Health Care Reform--Planning Tips

I have been spending a lot of time with the Health Care Bill and its various provisions. This is the first of my EMAIL LETTERs on the issue:

If your goal is to make people lividly angry these days, just mention that you're for (or against) health care reform. Many Americans hate or love the legislation depending on their party of affiliation, which some health care insiders think is odd, because the final language of the legislation most closely resembles the health care package passed by the Massachusetts legislature with the support of Republican Governor Mitt Romney.

By now you know the basic provisions; in 2014, the bill will expand health coverage to 32 million U.S. residents who currently don't have it, mainly by allowing low-income uninsured persons into Medicaid and paying part of the premiums for people with incomes near the federal poverty line. Some of those costs will be covered by (starting in 2014) a $2,000 per employee tax on businesses with 50 or more employees who do not offer health coverage, and by adding taxes to the most expensive medical insurance plans--those which cost more than $10,200 for single coverage, or $27,500 a year for family coverage. (High risk industries will be allowed slightly higher-cost plans.)

We don't recommend that you read this bill unless you have a serious case of insomnia. Hundreds of pages spell out how the medical industry should create electronic records, and hundreds more discuss how patient privacy should be protected whenever those records are shared with other health providers. A huge part of the bill talks about cost-reduction experiments and how their results will be shared, and, of course, there are odd provisions like the 10% tax on tanning salons, a requirement that fast food chains disclose calorie counts on their menus and a tax credit for people who adopt orphaned children.

Financial planners have been trying to digest all these provisions so we can give reasonable advice to our clients. A recent article in Financial Planning, one of our leading trade magazines, offers a first hint at how planning for health care reform might look in the next few years:

The new law includes several tax increases. Starting in 2013, the Medicare payroll tax will go up from 1.45% to 2.35% of income for single taxpayers earning more than $200,000 a year (and couples earning more than $250,000). At the same time, people in these income levels will be hit by a new 3.8% Medicare tax on all dividends, capital gains and income from rental property. These new taxes will be applied in a way that most of us are not familiar with; if you earn one dollar over the threshold, the higher Medicare tax counts against your ENTIRE income, not just the income you earned over the threshold amount. And the extra Medicare tax on dividends, capital gains and rent is only applied to people with income above these threshold amounts; if your adjusted gross income is one dollar lower than the threshold, the tax doesn't apply to you--at all.

Next year, high-earning taxpayers will see dividend taxes rise from 15% to ordinary income rates (maximum: 39.6%), and capital gains taxes will rise from 15% to 20%--and, yes, this is in addition to the Medicare surtaxes.

How can we plan for this? Anybody who has accumulated earnings in a C corporation might be advised to take as much of the money out in dividends this year as possible, paying a 15% tax and avoiding the higher taxes in 2011 and later. People who own an S corporation might consider taking more of their income in salary and less in dividends, paying less Medicare tax in the process. But this can be tricky, since any salary increase might be subject to additional FICA taxes of 12.4%.

Another way to avoid some of the tax bite is to move money out of investments which generate high dividends or interest (corporate bonds and utilities) to muni bonds, which provide tax-exempt or tax-deferred income. Some might also defer more income through employer sponsored retirement plans or annuities.

Meanwhile, high deductible health insurance policies will face restriction; $2,000 will be the highest deductible for small group health plans for individuals; $4,000 for families. But existing policies will be grandfathered so long as they eliminate exclusions for pre-existing conditions, and eliminate yearly and lifetime limits on coverage. The best way to plan for this provision is to buy a high-deductible policy now before they disappear. People with a health savings account should consider contributing the maximum this year, and employers might switch to a high-deductible group policy now in order to contain future costs.

Speaking of which, some companies that are just above the 50-employee threshold might decide to downsize, outsource the workforce or split up their companies into parts in order to fall below the minimums.

Finally, beginning in 2016, every American must either buy health insurance or pay a $695 fine or a fine of 2.5% of income, whichever is greater. The IRS will enforce payment, so people without health insurance should start planning their budget and seeing if they qualify for the government subsidies.

Is it possible that the health care law will be repealed before then? Not likely. A recent article in the April 5 issue of The New Yorker ("Now What?") points out that when Medicare was signed into law by then-President Lyndon Johnson, in 1965, it kicked off a national protest not unlike the one we're seeing now. Alabama's governor George Wallace encouraged national resistance, and two months before the coverage was to begin, half the hospitals in a dozen Southern states refused to meet Medicare certification. Eventually, Americans got used to extra coverage, and hospitals and doctors adjusted to the system. Today, unlike then, the law known as Obamacare was endorsed by the American Medical Association and many hospital associations. It's possible that many Americans aren't fond of our current income tax system either; like taxes, the best way to adjust to new health care reforms is to plan carefully and watch our health more carefully than ever before.