Chapter 12: New Legislation

Corrections were made to this workbook through January of 2011. No subsequent modifications were made.

WORKER, HOMEOWNERSHIP, AND BUSINESS ASSISTANCE ACT OF 2009

On November 6, 2009, President Obama signed into law the Worker, Homeownership, and Business Assistance Act of 2009 (WHBAA). The main provisions of the WHBAA, other than those covered in other chapters of this workbook, are analyzed below.

NOL CARRYBACK PERIOD EXTENDED

Old Law. Under the provisions of the American Recovery and Reinvestment Act of 2009 (ARRA), an eligible small business (ESB) could elect a 3-, 4-, or 5-year carryback period for an NOL arising from a tax year beginning or ending in 2008, instead of the standard 2-year carryback. An ESB for purposes of the increased carryback period is one whose 3-year average gross receipts ending with the tax year in which the loss arose do not exceed $15 million. When applying the average gross-receipts test, the receipts of all entities under common control must be included in the calculation. An ESB can be a sole proprietorship, a partnership, or a corporation.

5-Year NOL Carryback Available to All Businesses

New Law. The WHBAA allows businesses of any size (with the exception noted below) up to a 5-year carryback period for NOLs arising in tax years ending after December 31, 2007, and beginning before January 1, 2010. This election is generally available for only one taxable year. However, those ESBs that made a timely election under ARRA to carry back 2008 NOLs for three, four, or five years may also make the election for 2009; thus, these businesses may carry back both 2008 and 2009 NOLs for up to five years.

Limitation. Under the WHBAA, businesses are limited in the NOL amount that can be carried back to the fifth preceding taxable year. This amount cannot exceed 50% of the taxable income for the fifth carryback year. However, the NOL remaining after applying the 50% limitation in the fifth carryback year is fully available to offset taxable income in years subsequent to the fifth carryback year.

> **Example 1.** Nebulous Concrete Co. has taxable income of $10 million for every year from 2004 through 2008. In 2009, there is a management change at Nebulous, which results in a lack of focus on the company's primary business purpose. Consequently, Nebulous incurs a $45 million NOL for the year. The company elects to carry back the 2009 NOL for the maximum 5-year period. The amount of the NOL that can be carried back to 2004 is $5 million (half of the taxable income for 2004). Nebulous can use the remaining $40 million NOL carryback to fully offset the taxable income for 2005, 2006, 2007, and 2008.

The 50% limitation for the fifth preceding taxable year does not apply to ESBs that elected to carry back 2008 NOLs under the ARRA, even if such election is made after the date of enactment of the WHBAA. However, the limitation does apply to 2009 NOLs carried back by ESBs.

TARP Recipients Not Eligible. Taxpayers that received benefits under the Emergency Economic Stabilization Act of 2008 (TARP recipients) are not eligible for an extension of the NOL carryback period.

AMT Limitation Suspended

Under previous rules, a taxpayer's NOL deduction could not reduce the taxpayer's alternative minimum taxable income (AMTI) by more than 90% of the AMTI.[1] The WHBAA suspends this 90% limitation on NOL deductions for which an extended carryback period is elected.

Election

In order to apply the extended carryback provision, an election must be made by the 2009 tax return's due date (including extensions). This election is irrevocable.

Rev. Proc. 2009-52 provides guidance on the proper manner of electing the 3-, 4-, or 5-year NOL carryback period. Under this revenue procedure, there are two methods for electing the carryback:

Method 1. For the year in which the NOL arises, a statement is attached to the timely-filed return, including extensions. If the taxpayer has already filed an income tax return for the year in which the NOL arises, the business may make the election by attaching a statement to an amended return for the taxable year of the applicable NOL. The statement must stipulate that the taxpayer elects to apply IRC §172(b)(1)(H) or §810(b)(4) under Rev. Proc. 2009-52, and that the taxpayer is not a TARP recipient nor an affiliate of a TARP recipient. The statement must also specify the length of the NOL carryback period elected by the taxpayer (three, four, or five years).

The taxpayer's original or amended income tax return for the taxable year of the NOL must be filed with the election statement on or before the due date (including extensions) for the 2009 tax return.

If the taxpayer completes a claim for a tentative carryback adjustment (Form 1045, *Application for Tentative Refund*, or Form 1139, *Corporation Application for Tentative Refund*), a copy of the election statement must be attached. The due date for filing a claim on Form 1045 or 1139 for a taxpayer making the §172(b)(1)(H) election is extended to the due date, including extensions, for filing the 2009 tax return.

Method 2. If the return was filed without an election to apply the new law and the return did not include an election to forgo the carryback period, the IRS permits the taxpayer to make the election by filing one of the appropriate forms applying the NOL carryback period chosen by the taxpayer. The election statement described above under Method 1 must be attached to the form. This form must be filed within six months of the due date of the return, excluding extensions.

For the following types of taxpayers, the appropriate forms are as follows:

- **For corporations:** Form 1139, *Corporation Application for Tentative Refund*, or Form 1120X, *Amended U.S. Corporation Income Tax Return,* for the earliest tax year of the carryback period
- **For individuals:** Form 1045, *Application for Tentative Refund*, or Form 1040X, *Amended U.S. Individual Income Tax Return,* for the earliest tax year of the carryback period
- **For estates or trusts:** Form 1045, or an amended Form 1041, *U.S. Income Tax Return for Estates and Trusts,* for the earliest tax year of the carryback period
- **For tax-exempt organizations with unrelated business income:** Form 1139, or an amended Form 990-T, *Exempt Organization Business Income Tax Return (and proxy tax under section 6033(e)),* for the earliest tax year of the carryback period

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1. IRC §56(d).

Procedure if Previous Carryback Application Filed. A taxpayer that previously filed an amended return or application for a tentative carryback adjustment prior to enactment of the WHBAA may make the §172(b)(1)(H) election by following the procedures previously described under either **Method 1** or **2.** The taxpayer's election statement must specify that the election amends a previous carryback application or claim. This procedure does not apply to ESBs that made a carryback election under ARRA.

Revocation of Election to Waive Carryback Period. A taxpayer that previously elected under IRC §172(b)(3) or §810(b)(3) to forgo the carryback period for an applicable NOL for a taxable year ending before November 6, 2009, may revoke that election and make the election under §172(b)(1)(H). This revocation also applies to a carryback of any alternative tax NOL for the same taxable year. The taxpayer should attach an election statement to the appropriate tax return (listed previously) that states that the taxpayer is revoking an NOL carryback waiver and electing to apply §172(b)(1)(H) or §810(b)(4) under Rev. Proc. 2009-52 and that the taxpayer is neither a TARP recipient nor an affiliate of a TARP recipient. The statement must also specify the length of the NOL carryback period the taxpayer elects. The revocation must be made by the extended due date of the taxpayer's 2009 tax return.

> **Note.** The Joint Committee on Taxation (JCT) estimates that the expansion of the NOL carryback period will cost the federal government $33.2 billion in fiscal year 2010, leveling off to $10.4 billion over 10 years.

MODIFICATION OF FAILURE-TO-FILE PENALTY

Old Law. For returns required to be filed after December 31, 2008, the failure-to-file penalty for S corporations and partnerships was $89 multiplied by the number of shareholders or partners for each month (or fraction of a month) that the failure continues, up to a maximum of 12 months.

New Law. Under the WHBAA, the failure-to-file penalty is increased to $195 per month (or fraction thereof) for each shareholder or partner, up to a maximum of 12 months. This provision applies to S corporation and partnership returns for taxable years beginning after December 31, 2009.

> **Note.** The JCT estimates that the increase in the failure-to-file penalty on S corporations and partnerships will raise $1.2 billion over 10 years.

FUTA SURTAX EXTENDED

The federal unemployment tax act (FUTA) surtax of 0.2% is extended through June 30, 2011. The total FUTA tax on employers remains at 6.2% of taxable wages, with a credit of up to 5.4% of taxable wages for amounts paid into state unemployment funds.

ELECTRONIC-FILING REQUIREMENT

Old Law. For tax years ending on or after December 31, 2006, corporations and tax-exempt organizations with assets of at least $10 million and that file 250 or more returns during a calendar year are required to electronically file their Forms 1120/1120S income tax returns and Form 990 information returns. Income tax, information, excise tax, and employment tax returns are counted in determining whether the 250-return threshold is met. Additionally, private foundations and charitable trusts, regardless of asset size, are required to electronically file their Forms 990-PF returns for tax years ending on or after December 31, 2006, if they file at least 250 returns in a calendar year.

New Law. The WHBAA includes a provision that requires electronic filing for the vast majority of tax return preparers for tax returns filed after December 31, 2010. Only tax return preparers who prepare, or can reasonably expect to prepare, fewer than 10 individual income tax returns in a calendar year are exempted from the electronic-filing requirement. The term "individual income tax returns" in this context includes estate and trust returns.

The e-file mandate will be phased in over two years. Preparers are required to start using IRS e-file according to the following timetable:[2]

- January 1, 2011 — for tax preparers who anticipate preparing 100 or more federal individual or trust tax returns during the year
- January 1, 2012 — for tax preparers who anticipate preparing 11 or more federal individual or trust tax returns during the year

CONTINUING EXTENSION ACT OF 2010

Old Law. The ARRA established a subsidy of 65% of COBRA[3] health insurance premiums for workers who were involuntarily terminated from employment. The subsidy was limited to no more than nine months per individual and was provided to individuals subject to involuntary terminations on or after September 1, 2008, and before January 1, 2010. The subsidy applied to terminated employees and their family members who were qualified beneficiaries.

The Department of Defense Appropriations Act of 2010 lengthened the maximum subsidy period from nine to 15 months and extended the eligibility period to include individuals subject to involuntary terminations from September 1, 2008, through February 28, 2010.

The Temporary Extension Act of 2010 (H.R. 4691)[4] further extended the eligibility period to include workers involuntarily terminated through March 31, 2010. It also redefined a qualified individual to include certain workers who had their hours reduced and later lost their jobs.

New Law. The Continuing Extension Act of 2010[5] was enacted on April 15, 2010. It reinstated the previously-expired COBRA subsidy. As a result, workers who were involuntarily terminated from employment between September 1, 2008, and May 31, 2010, may be eligible for a 65% subsidy of their COBRA premiums for a period of up to 15 months.[6]

In order to qualify for the subsidy, employers must provide COBRA continuation coverage for health insurance to eligible individuals who pay 35% of the premiums. These employers were eligible to offset their payroll taxes for purposes of reimbursement. The credit is claimed on the employer's payroll tax return using either Form 941, *Employer's Quarterly Federal Tax Return;* Form 944, *Employer's Annual Federal Tax Return;* or Form 943, *Employer's Annual Federal Tax Return for Agricultural Employees.*

> **Note.** For more information about the COBRA subsidy under the ARRA, see Chapter 11, New Legislation, in the 2009 *University of Illinois Federal Tax Workbook.* This can be found on the accompanying CD.

2. [www.irs.gov/taxpros/providers/article/0,,id=223832,00.html] Accessed on July 29, 2010.
3. Consolidated Omnibus Budget Reconciliation Act.
4. P.L. 111-144.
5. P.L. 111-157.
6. IRS News Rel. IR-2010-052 (Apr. 26, 2010).

MILITARY SPOUSES RESIDENCY RELIEF ACT

On November 11, 2009, the president signed the Military Spouses Residency Relief Act.[7] The purpose of the act is to prevent a person from losing domicile or residence in a state as a consequence of accompanying a spouse to a different state in compliance with military or naval orders. The act covers both voting rights and state income taxation.

Example 2. Harry and Martha currently live in Texas, a state with no state income tax. Harry is a member of the armed forces and is transferred to Ohio, a state with an income tax. Martha chooses to follow Harry to Ohio and lives there while Harry serves in the military. Martha's and Harry's combined income level requires them to file a federal income tax return. While they would normally be required to file an Ohio state income tax return, the Military Spouses Residency Relief Act allows them to continue to claim Texas residency.

The act also allows them to continue to vote in state and local elections in Texas rather than in Ohio even though they are absent from Texas.

Another provision of the act prohibits income from **services performed** by a military spouse from being considered income earned in a state when the spouse is in that state solely to be with a military servicemember serving under military orders.

Note. In what was most likely an unintended omission, this provision applies only to spouses of military personnel. Military personnel earning income outside the military in a state that is not considered their residence are subject to that state's income taxation.

Example 3. Martha, from **Example 2**, starts a new job after moving with Harry to Ohio. Martha's wages from this job are not considered income earned in Ohio. She will not pay taxes to Texas either, since Texas has no state income tax.

Note. The procedure to claim exemption from withholding under the provisions of this act varies by state. For example, in Illinois, nonresident military spouses should complete Form IL-W-5-NR, *Employee's Statement of Nonresidence in Illinois*, and give it to their Illinois employers. Military spouses should also complete Illinois Schedule MR, *Military Spouse Relief*, and Schedule NR, *Nonresident and Part-Year Resident Computation of Illinois Tax*, and attach these forms to their Illinois tax returns. Following these procedures will allow military spouses to claim exemption from tax on their wages and to get a refund of any taxes withheld by Illinois employers.[8] On the other hand, if the tax laws of the military couple's new state are more advantageous than their former state of residence, they will want to comply with residency requirements in the new state.

This legislation is effective for any tax year that includes the date of enactment. For calendar-year taxpayers, this includes all 2009 income.

7. P.L. 111-97.

8. [www.revenue.state.il.us/taxforms/IncmCurrentYear/Individual/Schedule-MR.pdf] Accessed on July 29, 2010.

HIRING INCENTIVES TO RESTORE EMPLOYMENT ACT

President Obama signed the Hiring Incentives to Restore Employment Act (HIRE) into law on March 18, 2010. It contains **two new tax benefits available to employers** who hire certain previously-unemployed workers:

- **Payroll Tax Exemption.** Employers are given an exemption from their share of social security taxes and railroad retirement taxes on wages paid to qualifying employees from March 19, 2010, through December 31, 2010.
- **New Hire Retention Credit.** A general business tax credit of up to $1,000 is allowed for each qualified employee retained for at least 52 consecutive weeks.

The HIRE Act also contains several other important provisions that include the following:

- An extension of the IRC §179 enhanced expensing election
- A refundable credit allowed to issuers of certain qualified tax credit bonds
- Various revenue offsets

TAX BENEFITS FOR HIRING UNEMPLOYED WORKERS

Qualified Employers

Businesses, agricultural employers, tax-exempt organizations, public colleges and universities, and tribal governments qualify for the payroll tax exemption and the new hire retention credit (discussed below) for eligible employees. Household employers and federal, state, and local government employers (other than public colleges and universities) do not qualify for the payroll tax exemption or the new hire retention credit.[9]

Qualified Employees

For purposes of the payroll tax exemption and the new hire retention credit, qualified employees are individuals who meet all the following criteria:

1. The employee began employment with a qualified employer after February 3, 2010, and before January 1, 2011.
2. The employee was not employed for more than 40 hours during the 60-day period ending on the date that qualified employment begins.
3. The employee is not employed by the qualified employer to replace another employee unless the other employee voluntarily separated from employment or was terminated for cause.
4. The employee is not a family member or related in certain other ways to the employer (see IRC §51(i)(1)).[10]

Under penalties of perjury, qualified employees must sign an affidavit that they were not employed for more than 40 hours during the continuous 60-day period ending on the date they started employment. Employers must retain these affidavits in their files. The IRS created Form W-11, *Hiring Incentives to Restore Employment (HIRE) Act Employee Affidavit,* to use for certification purposes.

9. IRS News Rel. IR-2010-43 (Apr. 7, 2010).
10. IRC §3111(d)(3).

Form **W-11**
(April 2010)
Department of the Treasury
Internal Revenue Service

Hiring Incentives to Restore Employment (HIRE) Act Employee Affidavit

► **Do not send this form to the IRS. Keep this form for your records.**

To be completed by new employee. Affidavit is not valid unless employee signs it.

I certify that I have been unemployed or have not worked for anyone for more than 40 hours during the 60-day period ending on the date I began employment with this employer.

Your name _____ Social security number ► _____

First date of employment ___/___/___ Name of employer _____

Under penalties of perjury, I declare that I have examined this affidavit and, to the best of my knowledge and belief, it is true, correct, and complete.

