

# Health Care

## Overview of Presentation

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- ❖ General comments
- ❖ Various tax issues
- ❖ .9% Additional Medicare Surtax
- ❖ 3.8 % Net Investment Income Tax
- ❖ Individual Mandate
- ❖ Premium Assistance Credit
- ❖ Employer Mandate

# American Taxpayer Relief Act

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	<u>2012</u>	<u>2013</u>
Individual tax rates	10%	10%
	15%	15%
	25%	25%
	28%	28%
	33%	33%
	35%	35%
		39.6%
Capital gains - max	15%	20%
Qualified dividends - max	15%	20%
Estate/Gift tax rate	35%	40%

# American Taxpayer Relief Act

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## Individual tax rates 2013

On taxable income over these amounts:

	<u>Joint</u>	<u>HOH</u>	<u>Single</u>	<u>MFS</u>
10%	0	0	0	0
15%	17,850	12,750	8,925	8,925
25%	72,500	48,600	36,250	36,250
28%	146,400	125,450	87,850	73,200
33%	223,050	203,150	183,250	111,525
35%	398,350	398,350	398,350	199,175
39.6%	450,000	425,000	400,000	225,000

*As usual these numbers have been indexed for inflation for 2013.*

*However the 39.6% brackets will not be indexed until after 2013.*

# American Taxpayer Relief Act

## Capital Gains / Qualified Dividends rates after 2012

On taxable income over these amounts:

	<u>Joint</u>	<u>HOH</u>	<u>Single</u>	<u>MFS</u>
0%	0	0	0	0
0%	17,850	12,750	8,925	8,925
15%	72,500	48,600	36,250	36,250
15%	146,400	125,450	87,850	73,200
15%	223,050	203,150	183,250	111,525
15%	398,350	398,350	398,350	199,175
20%	450,000	425,000	400,000	225,000

*As usual these numbers have been indexed for inflation for 2013.*

*However the 20% bracket will not be indexed until after 2013.*

# Return of the Phase-outs

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Phase out of personal exemptions

Starting after 2012

2% for each \$2,500 or part thereof adjusted gross income in excess of new thresholds:

- Joint \$300,000
- Head of Household 275,000
- Single 250,000
- Married filing separate 150,000

Can be completely phased out

Adjusted for inflation after 2013

# Return of the Phase-outs

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Limitation of itemized deductions starting after 2012

3% of excess of adjusted gross income in excess of new thresholds:

- Joint \$300,000
- Head of Household 275,000
- Single 250,000
- Married filing separate 150,000

Adjusted for inflation after 2013

Reduction not to exceed 80% of Sch A

Medical, investment interest, casualty and gambling losses not reduced by limitation

# Health Care Overview

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- ❖ Largest social program since Medicare and Medicaid
- ❖ A goal of the law was to make certain that people would have an opportunity to obtain insurance providing essential benefits with minimal essential coverage
- ❖ Big opportunity for practitioners :
  - Be proactive in avoiding penalties or taking the penalties, minimizing tax liability, planning for the tax credit , explaining how all this works

# Health Care Overview

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- ❖ The individual mandate penalty will be enforced via the 1040.
- ❖ For Health Care and the Marketplace (Exchanges) you will see storefronts, kiosks in malls, call centers, counselors, multi-lingual translation
- ❖ Choices (competition) will vary between exchanges
- ❖ The exchanges will have SHOPS (Small Business Health Options Program)



# Health Care

## Status of Reform

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- ❖ By a 5:4 ruling the US Supreme Court upheld most of the provisions of the Affordable Care Act
- ❖ The key provision not upheld was the requirement that the states participate in the Medicaid expansion which was expected to cover 17 million
- ❖ Other key issues left to address: Malpractice reform, end of life costs, continuing escalation and more
- ❖ Recent Oregon study.. Is it too late to change?

# Health Care Insurance Options

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- ❖ Insurance will be offered by :
  1. Employers
  2. The Marketplace (Exchanges)
  3. Public programs like Medicare and Medicaid
  
- ❖ There are special rules for Grandfathered and self-insured plans
  
- ❖ Stand alone plans not covered include Long-term care, nursing home assistance, home health care and disability.
  
- ❖ Stand alone Medicare supplemental insurance (Medigap) is generally not covered.

