.

- *Health Savings Accounts (HSAs):* Under current law, individuals may establish HSAs to fund health care expenses incurred with a high-deductible health insurance plan on a pre-tax basis. Distributions from an HSA that are used for qualified medical expenses are excluded from tax. Distributions from an HSA that are not used for qualified medical expenses are subject to both income tax and an additional 10 percent excise tax. The health care reform legislation doubles this excise tax to 20 percent beginning in 2011. As under current law, the excise tax does not apply if the distribution is made after death, disability, or attainment of age of Medicare eligibility (currently, 65).
- *Higher Threshold for Itemized Deductions for Medical Expenses:* Under current law, individuals may take an itemized deduction for medical expenses to the degree expenses exceed 7.5 percent of adjusted gross income. Beginning in 2013, expenses will have to exceed 10 percent of adjusted gross income for a medical expense deduction to be allowable. The threshold will remain at 7.5 percent of adjusted gross income for individuals over 65 (and their spouses) through 2016.