Employee's signature ► _____ Date ► ___/___/___

Instructions to the Employer

Section references are to the Internal Revenue Code.

Purpose of Form

Use Form W-11 to confirm that an employee is a qualified employee under the HIRE Act. You can use another similar statement if it contains the information above and the employee signs it under penalties of perjury.

Only employees who meet all the requirements of a qualified employee may complete this affidavit or similar statement. You cannot claim the HIRE Act benefits, including the payroll tax exemption or the new hire retention credit, unless the employee completes and signs this affidavit or similar statement under penalties of perjury and is otherwise a qualified employee.

A "qualified employee" is an employee who:

- begins employment with you after February 3, 2010, and before January 1, 2011;
- certifies by signed affidavit, or similar statement under penalties of perjury, that he or she has not been employed for more than 40 hours during the 60-day period ending on the date the employee begins employment with you;
- is not employed by you to replace another employee unless the other employee separated from employment voluntarily or for cause (including downsizing); and
- is not related to you. An employee is related to you if he or she is your child or a descendent of your child, your sibling or stepsibling, your parent or an ancestor of your parent, your stepparent, your niece or nephew, your aunt or uncle, or your in-law. An employee also is related to you if he or she is related to anyone who owns more than 50% of your outstanding stock or capital and profits interest or is your dependent or a dependent of anyone who owns more than 50% of your outstanding stock or capital and profits interest.

If you are an estate or trust, see section 51(i)(1) and section 152(d)(2) for more details.

CAUTION *Do not send this form to the IRS. Keep it with your other payroll and income tax records.*

Cat. No. 10744F Form **W-11** (4-2010)

Payroll Tax Exemption

Employers who hire unemployed workers after February 3, 2010, and before January 1, 2011, may qualify for a 6.2% payroll tax incentive. This effectively exempts the employer from its share of social security tax or railroad retirement tier 1 tax on wages paid to qualified workers after March 18, 2010, and before January 1, 2011. The reduction has no effect on the employee's future social security or railroad retirement benefits.

Employers must continue to withhold the **employees**' 6.2% share of social security or railroad retirement taxes, as well as income taxes. Both the employer and the employee are still responsible for their respective shares of Medicare and railroad retirement tier II tax.

Form 941, *Employer's Quarterly Federal Tax Return*, can be used by most eligible employers to claim the payroll tax exemption. This form was revised for use beginning with the second quarter of 2010. (See a copy of the revised Form 941 after **Example 4.**)

The payroll tax exemption generally does not apply to wages paid to a qualified employee who is hired to replace an existing worker. However, if an employee is laid off due to lack of work and later the employer hires a new employee when the workload increases, the payroll tax exemption applies to wages paid to the new **qualified** employee. The employer may also rehire the laid-off employee after a 60-day period and qualify for the payroll tax exemption as long as the employee meets all the qualification criteria previously listed.

Special Rule for First Quarter of 2010

Although the payroll tax exemption applies to qualified wages paid after March 18, 2010, the exemption cannot be claimed on the return for the first calendar quarter of 2010. However, the amount of social security tax imposed on qualified wages during the first quarter of 2010 is treated as a payment against the tax imposed for the qualified employer for the second quarter of 2010.

Example 4. Juliette is a qualified employee for purposes of the payroll tax exemption. She is hired by New Logistics, Inc., on March 8, 2010. She is paid $1,500 in wages for the period from March 19 through March 31, 2010. New Logistics must pay the social security tax of $93 ($1,500 × 6.2%) on her wages for this period on its first quarter Form 941. It is allowed a deduction for this amount on its second quarter Form 941.

Juliette is paid $9,000 in wages for the second quarter of 2010. New Logistics is allowed a deduction on Form 941 for Juliette's second quarter social security taxes of $558 ($9,000 × 6.2%).

New Logistics does not have any other qualified employees for purposes of the payroll tax exemption. The company pays a total of $125,000 in wages for the second quarter of 2010.

The first page of New Logistics' second quarter Form 941 follows. Note that the payroll tax exemption for Juliette's second quarter wages is deducted on line 6d, and the payroll tax exemption for her first quarter wages is deducted on line 12e.

For Example 4

Form **941 for 2010: Employer's QUARTERLY Federal Tax Return**
(Rev. April 2010) Department of the Treasury — Internal Revenue Service

951110
OMB No. 1545-0029

(EIN) Employer identification number: 36-2222222

Name (not your trade name): New Logistics, Inc.

Trade name (if any):

Address: 789 Lois Lane (Number, Street) — Suite or room number:

Metropolis (City) — IL (State) — 60000-0789 (ZIP code)

Report for this Quarter of 2010 (Check one.)

- ☐ 1: January, February, March
- ☑ 2: April, May, June
- ☐ 3: July, August, September
- ☐ 4: October, November, December

Read the separate instructions before you complete Form 941. Type or print within the boxes.

Part 1: Answer these questions for this quarter.

1	Number of employees who received wages, tips, or other compensation for the pay period including: *Mar. 12* (Quarter 1), *June 12* (Quarter 2), *Sept. 12* (Quarter 3), or *Dec. 12* (Quarter 4)			1	12
2	Wages, tips, and other compensation			2	125,000 . 00
3	Income tax withheld from wages, tips, and other compensation			3	20,000 . 00
4	If no wages, tips, and other compensation are subject to social security or Medicare tax				☐ Check and go to line 6e.
		Column 1	Column 2		
5a	Taxable social security wages* .	125,000 . 00 × .124 =	15,500 . 00		*Report wages/tips for this quarter, including those paid to qualified new employees, on lines 5a–5c. The social security tax exemption on wages/tips will be figured on lines 6c and 6d and will reduce the tax on line 6e.
5b	Taxable social security tips* . .	. × .124 =	.		
5c	Taxable Medicare wages & tips*	125,000 . 00 × .029 =	3,625 . 00		
5d	Add *Column 2* line 5a, *Column 2* line 5b, and *Column 2* line 5c			5d	19,125 . 00
6a	Number of qualified employees *first* paid exempt wages/tips this quarter		0		See instructions for definitions of qualified employee and exempt wages/tips.
6b	Number of qualified employees paid exempt wages/tips this quarter		1		
6c	Exempt wages/tips paid to qualified employees this quarter	9,000 . 00 × .062 =		6d	558 . 00
6e	Total taxes before adjustments (line 3 + line 5d – line 6d = line 6e)			6e	38,567 . 00
7a	Current quarter's adjustment for fractions of cents			7a	.
7b	Current quarter's adjustment for sick pay			7b	.
7c	Current quarter's adjustments for tips and group-term life insurance			7c	.
8	Total taxes after adjustments. Combine lines 6e through 7c			8	38,567 . 00
9	Advance earned income credit (EIC) payments made to employees			9	.
10	Total taxes after adjustment for advance EIC (line 8 – line 9 = line 10)			10	38,567 . 00
11	Total deposits, including prior quarter overpayments			11	38,567 . 00
12a	COBRA premium assistance payments (see instructions)			12a	.
12b	Number of individuals provided COBRA premium assistance . .				Complete lines 12c, 12d, and 12e only for the 2nd quarter of 2010.
12c	Number of qualified employees paid exempt wages/tips March 19–31		1		
12d	Exempt wages/tips paid to qualified employees March 19–31	1,500 . 00 × .062 =		12e	93 . 00
13	Add lines 11, 12a, and 12e			13	38,660 . 00
14	Balance due. If line 10 is more than line 13, enter the difference and see instructions			14	.
15	Overpayment. If line 13 is more than line 10, enter the difference	93 . 00	Check one: ☑ Apply to next return. ☐ Send a refund.		

▶ You MUST complete both pages of Form 941 and SIGN it. Next ▶

For Privacy Act and Paperwork Reduction Act Notice, see the back of the Payment Voucher. Cat. No. 17001Z Form 941 (Rev. 4-2010)

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New Hire Retention Credit

A qualified employer (defined earlier) may claim a general business credit for each qualified employee (defined earlier) who remains employed for 52 consecutive weeks. This is contingent upon the employee's pay during the second half of the 52-week period being at a level that is at least 80% of the wages paid in the first half of the period. The amount of the credit is the lesser of $1,000 or 6.2% of wages paid by the employer to the qualified employee during the consecutive 52-week period. The credit may be carried forward but cannot be carried back. The retention credit is claimed on the employer's 2011 income tax return, using Form 5884-B, *New Hire Retention Credit.*

Example 5. Assume the same facts as in **Example 4.** Juliette works for New Logistics for 52 consecutive weeks. Her wages for the first 26 weeks of employment are $18,750, and her wages for the second 26 weeks are $19,500. New Logistics qualifies for a $1,000 new hire retention credit based on Juliette's employment.

New Logistics' tax preparer completes the following form to claim the credit on its 2011 tax return.

Form **5884-B** (December 2010)
Department of the Treasury
Internal Revenue Service

New Hire Retention Credit

► Attach to your tax return.

OMB No. 1545-XXXX

Attachment Sequence No. **77B**

Name(s) shown on return: **New Logistics, Inc.**

Identifying number: **36-2222222**

Use a separate column for each retained worker. A retained worker generally is a qualified employee (see instructions) whose first 52 consecutive weeks of employment ended in the current tax year. However, the worker's wages (as defined for income tax withholding purposes) for the second 26 consecutive weeks must equal at least 80% of the worker's wages for the first 26 consecutive weeks. If you need more columns, use additional Forms 5884-B and include the totals on line 9.

			(a) Retained Worker 1		(b) Retained Worker 2		(c) Retained Worker 3	
1	Enter the first date of employment from the retained worker's Form W-11 or similar statement	1	03 / 08 / 2010		/ / 2010		/ / 2010	
2	Enter the retained worker's wages for the first 26 consecutive weeks of employment	2	18,750	00				
3	Multiply line 2 by 80% (.80)	3	15,000	00				
4	Enter the retained worker's wages for the second 26 consecutive weeks of employment. If line 3 is larger than this amount, the qualified employee is not a retained worker and should not be listed on this form	4	19,500	00				
5	Add lines 2 and 4	5	38,250	00				
6	Multiply line 5 by 6.2% (.062)	6	2,371	50				
7	Maximum credit allowable	7	1,000	00	1,000	00	1,000	00
8	Enter the **smaller** of line 6 or line 7	8	1,000	00				
9	Add columns (a) through (c) on line 8	9					1,000	00
10	New hire retention credit from partnerships and S corporations	10						
11	**Current year credit.** Add lines 9 and 10. Partnerships and S corporations, report this amount on Schedule K; all others, report this amount on the applicable line of Form 3800 (e.g., line 1aa of the 2010 form 3800)	11					1,000	00

For Paperwork Reduction Act Notice, see instructions. Cat. No. 55035V Form **5884-B** (12-2010)

Coordination with Work Opportunity Credit

An employer may not claim the payroll tax exemption or the new hire retention credit (under HIRE) and the work opportunity credit for the same wages. If the employer chooses to utilize the benefits available for qualified workers under HIRE, it must make an election to not apply the work opportunity credit under IRC §3111(d) for that taxable year.

IRC §179 EXPENSING ELECTION

The HIRE Act extends the $250,000 maximum amount that a taxpayer can deduct under §179 for an additional year. The enhanced expensing amount is available for tax years **beginning in 2010,** just as it was for tax years beginning in 2008 and 2009. The maximum amount is reduced on a dollar-for-dollar basis when the amount of qualifying property placed in service during the year exceeds $800,000.

> **Note.** For more information about the §179 deduction, see Chapter 7, Depreciation, in the 2008 *University of Illinois Federal Tax Workbook.* This can be found on the accompanying CD.

REFUNDABLE CREDIT FOR QUALIFIED TAX CREDIT BONDS

Old Law. The Build America bond program was created under the ARRA. State and local governments can issue Build America bonds after February 17, 2009, and before January 1, 2011. These bonds may provide both taxable interest and a federal tax credit to the bondholder. In lieu of the bondholder's federal tax credit, state and local governments can elect to receive a payment credit for the qualified bonds. The IRS pays the issuer 35% of the interest payable under the terms of the bond on that date.

> **Note.** For more information about Build America bonds, see Chapter 11, New Legislation, in the 2009 *University of Illinois Federal Tax Workbook.* This can be found on the accompanying CD.

New Law. A similar provision in the HIRE Act allows issuers of certain qualified bonds issued after March 18, 2010, to receive a direct payment from the federal government in an amount that varies from 70% to 100% of the issuer's interest cost. Qualified tax credit bonds include the following:

- New clean renewable energy bonds (as defined in IRC §54C)
- Qualified energy conservation bonds (as defined in IRC §54D)
- Qualified zone academy bonds (as defined in IRC §54E)
- Qualified school construction bonds (as defined in IRC §54F)

REVENUE OFFSETS

The HIRE Act contains a number of revenue offset provisions. These include the following:

- The imposition of a 30% withholding tax on certain payments to foreign financial institutions unless the foreign institution complies with reporting requirements
- The imposition of a $10,000 penalty on any individual who fails to disclose applicable information about foreign financial assets if the aggregate value of such assets exceeds $50,000
- A 40% accuracy-related penalty for underpaying tax attributable to any undisclosed foreign financial asset
- An increase of the statute of limitations to six years for any significant omission of income in connection with foreign assets
- Required annual reporting for shareholders of passive foreign-investment companies
- A delay in the application of worldwide allocation of interest from December 31, 2017, to December 31, 2020
- A change in the schedule for payment of estimated taxes for corporations with assets of at least $1 billion beginning in 2015

> **Note.** The timeframe for payment of corporate estimated taxes was changed again by a provision in the Patient Protection and Affordable Care Act. This is discussed in the next section of this chapter.

PATIENT PROTECTION AND AFFORDABLE CARE ACT

The president signed H.R. 3590, the Patient Protection and Affordable Care Act (PPACA), into law on March 23, 2010. A few days later, this act was amended by H.R. 4872, the Health Care and Education Reconciliation Act of 2010, which the president signed into law on March 30, 2010.

Following is an overview of this massive and controversial piece of legislation, and a summary of the tax-related provisions it contains.

> **Note.** On August 2, 2010, a federal district court in Virginia denied the federal government's motion to dismiss a constitutional challenge to the individual mandate provision of the PPACA. The court noted that no court had ever determined whether the federal government's taxing power applies to individuals that choose to not engage in commerce. If the individual mandate provision is ruled unconstitutional, it appears that the entire PPACA may be struck down because Congress did not include a severability clause in the health care legislation.[11]

OVERVIEW

The goal of the PPACA is to ensure that all Americans have access to quality, affordable health insurance. The Congressional Budget Office determined that the legislation will provide coverage to an estimated 32 million Americans and lower healthcare costs over the long term.

As defined in the PPACA, a **qualified health plan** is one with the following characteristics:

1. The plan is certified to meet certain criteria and is issued or recognized by each **exchange** (described below) that offers it.
2. The plan provides an **essential health benefits package** that:[12]
   - **a.** Provides essential health benefits defined by the Department of Health and Human Services (HHS),
   - **b.** Limits cost-sharing for coverage, and
   - **c.** Provides one of the following levels of coverage
     - **Bronze** benefits, actuarially equivalent to 60% of the full actuarial value of benefits provided under the plan
     - **Silver** benefits, actuarially equivalent to 70% of the full actuarial value of benefits provided under the plan
     - **Gold** benefits, actuarially equivalent to 80% of the full actuarial value of benefits provided under the plan
     - **Platinum** benefits, actuarially equivalent to 90% of the full actuarial value of benefits provided under the plan
3. The plan is offered by a health insurance issuer that meets all four of the following requirements:
   - **a.** The issuer is licensed and in good standing to offer health insurance coverage.
   - **b.** The issuer agrees to offer at least one qualified health plan in the "silver" level and at least one plan in the "gold" level through the exchange (defined below).
   - **c.** The issuer agrees to charge the same premium rate for each qualified health plan regardless of whether the plan is offered through an exchange or whether the plan is offered directly from the issuer or through an agent.
   - **d.** The issuer complies with the applicable regulations and other requirements established by an exchange.

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11. *Commonwealth of Virginia, et al. v. Sebelius,* No. 3:10CV188-HEH (E.D. Va. Aug. 2, 2010).
12. PPACA Sec. 1302.

