City National Bank
The way up.®

Jobs, Healthcare and Your Taxes

By **Roger S. Stinnett** CPA, CFP®, CIMA®
Manager, Tax & Financial Planning

Recent legislation aimed at reducing unemployment and expanding access to healthcare contains new taxes and tax incentives that may have an effect on your financial situation. It's prudent to examine the provisions in the new laws, as well as strategies that could mitigate additional tax liabilities.

The first piece of legislation enacted was the Hiring Incentives to Restore Employment (HIRE) Act, which focuses on accelerating the hiring of unemployed workers by providing immediate tax incentives for businesses that hire qualified individuals. The remaining two laws, the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010, are intended, over a multiyear period, to expand the number of Americans who have access to health insurance. Here is a brief guide to some of their key provisions, how they may impact your tax situation, and some tips that could be helpful.

Legislation Impacting Individuals

3.8% surtax on unearned income for individuals, trusts and estates earning over $200K ($250K for joint filers).
Effective: Tax years beginning after December 31, 2012.

A surtax of 3.8% is imposed on the net investment income of individuals earning over $200,000 ($250,000 for joint filers). Net investment income includes interest, dividends, royalties, rents, gross income from a trade or business involving passive activities, and net gains from sales of property. However, investors may not owe the 3.8% tax on all of their investment income. The tax applies to whichever is less – net investment income or the amount by which modified adjusted gross income exceeds the high income thresholds. Tax-exempt income such as municipal bond interest and distributions from IRAs and 401(k)s are not subject to this surtax.

Similarly, estates and trusts will pay 3.8% on the lesser of their undistributed net investment income or the amount by which modified adjusted gross income exceeds the high income thresholds. For estates and trusts the high income thresholds start at $11,200.

Planning Tips
Investors should consult with their tax and investment advisors to determine if and how this surtax will affect them. Being mindful of asset location as well as asset allocation may help to minimize or even avoid this tax. For example, one strategy is to maximize the advantage of tax-deferred accounts by placing income-producing investments within these accounts and shifting to tax-exempt income in your taxable accounts. Another option for your taxable accounts is to shift to investments intended to achieve long-term appreciation, thus potentially enabling you to realize any gains in years when earned income is below the trigger thresholds.

Investors also should review their cash accounts. Since the surtax would affect interest income on checking, savings and money market accounts, where rates are currently quite low, it may make sense to shift your funds to tax-free money market alternatives. Also, investors with substantial investment income should keep in mind that they may need to increase their estimated tax payments to cover this new tax.

TO DO CHECKLIST

- ☐ Consult with tax and investment advisors to determine impact of surtax
- ☐ Review asset allocation and asset location strategies
- ☐ Review cash accounts
- ☐ Determine if estimated tax payments should be increased

Medicare taxes increase by 0.9% for high wage earners.
Effective: Tax years beginning after December 31, 2012.

The Medicare Hospital Insurance (HI) tax rate will increase by 0.9% – from 1.45% to 2.35% – on an individual with wages over $200,000 ($250,000 for married couples filing jointly). Two key provisions: 1) The threshold for HI tax does not rise with inflation; and 2) If a self-employed individual also has wage income, the HI threshold is reduced by the amount of that wage income. For example, if an individual has self-employed income of $350,000 and also receives wages of $25,000, then the threshold for applying the HI tax would drop from $200,000 to $175,000.

Planning Tips
Some individuals may be able to mitigate the impact of this increase by accelerating any wage or self-employment income that would otherwise fall into the 2013 tax year. One quirk in the law is that a couple who exceed the joint threshold ($250,000) when combining their wages but who each fall below the individual threshold ($200,000) nonetheless may have an additional HI tax liability that is not satisfied through employer withholding. In such cases, a minor adjustment to estimated tax payments may be necessary since employers are not required to consider wages received by the employee's spouse.

TO DO CHECKLIST

- ☐ Investigate accelerating any wage or self-employment income that would otherwise fall into 2013
- ☐ For couples, check to see whether you need to increase estimated tax payments

Restricted definition of medical expenses.
Effective: Expenses incurred after December 31, 2010.

