



LINDABURY

McCORMICK, ESTABROOK & COOPER, P.C.

Attorneys at Law

Telephone 908-233-6800 ext.2395

E-Mail: rschwartz@lindabury.com

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Re: House Rule 3200 – “America’s Affordable Health Choices Act of 2009”

Dear Client:

House Rule 3200, known as “America’s Affordable Health Choices Act of 2009,” was introduced in the House of Representatives on July 14, 2009. The bill, a joint product of several House Committees, addresses health insurance coverage issues. But it also proposes amendments to the Internal Revenue Code of 1986, as amended (“the Code”). I have prepared the following summary of the Code provisions. This summary is based solely upon my personal reading of the bill and not upon any secondary or explanatory sources.

The bill adds Section 59B to the Code. This section requires that any “individual” who during a given year does not have coverage under a “qualified health benefits plan,” “grandfathered health insurance coverage” or a “current employment-based health plan,” “for any period” for him/herself and for any and all “qualifying children” pay a new tax. The tax is equal to 2.5% of the amount of the taxpayer’s, essentially, adjusted gross income for the year that is over the amount of income at or below which an individual need not file an income tax return, i.e., the personal exemption amount of three or four thousand dollars. If an individual has the required coverage for part of the year, the tax is reduced proportionately for the part of the year the individual maintains the required coverage. The new 2.5% tax is proposed to apply beginning with 2013.

Further noteworthy details of this 2.5% tax are as follows: (1) the 2.5% rate is applied to income before deductions, whether itemized deductions or the standard deduction; (2) the tax is imposed upon each uninsured individual, including married persons, so long as the individual in question has income for the year in excess of the personal exemption amount; (3) if with respect to any year the IRS publishes an “applicable national average premium,” the tax does not exceed this amount even though for a particular individual the 2.5% tax may be higher; (4) the tax is prorated for part-year failures.

The IRS, in coordination with the new Health Choices Administration Commissioner, is granted regulatory authority to provide for a de minimus failure



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33 CARDINAL DRIVE | P.O. BOX 2369 | WESTFIELD, NJ 07091-2369 | (908) 233-6800 | FAX (908) 233-5078
SUMMIT, NJ | RUMSON, NJ | NEW YORK, NY | PHILADELPHIA, PA

exception and a waiver procedure “in cases of hardship.” Members of religious orders and other individuals who first receive from the IRS a “religious conscience exemption certificate” are exempt from the 2.5% tax. Exemption must be based upon “established tenets or teachings” of a “recognized sect.”

The bill adds Section 6050X to the Code. This section requires every person who provides “acceptable coverage” to any individual for any part of a year to report to the IRS the name, address and Social Security Number of the primary insured and the name of each other person covered by the insured’s policy, the period during the year that the individual was covered, and “such other information as the Secretary may require,” and to provide a copy of the report to the insured. In effect, this provision adds to the 1099 family of information reporting returns, with attendant penalties for non-compliance.

Proposed Section 6050X adds Section 6012(a)(10), which provides that every individual without an “acceptable plan” during a year is required to file an income tax return disclosing that fact and paying the tax. Code penalties and interest charges for late filing, late payment, non-filing, non-payment, etc., apply. The new section enhances the IRS’s ability to make 1099/1040 matches. Section 6050X is proposed to apply beginning with 2013.

The bill adds new Section 4980H to the Code. It provides that should “any employer” fail to satisfy the “health coverage participation requirements with respect to any employee,” there will be imposed a tax of \$100 per day on each such failure during the period beginning on the date such failure first occurs and ending on the date the failure is corrected. Should an employer be able to establish “reasonable cause and an absence of willful neglect,” which standard has been in the Code for a long time in other contexts, and is construed toughly against taxpayers, the penalty can be limited in the discretion of the IRS. The IRS can limit the penalty to the lesser of 10% of the preceding year’s costs of employer provided health plans, or \$500,000, or, in appropriate situations, \$0 in the case of failures voluntarily corrected within 30 days of when an employer knew or “exercising reasonable diligence would have known” the failure existed.

The penalty is reduced by the amount of any overlapping civil penalty collected under Section 502(c)(11) of ERISA or Section 2793(g) of the Public Health Service Act.

This penalty tax regime is applicable to an employer only if he/she elects to provide health coverage, and not to, by default, go with the national health insurance program by paying the 8% tax discussed below. Also, the IRS is granted authority to terminate an employer’s election, if the IRS determines that the employer is “in substantial non-compliance with the health coverage participation requirements.” The

penalty will in some manner be imposed by the IRS in connection with IRS election terminations.

Noteworthy details concerning an employer's election to provide coverage are as follows: (1) separate elections may be made along an employer's "separate lines of businesses"; (2) separate elections may be for full-time employees and employees who are not full-time; and (3) since a "employer" includes any group of companies who are treated as a single employer under very broad related party rules, there may be a multiplicity of elective choices to be made.