HEALTH BENEFIT EXCHANGES

The term **health benefit exchange** (exchange) is not defined in the PPACA. However, a Senate summary of the provisions refers to an exchange as a **government-sponsored venue that enables people to comparison shop for standardized health packages.** It facilitates enrollment and administers tax credits so that people of all income levels can obtain affordable coverage.[13]

The HHS Secretary, in consultation with the states, established a website through which a resident of any state may identify affordable health insurance coverage options available in that state.[14] The website can be accessed at **www.healthcare.gov.**

The HHS requires an exchange to provide all of the following:

- An initial open enrollment, to be determined by HHS, no later than July 1, 2012
- Annual open-enrollment periods, as determined by HHS, for calendar years after the initial enrollment period
- Special-enrollment periods specified in IRC §9801 and other special-enrollment periods similar to those under the Social Security Act
- Special monthly-enrollment periods for American Indians

Each state must establish an exchange no later than January 1, 2014, that satisfies all the following requirements:

1. The exchange must facilitate the purchase of qualified health plans.
2. The exchange must establish a small business health-options program that assists qualified small employers in the state with enrolling their employees in qualified health plans offered in the small-group market (small employers).
3. The exchange must meet certain other requirements, including the following:
   - **a.** The exchange must be a governmental agency or nonprofit entity established by the state.
   - **b.** The exchange must make qualified health plans available to qualified individuals and employers.
   - **c.** An exchange may make a qualified health plan available despite any other provision of law that may require benefits other than essential health benefits.
   - **d.** The exchange must implement certification procedures and other functional standards.
   - **e.** The exchange must comply with funding limitations.
   - **f.** The exchange must consult with relevant stakeholders.
   - **g.** The exchange must publish the costs on an Internet website.

13. [www.dpc.senate.gov/healthreformbill/healthbill65.pdf] Accessed on June 28, 2010.
14. PPACA, Sec. 1103(a).

NON-HEALTHCARE TAX PROVISIONS

> Many PPACA provisions are effective for taxable years beginning several years in the future. The IRS will likely issue regulations and procedures to help clarify areas of uncertainty.

The non-healthcare tax provisions are presented in chronological order according to effective date.

EXPANSION OF THE ADOPTION CREDIT

Old Law. Under previous law, a nonrefundable tax credit against income tax and alternative minimum tax (AMT) was allowed for qualified adoption expenses paid or incurred by a taxpayer. The maximum credit allowed prior to passage of the PPACA was $12,170 per eligible child for taxable years beginning in 2010. The credit is phased out ratably for taxpayers with modified adjusted gross income (MAGI) between $182,520 and $222,520 for taxable years beginning in 2010.

Prior to the PPACA, sunset provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) provided that the adoption credit be reduced to a maximum of $6,000 for special-needs adoptions and no tax credit for adoptions of children without special needs for taxable years after 2010. The credit phaseout range also reverted to pre-EGTRRA levels between $75,000 and $115,000 MAGI. The adoption credit was allowed only to the extent the individual's regular income tax liability exceeded the individual's tentative minimum tax, determined without regard to the minimum foreign tax credit.

New Law. Under the PPACA, **the maximum credit for 2010 is increased to $13,170 per eligible child** (a $1,000 increase). In the case of an adoption of a child without special needs, the credit is equal to the amount of the qualified adoption expenses paid or incurred by the taxpayer, up to the maximum of $13,170.[15] In the case of an adoption of a special-needs child, the maximum $13,170 credit may be claimed, regardless of actual expenses.[16] Additionally, **the adoption credit is fully refundable.**

> **Note.** Because the adoption credit is now refundable, it is no longer covered by IRC §23. The new legislation redesignates the adoption credit as IRC §36C.

For 2010, the adoption credit phases out ratably for taxpayers with MAGI between $182,520 and $222,520. This is the same phaseout range that existed prior to passage of the PPACA.

The new dollar limit and phaseout of the adoption credit are adjusted for inflation in taxable years beginning after December 31, 2010. Additionally, the EGTRRA sunset provision related to the credit amount is delayed for one year until December 31. 2011.

Effective Date. The provision is effective for taxable years beginning after December 31, 2009.

15. IRC §36C(1)(A).
16. IRC §36C(1)(B).

EXCLUSION FROM GROSS INCOME FOR EMPLOYER-PROVIDED ADOPTION ASSISTANCE

Old Law. An exclusion from an employee's gross income is allowed for qualified adoption expenses paid or reimbursed by an employer under an adoption-assistance program. For 2010, the maximum exclusion is $12,170. The exclusion is phased out ratably for taxpayers with MAGI between $182,520 and $222,520. For purposes of this exclusion, MAGI also includes all employer payments and reimbursements for adoption expenses whether or not they are taxable to the employee.[17]

Adoption expenses paid or reimbursed by the employer under an adoption-assistance program are not eligible for the adoption credit. In the case of an adoption of a special-needs child which becomes final during a taxable year, the maximum exclusion amount is allowable, regardless of the amount of actual adoption expenses incurred.[18]

Because of the EGTRRA sunset, the exclusion for employer-provided adoption assistance does not apply to amounts paid or incurred after December 31, 2010.

New Law. The new law modifies the exclusion amount and the sunset date. For 2010, the maximum exclusion on the amount of employer-provided adoption assistance is increased by $1,000 to $13,170 per eligible child. The exclusion amount is adjusted for inflation in taxable years beginning after December 31, 2010.

The EGTRRA sunset of December 31, 2010, is delayed for one year until December 31, 2011.

Effective Date. The provision is effective for taxable years beginning after December 31, 2009.

EXCLUSION OF UNPROCESSED FUELS FROM CELLULOSIC BIOFUEL PRODUCER CREDIT

Old Law. The cellulosic biofuel producer credit is a nonrefundable income tax credit for each gallon of qualified cellulosic fuel produced for the taxable year. The credit amount is generally $1.01 per gallon.

In an informal Chief Counsel Advice, the IRS concluded that black liquor is a liquid fuel from biomass. It may qualify for either the cellulosic biofuel producer credit or the refundable alternative fuel mixture credit, but both credits cannot be claimed for the same fuel. The alternative fuel credits and payment provisions expired December 31, 2009.

New Law. A provision in the PPACA modifies the cellulosic biofuel producer credit to exclude fuels with significant water, sediment, or ash content, such as black liquor. Consequently, credits are no longer available for these fuels. Specifically, the provision excludes from the definition of cellulosic biofuel any fuels that:

1. Are more than 4% (determined by weight) water and sediment in any combination, or
2. Have an ash content of more than 1% (determined by weight).[19]

Effective Date. This provision is effective for fuels sold or used after December 31, 2009.

17. Joint Committee on Taxation report JCX-18-10, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act."*
18. IRC §137(a)(2).
19. Joint Committee on Taxation report JCX-18-10, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act."*

CODIFICATION OF ECONOMIC-SUBSTANCE DOCTRINE

Old Law. Courts generally deny claimed tax benefits if the transaction that gives rise to those benefits lacks economic substance independent of federal income tax considerations, even if the purported activity actually occurred. The Tax Court has described the doctrine as follows:

> *The tax law . . . requires that the intended transactions have economic substance separate and distinct from economic benefit achieved solely by tax reduction. The doctrine of economic substance becomes applicable, and a judicial remedy is warranted, where a taxpayer seeks to claim tax benefits, unintended by Congress, by means of transactions that serve no economic purpose other than tax savings.*[20]

The business-purpose doctrine is often considered in conjunction with the economic-substance doctrine. The business-purpose doctrine involves an inquiry into the subjective motives of the taxpayer — whether the taxpayer intended the transaction to serve some useful nontax purpose. In making this determination, some courts bifurcated a transaction in which activities with nontax objectives were combined with unrelated activities having only tax-avoidance objectives in order to disallow the tax benefits of the overall transaction.[21]

There is a lack of uniformity in applying the economic-substance doctrine. Some courts apply a conjunctive test that requires a taxpayer to establish the presence of **both** economic substance (i.e., the objective component) and business purpose (i.e., the subjective component) in order for the transaction to survive judicial scrutiny.[22] A narrower approach used by some courts concludes that **either** a business purpose or economic substance is sufficient to respect the transaction.[23] A third approach regards economic substance and business purpose as "simply more precise factors to consider" in determining whether a transaction has any practical economic effects other than the creation of tax benefits.[24]

New Law. A provision in the PPACA clarifies and enhances the application of economic substance, as defined in IRC §7701(o). Under the provision, a transaction is treated as having economic substance only if **both** of the following requirements are met:

1. The transaction changes the taxpayer's economic position in a meaningful way (apart from federal income tax effects).
2. The taxpayer has a substantial purpose (apart from federal income tax effects) for entering into the transaction.[25]

The provision clarifies that the economic-substance doctrine involves a conjunctive analysis — there must be an inquiry regarding the objective effects of the transaction on the taxpayer's economic position as well as an inquiry regarding the taxpayer's subjective motives for engaging in the transaction. A transaction must satisfy **both tests** in order for it to be treated as having economic substance. This clarification eliminates the disparity that exists among the federal circuit courts regarding the application of the doctrine. The provision modifies the doctrine's application in those circuits in which either a change in economic position or a nontax business purpose (but not both) is sufficient to satisfy the economic-substance doctrine.

An individual is subject to the economic-substance doctrine only for transactions entered into in connection with a trade or business or income-producing activity.[26]

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20. *ACM Partnership v. Comm'r*, 73 TCM at 2215.
21. See e.g., *ACM Partnership v. Comm'r*, 157 F.3d at 256 n.48.
22. See, e.g., *Pasternak v. Comm'r*, 990 F.2d 893, 898 (6th Cir. 1993).
23. See, e.g., *Rice's Toyota World v. Comm'r*, 752 F.2d 89, 91-92 (4th Cir. 1985).
24. See, e.g., *ACM Partnership v. Comm'r*, 157 F.3d at 247; *James v. Comm'r*, 899 F.2d 905, 908 (10th Cir. 1995); *Sacks v. Comm'r*, 69 F.3d 982, 985 (9th Cir. 1995).
25. IRC §7701(o)(1).
26. IRC §7701(o)(5)(B).

Penalty for Transactions Lacking Economic Substance. The accuracy-related penalty under IRC §6662 is expanded to include an underpayment attributable to any disallowance of claimed tax benefits due to lack of economic substance, as defined in §7701(o), or failing to meet the requirements of any similar rule of law.

The penalty is 20% and is increased to 40% of the understatement of income tax if the taxpayer does not adequately disclose the relevant facts affecting the tax treatment either in the return or in a statement attached to the return. An amended return or supplement to a return is not taken into account if filed after the taxpayer is contacted for audit or on another date as specified by the IRS. No exceptions (including the reasonable-cause rules) to the penalty are available. Therefore, under the provision, outside opinions or in-house analysis do not protect a taxpayer from the penalty if it is determined that the transaction lacks economic substance or fails to meet the requirements of any similar rule of law.

Similarly, a claim for refund or credit that is excessive under IRC §6676 because the claim lacks economic substance or fails to meet the requirements of any similar rule is subject to the 20% penalty, and the reasonable-basis exception is not available.[27]

Effective Date. The provision applies to transactions entered into after March 30, 2010.

> **Note.** For extensive information about the economic-substance doctrine, see pages 378-381 in the 2008 *University of Illinois Federal Tax Workbook.* This can be found on the accompanying CD.

TIME FOR PAYMENT OF CORPORATE ESTIMATED TAXES

Old Law. For corporations with assets of at least $1 billion (determined at the end of the preceding taxable year), payments due in July, August, or September 2014, were increased to 157.75% of the payment otherwise due by a provision in the HIRE Act.

New Law. A provision in the PPACA increases the required payment of estimated tax otherwise due in July, August, or September 2014, to 173.50% of the payment otherwise due (a 15.75% increase). The next required payment is reduced accordingly.

Effective Date. This provision is effective on March 30, 2010.

REQUIRED INFORMATION REPORTING ON PAYMENTS FOR PROPERTY

Old Law. Taxpayers engaged in a trade or business who make payments aggregating $600 or more in any year to a single payee are generally required to furnish information returns to these payees. The reporting requirements do not include payments for goods or payments subject to other specific reporting requirements. Most payments to corporations are excepted from the reporting requirements.

New Law. For payments made after December 31, 2011, businesses will be required to file information returns for **all payments aggregating $600 or more in a calendar year to a single payee** (other than to a tax-exempt corporation). **The reported payments include gross proceeds paid in consideration for property or services.** However, the provision does not override specific provisions elsewhere in the Code that except certain payments from reporting, such as securities or broker transactions as definedunder IRC §6045(a) and associated regulations.

> **Note.** The term **gross proceeds** is not defined in the PPACA or in IRC §6041(a), as amended by the PPACA. It has also not been specified whether such gross proceeds will be reported on Form 1099-MISC or some other form.

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27. Joint Committee on Taxation report JCX-18-10, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act."*

Example 6. Mallie's Accounting Service buys office supplies for $300 from Paper Clips N Stuff, Inc., in July 2012. In September, Mallie buys more office supplies from Paper Clips for $400. Mallie must issue a Form 1099 to Paper Clips in 2013 for the total value of her 2012 purchases.

Note. The National Taxpayer Advocate estimates that the new law will affect 26 million nonfarm sole proprietors, 3 million partnerships, 4 million S corporations, 2 million C corporations, 2 million farming businesses, 1 million charities and other tax-exempt organizations, and more than 100,000 federal, state, and local government entities.[28] The IRS asked for public comments regarding how to most effectively carry out this law change. Comments were due September 29, 2010.

Effective Date. This provision is effective for payments made after December 31, 2011.

HEALTHCARE TAX PROVISIONS

The healthcare tax provisions are presented in chronological order according to effective date.

EXCLUSION FOR STUDENT LOAN REPAYMENT PROGRAM FORGIVENESS FOR CERTAIN HEALTH PROFESSIONALS

Old Law. Gross income generally includes the taxpayer's discharge of indebtedness. Under an exception to this general rule, gross income does not include any amount from the forgiveness (in whole or in part) of certain student loans, provided that the forgiveness is contingent on the student working for a certain period of time in certain professions for any of a broad class of employers.

Student loans eligible for this special rule must be made to assist an individual in attending an educational institution. The education institution must normally maintain a regular faculty and curriculum and have a regularly-enrolled body of students in attendance at the place where its education activities occur. Loan proceeds can be used for tuition and required fees, and also for room and board expenses. The loan must be provided by one of the following:

1. The United States (or an instrumentality or agency thereof)
2. A state (or any political subdivision thereof)
3. Certain tax-exempt public benefit corporations that control a state, county, or municipal hospital and whose employees have been deemed to be public employees under state law
4. An educational organization that originally received the funds from which the loan was made from the United States, a state, or a tax-exempt public benefit corporation

An individual's gross income also does not include amounts from the forgiveness of loans made by educational organizations (and certain tax-exempt organizations in the case of refinancing loans) out of private, nongovernmental funds. Such amounts are excluded from gross income if the proceeds of the loans are used to pay costs of attendance at an educational institution or to refinance any outstanding student loans. The student cannot be employed by the lender organization. In the case of such loans made or refinanced by educational organizations (or refinancing loans made by certain tax-exempt organizations), cancellation of the student loan must be contingent upon the student working in an occupation or area with unmet needs. Such work must be performed for, or under the direction of a tax-exempt charitable organization or a governmental entity.

Finally, an individual's gross income does not include any loan repayment amount received under the National Health Service Corps loan repayment program or certain state loan repayment programs.[29]

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28. [www.irs.gov/pub/irs-utl/nta2011objectivesfinal.pdf] Accessed on July 28, 2010.

29. Joint Committee on Taxation report JCX-18-10, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act."*

New Law. A provision in the PPACA modifies the gross income exclusion for amounts received under the National Health Service Corps loan repayment program or certain state loan repayment programs. The gross income exclusion now includes any amount received by an individual under any state loan repayment or loan forgiveness program that is intended to provide for the increased availability of healthcare services in underserved or health professional shortage areas (as determined by the state).

> **Note.** For more information about medically underserved and health professional shortage areas, see the Health Resources and Services Administration's website at **bhpr.hrsa.gov/shortage/.**

Effective Date. This provision is effective for taxable years beginning after December 31, 2008.