# Health Care

## Grandfathered Plans

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- ❖ A plan that has existed since March 23, 2010 (the date of enactment of the ACA)
- ❖ Subject to only certain portions of the ACA including:
  - No lifetime limits
  - Cannot rescind coverage
  - Extension of dependent coverage (some difference)
  - Prohibits pre-existing condition exclusions
  - Cannot have excessive waiting periods for coverage
  - Must provide a summary of benefits

# Health Care

## Self –Insured Plans

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- ❖ Stop loss insurance is purchased to covers claims over a specified amount
- ❖ Self- insured plans are becoming attractive to small employers

# Health Care

## Individual plans

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- ❖ The insurance price is determined by only four criteria
  1. Age – Older people won't pay more than three times the amount younger people pay
  2. Premium Rating Area-High cost areas will have more expensive insurance
  3. Number of family members covered
  4. Tobacco use

Observation : Young adults and men may see an increase in premiums

## Essential Health Benefits

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❖ Generally, the following (ten) benefits must be provided with no annual or lifetime limits:

Ambulatory services

Emergency services

Hospitalization

Maternity and Newborn care

Mental Health and substance abuse

Prescription drugs

Rehabilitative services

Laboratory services

Pediatric services including oral and vision care

Preventative and wellness services and chronic disease

## Deductibles and Limits

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❖ The following deductibles and out-of-pocket limits do not apply to large group plans offered outside the marketplace or self-funded plans;

❖ Deductibles :	Self- only	Other
	\$2,000	\$4,000
❖ Out- of –Pocket limits(2013)		
( matches HSA limits)	\$6,250	\$12,500

Note: These limits may be adjusted annually

# Health Care Insurance Plans

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- ❖ Non- grandfathered plans must meet the Platinum, Gold , Silver , or Bronze actuarial levels of benefits and coverage
- ❖ Platinum 90%,Gold 80%, Silver 70% and Bronze 60% of Actuarial Value.
- ❖ Actuarial Value refers to a percentage of costs expected to be covered by the plan .



# Health Care Observations

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- ❖ We have a disease care system that encourages procedures ( fee for service)
- ❖ We are seeing movement towards a system that rewards outcomes( managed care)
- ❖ Example: Hospitals cannot readmit Medicare patients within 30 days for the same issue and expect to be paid
- ❖ The government has been paying on volume but now is wanting to pay for quality of care
- ❖ The military is experimenting with alternative health care that if successful is less expensive and then could go main stream

# Health Care Observations

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- ❖ Health Care spending in the US was \$2.67 trillion last year about 17% of our GDP.
- ❖ Medicaid covers 56 million poor people up about 10 million from 5 years ago. It is expected to add about 20 million to its rolls next year.
- ❖ Many employers are putting a cap on employees working over 30 hours per week so the employer does not have to provide health care
- ❖ Employers are renewing plans before 1/1/2014 to delay implementation for a year
- ❖ Employers are rewarding employees who are healthier and/ or participating in healthy activities

# Health Care Observations

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- ❖ Employers may not pay for spousal coverage. Why? Because employers are required to cover dependents and a spouse is not considered a dependent
- ❖ The new health insurance subsidy (Premium Assistance Credit) could result in surprise tax bills
- ❖ Health Care costs are not increasing as fast as they were: How much of this slowdown is due to the economy, health care efficiency and/or the lack of new expensive drugs?

# Health Care Physicians

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- ❖ There is a shortage of primary care physicians
- ❖ Small physician practices are being acquired by hospitals –this could create local monopolies
- ❖ Physician assistants are doing more
- ❖ More retail health care( 1400 clinics now)
- ❖ The virtual doctor

# Health Care Observations

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- ❖ In June the federal government is supposed to establish call centers
- ❖ The government is creating a computer network to verify income and citizenship for purposes of the Premium Assistance Credit. Each state will be allowed to exchange data with the IRS, HHS, SSA and other agencies
- ❖ October 1, 2013 the exchanges are open for enrollment in 2014 insurance plans
- ❖ The administration announced that some small businesses will not have choices on the exchange until 2015- they will be limited to a single plan... not good news for small business

# Health Care Observations

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- ❖ Many people will not be able to pay for insurance with credit cards
- ❖ Employers will have to inform employees of their insurance coverage by 10/1/2013 ?
- ❖ Will legislators and congressional staff members leave if they lose their subsidized plans because of Obamacare ?

# Health Care Key Terms

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- **Guaranteed Issue:** The requirement that health insurance be sold to anyone regardless of their health status
- **Community Rating:** The requirement that people in the same age group pay the same premiums regardless of their health status
- **Employer Responsibility :** The requirement that all companies with more than 50 full – time employees offer minimum health care.

# Health Care Observations

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- ❖ 80% rebate rule for small employers, 75% for large employers- \$1.1 billion refunded in 2012
- ❖ Is my insurance agent going away?