The bill adds Section 3111(c) to Section 3111 of the Code as follows. An employer (except the Federal government) who does not elect to provide any coverage—or to the extent that it does not elect, as discussed above—automatically pays a Social Security like excise tax equal to 8% of each non-covered individual's "wages" (as defined in Section 3121 of the Code). The 8% rate is reduced to 0% if in the preceding calendar year, the employer's payroll does not exceed \$250,000; or 2% if it exceeds such figure but does not exceed \$300,000; or 4% if it exceeds \$300,000 but does not exceed \$350,000; and 6% if it exceeds \$350,000, but not does exceed \$400,000. There is no wage cap as is the case with today's Medicare taxes. The new tax is proposed to apply beginning with 2013.

The bill adds new Section 45R to the Code. New Section 45R provides for a small business health coverage cost tax credit. The credit for each taxable year is an amount equal to the applicable percentage of the "qualified employee health coverage expenses" for such taxable year. The term "qualified employee" means any employee receiving at least \$5,000 in compensation for a given year.

The applicable percentage starts out at 50% of coverage cost but is phased out once average annual employee compensation exceeds \$20,000. For example, if the average employee compensation is \$40,000, the applicable percentage becomes 0%. If the payroll averages \$30,000, the applicable percentage is reduced to 25% and so forth in between \$20,000 and \$40,000.

There is another phase-out formula. In the case of an employer who employs more than 10 "qualified employees" during the taxable year, the credit is reduced once the number of qualified employees employed during the taxable year is over 10. For example, if an employer's coverage cost is \$100,000 and the number of "qualified employees" is 14, the credit amount is reduced to \$73,333. At 25 employees, the credit amount becomes \$0. In addition, no credit amount is allowed for the cost of health coverage for an employee earning more than \$80,000 per year.

Section 45R reduces a small employer’s deduction for the cost of health coverage by the amount of available Section 45R credit. Section 45R contains an inflation adjustment for the \$20,000 phase out starting point, the highly compensated employee cost disallowance rule, and the qualified employee definition. Because Section 45R is part of the general business credit of Section 38 of the Code, it partakes of any and all limitations on the use of Section 38 credits imposed by the other sections of the Code. Section 45R is proposed to apply beginning with 2013.

The bill adds Section 59C to the Code providing for additional income taxation, effective 2011. This new tax is expressly not treated as part of the regular income tax for purposes of determining whether a taxpayer is subject to alternative minimum taxes. The tax is imposed upon all taxpayers, “other than a corporation,” so it would include individuals, trusts and estates and would extend to such circumstances as the income of tax-exempt organizations that fail to obtain IRS 501(c)(3) tax-exempt determination letters within the requisite period of time and other unusual situations that are common when it comes to applying provisions of the Code in practice. Trusts, all the unexpired interests of which are devoted to one or more charitable purposes, are not subject to the tax, however.

As in the case of the 2.5% tax imposed upon individuals without acceptable health care coverage, Section 59C’s tax rates apply, essentially, to adjusted gross income, as opposed to taxable income, so that deductions, whether itemized or the standard deduction, are not taken into account, and moreover, personal exemptions are also not taken into account in the case of the proposed Section 59C tax. The tax rate schedule is as follows:

<u>AGI Tax Bracket</u>	<u>Tax Rate</u>
Over \$350,000 to \$500,000	1%
Over \$500,000 to \$1M	1.5%
Over \$1M	5.4%

For years beginning January 1, 2013, the 1% rate is increased to 2% and the 1.5% rate is increased to 3%, unless “Federal health reform savings” are at least \$150B above baseline projected savings of \$525B but are not more than \$175B. Further, if the savings over and above \$525B are more than \$175B, the 1% and 1.5% tax will be imposed for 2011 and 2012 but not for 2013 et seq. The 5.4% tax rate would remain, however.

The tax brackets shift for taxpayers other than a taxpayer making a joint return or surviving spouse filer as follows: 50% of the dollar amounts set forth above in the case of married individuals filing separate returns and 80% of the dollar amounts in case of any other filing status. Accordingly, for estates and trusts, for example, the tax is imposed once adjusted gross income reaches \$175,000, and the top 5.4% rate applies once adjusted gross income reaches \$500,000. The tax brackets are adjusted for inflation for tax years beginning with 2012.

I trust you have found this summary useful. Again, the bill is not law. Our attorneys working in the taxation and employee benefits areas are ready to advise you further in the event of finalized national health care legislation.

Very truly yours,

LINDABURY, McCORMICK, ESTABROOK & COOPER

Robert S. Schwartz

RSS/dmp

Cc: James K. Estabrook, Esq.

Elizabeth Engert Manzo, Esq.