INVESTMENT CREDIT FOR QUALIFYING THERAPEUTIC DISCOVERY PROJECTS

For taxable years beginning after December 31, 2008, a provision in the PPACA establishes a 50% nonrefundable investment tax credit for qualified investments in qualifying therapeutic discovery projects. Such projects are designed to develop a product, process, or therapy to diagnose, treat, or prevent diseases and afflictions.

Companies must apply to the IRS to obtain certification for qualifying investments. The credit is available only to companies with 250 or fewer employees.

Effective Date. This provision is effective for taxable years beginning after December 31, 2008.

SMALL BUSINESS TAX CREDIT

This credit is designed to encourage small employers to offer health insurance for the first time or maintain coverage they already have.

A tax credit is provided for a qualified small employer for nonelective contributions to purchase health insurance for its employees. Any payment made in accordance with a salary reduction arrangement under a §125 cafeteria plan is not treated as paid by the employer. The tax credit is available initially for any taxable year beginning in 2010–2013. **An eligible small employer** is one that meets all the following criteria:

- The employer has no more than 25 full-time equivalent (FTE) employees for the taxable year.
- The average annual wages of the employees do not exceed $50,000 (indexed for inflation in years after 2013).
- The employer has a qualifying contribution arrangement under which it must pay **at least 50%** of the premium cost of the qualified health plan for each enrolled employee.

> **Note.** The requirement that the employer pay at least 50% of the premium for an employee applies to the premium for single (employee-only) coverage. Therefore, if the employee receives single coverage, the employer satisfies the 50% requirement for the employee if it pays at least 50% of the premium for that coverage. If the employee receives coverage that is more expensive than single coverage (such as family or self-plus-one coverage), the employer satisfies the 50% requirement for the employee if the amount it pays for such coverage is no less than 50% of the premium for single coverage for that employee (even if it is less than 50% of the premium for the coverage the employee is actually receiving).[30]

30. *Small Business Health Care Tax Credit: Frequently Asked Questions.* IRS. [www.irs.gov/newsroom/article/0,,id=220839,00.html] Accessed on May 4, 2010.

Calculating FTEs

Employee FTEs are determined by dividing the total wage-paying hours for employees during the year (but not more than 2,080 hours per employee) by 2,080. The result, if not a whole number, is rounded to the next lowest whole number.

Example 7. For the 2010 taxable year, an employer pays five full-time employees wages for 2,080 hours each, three employees wages for 1,040 hours each, and one employee wages for 2,300 hours. The employee FTEs for this employer are calculated as follows:

Employee Hours	Hours of Service
5 employees × 2,080 hours	10,400
3 employees × 1,040 hours	3,120
1 employee × 2,080 hours (lesser of 2,300 and 2,080)	2,080
Total hours of service	15,600
Hours per year	÷ 2,080
Total FTEs (7.5 rounded down)[31]	7

The following persons are not counted in the determination of FTEs and average annual wages:

1. Seasonal workers (unless the seasonal worker works for the employer for more than 120 days during the tax year)
2. Sole proprietors
3. Partners in a partnership
4. Shareholders owning more than 2% of an S corporation
5. Any owner of more than 5% of a business
6. Family members (i.e., lineal descendant, sibling or step-sibling, parent or parent's ancestor, step-parent, niece or nephew, aunt or uncle, son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law) of any person described in items 2–5 above

Premiums paid on behalf of these persons are not counted in determining the amount of the credit.

Amount of Credit

The credit is equal to the **lesser** of the following two amounts multiplied by an applicable tax credit percentage:

1. The amount of contributions the employer made on behalf of the employees during the taxable year for the qualifying health coverage
2. The amount of contributions that the employer would have made during the taxable year if each employee had enrolled in coverage with a small business benchmark premium (The benchmark premium is the average total premium cost in the small-group market for employer-sponsored coverage in the employer's state. The benchmark premium varies based on the type of coverage provided to the employee — single, adult with child, two adults, or family.)

   The benchmark premium is multiplied by the number of employees enrolled in coverage and then multiplied by the uniform percentage that applies for calculating the level of coverage selected by the employer. As discussed above, this tax credit is only available if this uniform percentage is at least 50%.

31. Example adapted from IRS Notice 2010-44, 2010-22 IRB.

Note. Rev. Rul. 2010-13 contains a chart that sets forth the average premium for the small-group market in each state for the 2010 taxable year. For Illinois, the 2010 average premium is $5,198 for employee-only coverage and $12,309 for family coverage.

For years prior to 2014, health insurance coverage for purposes of the credit means benefits consisting of medical care under any hospital or medical service policy or certificate, hospital or medical service plan contract, or health maintenance organization contract offered by a health insurance issuer.[32] Health insurance coverage for purposes of the credit also includes the following:

- Limited scope dental or vision
- Long-term care, nursing-home care, home-health care, community-based care, or any combination of these
- Coverage only for a specified disease or illness
- Hospital indemnity or other fixed-indemnity insurance
- Medicare supplemental health insurance, certain other supplemental coverage, and similar supplemental coverage provided to coverage under a group health plan[33]

Different types of health insurance plans are not aggregated for purposes of meeting the qualifying arrangement requirement. Consequently, if an employer offers a major-medical insurance plan and a stand-alone vision plan, the employer must separately satisfy the requirements for a qualifying arrangement for each type of coverage.

Example 8. For the 2010 taxable year, an eligible small employer offers a major-medical plan and a dental plan. The employer pays 50% of the premium cost for single coverage for all employees enrolled in the major-medical plan and 40% of the premium cost for single coverage for all employees enrolled in the dental plan.

For purposes of calculating the credit, the employer can take into consideration only the premiums paid by the employer for the major-medical plan, and only up to 50% of the amount of the average premium for single coverage for the small-group market in the employer's state. The employer cannot take into consideration premiums paid for the dental plan because it did not pay at least 50% of the premium cost.[34]

For the first phase of the credit (any taxable year beginning in 2010–2013), **the maximum tax credit percentage is 35% for an employer that is not tax-exempt.** For the second phase of the credit (taxable years beginning in years after 2013), the applicable tax credit percentage is 50%. The second phase of the credit is only available to a qualified small employer that purchases health insurance coverage through a state exchange and can be claimed for only two additional consecutive years.

Example 9. For the 2010 tax year, Ledbetter Co., a qualified employer, has nine FTEs with average annual wages of $23,000 per FTE. Ledbetter Co. pays $72,000 in health insurance premiums for those employees (which does not exceed the average premium for the small-group market in the employer's state) and otherwise meets the requirements for the credit. The credit for 2010 equals $25,200 (35% × $72,000).[35]

32. IRC §9832(b)(1).
33. IRS Notice 2010-44, 2010-22 IRB.
34. Adapted from Examples 8 and 9 in IRS Notice 2010-44, 2010-22 IRB.
35. Example adapted from *Small Business Health Care Tax Credit: Frequently Asked Questions.* IRS. [www.irs.gov/newsroom/article/0,,id=220839,00.html] Accessed on May 4, 2010.

For a **tax-exempt qualified employer, the maximum credit for tax years beginning in 2010–2013 is 25%** of the employer's premium expenses that count towards the credit. For the second phase of the credit, the maximum credit is 35%. However, the credit cannot exceed the total amount of income and Medicare tax the employer is required to withhold from employees' wages for the year and the employer share of Medicare tax on employees' wages. **The small business tax credit for tax-exempt organizations is otherwise calculated in the same manner as it is calculated for all other qualified small employers.**

Example 10. For 2010, Metta Association, a qualified tax-exempt employer, has 10 FTEs with average annual wages of $21,000. Metta pays $80,000 in health insurance premiums for those employees (which does not exceed the average premium for the small-group market in the employer's state) and otherwise meets the requirements for the credit. The total amount of income tax and Medicare tax withholding for the employees plus Metta's share of the Medicare tax equals $30,000 in 2010.

The credit is calculated as follows.

1. The initial credit amount is determined before any reduction (25% × $80,000 = $20,000).
2. The income and Medicare taxes are $30,000.
3. Total 2010 tax credit is $20,000 (the lesser of $20,000 or $30,000).[36]

Note. In determining the employer's deduction for health insurance premiums, the amount of premiums that can be deducted is reduced by the amount of the credit.

Credit Reduction

The credit is reduced for any employer who has more than 10 but not more than 25 FTEs. For an employer with more than 10 FTEs, the reduction is determined by multiplying the otherwise applicable credit amount by a fraction, the numerator of which is the number of FTEs in excess of 10 and the denominator of which is 15. In effect, the credit is reduced by 6.667% for each FTE in excess of 10.

The credit is also reduced for employers with average wages per employee between $25,000 and $50,000. The amount of this reduction is equal to the amount of the credit (determined before any reduction) multiplied by a fraction, the numerator of which is the average annual wages of the employer in excess of $25,000 and the denominator of which is $25,000. In effect, the credit amount is reduced by 4% for each $1,000 of average annual wages in excess of $25,000.

For an employer with both more than 10 FTEs and average annual wages in excess of $25,000, the total reduction is the sum of the two reduction amounts.[37]

Example 11. For 2010, Belweather Co., a qualified employer, has 12 FTEs and average annual wages of $30,000. Belweather pays $96,000 in health insurance premiums for its employees (which does not exceed the average premium for the small-group market in the employer's state) and otherwise meets the requirements for the credit.[38]

The credit is calculated as follows:

Initial credit amount determined before any reduction (35% × $96,000)	$33,600
Credit reduction for FTEs in excess of 10 ($33,600 × (2/15))	(4,480)
Credit reduction for average annual wages in excess of $25,000 ($33,600 × ($5,000/$25,000))	(6,720)
Total 2010 tax credit	$22,400

36. Ibid.

37. Joint Committee on Taxation report JCX-18-10, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act."*

38. Example adapted from *Small Business Health Care Tax Credit: Frequently Asked Questions.* IRS. [www.irs.gov/newsroom/article/0,,id=220839,00.html] Accessed on May 4, 2010.

Claiming the Credit

For an employer that is not tax-exempt, the credit is claimed on the employer's annual income tax return. The credit for a year offsets only an employer's actual income tax liability (or AMT liability) for the year. However, as a general business credit, an unused credit amount can generally be carried back one year and carried forward 20 years. Because an unused credit amount cannot be carried back to a year before the effective date of the credit, any unused credit amount for 2010 can only be carried forward.[39]

For partnerships and S corporations, this credit is calculated at the entity level and allocated to the partners or shareholders for inclusion on their individual returns.

For a tax-exempt employer, the credit is refundable. Tax-exempt organizations claim the credit on Form 990-T, *Exempt Organization Business Income Tax Return (and proxy tax under section 6033(e))*. Form 990-T will be revised for the 2011 filing season to enable tax-exempt organizations — including those that do not owe tax on unrelated business income — to claim the small business health care tax credit.[40]

Both small businesses and tax-exempt organizations will use Form 8941, *Credit for Small Employer Health Insurance Premiums,* to calculate the credit. A copy of the form follows.

39. *Small Business Health Care Tax Credit: Frequently Asked Questions.* IRS. [www.irs.gov/newsroom/article/0,,id=220839,00.html] Accessed on May 4, 2010.

40. IRS News Rel. IR-2010-96 (Sept. 7, 2010).

Form **8941**

Department of the Treasury
Internal Revenue Service

Credit for Small Employer Health Insurance Premiums

► See separate instructions.
► Attach to your tax return.

OMB No. 1545-xxxx

2010

Attachment Sequence No. **63**

Name(s) shown on return | Identifying number

1	Enter the number of individuals you employed during the tax year who are considered employees for purposes of this credit (see instructions)	1	
2	Enter the number of full-time equivalent employees you had for the tax year (see instructions). If you entered 25 or more, skip lines 3 through 11 and enter -0- on line 12	2	
3	Average annual wages you paid for the tax year (see instructions). If you entered $50,000 or more, skip lines 4 through 11 and enter -0- on line 12	3	
4	Premiums you paid during the tax year for employees included on line 1 for health insurance coverage under a qualifying arrangement (see instructions)	4	
5	Premiums you would have entered on line 4 if the total premium for each employee equaled the average premium for the small group market in which you offered health insurance coverage (see instructions)	5	
6	Enter the **smaller** of line 4 or line 5	6	
7	Multiply line 6 by the applicable percentage: • Tax-exempt small employers, multiply line 6 by 25% (.25) • All other small employers, multiply line 6 by 35% (.35)	7	
8	If line 2 is 10 or less, enter the amount from line 7. Otherwise, see instructions	8	
9	If line 3 is $25,000 or less, enter the amount from line 8. Otherwise, see instructions	9	
10	Enter the total amount of any state premium subsidies paid and any state tax credits available to you for premiums included on line 4 (see instructions)	10	
11	Subtract line 10 from line 4. If zero or less, enter -0-	11	
12	Enter the **smaller** of line 9 or line 11	12	
13	If line 12 is zero, skip lines 13 and 14 and go to line 15. Otherwise, enter the number of employees included on line 1 for whom you paid premiums during the tax year for health insurance coverage under a qualifying arrangement (see instructions)	13	
14	Enter the number of full-time equivalent employees you would have entered on line 2 if you only included employees included on line 13	14	
15	Credit for small employer health insurance premiums from partnerships, S corporations, cooperatives, estates, and trusts (see instructions)	15	
16	Add lines 12 and 15. Partnerships and S corporations, stop here and report this amount on Schedule K; all others, go to line 17	16	
17	Credit for small employer health insurance premiums included on line 16 from passive activities (see instructions)	17	
18	Subtract line 17 from line 16	18	
19	Credit for small employer health insurance premiums allowed for 2010 from a passive activity (see instructions)	19	
20	Carryback of the credit for small employer health insurance premiums from 2011	20	
21	Add lines 18 through 20. Cooperatives, estates, and trusts, go to line 22. Tax-exempt small employers, skip lines 22 and 23 and go to line 24. All others, stop here and report this amount on Form 3800, line 29h	21	
22	Amount allocated to patrons of the cooperative or beneficiaries of the estate or trust (see instructions)	22	
23	Cooperatives, estates, and trusts, subtract line 22 from line 21. Stop here and report this amount on Form 3800, line 29h	23	
24	Enter the amount you paid in 2010 for taxes considered payroll taxes for purposes of this credit (see instructions)	24	
25	Tax-exempt small employers, enter the **smaller** of line 21 or line 24 here and on Form 990-T, line 44f	25	

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 37757S Form **8941** (2010)

Employer Aggregation Rules

The following individuals are treated as employed by a single employer for purposes of determining the credit:

- Employees of a controlled group of corporations (see IRC §414(b))
- Employees of trades or businesses under common control (see IRC §414(c))
- Employees of affiliated service groups (see IRC §414(m))
- Leased employees (see IRC §414(n))

Effective Date. This provision is effective for taxable years beginning after December 31, 2009.

MODIFICATION OF TREATMENT OF CERTAIN HEALTH ORGANIZATIONS

Old Law. A property and casualty insurance company is subject to tax on its taxable income. For this purpose, gross income includes underwriting income and investment income, as well as other items. Underwriting income is defined as the premiums earned on insurance contracts during the year, less losses and expenses. The amount of loss incurred is determined by taking into account the discounted unpaid losses. The amount of premiums earned during the year is determined by taking into account a 20% reduction in the otherwise allowable deduction, which is intended to represent the allocable portion of expenses incurred in generating the unearned premiums.

An organization described in IRC §501(c)(3) and (4) is tax-exempt if no substantial part of its activities consists of providing commercial-type insurance. Special rules under IRC §833 apply to Blue Cross and Blue Shield organizations and certain other organizations.

IRC §833 provides a deduction related to the health business of such organizations. The deduction is equal to 25% of the sum of:

1. Claims incurred and liabilities incurred under cost-plus contracts for the taxable year, plus
2. Expenses incurred in connection with administration, adjustment, or settlement of claims or in connection with administration of cost-plus contracts during the taxable year, to the extent this sum exceeds the adjusted surplus at the beginning of the taxable year.

IRC §833 also provides an exception for such organizations from the application of the 20% reduction in the deduction for premiums earned.

New Law. For taxable years beginning in 2010, the PPACA limits eligibility for the §833 rules to organizations that meet a medical-loss ratio[41] standard of 85% for the taxable year. An organization that does not meet this standard is not allowed the 25% deduction and the exception from the 20% reduction in the unearned premium reserve deduction.

Effective Date. This provision is effective for taxable years beginning after December 31, 2009.