The definition of qualified medical expenses has been changed to conform to the definition for itemized deductions. Therefore, over-the-counter medicine (other than doctor-prescribed medicines, drugs and insulin) will no longer qualify for nontaxable reimbursements through health reimbursement accounts, health flexible savings accounts (FSAs), health savings accounts (HSAs), and Archer medical savings accounts (MSAs).

Planning Tips
To the degree possible, plan your medical expenses for the rest of this year. You may want to stock up on your medications before year-end to ensure that you maximize what you are reimbursed for this year. In addition, make sure you adjust your elections for planned contributions to your FSA to account for the elimination of this reimbursement.

TO DO CHECKLIST

- ☐ Plan discretionary medical expenses for the rest of 2010
- ☐ Consider stocking up on medications now to maximize 2010 reimbursements
- ☐ Adjust health flexible savings account (FSA) contributions to reflect new definitions

Limit on health flexible savings account (FSA) contributions.
Effective date: Tax years beginning after December 31, 2012.

Many employers have allowed employees to contribute up to $5,000 annually to these accounts. However, contributions to FSAs will be limited to $2,500 per year, and will be indexed for inflation after 2013.

Planning Tips
Employees who contribute the maximum, or will exceed the new maximum contribution, should plan for future expenses that are not fully covered by their medical plan. Employees may wish to spread bigger medical expenses (e.g., braces, laser vision-corrective surgery, etc.) over multiple years to make the most of current larger balances available in FSAs. Consider working with your medical provider(s) to set up treatment plans for non-emergency needs that can be accomplished over multiple years.

TO DO CHECKLIST

- ☐ Plan for future medical expenses that may not be fully covered
- ☐ Consider spreading bigger medical expenses over several years to make the most of current FSA balances
- ☐ Consider setting up treatment plans for non-emergency needs that can be accomplished over multiple years

We will keep you posted on upcoming legislation that may affect your tax and overall financial situation. In the meantime, please don't hesitate to contact your team of trusted advisors at City National Bank if you have any questions.

Increased threshold to deduct medical expenses.

Effective: Tax years beginning after December 31, 2012. Individuals age 65 and older (and their spouses) have an effective date of December 31, 2016 for the new threshold.

The adjusted gross income (AGI) threshold for claiming an itemized deduction for medical expenses will increase from 7.5% to 10%.

Planning Tip

Individuals who anticipate and can schedule significant medical expenses may want to accelerate into 2012 any expenses they know they will incur in 2013. Consider accelerating such expenses only if you believe doing so will push you over the 7.5% threshold in 2012. After 2012, try to "bunch" medical expenses together in order to exceed the increased threshold.

TO DO CHECKLIST

- [ ] Consider accelerating significant but discretionary medical expenses from 2013 into 2012 if this will push you over the new 7.5% threshold in 2012
- [ ] Try to "bunch" medical expenses together after 2012 so you exceed the increased threshold

Mandatory health insurance coverage for individuals.

Effective: Tax years beginning after December 31, 2013.

Most individuals will be required to obtain acceptable health coverage or pay penalties that begin at the greater of $95 or 1% of income in 2014 and rise to $695 or 2.5% of income in 2016. An individual will not be penalized if affordable coverage is not available.

Planning Tip

Individuals will need to follow further developments closely since some of the details are still being worked out. Healthcare policies may be available through several different channels and some individuals may qualify for tax credits to ease the cost of coverage.

TO DO CHECKLIST

- [ ] Follow further developments closely – some details are still unknown
- [ ] Determine what health care policies are available to you
- [ ] Determine if you qualify for tax credits to ease the cost of coverage

Legislation Impacting Businesses

Payroll tax forgiveness for new hires.

Effective: Wages paid after March 18, 2010 through December 31, 2010.

A company's Social Security tax liability is forgiven for wages paid to what are termed "qualified" employees and who are hired after March 18, 2010 through December 31, 2010. In general, qualified employees must have been unemployed for at least 60 days before their start date and must have begun work after February 3, 2010 and before January 1, 2011. The maximum value of this incentive is $6,621, which equals 6.2% of 2010 wages up to the FICA wage limit of $106,800. While there is a limit on the exemption per employee ($6,621), employers may hire as many qualified workers as they wish. Employers will still need to withhold the employee's share of the Social Security tax.