# Small Business Health Care Credit

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- Available for those offering health coverage
- For uniform nonelective contribution
  - No more than 25 FTE with
  - Average annual wage of no more than \$50,000
- Maximum credit—The lesser of:
  - Actual insurance paid by the employer, or
  - What ER would have paid had EE enrolled in coverage with a small business benchmark premium (Rev. Rul. 2010-13)
- Multiplied by the percentages below
  - 2010–2013: 35%
  - 2014 and beyond: 50%

# Small Business Health Care Credit

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- Credit phase-out is the sum of :
  - The credit x (# of FTE – 10)/15, and
  - The credit x (average annual wage – \$25,000)/\$25,000

**Example:** Tony's Tigers had 15 FTE with an average annual wage of \$40,000. Before phase-out the credit was \$20,000.

The reduction of credit is:

$$\$20,000 \times (15 - 10) \div 15 = \$6,667$$

$$\$20,000 \times (\$40,000 - \$25,000) / \$25,000 = \$12,000$$

$$\text{Total reduction} = \$18,667$$

$$\text{Net credit allowed } \$20,000 - \$18,667 = \$1,333$$

*Notes: Credit is completely phased out at 25 FTE or average annual wage in excess of \$50,000.*

*Full credit is allowed where no more than 10 FTE and average annual wage below \$25,000.*

# Small Business Health Care Credit

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- Employer contribution must be at least 50% of the premiums paid for single (employee only coverage)
- Tax-exempt employers can qualify
- Any unused credit is carried forward
- Qualified premiums are those paid in a uniform percentage for all employees

# Small Business Health care Credit

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- ❖ 2014 Budget- Expand the coverage to include employers providing health insurance with up to 50 full-time equivalent employees, and begin the phase-out at 20 full-time equivalent employees

# Health Care - Review

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- Over-the-counter drugs (OTCD)
  - Unless prescribed by the doctor OTCD (other than insulin) are no longer treated as an allowable expense for FSA, HSA, HRA and MSA.
- Increased tax on nonqualifying HSA and MSA distributions
  - HSA from 10%–20%
  - MSA from 15%–20%

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- Medicare Part D—Subsidy is reduced for those with incomes above \$170,000 (couples)/\$85,000(single)
  - Disclosure of nutritional content at fast food restaurants and vending machines
  - Grants for small employers who set up wellness programs
  - Free preventative care (No co-pays, no-deductible)
  - Grants to states for developing alternative programs to current tort litigation

# Health Care 2013

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- Increased threshold for claiming medical on Schedule A
  - From 7.5% to 10%
  - Remains at 7.5% for those age 65 and older until 2016
- Medical device manufacturers and importers
  - 2.3% tax is imposed on the sale of any medical device
  - The tax is paid by the manufacturers
  - New tax bites pet owners
  - Not imposed on bows and arrows

# Health Care 2013

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- New limit on FSA contributions
  - \$2,500 per year
- Medicare Part D
  - Phase-in of federal subsidies for brand-name prescriptions begins
  - By 2020, the discount is 75% until the catastrophic coverage kicks in
  - Information reporting for large employers ( Over 250 ee)- Box 12 Code DD



# Health Care 2013

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- ❖ PICORI fees (Patient-Centered Outcome Research Institute Fees)
- ❖ Fees used to help fund a private , non-profit institute that provides research into the effectiveness of various medical treatments and procedures
- ❖ The fee is \$1 per covered person (\$2 for plan years ending after September 30,2013)
- ❖ The fee is reported on form 720 . The first return is due on July 31, 2013.
- ❖ Generally insurance companies are responsible
- ❖ Employers that have self –insured plans including HRA’s are responsible for the fee and reporting.

- ❖ IRS has issued proposed regulations under IRC Sec(s). 1401, 3101, 3102, et al addressing the new 2013 .9% Medicare tax.
- ❖ These are PROPOSED regulations; they are not effective any earlier than when finalized. However, they may be used as guidance .

# Health Care 2013 – .9% Surtax

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- Additional Medicare tax on high income workers
  - The tax is increased by .9% (1.45% to 2.35%) on those earning over \$250,000 joint/\$200,000 single
  - Threshold is not indexed for inflation
  - Does not impact the Medicare tax paid by the employer
  - This tax will not generate an above-the-line deduction
  - Employer is required to withhold on wages over \$200,000

# Health Care 2013

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**Example:** Harry and Sharie, a married couple, earn wages of \$125,000 and \$175,000 respectively. For the first \$250,000 of combined wages the Medicare tax is:

$$\$250,000 \times 1.45\% = \$3,625$$

The next \$50,000 is taxed at the higher rate of 2.35% (1.45% + .9%)

$$\$50,000 \times 2.35\% = \$1,175$$

The combined Medicare tax is:  $\$3,625 + \$1,175 = \$4,800$

The new additional tax is  $.009 \times \$50,000 = \$ 450$

*Observation: The employer is not required to withhold the additional \$450.*

# IRS Frequently Asked Q&A...

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### 3. When are individuals liable for Additional Medicare Tax?