TAX-FREE HEALTH COVERAGE FOR CHILDREN UNDER AGE 27

Old Law. Reimbursements under an accident or health plan for medical expenses for employees, their spouses, and their dependents are generally excluded from gross income. For purposes of this provision, the term **dependents** includes **qualifying children** under age 19 (or in the case of full-time students, under age 24).

> **Note.** For a thorough discussion of the definition of "qualifying child," see Chapter 2, Dependency Exemption Issues, in the 2009 *University of Illinois Federal Tax Workbook*. This can be found on the accompanying CD.

41. Defined as the ratio of incurred claims to earned premiums.

New Law. Effective March 30, 2010, health coverage provided for an employee's children under age 27 is generally tax-free to the employee. Additionally, employer-provided coverage under an accident or health plan for injuries or sickness for such a child is also excluded from the employee's gross income.

For purposes of this provision, a child is an individual who is the son, daughter, stepson, or stepdaughter of the employee. A child also includes legally-adopted individuals and an eligible foster child.[42]

The exclusion from gross income applies for an employee's child who has not attained age 27 as of the end of the taxable year, including a child of the employee who is **not the employee's dependent within the meaning of IRC §152(a).** Thus, the age limit, residency, support, and other tests described in §152(c) do not apply.[43]

> **Example 12.** Employer Krypton provides health insurance for its employees, their spouses, and dependents. This includes any employee's child (as defined in §152(f)(1)) who has not attained age 27 as of the end of the taxable year. For the 2010 taxable year, Krypton provides health insurance to employee Alan and to Alan's son, Caleb. Caleb has never worked for Krypton.
>
> Caleb is not eligible for health insurance from his own employer. Caleb is age 25 in the 2010 taxable year. During 2010, Caleb earns $50,000 and does not live with Alan. Caleb is not a dependent of Alan; however, he is Alan's child within the meaning of §152(f)(1).
>
> Accordingly, and because Caleb will not attain age 27 during 2010, the health insurance and reimbursements provided to him under the terms of Krypton's plan are excludible from Alan's gross income for the period on and after March 30, 2010, through the end of the taxable year.[44]

The exclusion of coverage and reimbursements from an employee's gross income for an employee's child who has not attained age 27 as of the end of the taxable year **also applies to the definition of qualified benefits for IRC §125 cafeteria plans, including health flexible spending accounts (FSA).**[45]

The provision permits self-employed individuals to take a deduction for the cost of health insurance provided for any child of the taxpayer who has not attained age 27 as of the end of the taxable year.[46]

Effective Date. This provision is effective March 30, 2010.

ADDITIONAL REQUIREMENTS FOR TAX-EXEMPT HOSPITALS

Old Law. Charitable organizations described in IRC §501(c)(3) are generally exempt from federal income and state and local taxes, are eligible to receive tax deductible contributions, and have access to tax-exempt financing. Hospitals qualify for exemption if they are organized and operated for charitable purposes and otherwise meet the requirements of §501(c)(3).

New Law. A provision in the PPACA establishes new requirements applicable to §501(c)(3) hospitals. The requirements generally apply to any §501(c)(3) organization that operates at least one hospital facility.

To qualify for tax exemption under §501(c)(3), an organization subject to the provision must comply with certain requirements with respect to each hospital facility operated by the organization:

- Conduct a community health needs assessment at least once every three years. Failure to complete the assessment in the applicable period results in a penalty of up to $50,000.
- Adopt, implement, and publicize a financial assistance policy.

42. IRC §152(f)(1).
43. IRS Notice 2010-38, 2010-20 IRB.
44. Example adapted from IRS Notice 2010-38, 2010-20 IRB.
45. IRS Notice 2010-38, 2010-20 IRB.
46. IRC §162(l)(1)(D).

- Bill individuals who qualify for financial assistance no more than the amounts generally billed to individuals who have insurance.
- Make reasonable efforts to determine whether an individual is eligible for financial assistance before undertaking extraordinary collection actions.

In addition, each tax-exempt organization to which the provision applies must file a copy of its audited financial statements with its Form 990.

Effective Date. The community health needs assessment requirement is effective for taxable years beginning after March 30, 2012. All other provisions are generally effective for taxable years beginning after March 30, 2010.

EXCISE TAX ON TANNING SALONS

The PPACA imposes a 10% tax on the amount each individual pays for indoor tanning services. If the tax is not paid by the person receiving the indoor tanning services, the person performing the procedure pays the tax.[47] The provider of the services quarterly remits the tax to the government using Form 720, *Quarterly Federal Excise Tax Return.*[48]

If a service provider bundles indoor tanning services with other services, the service provider calculates the tax using a ratio based on the unbundled price of each service. If the provider does not normally charge for a certain service separately, the provider should use the fair market value of the service for purposes of the calculation. To create the ratio, the unbundled price for the indoor tanning services is divided by the total unbundled price of all services in the bundle. This ratio is applied to the bundled charge to obtain the taxable amount.

> **Example 13.** A salon operator offers a special bundle price for 10 swimming lessons and two "free" indoor tanning services for $200. Outside of the bundled service, the operator charges $20 for each swim lesson and $15 for each tanning service, for a total regular charge of $230. The amount subject to tax for the bundled service is $26.09 ($30 unbundled price for tanning services ÷ $230 unbundled price of all services × $200 bundled price for all services). The indoor tanning tax is $2.61 ($26.09 × 10%).[49]

A membership fee paid to a "qualified physical fitness facility" is not subject to the indoor tanning services tax. A qualified physical fitness facility is a facility that meets all of the following requirements:

1. The predominant business is providing facilities, equipment, and services to its members for purposes of exercise and physical fitness.
2. Indoor tanning services are not a substantial part of its business.
3. It does not offer tanning services to the public for a fee or offer pricing options to members based on tanning services.

Indoor tanning services applicable to this provision do not include any phototherapy service performed by a licensed medical professional.

Effective Date. This provision is effective for services rendered on or after July 1, 2010.

47. IRC §5000B(c).
48. IRS News Release IR-2010-073 (June 11, 2010).
49. Example adapted from *Excise Tax on Indoor Tanning Services Frequently Asked Questions.* [www.irs.gov/businesses/small/article/0,,id=224600,00.html] Accessed on Aug. 9, 2010.

EXTENSION OF DEPENDENT COVERAGE

Old Law. Group health plans and health insurance issuers that provide dependent coverage of children were not required to cover adult children.

New Law. Group health plans and health insurance issuers offering group or individual health insurance coverage that provide dependent coverage of children are **required** to make such coverage available until the child turns age 26.[50]

Effective Date. The extended coverage must be provided not later than plan years beginning on or after September 23, 2010.[51]

HIGHER PENALTY FOR NONQUALIFIED DISTRIBUTIONS FROM HSAs AND ARCHER MSAs

Old Law. Individuals with a high-deductible health plan may establish and make tax-deductible contributions to a health savings account (HSA). Distributions from an HSA that are used for qualified medical expenses are excludible from gross income. All HSA disbursements that are **not** made for qualified medical expenses are includible in gross income, and an additional 10% penalty tax is assessed on these distributions.

An Archer MSA is a tax-exempt trust or custodial account to which tax-deductible contributions may be made by individuals with a high-deductible health plan. Archer MSAs provide tax benefits similar to, but generally not as favorable as, those provided by HSAs for individuals covered by high-deductible health plans. After 2007, no new contributions are permitted to Archer MSAs except by, or on behalf of, individuals who previously had made Archer MSA contributions and employees of a participating employer. An additional 15% penalty is imposed on Archer MSA distributions not used for medical expenses.[52]

New Law. Under the PPACA, distributions from an HSA or an Archer MSA that are not used for qualified medical expenses are assessed a 20% penalty.

Effective Date. This change is effective for disbursements made during tax years beginning after December 31, 2010.[53]

DISTRIBUTIONS FROM HEALTH ACCOUNTS ALLOWED FOR PRESCRIBED DRUGS AND INSULIN ONLY

Old Law. Under a health reimbursement arrangement (HRA) or health FSA, amounts paid for prescription and over-the-counter medicine are treated as medical expenses. Reimbursements for these expenses are excludible from gross income.

Similarly, a distribution from an HSA or an Archer MSA used to purchase over-the-counter medicine is excludible from gross income as qualified medical expenses.

New Law. The definition of medical expense for purposes of employer-provided health coverage, including HRAs, health FSAs, HSAs, and Archer MSAs is the same as that used for the itemized deduction for medical expenses. This limits distributions to prescribed drugs and insulin. However, **the prescription drug category is determined without regard to whether the drug is available without a prescription. Thus, under the provision, the cost of over-the-counter medicines may not be reimbursed through a health FSA, HRA, HSA, or Archer MSA, unless the medicine is prescribed by a physician.[54]**

Effective Date. This provision is effective for expenses incurred after December 31, 2010.

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50. PPACA, Sec. 1001.

51. IRS News Rel. IR-2010-53 (Apr. 27, 2010).

52. Joint Committee on Taxation report JCX-18-10, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act."*

53. IRC §§223(f)(4)(A) and 220(f)(4)(A).

54. Joint Committee on Taxation report JCX-18-10, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act."*

SIMPLE CAFETERIA PLANS FOR SMALL BUSINESSES

Old Law. Employees electing a qualified benefit through salary reduction under a cafeteria plan forgo salary and instead receive a benefit that is excludible from gross income. Cafeteria plans and certain qualified benefits are subject to nondiscrimination requirements to prevent discrimination in favor of highly-compensated individuals. Although the basic purpose of each of the nondiscrimination rules is the same, the specific rules for satisfying the relevant nondiscrimination requirements vary for cafeteria plans generally and for each qualified benefit. An employer maintaining a cafeteria plan in which any highly-compensated individual participates must ensure that both the cafeteria plan and each qualified benefit satisfy the relevant nondiscrimination requirements. Failure to satisfy the nondiscrimination rules generally results in a loss of the tax exclusion by the highly-compensated individuals.

New Law. Under the PPACA, a new SIMPLE cafeteria plan will be available for years beginning after 2010. An eligible small employer is provided with a safe harbor from the nondiscrimination requirements for cafeteria plans and from the nondiscrimination requirements for specified qualified benefits offered under a cafeteria plan. Under the safe harbor, a cafeteria plan and the specified qualified benefits are treated as meeting the specified nondiscrimination rules if the cafeteria plan satisfies minimum eligibility and participation requirements and minimum contribution requirements.[55]

Eligibility and Participation Requirements

The eligibility requirement is met if **both** of the following criteria are met:

- All employees (other than excludable employees) are eligible to participate.
- Each employee eligible to participate is able to elect any benefit available under the plan (subject to the terms and conditions applicable to all participants).

Excludable employees are those that:

1. Have not attained age 21 (or a younger age provided in the plan) before the close of a plan year,
2. Have fewer than 1,000 hours of service for the preceding plan year,
3. Have not completed one year of service with the employer as of any day during the plan year,
4. Are covered under a collective-bargaining agreement if there is evidence that the benefits covered under the cafeteria plan were the subject of good faith bargaining between employee representatives and the employer, or
5. Are nonresident aliens working outside the United States.

With respect to items 1 and 2, an employer may have a younger age and shorter service requirement but only if the younger age or shorter service applies to all employees.[56]

Minimum Contribution Requirement

The minimum contribution requirement is met if the employer provides a minimum contribution for each non-highly-compensated employee[57] in addition to any salary reduction contributions made by the employee. The minimum must be available for application toward the cost of any qualified benefit (other than a taxable benefit) offered under the plan.

55. Ibid.
56. Ibid.
57. A non-highly-compensated employee is one who is not a highly compensated employee within the meaning of IRC §414(q) or a key employee within the meaning of IRC §416(i).

The minimum contribution is permitted to be calculated under **either** of the following methods:

1. **Nonelective Contribution Method.** This method uses an amount equal to a uniform percentage (not less than 2%) of each eligible employee's compensation for the plan year.
2. **Matching Contribution Method.** This method uses an amount not less than the lesser of:
   a. Twice the amount of the salary reduction contributions of each qualified employee, or
   b. Six percent of the employee's compensation for the plan year.[58]

The same method must be used for calculating the minimum contribution for all non-highly-compensated employees.[59]

If the employer chooses the matching contribution method for calculating the minimum contribution, the requirement is not satisfied if the rate of contributions for any salary reduction contribution of a highly-compensated or key employee is greater than that for any other employee.[60]

Eligible Employer

An eligible small employer under the provision is, for any year, an employer who employed an average of 100 or fewer employees on business days during either of the two preceding years. For purposes of the provision, a year may only be taken into account if the employer was in existence throughout the year. If an employer was not in existence throughout the preceding year, the determination is based on the average number of employees that the employer is reasonably expected to employ on business days in the current year.

An eligible employer who maintains a SIMPLE cafeteria plan for its employees for any year and maintains the cafeteria plan in subsequent years without interruption will continue to be deemed an eligible small employer. This holds true until the employer employs an average of 200 or more employees on business days during the preceding year.

Effective Date. This provision is effective for taxable years beginning after December 31, 2010.

REPORTING COST OF HEALTH INSURANCE ON FORM W-2

For reporting years starting in 2011, employers must disclose the value of the employee's health insurance on each employee's Form W-2. If an employee is enrolled in employer-sponsored health insurance under multiple plans, the employer must disclose the aggregate value of all health insurance. For example, if an employee is enrolled in employer-sponsored major-medical health insurance, a dental plan, and a vision plan, the employer is required to report the total value of all these health-related insurance plans.

> **Note.** The value of health insurance reported on Form W-2 is for informational purposes only.

To determine the value of employer-sponsored health insurance, the employer calculates the applicable premiums for the taxable year for the employee using the rules for COBRA continuation,[61] including the special rule for self-insured plans. The value that the employer must report is the portion of the aggregate premium attributable to the employee.[62]

The term **applicable employer-sponsored coverage** means coverage under any group health plan made available to the employee by an employer which is excludable from the employee's gross income under IRC §106.[63]

58. IRC §125(j)(3)(A).
59. Joint Committee on Taxation report JCX-18-10, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act."*
60. IRC §125(j)(3)(B).
61. As defined in IRC §4980B(f)(4) and its accompanying regulations.
62. Joint Committee on Taxation report JCX-18-10, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act."*
63. IRC §4980I(d)(1)(A).

Coverage is treated as applicable employer-sponsored coverage regardless of whether the employer or employee pays for the coverage.[64]

The aggregate cost of employer-sponsored coverage for an employee (or employee's spouse) does **not** include any of the following:

- The amount contributed to any Archer MSA
- The amount contributed to any HSA
- The amount of any salary reduction contributions to a health FSA[65]

Effective Date. This provision is effective for taxable years beginning after December 31, 2010. IRS Notice 2010-69, which was issued on October 12, 2010, made the reporting **optional** for Forms W-2 issued for 2011.

ANNUAL FEE FOR BRANDED PRESCRIPTION DRUG MANUFACTURERS AND IMPORTERS

For each calendar year beginning after 2010, a provision in the PPACA imposes a fee on each covered entity engaged in the business of manufacturing or importing branded (nongeneric) prescription drugs that are for sale to any specified government program or pursuant to coverage under any such program. Fees collected under the provision are credited to the Medicare Part B trust fund.

The aggregate annual fee for all covered entities is $2.5 billion for calendar year 2011, $2.8 billion for calendar years 2012 and 2013, $3 billion for calendar years 2014–2016, $4 billion for calendar year 2017, $4.1 billion for calendar year 2018, and $2.8 billion for calendar year 2019 and thereafter.

The aggregate fee is apportioned among the covered entities each year based on each entity's relative share of branded prescription drug sales during the previous calendar year.

The fees imposed under this provision are treated as excise taxes and thus are not deductible for federal income tax purposes.

Effective Date. This provision is effective for calendar years beginning after December 31, 2010.

LIMITATION ON HEALTH FSA CONTRIBUTIONS

Old Law. Employers may provide health coverage by reimbursing medical expenses of their employees through health FSAs. These FSAs allow reimbursement for medical care under a specified dollar amount, which is either elected by an employee under a cafeteria plan or specified by the employer.

New Law. For taxable years beginning in 2013, the maximum amount of salary reduction contributions that an employee may elect to make to a health FSA maintained under a cafeteria plan for a plan year cannot exceed $2,500.[66] The $2,500 limitation is indexed for inflation for years beginning after December 31, 2013.