Planning Tips

Businesses contemplating adding temporary, part-time or full-time employees will want to consider whether the new hire meets the required qualifications. Employers also will need to obtain certification of the new hire's eligibility. The IRS has released Form W-11, which may be found at www.IRS.gov, to help employers obtain this certification. The tax forgiveness is not applicable to employees related to the employer or those who are hired simply to replace another employee, unless the prior employee separated voluntarily or was terminated for cause. Household employers cannot claim this new tax benefit.

TO DO CHECKLIST

- [ ] Consider whether prospective new hires meet the required qualifications
- [ ] Obtain certification of eligibility for new hires – see IRS Form W-11

Tax credit for retained workers.

Effective: Wages paid after March 18, 2010 through December 31, 2010. Credit taken in the company's taxable year ending after 2010.

Businesses with new hires who qualify for payroll tax forgiveness may also receive a tax credit if they retain these employees for a period of 52 consecutive weeks. This tax credit for retaining workers is the lesser of $1,000 or 6.2% of wages paid to the employee.

Planning Tips

The 52-week period will not be met until 2011, so any credit related to this provision will generally be taken on the company's 2011 tax return. Hiring sooner may allow a business to maximize the available credit.

TO DO CHECKLIST

- [ ] Recognize that hiring sooner may maximize the tax credit since new employees must be retained for 52 consecutive weeks for the company to qualify for the credit
- [ ] Be aware that the 52-week period will not be met until 2011, so any credit will generally affect the company's 2011 tax return

Increased Section 179 deduction extended.

Effective: Taxable years beginning after December 31, 2009.

In 2009, the amount that businesses could write off for capital expenditures was temporarily increased from $125,000 to $250,000. The HIRE Act makes this $250,000 amount effective for capital expenditures incurred in 2010.

Planning Tip

This provision provides added incentive for business owners considering a substantial investment in their company's depreciable assets during 2010. A business that invests up to $800,000 in depreciable assets this year may be able to write off as much as $250,000 of these costs on their 2010 tax return. This larger deduction can lower the company's taxable income significantly. Business owners who are contemplating a sizeable capital expenditure may wish to accelerate the transaction into 2010.

TO DO CHECKLIST

- ☐ Consider accelerating significant capital expenditures into 2010

Small business tax credits available to ease the cost of employee health coverage.

Effective: Amounts paid or incurred after 2009.

This provision is intended to help small businesses (defined as 25 or fewer employees and paying average annual wages of $50,000 or less) with the cost of employee health insurance. These firms are eligible for immediate tax credits of up to 35% of the premiums paid by the company, with these credits rising to 50% by 2014, when qualified small businesses are supposed to be able to purchase insurance for employees through state-based exchanges known as Small Business Health Options Programs (SHOPs).

Planning Tips

Small business owners should begin working with their tax advisors to ensure that they maximize this credit. Owners also would be wise to stay current on developments as the SHOPs are established.

TO DO CHECKLIST

- ☐ Work with tax advisors to maximize this credit
- ☐ Stay current on developments as state-based insurance exchanges, known as Small Business Health Options Programs (SHOPs), are established

Health coverage mandate for companies with more than 50 employees.

Effective: Tax years beginning after 2013.

Businesses with more than 50 employees may be subject to penalties if they do not offer health coverage to their employees. Penalties are currently set at $2,000 per employee, although the first 30 employees are not included in the penalty calculation.

Planning Tips

Businesses that do not offer health care coverage and are close to the 50 employee threshold will need to monitor employee headcount as the effective date approaches. Companies will need to consider the cost – in either premiums or penalties – of crossing the 50 employee threshold and whether it makes sense to outsource some of their internal functions rather than add new workers.

TO DO CHECKLIST

- ☐ Businesses that do not offer healthcare coverage will need to monitor employee headcount as the effective date approaches
- ☐ Quantify the cost – in either premiums or penalties – of crossing the 50 employee threshold and consider outsourcing some functions rather than adding new workers