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U.S. SUPREME COURT UPHOLDS THE "INDIVIDUAL MANDATE" AND MAJORITY OF THE AFFORDABLE CARE ACT - BUT WILL TAXPAYERS AGREE IN NOVEMBER?

In a surprising 193-page landmark decision on June 28, 2012, the U.S. Supreme Court, in a 5-4 vote, upheld the "individual mandate" and the majority of the Patient Protection and Affordable Care Act ("ACA"). Employers and taxpayers alike await further clarification on what will be deemed "minimum essential health coverage" and how it will potentially affect their bottom line, while recognizing that the upcoming November election may dismantle much of this healthcare legislation. In the meantime, however, all must assume that many key provisions will go into effect in 2013 and beyond, or risk being unprepared to fully comply in time for the law's complex provisions.

The "individual mandate" requires most U.S. citizens and legal residents to maintain minimum essential health coverage for all tax years beginning after December 31, 2013. Minimum essential health coverage, as currently defined by the ACA, includes government sponsored programs, eligible employer sponsored plans, plans in the individual market, certain grandfathered group health plans and other coverage recognized by the Department of Health and Human Services. Please note that, beginning in 2014, uninsured individuals will face a penalty in the event this minimum essential health coverage is not maintained. The penalty, when it reaches its maximum in 2016, will be equal to the greater of:

1. 2.5% of household income in excess of a taxpayer's household income for the taxable year over the threshold amount of income required to file an income tax return under Internal Revenue Code §6012(a)(1), or
2. $695 per uninsured adult in the taxpayer's household and $347.50 per child (up to a maximum of $2,085 for a family).

Prior to the decision and over the course of the past year or so, the Supreme Court appeared to be split on the constitutionality of the "individual mandate" with the thought being that Justice Anthony Kennedy represented the swing vote. What is surprising about the decision is that Kennedy dissented the "individual mandate" while Chief Justice John Roberts, a George W. Bush appointee in 2008, voted to uphold the "individual mandate".

In its decision, the Supreme Court ruled that the "individual mandate" is constitutional and that Congress has the power to impose a tax liability on those individuals who choose not to purchase insurance. The majority opinion concluded that the provision in the ACA requiring an individual to pay a tax penalty for not maintaining minimum essential health coverage is allowable under the U.S. Constitution. In the decision, Chief Justice John Roberts said "Under that theory, the mandate is not a legal command to buy insurance. Rather it makes going without insurance just another thing the Government taxes, like buying gasoline or earning

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income. And if the mandate is in effect just a tax hike on certain taxpayers who do not have health insurance, it may be within Congress' constitutional power to tax."

Justices joining Chief Justice John Roberts in upholding the "individual mandate" were Ruth Bader Ginsburg, Stephen G. Breyer, Sonia M. Sotomayor, and Elena Kagan. Those joining Justice Anthony M. Kennedy in the dissenting opinion were Antonin Scalia, Clarence Thomas, and Samuel A. Alito Jr. The dissenting Justices argued that the "individual mandate" violates the Commerce Clause of the Constitution by forcing individuals to engage in commercial activity by requiring them to purchase a commodity or service. Kennedy wrote for the dissenting Justices in the opinion and stated that "the entire statute is inoperative."

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The case and decision arose as a result of three petitions brought to the U.S. Court of Appeals for the Eleventh Circuit. The U.S. Court of Appeals for the Eleventh Circuit, in a split opinion, held the "individual mandate" unconstitutional. Courts agreed that the "individual mandate" could not be considered a tax for constitutional purposes. The three petitions were filed by:

1. 26 states led by the State of Florida,
2. National Federation of Independent Business, and
3. The Obama administration.

The U.S. Supreme Court also ruled on the Medicaid provisions included in the ACA. Although the "individual mandate" took the forefront, the Supreme Court held that the ACA's expansion of Medicaid is constitutional; however, Congress does not have the constitutional authority to force states to participate in Medicaid expansion by taking away their existing Medicaid funding if they choose not to participate.