A cafeteria plan that does not include this contribution limitation for any health FSA is not a cafeteria plan within the meaning of IRC §125. Consequently, when an employee is given the option under a cafeteria plan to reduce current cash compensation and instead has the salary reduction amount made available for reimbursement of medical expenses under a health FSA, the amount must be limited to $2,500 per year.

Regulations require that all the employer's cafeteria plans be aggregated for purposes of applying the $2,500 limit. The limit must be prorated in the case of a plan year or coverage period less than 12 months.

Effective Date. This provision is effective for taxable years beginning after December 31, 2012.

64. IRC §4980I(d)(1)(C).
65. IRC §6051(a)(14).
66. IRC §125(i)(1).

THRESHOLD TO ITEMIZE MEDICAL EXPENSES RAISED

Old Law. For regular income tax purposes, taxpayers are allowed to itemize unreimbursed medical expenses to the extent that such expenses exceed 7.5% of AGI.

New Law. For taxable years beginning in 2013, the threshold for taxpayers to itemize unreimbursed medical expenses increases from 7.5% to 10% of AGI for regular income tax purposes.

For the years 2013–2016, if either the taxpayer or the taxpayer's spouse has attained age 65 before the end of the taxable year, the increased threshold does not apply and the threshold remains at 7.5% of AGI. The provision does not change the AMT treatment of the itemized deduction for medical expenses.

Effective Date. The provision becomes effective for taxable years beginning after December 31, 2012.

ADDITIONAL MEDICARE TAX ON NET INVESTMENT INCOME

Old Law. The FICA[67] tax is imposed on employers based on the amount of wages paid to an employee during the year. The tax is comprised of two parts: (1) the OASDI[68] tax equals 6.2% of covered wages up to the taxable wage base ($106,800 in 2010); and (2) the Medicare tax equals 1.45% of covered wages. Each employee is subject to FICA taxes in an amount equal to that imposed on employers.

The SECA[69] tax is imposed on net income from self employment (SE). The rates of the OASDI and Medicare portions of SECA taxes are equal to the combined employee and employer FICA tax rates and apply to SE income up to the FICA taxable wage base.

New Law. For tax years beginning in 2013, a Medicare contribution tax is imposed on **individuals, estates, or trusts** with unearned income.

For individuals, the tax is 3.8% of the **lesser** of the following two amounts:

1. Net investment income, which is defined as:
   - **a.** Gross income from interest, dividends, annuities, royalties, and rents (other than income derived from any trade or business to which the tax does not apply); **plus**
   - **b.** Other gross income derived from any business to which the tax applies; **plus**
   - **c.** Net gain attributable to the disposition of property other than property held in a trade or business to which the tax does not apply; **minus**
   - **d.** The deductions properly allocable to the gross income or net gain.[70]

> **Note.** The tax applies to trade or business income if the trade or business is a passive activity for the taxpayer or consists of trading financial instruments or commodities. The tax does not apply to other trades or businesses conducted by a sole proprietor, partnership, or S corporation.[71]

2. The excess of MAGI over the threshold amount ($250,000 for MFJ taxpayers or surviving spouses, $125,000 for MFS taxpayers, and $200,000 for all other taxpayers)

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67. Federal Insurance Contribution Act.
68. Old Age, Survivors, and Disability Insurance.
69. Self-Employment Contribution Act.
70. IRC §1411(c)(1).
71. Joint Committee on Taxation report JCX-18-10, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act."*

Example 14. Claire, a single taxpayer, has MAGI of $220,000 which includes net investment income of $30,000 for taxable year 2013. She is liable for the Medicare contribution tax on $20,000 of income (the lesser of $220,000 MAGI – $200,000 threshold amount for single taxpayers or $30,000 of net investment income). Claire must pay additional Medicare tax of $760 ($20,000 × 3.8%).

For estates and trusts, the tax is 3.8% of the **lesser** of the following two amounts:

1. Undistributed net investment income
2. The excess of AGI (as defined in IRC §67(e)) over the dollar amount at which the highest income tax bracket applicable to an estate or trust begins

Note. For 2010, the highest income tax bracket applicable to estates and trusts begins at $11,200. This bracket may likely be higher by the time the additional Medicare tax becomes effective in 2013.

The tax also applies to **income from a trade or business** that either:

- Is a passive activity (within the meaning of IRC §469) for the taxpayer, or
- Consists of trading financial instruments or commodities.

The tax does not apply to the following taxpayers:

- Nonresident aliens
- A trust in which all the unexpired interests are devoted to charitable purposes
- Trusts exempt from tax under §501
- Charitable remainder trusts exempt from tax under §664

Effective Date. This provision is effective for tax years beginning after December 31, 2012.

ADDITIONAL MEDICARE TAX ON HIGH-INCOME TAXPAYERS

For taxable years beginning in 2013, the **employee** portion of the Medicare tax is increased by an additional 0.9% on wages received in excess of the threshold amount. The threshold amount is $250,000 for MFJ taxpayers or surviving spouses, $125,000 for MFS taxpayers, and $200,000 for all other taxpayers. Unlike the general 1.45% Medicare tax on wages, this additional tax is on the combined wages of the employee and the employee's spouse (MFJ taxpayers).

In determining the amount that an employer must withhold from wages, only wages that an employee receives from an employer in excess of $200,000 per year are taken into account for this additional tax. The employer must disregard any wages received by the employee's spouse. The total amount of the additional Medicare tax will be computed on Form 1040. The amount of Medicare tax not withheld by an employer must also be taken into account in determining a taxpayer's liability for estimated tax.[72]

Example 15. For the taxable year 2013, Rose has wages of $250,000. Her husband, Bernard, has wages of $100,000. Rose's employer is obligated to withhold an additional $450 in Medicare taxes (($250,000 wages – $200,000 threshold amount) × 0.9%). Bernard's employer is not required to withhold any additional Medicare tax.

On Rose and Bernard's joint return, they will have an additional Medicare tax liability of $900 ((250,000 + $100,000 – $250,000 threshold for MFJ taxpayers) × 0.9%) of which $450 was already covered by employer withholding. This is in addition to the regular Medicare tax of $5,075 ($350,000 combined wages × 1.45%) which was withheld from their wages.

72. Joint Committee on Taxation report JCX-18-10, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act."*

Self-Employed Individuals

The additional Medicare tax also applies to the portion of SE income in excess of the threshold amount. The threshold amount is reduced (but not below zero) by the amount of wages taken into account in determining the taxpayer's FICA tax. No deduction for one-half of SE tax is allowed under IRC §164(f) for the additional 0.9% SE tax, and the deduction under IRC §1402(a)(12) for net earnings from self employment is determined without regard to the additional SE tax rate.

Effective Date. This provision is effective for taxable years beginning after December 31, 2012.

EXCISE TAX ON MEDICAL DEVICE MANUFACTURERS

Beginning in 2013, a tax equal to 2.3% of the sale price is imposed on the sale of any taxable medical device by the manufacturer, producer, or importer of such device.

A taxable medical device is defined in section 201(h) of the Federal Food, Drug, and Cosmetic Act as an instrument, apparatus, implement, machine, contrivance, implant, in vitro reagent, or other similar or related article, including any component, part, or accessory which meets any of the following criteria:

1. The device is recognized in the official National Formulary, or the United States Pharmacopeia, or any supplement to them.
2. The device is intended for use in the diagnosis of disease or other conditions, or in the cure, mitigation, treatment, or prevention of disease in humans or other animals.
3. The device is intended to affect the structure or any function of the human body or other animals, and does not achieve its primary intended purposes through chemical action within or on the human body or other animals, and is not dependent upon being metabolized for the achievement of its primary intended purposes.

Examples range from simple tongue depressors and bedpans to complex programmable pacemakers, laser surgical devices, x-ray machines, and medical lasers.[73]

The excise tax does **not** apply to any of the following:

- Eyeglasses
- Contact lenses
- Hearing aids
- Any other type of medical device that is generally purchased by the public at retail for individual use[74]

> **Note.** It is anticipated that the IRS will publish a list of medical device classifications that are generally purchased by the public at retail for individual use.

Effective Date. This provision is effective for sales made after December 31, 2012.

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73. See [www.fda.gov/MedicalDevices/ProductsandMedicalProcedures/default.htm] Accessed on June 25, 2010.

74. IRC §4191(b)(2).

ELIMINATION OF EMPLOYER MEDICARE PART D DEDUCTION

Old Law. Sponsors of qualified retiree prescription drug plans are eligible for subsidy payments from the HHS for a portion of each qualified covered retiree's gross covered prescription drug costs. A qualified retiree prescription drug plan is employment-based retiree health coverage that has an actuarial value at least as great as the Medicare Part D standard plan for the risk pool[75] and that meets certain other disclosure and recordkeeping requirements. These qualified retiree prescription drug plan subsidies are excludable from the plan sponsor's gross income for the purposes of regular income tax and AMT.

For each qualifying covered retiree enrolled in a qualified retiree prescription drug plan, the subsidy is equal to 28% of the portion of the allowable retiree costs paid by the plan sponsor on behalf of the retiree that exceed the cost threshold but do not exceed the cost limit. A **qualifying covered retiree** is an individual who is Medicare-eligible but not enrolled in either a Medicare Part D prescription drug plan or a Medicare Advantage prescription drug plan, and who is covered under a qualified retiree prescription drug plan.[76]

A provision under IRC §139A specifies that the exclusion of the qualified retiree prescription drug plan subsidy from income is not taken into account in determining whether any deduction is allowable for the covered retiree prescription drug expenses. Therefore, under present law, a taxpayer may claim a business deduction for covered retiree prescription drug expenses, notwithstanding that the taxpayer excludes from income qualified retiree prescription drug plan subsidies allocable to such expenses.[77]

New Law. Beginning in 2013, the PPACA eliminates the rule that the exclusion for subsidy payments is not taken into account for purposes of determining whether a deduction is allowable for retiree prescription drug expenses. Thus, under the provision, the amount otherwise allowable as a deduction for retiree prescription drug expenses is reduced by the amount of the excludable subsidy payments received.

> **Example 16.** Linx, Inc., receives a subsidy of $28 for eligible drug expenses of $100. The $28 is excludable from income under §139A. The amount otherwise allowable as a deduction is reduced by $28. If the company otherwise meets the requirements of IRC §162 for its eligible drug expenses, it is entitled to an ordinary business expense deduction of $72.

> **Observation.** This provision eliminates the double benefit to the employer providing retiree prescription drug coverage and may cause many employers to drop such coverage.

Effective Date. This provision is effective for taxable years beginning after December 31, 2012.

LIMITATION ON DEDUCTION FOR COMPENSATION OF CERTAIN EXECUTIVES

Old Law. The otherwise allowable deduction for compensation paid or accrued for a covered employee of a publicly-held corporation is limited to no more than $1 million per year. A covered employee is defined in IRC §162(m) as the chief executive officer of the corporation at the close of the taxable year and the four most highly-compensated officers for the taxable year.

75. For an explanation of how the Medicare Part D actuarial value is calculated, see [rds.cms.hhs.gov/news/announcements/net_value_part_d.htm] Accessed on July 29, 2010.

76. Joint Committee on Taxation report JCX-18-10, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act."*

77. Ibid.

For those companies involved in the Troubled Assets Relief Program (TARP), the deduction limit is reduced to $500,000 in the case of compensation of a covered executive for any applicable taxable year of an applicable employer.[78] A **covered executive** is defined as the chief executive officer or chief financial officer and any employee who is one of the three highest-compensated officers of the applicable employer for the applicable taxable year. An **applicable employer** is one from which one or more troubled assets were acquired under TARP if the aggregate amount of the acquired assets exceeds $300 million.

New Law. The PPACA imposes a deduction limit of $500,000 on remuneration attributable to services performed by applicable individuals employed by a covered health insurance provider during an applicable taxable year. In the case of remuneration that relates to services that an applicable individual performs during a taxable year that is not deductible until a later year (e.g. nonqualified deferred compensation), any unused portion of the $500,000 limit for the year is carried forward until the year in which the compensation is otherwise deductible, and the remaining unused limit is then applied to the compensation.

A **covered health insurance provider** is one that derives at least 25% of gross premium income from providing minimum essential coverage as defined in IRC §5000A(f).

Applicable individuals include all officers, employees, directors, and other workers or service providers (such as consultants) performing services for or on behalf of a covered health insurance provider.

Effective Date. This provision is effective for remuneration paid in taxable years beginning after December 31, 2012 for services performed after December 31, 2009.

EXCISE TAX ON INDIVIDUALS WITHOUT ESSENTIAL HEALTH COVERAGE

Beginning in 2014, nonexempt U.S. citizens and legal residents are required to maintain minimum essential coverage or incur an excise tax as a penalty. Minimum essential coverage includes government-sponsored programs, eligible employer-sponsored plans, plans available in the individual market, grandfathered group health plans, and other health coverage plans recognized by the HHS in coordination with the Treasury.

Exempt individuals are those who:

- Are incarcerated,
- Are not legally present in the United States, or
- Maintain religious exemptions.

Those exempt from the requirement due to religious reasons must be members and adhere to the tenets of a recognized religious sect that exempts them from SE taxes. If an individual is a dependent of another taxpayer, the other taxpayer is liable for any excise tax related to the individual.[79]

78. IRC §162(m)(5).

79. Ibid.

Individuals who cannot afford coverage because their required contribution for employer-sponsored coverage or the lowest-cost "bronze" plan[80] in the local exchange exceeds 8% of household income for the year are exempt from the penalty. In years after 2014, the 8% exemption is increased by the amount by which premium growth exceeds income growth. If self-only coverage is affordable to an employee but family coverage is unaffordable, the employee is subject to the mandate penalty if the employee does not maintain minimum essential coverage. However, any individual eligible for employer coverage due to a relationship with an employee (e.g., spouse or child of employee) is exempt from the penalty if that individual does not maintain minimum essential coverage because family coverage is not affordable (i.e., exceeds 8% of household income). Taxpayers with income below the income tax filing threshold[81] are also exempt from the penalty for failure to maintain minimum essential coverage. All members of American Indian tribes are exempt from the penalty.[82]

Individuals who fail to maintain minimum essential coverage are subject to an excise tax equal to the **greater** of:

1. The **applicable percentage** of the taxpayer's household income for the taxable year that exceeds the income threshold required for income tax return filing for that taxpayer, or
2. The sum of the **applicable annual dollar amounts** for the uninsured individuals in the household for the taxable year.

The applicable percentages (item 1 above) and applicable annual dollar amounts (item 2) vary by year as follows:

Year	Applicable Percentage	Applicable Annual Dollar Amount for Adults	Applicable Annual Dollar Amount for Children Under Age 18
2014	1.0	$ 95.00	$ 47.50
2015	2.0	325.00	162.50
2016	2.5	695.00	347.50
After 2016	2.5	695.00 + inflation adjustment	347.50 + inflation adjustment

The total household excise tax may not exceed 300% of the applicable annual dollar amount for adults (e.g., $2,085 for 2016). The total annual household payment may not exceed the national average annual premium for a bronze level health plan offered through the exchange that year for the household size.[83]

Example 17. For tax year 2014, Penny and Clayton Mandos file a joint return. They have two dependent children under the age of 18. Although they are not exempt from the requirement to maintain minimum essential coverage, they do not have health insurance at any time during 2014. Their combined household income is $45,000 and their filing threshold is $27,000.

The Mandos family's excise tax is calculated as follows.

- Using the applicable percentage test, the excise tax is $180 (($45,000 household income – $27,000 filing threshold) × 1% applicable percentage for 2014).
- Using the applicable dollar amount test, the excise tax is $285 (($95 × 2 adults) + ($47.50 × 2 children)).

The **greater** of items 1 and 2 above is $285. This amount does not exceed 300% of the applicable dollar amount for adults ($95 × 300% = $285). Thus, the Mandos' total penalty for 2014 is $285, assuming this amount does not exceed the national average premium for a bronze level health plan.

80. Bronze level benefits are actuarially equivalent to 60% of the full actuarial benefits provided under the plan.

81. In 2010, the general filing threshold is $9,350 for a single person or a married person filing separately and is $18,700 for MFJ taxpayers. IR-2009-93, Oct. 15, 2009.

