# Financial Planning Implications Healthcare and Education Reconciliation Act of 2010

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Weighing in at more than 2,000 pages, the Healthcare and Education Reconciliation Act of 2010 is no light read. Of course, the overarching achievement may be the expansion of health insurance to cover roughly 30 million of the 50 million U.S. residents who don't currently have insurance. Other immediate changes include:

- Uninsured individuals with pre-existing health conditions will be able to buy insurance from temporary high-risk pools.
- Young adults can remain on their family's insurance plan until age 26.
- Affected seniors will receive a $250 rebate to help fill the so-called "donut hole" in Medicare Part D prescription drug coverage.
- Insurers will no longer be able to rescind coverage due to an insured's poor health, require exclusions for children with pre-existing conditions, or impose lifetime limits on policy benefits.

Those changes seem substantial, but they are just the tip of the iceberg. While the end result of the legislative process is necessarily health care related, the tax law plays a major role in its implementation. From the tax credits and subsidies used to expand health coverage, to the many penalties, fees and surtaxes designed to pay for it, the Tax Code is front and center.

Perhaps the most quantifiable change of the Act is an increase in taxes for upper income Americans, particularly on investment income. Starting in 2013, the Medicare tax rate on individuals making more than $200,000 or couples with income over $250,000 will increase from 1.45 percent to 2.35 percent. In addition, a new 3.8 percent Medicare tax will be introduced for the same group on investment income. Currently, the tax rate on dividends and long-term capital gains is 15 percent. In 2011, those rates are expected to rise to 20 percent for households earning over $250,000, and with the new Medicare tax, these rates will rise to 23.8 percent for the same group.

Source: Financial Planning Association Summary and Timeline of the *Patient Protection and Affordable Care Act*, March 26, 2010.

Business owners also have changes coming under the new legislation. Starting this year, small-business employers with 10 or fewer employees earning less than $25,000, can get at 35 percent tax credit on the cost of providing health insurance for employees. Companies with 25 or fewer employees with an average wage of $50,000 or less, can qualify for a smaller tax credit.

However, companies with more than 50 employees won't get any tax credits. And, starting in 2014, those employers generally will be required to provide a minimum level of health insurance for their employees or pay a penalty per employee. For those companies who provide their employees with "Cadillac" health insurance, a 40 percent excise tax will be imposed which may mean higher premiums for both employers and employees.

Source: http://www.businesspundit.com/what-health-care-reform-means-for-small-business/

**How can we plan for that tax increase?**
Clearly, those who can should accelerate income in 2010. Because the 3.8 percent surtax does not apply to distributions from IRAs and other qualified retirement plans, you may wish to increase your contributions to IRAs and 401(k), 403(b) and 457 plans, or Roth IRA. Further, because income from tax exempt and tax deferred vehicles like municipal bonds, tax deferred non-qualified annuities, life insurance, and non-qualified deferred compensation are not included in investment income, investments in these vehicles should become more favorable relative to investments producing income subject to the tax. Those with C Corps might take out in dividends before the tax rate goes up in 2013, while high earners with S corps may want to re-evaluate how much they take in dividends and salary.

In the estate planning realm, charitable remainder trusts could become more appealing because they permit you to defer income over a period of time and stay under the threshold amount. It may also be beneficial to shift investment income to a charitable lead trust which will be offset by the "above the line" charitable deduction.

Notably, the Act also increases the Medicare Portion of FICA in 2013. The FICA tax is currently 1.45 percent for both employers and employees. The Act will add 0.9 percent to the employee portion for individuals earning more than $200,000 per year and married couples earning more than $250,000 per year, increasing their FICA contribution to Medicare to 2.35 percent. This increase will likely result in more business owners establishing S corps rather than LLCs or partnerships.

Source: Financial Planning Association Summary and Timeline of the *Patient Protection and Affordable Care Act*, March 26, 2010.

In an environment where interest rates are likely to rise, business owners and individuals alike should lock in low rates today for as long as they can. Additionally, those with unearned income approaching the upper limit, working closely with a financial planner and CPA early in the year to control modified adjusted gross income (MAGI) will be critical.

With folks focused on the increase in taxes, there are some interesting provisions of the Act that have yet to receive a lot of press. For example, the Act requires the Department of Health and Human Services to set up a new, voluntary long-term care insurance program, scheduled to take effect in January 2011. The Community Living Assistance Services and Supports (CLASS) will not be limited to the elderly; anyone who opts for the payroll deduction can enroll.

After five years of enrollment, the policyholder will be eligible for benefits. The program is not intended to pay for the entire cost of nursing home care. Instead, it will pay cash benefits of $50 per day or more, depending on the degree of disability. Also, the program permits benefits to be spent on needs other than nursing home care, such as paying a home health aide to help with bathing and other chores.

The Congressional Budget Office (CBO) estimates that in 2011, CLASS' first year of operation, monthly premiums would average about $123. By 2019, about 10 million people, or 3.5 percent of the population, will have signed up for the program, the CBO estimates. Because CLASS premiums will be much lower than those for private plans and you won't get screened out and denied if you already have health problems. However, this does not replace a comprehensive long-term care policy.

Also beginning in 2011, the cost of non-prescribed, over-the-counter drugs (cough medicine or aspirin, for example) will generally no longer be reimbursable through health reimbursement accounts or health flexible spending accounts, nor will the cost of these drugs be eligible for tax-free reimbursement from Health Savings Accounts or Archer MSAs. In addition, non-qualified distributions from Health Savings Accounts and Archer MSAs will be subject to an increased penalty tax of 20 percent. It will be important to take this into account when projecting the amount of money you set aside in next year's flexible spending account. along with placing a $2,500 annual cap on expenses covered under health FSAs.

Finally, included in a rider to the Act is the Student Aid and Fiscal Responsibility Act of 2009 (SAFRA). That expands federal Pell Grants to a maximum of $5,500 in 2010 and ties increases in Pell Grant maximum values to annual increases in the Consumer Price Index plus 1 percent.

Naturally, we'll be discussing these changes and relevant planning strategies in detail with you during annual reviews. In the meantime, if you have questions as you read about the Healthcare Reconciliation Act of 2010, please don't hesitate to contact us.

**About John Jenkins and Asset Preservation Strategies, Inc.**
John Jenkins is president and founder of San Diego-based Asset Preservation Strategies, Inc., which provides a team of financial professionals collaborating to address all of the elements of successful wealth management. He has conducted numerous financial planning workshops during his career and has been a guest on the PBS show "The Money Makers" and its successor, "The Financial Advisors," as well as the syndicated news magazine show "Heartbeat of the City." Jenkins has also authored and co-authored several financial planning books and publications. He is frequently quoted in the financial press, including Financial Planning News, The San Diego Union-Tribune, the La Jolla Light and the San Diego Business Journal. He has been named for three years in a row as a 5 Star, Best in Client Satisfaction Wealth Manager by San Diego Magazine based on surveys of more than 30,000 clients of wealth mangers and data from more than 4,000 financial service professionals. Learn more at www.asset-preservation.com



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