Although the majority of the ACA has been upheld, much time, money and energy will need to be spent in carrying out the various provisions of the law. An example is the Internal Revenue Service's ("IRS") enforcement of the "individual mandate" and collection of the applicable penalty. The IRS does not have the power to file a tax lien against individuals who do not maintain minimum essential health coverage. Penalties can only be collected by withholding from an income tax refund or Social Security check. Several key healthcare-related provisions of the ACA are already in effect and the Court's decision allows them to continue. Some of these include a temporary high-risk pool for individuals with pre-existing health conditions, a prohibition on lifetime dollar limits for essential benefits in insurance policies, and a requirement that dependents be allowed to remain on their parents' health coverage until they turn 26. There are also a host of additional tax provisions contained in the law which the IRS will have the responsibility of enforcing. These include, but are not limited to, the following:

- **Tax credits for certain small businesses that provide healthcare coverage to employees.** This provision went into effect in 2010 and is available through 2013.
- **Additional hospital insurance tax on high-income taxpayers.** Starting in 2013, taxpayers with earned income in excess of certain limits will pay an additional 0.9% Medicare tax on the excess.
- **Medicare tax on investment income.** Starting in 2013, individuals will pay a 3.8% Medicare tax on unearned income, such as interest, dividends, rents, royalties and certain capital gains; when modified adjusted gross income exceeds certain limits.
- **Increase in medical expense deduction floor.** Starting in 2013, the ACA raises the threshold for deducting unreimbursed medical expenses from 7.5% to 10% of adjusted gross income. The 7.5% threshold will still apply to taxpayers who turn 65 before the end of the tax year.
- **Changes to Flexible Spending Accounts ("FSA") for healthcare.** Starting in 2011, tax-free FSA distributions could no longer be used to pay for unprescribed over-the-counter medicine. Starting in 2013, annual contributions to FSAs for medical expenses
will be limited to $2,500 per year.

- **Premium assistance credit.** Effective for taxable years ending after December 31, 2013, the ACA creates a refundable premium assistance credit for eligible individual and families to subsidize the purchase of health insurance through a state-based exchange. The credit will be allowed on a monthly basis. The final regulations with respect to the premium assistance credit require that every taxpayer receiving monthly premium assistance amounts file their annual tax return by the fifteenth day of the fourth month after year end.

- **Large employers required to offer health insurance coverage.** Effective for months beginning after December 31, 2013, an applicable large employer that does not offer certain coverage to its full-time employees may be subject to a penalty.

- **Medical device excise tax.** Effective for sales after December 31, 2012, medical device manufacturers, producers or importers of medical devices will be subject to a 2.3% tax on the sale of any taxable medical device.

- **Form W-2 healthcare benefit cost reporting.** The ACA introduced IRC §6051(a)(14) which states that certain businesses must begin reporting the aggregate cost of employer-sponsored group health coverage provided to employees on their respective Forms W-2. This reporting was made optional for the 2011 tax year but is mandatory to be reported on an individual's 2012 Form W-2 to be issued in January of 2013.

- **State-based health insurance exchange.** Beginning in 2014, the ACA creates state-based health insurance exchanges that pool small businesses and their employees hoping to provide increased purchasing power and spur competition. These are referred to as American Health Benefit Exchanges of which a complete listing can be found at www.healthcare.gov. For states that choose not to operate their own exchange, the Department of Health and Human Services created a multi-state exchange.

- **Charitable hospitals.** The ACA introduced IRC §501(r) which, outlines four provisions that charitable hospitals will be required to follow. All of these provisions are effective for tax years beginning after March 23, 2010 with the exception of the community health needs assessment which is effective for tax years beginning after March 23, 2012. These provisions include (1) community health needs assessment, (2) financial assistance policy provisions, (3) limitation on charges provisions and (4) billing and collection practices.

- **Cadillac health plans.** Effective for taxable years beginning after December 31, 2017, the ACA imposes a tax of 40% on the aggregate value of a health plan in excess of certain dollar threshold amounts ($10,200 for single coverage and $27,500 for family coverage).

There still remains much uncertainty surrounding the ACA. As we await further guidance (e.g. definition for minimum essential health coverage and other items) we do need to remember that there is a presidential election this November which could potentially change the entire landscape of the ACA. President Obama said "The court has now spoken and the administration will continue to implement the Patient Protection and Affordable Care Act". He said that it is now time to move forward to implement, and, where necessary, improve the law. On the other hand, Republican presidential candidate Mitt Romney said that he plans on repealing the law on his first day in office should he win the election this November. He criticized the ACA saying that the U.S. Supreme Court may have deemed it constitutional, however, it is a bad law that will add trillions of dollars to the nation's deficit that will be passed on to future generations.

The House GOP leadership has already said that it will bring legislation to the floor on July 11th to repeal the ACA. The House has voted to repeal the law in the past; however, the Democratic controlled Senate has not taken up the legislation. Republican Cathy McMorris Rogers from Washington said "We are more determined today than ever to repeal this law. The Supreme Court spoke today, but they won't have the final word - the American people will have the final word."