82. Joint Committee on Taxation report JCX-18-10, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act."*

83. Ibid.

The excise tax is determined **monthly** and applies to any period the individual does not maintain minimum essential coverage. However, no excise tax is assessed for individuals who do not maintain health insurance for a period of three months or less during the taxable year. If an individual exceeds the 3-month maximum during the taxable year, the excise tax applies for the full duration of the gap during the year. If there are multiple gaps in coverage during a calendar year, the exemption from penalty applies only to the first gap in coverage during a taxable year.

The excise tax is assessed as an additional amount of federal tax owed; however, it is **not subject to the enforcement provisions** of subtitle F of the Code. Therefore, the use of liens and seizures otherwise authorized for collection of taxes does not apply to the collection of this penalty. Noncompliance with the requirement to have health coverage is not subject to criminal or civil penalties under the Code and interest does not accrue for failure to pay such assessments in a timely manner.

> **Note.** IRS Commissioner Doug Shulman has indicated that the IRS may use tax refund offsets to enforce this provision of the PPACA.[84]

Effective Date. This provision is effective for taxable years beginning after December 31, 2013.

PREMIUM ASSISTANCE CREDIT FOR QUALIFIED HEALTH PLAN COVERAGE

Beginning in 2014, a PPACA provision creates the premium assistance credit, which is a refundable tax credit.[85] This credit will be available for eligible individuals and families who purchase health insurance through an exchange. The premium assistance credit, which is refundable and payable in advance directly to the insurer, subsidizes the purchase of certain health insurance plans through an exchange.

Under the provision, eligible individuals enroll in a plan offered through an exchange and report their income to the exchange. Based on the information provided to the exchange and the individual's income, each individual receives an advance premium assistance credit. The Treasury pays the premium assistance credit amount directly to the individual's insurance plan carrier. The individual then pays the carrier the difference between the premium assistance credit and the total premium charged for the plan. Individuals who fail to pay all or part of the remaining premium are given a mandatory 3-month grace period prior to an involuntary termination of their participation in the plan. For employed individuals who purchase health insurance through a state exchange, the premium payments are made through payroll deductions.

Initial eligibility for the premium assistance credit is based on the individual's income for the tax year ending two years prior to the enrollment period. Individuals (or couples) may update eligibility information or request a redetermination of their tax credit eligibility if they meet one of the following conditions:[86]

- A change in marital status or other household circumstance
- A decrease in income of more than 20%
- The receipt of unemployment insurance

The premium assistance credit is available for individuals (single or joint filers) with household incomes between 100%–400% of the applicable federal poverty level (FPL) who do not receive health insurance through an employer or a spouse's employer.

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84. [dailycaller.com/2010/04/05/irs-chief-buy-health-insurance-or-lose-your-tax-refund/#ixzz0kQpviNwz] Accessed on July 29, 2010.

85. IRC §36B, as added by the PPACA Sec. 1401(a).

86. Joint Committee on Taxation report JCX-18-10, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act."*

For 2009 (the latest year for which figures were available), the FPL is shown below.[87]

Persons in Family	Poverty Guideline	400% Income Limitation
1	$10,830	$ 43,320
2	14,570	58,280
3	18,310	73,240
4	22,050	88,200
5	25,790	103,160
6	29,530	118,120
7	33,270	133,080
8	37,010	148,040

For families with more than 8 persons, add $3,740 for each additional person.

To be eligible for the premium assistance credit, taxpayers who are married must file a joint return. Dependent individuals are ineligible for the credit.

As shown in the following table, premium assistance credits are available on a sliding scale for individuals and families to help offset the cost of private health insurance premiums. The applicable percentage for any taxpayer whose household income is within an income tier specified in this table increases on a graduated scale from the initial premium percentage to the final premium percentage.[88]

Household Income as % of FPL	Initial Premium Percentage	Final Premium Percentage
100% up to 133%	2.00%	2.00%
133% up to 150%	3.00%	4.00%
150% up to 200%	4.00%	6.30%
200% up to 250%	6.30%	8.05%
250% up to 300%	8.05%	9.50%
300% up to 400%	9.50%	9.50%

The premium assistance amount for any coverage month is the **lesser of:**

- The **monthly premiums** for one or more qualified health plans enrolled in through an exchange and which cover the taxpayer, spouse, and dependents, or
- The amount, if any, that the **adjusted monthly premium** for the applicable second-lowest-cost silver plan for the taxpayer exceeds one-twelfth of the product of the applicable premium percentage (see above table) and the taxpayer's household income for the taxable year.[89]

Example 18. Drew and Shauna are married and have two children. Their 2014 annual premium for the applicable second-lowest-cost silver plan in the exchange is $11,000. Their total household income for 2011 (two years prior) was $55,125. Assume the FPL is the same as it was in 2009.

Drew and Shauna's total household income is 250% of the FPL. Their advance premium assistance credit for 2014 is $6,562 ($11,000 premium – ($55,125 household income × 8.05%), or the lesser of the premium or the computed credit.

87. See [aspe.hhs.gov/poverty/09poverty.shtml] Accessed on June 28, 2010.

88. IRC §36B(b)(3)(A)(i).

89. IRC §36B(b)(2).

Reconciliation

If the premium assistance received through an advance payment exceeds the amount of credit to which the taxpayer is entitled, the excess advance payment is treated as an increase in tax. For persons whose household income is below 400% of the FPL, the amount of the increase in tax is limited to $400 ($250 for single taxpayers). If the premium assistance received through an advance payment is less than the amount of the credit to which the taxpayer is entitled, the shortfall is treated as a reduction in tax.

Eligibility for and the amount of premium assistance is determined in advance of the coverage year on the basis of household income and family size from two years prior, and the monthly premiums for qualified health plans in the exchange in which the taxpayer, spouse, and any dependents enroll. Any advance premium assistance is paid during the year for which coverage is provided by the exchange. In the subsequent year, the amount of advance premium assistance is required to be reconciled with the **allowable refundable credit** for the year of coverage. Generally, this is accomplished on the tax return filed for the year of coverage, based on that year's actual household income, family size, and premiums. Any adjustment to tax resulting from the difference between the advance premium assistance and the allowable refundable tax credit is assessed as additional tax or a reduction in tax on the tax return.[90]

> **Example 19.** Assume the same facts as **Example 18.** Drew and Shauna's actual income in 2014 was $90,000. Since this is more than 400% of the FPL for their family size, Drew and Shauna are **not** eligible for the premium assistance credit, which was based on their income from the tax year ending two years prior (2011). The amount of Drew and Shauna's advance premium assistance credit will be assessed as an additional tax on their 2014 tax return.

Employer Offer of Health Insurance Coverage

An employee is ineligible for the premium assistance credit if the individual is offered minimum essential coverage in the group market, including employer-provided health insurance coverage. If an employee is offered unaffordable coverage (required premium is at least 9.5% of employee's household income) by his employer or the plan's share of provided benefits is less than 60%, the employee is eligible for the premium assistance credit only if the employee declines to enroll in the coverage and satisfies the conditions for receiving a tax credit through an exchange.

Effective Date. This provision is effective for taxable years beginning after December 31, 2013.

FREE-CHOICE VOUCHERS

Beginning in 2014, employers offering minimum essential coverage[91] through an eligible employer-sponsored plan and paying a portion of that coverage must provide qualified employees with a voucher whose value can be applied to the purchase of a health plan through a state exchange. A **qualified employee** is one who satisfies the following:

- The employee's required contribution for employer-sponsored minimum essential coverage is more than 8% but not more than 9.8% of the employee's household income for the taxable year.
- The employee's total household income does not exceed 400% of the FPL for the applicable family size (the FPL for 2009 was shown previously in this chapter).
- The employee does not participate in the employer's health plan.[92]

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90. Joint Committee on Taxation report JCX-18-10, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act."*

91. IRC §5000A(f)(1).

92. PPACA, Sec. 10108(c).

The voucher's value is equal to the employer contribution to the employer-offered health plan. If multiple plans are offered by the employer, the voucher's value is what would be paid if the employee chose the plan for which the employer would pay the largest percentage of the premium cost. The voucher's value is for self-only coverage unless the individual purchases family coverage in the exchange. If this is the case, the voucher's amount is the amount that the employer would pay for family coverage.

Vouchers can be applied to the monthly premium of any qualified health plan in the exchange. The voucher's value to the extent it is used for the purchase of a health plan is not includable in the employee's gross income. If the value of the voucher exceeds the premium of the health plan chosen by the employee, the employee is paid the excess value of the voucher. The excess amount received by the employee is includible in the employee's gross income.

If an individual receives a voucher, the individual is disqualified from receiving any tax credit or cost-sharing credit for the purchase of a plan in the exchange.

The **offering employer**[93] must pay the value of the voucher to the exchange.

Effective Date. This provision is effective after December 31, 2013.

EMPLOYER PENALTY FOR NOT PROVIDING SUFFICIENT LEVEL OF HEALTH COVERAGE

Failure to Offer Minimum Coverage

Beginning in 2014, certain applicable large employers are required to pay a penalty if any full-time employee is certified as having purchased health insurance through a state exchange with respect to which a premium tax credit or cost-sharing reduction is allowed or paid to the employee. The penalty will be assessed if the applicable large employer:

- Does not offer coverage for all full-time employees,
- Offers minimum essential coverage that is unaffordable (more than 9.5% of the employee's household income),[94] or
- Offers minimum essential coverage that consists of a plan under which the plan's share of the total allowed cost of benefits is less than 60%.

An employer is an **applicable large employer** for any calendar year if it employed an average of at least 50 full-time employees during the preceding calendar year. For purposes of the provision, **employer** also includes any predecessor employer. An employer is not treated as employing more than 50 full-time employees if its workforce exceeds 50 full-time employees for 120 days or fewer during the calendar year, and the employees that cause the employer's workforce to exceed 50 are seasonal workers.

Full-time employees are defined as those who work on average at least 30 hours per week. In counting the number of employees for purposes of determining whether an employer is an applicable large employer, each full-time employee is counted as one employee and all other employees are counted on a pro-rated basis. The number of FTEs that must be taken into account for purposes of determining whether the employer exceeds the threshold is equal to the aggregate number of hours worked for the month by employees who do not work full time, divided by 120 (or such other number based on an average of 30 hours of service each week as may be prescribed in regulations).

93. An offering employer is any employer who offers minimum essential coverage to its employees under an eligible employer-sponsored plan and who pays any portion of the costs of such plan, but only if the required contribution of any employee exceeds 8% of the wages paid by the employer to the employee. In the case of years after 2014, the 8% is indexed to reflect the rate of premium growth over income growth between 2013 and the preceding calendar year.

94. IRC §36B(c)(2)(C)(i)(II).

An applicable large employer who fails to offer its full-time employees and their dependents the opportunity to enroll in minimum essential coverage under an employer-sponsored plan for any month is subject to a penalty. The penalty applies if **at least one** of its full-time employees is certified as having enrolled in health insurance coverage purchased through a state exchange for which a premium tax credit or cost-sharing reduction is allowed or paid. The penalty for any month is an excise tax equal to the number of full-time employees over a 30-employee threshold during the applicable month (regardless of how many employees are receiving a premium tax credit or cost-sharing reduction) multiplied by $166.67 (i.e., one-twelfth of the annual penalty of $2,000).[95] The applicable penalty amount is adjusted for inflation for years after 2014.

> **Example 20.** In 2014, Adirondack Co. fails to offer minimum essential coverage. It has 100 full-time employees, and 10 of these enroll in a state exchange-offered plan and receive a tax credit for the year. For each employee over the 30-employee threshold, Adirondack Co. owes an annual penalty of $2,000, for a total penalty of $140,000 ($2,000 penalty × (100 employees – 30 employee threshold). The penalty is assessed on a monthly basis.

Employer Penalty for Employees Receiving Premium Credits

An applicable large employer who, for any month, offers its full-time employees and their dependents minimum essential coverage under an employer-sponsored plan is subject to a penalty if **any full-time employee** is certified as having enrolled in health insurance coverage purchased through a state exchange for which a premium assistance credit or cost-sharing reduction is allowed or paid.

For each full-time employee receiving a premium tax credit or cost-sharing subsidy through a state exchange, the employer must pay a monthly penalty of $250 (i.e., one-twelfth of the annual penalty of $3,000). The penalty for each employer for any month is capped at an amount equal to the number of FTEs during the month (regardless of how many employees are receiving a premium tax credit or cost-sharing reduction) in excess of 30, multiplied by $166.67 (one-twelfth of $2,000).[96]

> **Example 21.** In 2014, Tarjay Co. offers health coverage. It has 100 full-time employees, and 20 receive a tax credit for the year for enrolling in a state exchange-offered plan. For each employee receiving a tax credit, the employer owes an annual penalty of $3,000, for a total penalty of $60,000. The maximum penalty for this employer is capped at $140,000 ($2,000 × (100 employees – 30 employee threshold)). This is the amount that it would have been assessed if the company failed to provide coverage. Since the calculated penalty of $60,000 is less than the maximum amount, Tarjay Co. pays the $60,000 calculated penalty. This penalty is assessed on a monthly basis.

The monthly penalty is not assessed for any employee to whom the employer provides a free-choice voucher (explained previously).[97]

Effective Date. This provision is effective for months beginning after December 31, 2013.

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95. Joint Committee on Taxation report JCX-18-10, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act."*

96. Ibid.

97. IRC §4980H(b)(3).

REPORTING EMPLOYER HEALTH INSURANCE COVERAGE

Beginning in 2014, the following employers must report certain health insurance coverage information to both their full-time employees and to the IRS:

- Applicable large employers[98] required to offer employees minimum essential coverage under the provisions of new IRC §4980H[99]
- Each offering employer

The following information is required to be reported by the employer:

1. The name, address, and EIN of the employer
2. A certification as to whether the employer offers its full-time employees and their dependents the opportunity to enroll in minimum essential coverage under an eligible employer-sponsored plan
3. The number of full-time employees employed for each month during the calendar year
4. The name, address, and TIN of each full-time employee employed during the calendar year and the number of months, if any, during which the employee (and any dependents) were covered under a employer-sponsored plan
5. Any other information as may be required[100]

Employers, who certify that they offered the opportunity to full-time employees to enroll in minimum essential coverage, must also report the following:

1. For applicable large employers, the length of any waiting period related to coverage
2. The months during the calendar year that coverage was available
3. The monthly premium for the lowest cost option in each of the enrollment categories under the plan
4. The employer's share of the total allowed costs of benefits provided under the plan
5. For offering employers, the option for which the employer pays the largest portion of the cost of the plan and the portion of the cost paid by the employer in each of the enrollment categories under each option

The employer must report this information to each full-time employee, along with the employer's name, address, and contact information. The information must be reported by January 31 of the year following the calendar year for which the information is required to be reported to the IRS.

The provision amends the information reporting provisions of the Code to provide that an employer who fails to comply with these new reporting requirements is subject to the penalties for failure to file an information return and failure to furnish payee statements, respectively.

Effective Date. This provision is effective for years beginning after December 31, 2013.

98. An applicable large employer is one that employs an average of at least 50 full-time employees on business days during the preceding calendar year.
99. IRC §4980H(c)(2)(A).
100. IRC §6056(b)(2)(C).

ANNUAL FEE FOR HEALTH INSURANCE PROVIDERS

Beginning in 2014, an annual fee applies to any covered entity engaged in the business of providing health insurance for U.S. health risks. The aggregate annual fee for all covered entities is $8 billion for calendar year 2014, $11.3 billion for calendar years 2015 and 2016, $13.9 billion for calendar year 2017, and $14.3 billion for calendar year 2018. For calendar years after 2018, the applicable amount is indexed to the rate of premium growth.

Under the provision, the aggregate annual fee is apportioned among the providers based on a ratio designed to reflect relative market share of U.S. health insurance business. The amount of net premiums written that are taken into account for purposes of determining a covered entity's market share is subject to dollar thresholds. A covered entity's net premiums written during the calendar year that are not more than $25 million are not taken into account for this purpose.

A covered entity generally is one that provides health insurance for U.S. health risks during the calendar year in which the fee under this section is due. Specific exceptions are provided to the definition of a covered entity. These exceptions include the following:

1. An employer to the extent that the employer self-insures the health risks of its employees
2. Any governmental entity
3. An organization that qualifies as a voluntary employees' beneficiary association under IRC §501(c)(9) that is established by an entity other than the employer for the purpose of providing healthcare benefits
4. Any entity that:
    a. Qualifies as nonprofit under applicable state law,
    b. Meets the private inurement and limitation on lobbying provisions described in IRC §501(c)(3), and
    c. Receives more than 80% of its gross revenue from government programs that target low-income, elderly, or disabled populations.

For purposes of this provision, health insurance does not include the following:

- Disability income insurance, coverage only for accident, or a combination of these
- Coverage only for a specified disease or illness
- Hospital indemnity or other fixed-indemnity insurance
- Long-term care insurance
- Any Medicare supplemental health insurance[101]

This fee on health insurance providers is considered a **nondeductible** excise tax.

The annual fee is required to be paid in each calendar year beginning after December 31, 2013. The fee is determined for net premiums written after December 31, 2012.

Effective Date. This provision is effective for calendar years beginning after December 31, 2013.

[101] PPACA, Sec. 10905(d).

EXCISE TAX ON HIGH-COST EMPLOYER-SPONSORED HEALTH COVERAGE

Beginning in 2018, a provision in the PPACA imposes an excise tax (the so-called "Cadillac-plan tax") on insurers if the aggregate value of employer-sponsored health insurance coverage for an employee (including, for purposes of the provision, any former employee, surviving spouse, and any other primary insured individual) exceeds a threshold amount. The tax is equal to 40% of the aggregate value that exceeds the threshold amount. For 2018, the threshold amounts are as follows:

- $10,200 for individual coverage, multiplied by the health-cost adjustment percentage (defined below) and increased by the age- and gender-adjusted excess premium amount (defined below)
- $27,500 for family coverage, multiplied by the health-cost adjustment percentage and increased by the age- and gender-adjusted excess premium amount

The **health-cost adjustment percentage** is equal to 100% plus the percentage above 55% by which the cost of coverage per employee under the Blue Cross/Blue Shield standard benefit option under the Federal Employees Health Benefits Plan (FEHBP) for plan year 2018 exceeds the cost of standard FEHBP coverage per employee for plan year 2010.

The threshold amounts, after application of the health-cost adjustment percentage, are indexed for inflation in years after 2018.

The **age- and gender-adjusted excess premium amount** for each employee (except for certain retirees and employees in high-risk professions) is equal to the cost of standard FEHBP coverage for the type of coverage provided to the individual if priced for the age and gender characteristics of all employees of the individual's employer **that exceeds** the premium cost for that coverage if priced for the age and gender characteristics of the national workforce.

Note. The health-cost adjustment percentage is determined on a national level and is designed to increase the thresholds in the event that the actual growth in the cost of U.S. healthcare between 2010 and 2018 exceeds the projected growth for that period. In contrast, the age- and gender-adjusted excess premium amount is determined at the employer level and is intended to help employers whose workforce may be more expensive to insure than the national average workforce.

Example 22. If the growth in the cost of healthcare during the period between 2010 and 2018, calculated by reference to the growth in the per employee cost of standard FEHBP coverage during that period is 57%, the 2018 threshold amounts will be $10,200 for individual coverage and $27,500 for family coverage, multiplied by 102% (100% + (57% – 55%)), or $10,404 for individual coverage and $28,050 for family coverage.

The new threshold amounts are then increased for any employee by the age- and gender-adjusted excess premium amount, if any. In 2018, Juan has individual coverage and is employed by Bosworth Co. If standard FEHBP coverage priced for the age and gender characteristics of Bosworth's workforce is $11,400 and the IRS estimates that the premium cost for individual standard FEHBP coverage priced for the age and gender characteristics of the national workforce is $10,500, the threshold for Juan is increased by $900 ($11,400 – $10,500) to $11,304 ($10,404 + $900).[102]

[102] Adapted from example in Joint Committee on Taxation report JCX-18-10, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act."*

The excise tax is imposed pro rata on the coverage provider. The term **coverage provider** means any of the following:

- Health insurance issuer, in the case of coverage under a group health plan
- The employer, in the case of HSA and Archer MSA contributions under an arrangement in which the employer makes contributions (described in IRC §106(b) or (d))
- The person that administers the plan benefits (plan sponsor), in the case of any other applicable employer-sponsored coverage[103]

> **Note.** The JCT predicts that the excise tax will primarily be passed along through increases in premiums and that many consumers will respond by reducing their demand for insurance above the excise tax cap. Because health insurance premiums are a component of compensation, the JCT believes that as consumers spend less on tax-excluded health benefits, their taxable cash wages will increase. Therefore, as the value of health insurance plans decline, the income tax base will increase in the long run.[104]

Employer-sponsored health insurance coverage (ESHIC) is health coverage under any group health plan offered by an employer to an employee without regard to whether the employer provides the coverage (and thus the coverage is excludable from the employee's gross income) or the employee pays for the coverage with after-tax dollars.

ESHIC includes both fully-insured and self-insured health coverage excludable from the employee's gross income. In the case of a self-employed individual, employer-sponsored health insurance coverage is coverage for any portion of which a deduction is allowable to the self-employed individual under IRC §162(l).

The aggregate value of all ESHIC is taken into account in determining the amount by which its value exceeds the threshold amount. This includes the following types of coverage:

- Reimbursements under a health FSA or an HRA
- Contributions to an HSA or Archer MSA
- Other supplementary health insurance coverage

The following benefits are **not** taken into account in determining whether the value of health coverage exceeds the threshold amount:

- Long-term care coverage
- Accident or disability income insurance
- Liability insurance supplement
- General-liability insurance and automobile-liability insurance
- Workers' compensation or similar insurance
- Automobile medical payment insurance
- Credit-only insurance
- Other similar insurance coverage, under which benefits for medical care are secondary or incidental to other insurance benefits
- The value of independent, noncoordinated coverage described in IRC §9832(c)(3) (coverage only for a specified disease or illness or fixed indemnity insurance) if that coverage is purchased exclusively by the employee with after-tax dollars (or, in the case of a self-employed individual, for which a deduction under §162(l) is not allowable)
- Dental or vision coverage under a separate policy, certificate, or contract of insurance[105]

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103. IRC §4980I(c)(2).

104. See [courtney.house.gov/uploads/JCT_Excise_Tax_Review.pdf] Accessed on May 21, 2010.

105. Joint Committee on Taxation report JCX-18-10, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act."*

Calculation and Proration of Excise Tax

The amount subject to the excise tax on high-cost ESHIC for each employee is the sum of the aggregate premiums for health insurance coverage, the amount of any salary-reduction contributions to a health FSA for the taxable year, and the employer contribution amount to an HSA or an Archer MSA, minus the threshold amount. The aggregate premiums for health insurance coverage include all ESHIC including coverage for any supplementary health insurance coverage. The applicable premium for health coverage provided through an HRA is also included in this aggregate amount.

The excise tax is allocated pro rata among the insurers, with each insurer responsible for payment of the excise tax on the amount subject to the total excise tax multiplied by a fraction, the numerator of which is the amount of ESHIC provided by that insurer to the employee and the denominator of which is the aggregate value of all ESHIC provided to the employee. The employer is responsible for calculating the amount subject to the excise tax allocable to each insurer and plan administrator and for reporting these amounts to each insurer, plan administrator, and the IRS. Each insurer and plan administrator is then responsible for calculating, reporting, and paying the excise tax to the IRS on such forms and at such time as the IRS may prescribe.[106]

> **Example 23.** In 2018, Sara elects family coverage under a fully-insured major-medical policy with a value of $28,500 and contributes $2,500 to a health FSA. She has an aggregate health insurance coverage value of $31,000. If the health-cost adjustment percentage for that year is 100% and the age- and gender-adjusted excess premium amount for Sara is $600, the amount subject to the excise tax is $2,900 ($31,000 – ($27,500 family coverage threshold × 100% health cost adjustment percentage + $600 age and gender adjustment amount)). Sara's employer reports $2,666 ($2,900 × ($28,500 ÷ $31,000)) as taxable to the major-medical insurer, which then calculates and remits the excise tax to the IRS.
>
> If Sara's employer uses a third-party administrator for the health FSA, the employer reports $234 ($2,900 × ($2,500 ÷ $31,000)) to the administrator and the administrator calculates and remits the excise tax to the IRS. If the employer acts as the plan administrator of the health FSA, it is responsible for calculating and remitting the excise tax on the $234 to the IRS.[107]

Penalty for Underreporting Excise Tax Liability

If the employer reports to insurers, plan administrators, and the IRS a lower amount of insurance cost subject to the excise tax than required, the employer is subject to a penalty. The penalty is equal to the sum of any additional excise tax that each such insurer and administrator would have owed if the employer had reported correctly plus interest attributable to that additional excise tax from the date that the tax was due to the date paid by the employer. This may occur, for example, if the employer undervalues the aggregate premium and thereby lowers the amount subject to the excise tax for all insurers and plan administrators (including the employer, when acting as plan administrator of a self-insured plan).

The penalty will not apply if it is established to the satisfaction of the IRS that the employer neither knew, nor would have known exercising reasonable diligence, that the failure existed. In addition, no penalty will be imposed on any failure corrected within the 30-day period beginning on the first date that the employer knew, or exercising reasonable diligence, would have known, that the failure existed, so long as the failure is due to reasonable cause and not to willful neglect. All or part of the penalty may be waived by the IRS in the case of any failure due to reasonable cause and not to willful neglect, to the extent that the payment of the penalty would be excessive or otherwise inequitable relative to the failure involved.

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106. Ibid.

107. Adapted from example in Joint Committee on Taxation report JCX-18-10, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act."*

The penalty is in addition to the amount of excise tax owed. The excise tax may not be waived.[108]

Increased Thresholds for Certain Individuals

The threshold amounts[109] are increased for:

1. A person who has attained age 55 who is not Medicare eligible and who is receiving employer-sponsored retiree health coverage, or
2. A person who is covered by a plan sponsored by an employer, the majority of whose employees covered by the plan are engaged in a high-risk profession or employed to repair or install electrical and telecommunications lines. High-risk professions include the following employees:
   a. Law enforcement officers
   b. Employees in fire protection activities
   c. Persons who provide out-of-hospital emergency medical care (e.g., emergency medical technicians, paramedics, and first-responders)
   d. Longshoremen
   e. Individuals engaged in construction, mining, agriculture (not including food processing), forestry, and fishing industries

A retiree with at least 20 years of employment in a high-risk profession is also eligible for the increased threshold.

For the above individuals, the threshold amount in 2018 is increased by both of the following:

1. $1,650 for individual coverage, or $3,450 for family coverage[110]
2. The age- and gender-adjusted excess premium amount (as defined earlier)

In 2019 and thereafter, the additional $1,650 and $3,450 amounts are indexed for inflation.

Under this provision, an individual's threshold cannot be increased by more than $1,650 for individual coverage or $3,450 for family coverage (as indexed for inflation) and the age- and gender-adjusted excess premium amount, even if the individual would qualify for an increased threshold both on account of the individual's status as a retiree over age 55 and as a participant in a plan that covers employees in a high-risk profession.

Deductibility of Excise Tax

The amount of the excise tax imposed is not deductible for federal income tax purposes.

Effective Date. This provision is effective for taxable years beginning after December 31, 2017.

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108. Joint Committee on Taxation report JCX-18-10, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act."*

109. The 2018 threshold amounts are $10,200 for individual coverage and $27,500 for family coverage.

110. IRC §4980I(b)(3)(C)(iv).

PPACA Tax Provision Implementation Timeline

Provision	Effective Date
50% investment tax credit for qualifying therapeutic discovery projects	Taxable years after December 31, 2008
Gross income exclusion for student loan forgiveness under programs that provide for increased availability of healthcare services in underserved or shortage areas	Taxable years after December 31, 2008
Tax credit provided to eligible small businesses that pay at least 50% of premium cost for health insurance coverage to employees	Taxable years beginning after December 31, 2009
Maximum adoption credit is increased by $1,000 and made refundable	Taxable years beginning after December 31, 2009
Exclusion on employer-provided adoption assistance increased by $1,000	Taxable years beginning after December 31, 2009
Modification of treatment of certain health organizations under IRC §833	Taxable years beginning after December 31, 2009
Modification of cellulosic biofuel producer credit	Fuels sold or used after December 31, 2009
Codification of economic-substance doctrine	March 30, 2010
Health insurance coverage for children under 27 excluded from income of employee	March 30, 2010
Estimated taxes for large corporations due in July, August, or September 2014 increased by 15.75%	March 30, 2010
10% tax on indoor tanning services	July 1, 2010
Value of employee's health insurance coverage must be reported on W-2 forms	Taxable years after December 31, 2010
20% penalty on nonqualified distributions from HSAs and Archer MSAs	Taxable years after December 31, 2010
Distributions from health accounts (HRAs, health FSAs, HSAs, and Archer MSAs) allowed only for prescribed drugs and insulin	Expenses incurred after December 31, 2010
Annual fee imposed on branded prescription drug manufacturers and importers	Calendar years beginning after 2010
SIMPLE cafeteria plan arrangement available for small businesses	Years beginning after 2010
Forms 1099 required for payments totaling $600 or more for property or services	Payments made after December 31, 2011
Limitation of $2,500 on contributions to health FSAs	Taxable years after December 31, 2012
Threshold for itemizing medical expenses increased to 10% of AGI for taxpayers **under 65**	Taxable years after December 31, 2012
Additional 3.8% Medicare tax imposed on unearned income over threshold amount of individuals, estates, and trusts	Taxable years after December 31, 2012

PPACA Tax Provision Implementation Timeline *(Continued)*

Provision	Effective Date
Additional 0.9% Medicare tax imposed on employee portion of wages and SE income over $250,000 for MFJ taxpayers, $125,000 for MFS taxpayers, and $200,000 for all other taxpayers	Taxable years after December 31, 2012
2.3% tax imposed on medical devices sold by manufacturers, producers, and importers	Sales after December 31, 2012
Deduction for retiree prescription drug expenses reduced by amount of subsidy payments to sponsors of retiree drug plans	Taxable years after December 31, 2012
Deduction limit of $500,000 imposed on compensation of executives of health insurance providers	Taxable years after December 31, 2012
Employers offering minimum essential health coverage must provide free-choice vouchers to qualified employees	Taxable years after December 31, 2013
Penalty imposed on large employers that do not offer certain level of health insurance coverage to employees	Months beginning after December 31, 2013
Penalty imposed on individuals without minimum essential health coverage	Months beginning after December 31, 2013
Refundable tax credit available for individuals and families with incomes between 100%–400% of federal poverty level who purchase health insurance through exchange	Taxable years after December 31, 2013
Employers required to report health insurance coverage information to employees and the IRS	Years after December 31, 2013
Annual fee imposed on health insurance providers	Calendar years after December 31, 2013
Threshold for itemizing medical expenses increased to 10% of AGI for taxpayers **65 or older**	Taxable years after December 31, 2016
40% excise tax (“Cadillac-plan tax”) imposed on insurers if aggregate value of employer-sponsored health insurance coverage for an employee exceeds $10,200 for individual coverage and $27,500 for family coverage	Taxable years after December 31, 2017

EDUCATION, JOBS, AND MEDICAID ASSISTANCE ACT

The Education, Jobs, and Medicaid Assistance Act was signed into law on August 10, 2010. The Act's main purpose was to save and create jobs. It includes $10 billion in funding to save teacher jobs and $16.1 billion in assistance to states that will help keep others working, including police officers and firefighters.

One of the revenue offset provisions in the bill eliminates the advance earned income credit (EIC).

Old Law. Individuals who qualify for the EIC may request advance payments of the EIC by having their withheld income tax reduced by their employer throughout the year.

New Law. For years after 2010, the bill eliminates the advance EIC payment option. There is no change to the EIC itself.

Effective Date. For taxable years beginning after December 31, 2010.

Note. The November 2010 revision of IRS Pub. 963, *Federal-State Reference Guide*, will cover this change. Updated versions of Circular E, *Employer's Tax Guide;* Form 941, *Employer's Quarterly Federal Tax Return;* and the discontinuation of Form W-5, *Earned Income Credit Advance Payment Certificate*, should follow shortly thereafter.

Note. For additional information about the EIC, see Chapter 9, Income Tax Credits.