An individual is liable for Additional Medicare Tax if the individual's wages, compensation, or self-employment income (together with that of his or her spouse if filing a joint return) exceed the threshold amount for the individual's filing status:

Filing Status	Threshold Amount
Married filing jointly	\$250,000
Married filing separately	\$125,000
Single	\$200,000
Head of household (with qualifying person)	\$200,000
Qualifying widow(er) with dependent child	\$200,000

# IRS Frequently Asked Q&A...

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15. **If my employer withholds Additional Medicare Tax from my wages in excess of \$200,000, but I won't owe the tax because my spouse and I file a joint return and we won't meet the \$250,000 threshold for joint filers, can I ask my employer to stop withholding Additional Medicare Tax?**

No. Your employer must withhold Additional Medicare Tax on wages it pays to you in excess of \$200,000 in a calendar year. Your employer cannot honor a request to cease withholding Additional Medicare Tax if it is required to withhold it. You will claim credit for any withheld Additional Medicare Tax against the total tax liability shown on your individual income tax return (Form 1040).

16. **What should I do if I have two jobs and neither employer withholds Additional Medicare Tax, but the sum of my wages exceeds the threshold at which I will owe the tax?**

If you anticipate that you will owe Additional Medicare Tax but will not satisfy the liability through Additional Medicare Tax withholding (for example, because you will not be paid wages in excess of \$200,000 in a calendar year by an employer), you should make estimated tax payments and/or request additional income tax withholding using Form W-4. For information on making estimated tax payments and requesting an additional amount be withheld from each paycheck, see [Publication 505](#), Tax Withholding and Estimated Tax.

# .9% Medicare Tax

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- *Self-employed individuals who also have employment income.*
  - (1) Calculate the additional Medicare tax on any wages in excess over the applicable threshold for the filing status (\$250,000/\$125,000/\$200,000), without regard to whether any tax was withheld.
  - (2) Reduce the applicable threshold for the filing status by the total amount of Medicare wages received (but not below zero).
  - (3) Calculate the additional Medicare tax on any self-employment income in excess of the reduced threshold

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- **Illustration** : Allison, a single filer, has \$130,000 in wages and \$145,000 in self-employment income. Before calculating the additional Medicare tax on self-employment income, the \$200,000 threshold for single filers is reduced by Allison's \$130,000 in wages, resulting in a reduced self-employment income threshold of \$70,000. Allison has to pay additional Medicare tax on \$75,000 of self-employment income (\$145,000 in self-employment income minus the reduced threshold of \$70,000).



# .9% Medicare Tax

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- **Illustration** : Neal and Nancy are married and file jointly. Neal has \$150,000 in wages and Nancy has \$175,000 in self-employment income. Before calculating the additional Medicare tax on Nancy's self-employment income, the \$250,000 threshold for joint filers is reduced by Neal's \$150,000 in wages, resulting in a reduced self-employment income threshold of \$100,000. Neal and Nancy are liable to pay additional Medicare tax on \$75,000 of self-employment income (\$175,000 in self-employment income minus the reduced threshold of \$100,000).



# IRS Frequently Asked Q&A...

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**41. Will the IRS be changing Form 941 or any other forms for tax year 2013 to be completed by employers and payroll service providers?**

Yes. For example, a line will be added to Form 941 on which employers will report any individual's wages paid during the quarter that is in excess of \$200,000 for the year, and on which employers will report their withholding liability for Additional Medicare Tax on those wages. The existing line, on which employers report the liability for regular Medicare tax on all wages, will remain unchanged.

However, there will be no change to Form W-2. Additional Medicare Tax withholding on wages subject to Federal Insurance Contributions Act (FICA) taxes will be reported in combination with withholding of regular Medicare tax in box 6 ("Medicare tax withheld").

The IRS plans to release drafts of revised forms, including Forms 941, 943, and the tax return schemas for the F94X series of returns.

**42. When an employer deposits Additional Medicare Tax through the Electronic Federal Tax Payment System (EFTPS), does it need to separate Additional Medicare Tax from regular Medicare tax?**

No. When providing the deposit detail, regular Medicare tax and Additional Medicare Tax are entered as one combined amount.

# .9% Medicare Tax – New Rules

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- ❖ *Corporate payers.* When an employee is performing services for multiple subsidiaries of a company, and each subsidiary is an employer of the employee with regard to the services the employee performs for that subsidiary, wages paid by the payor on behalf of each subsidiary are combined for purposes of the additional Medicare tax only if the payor is a common paymaster. Wages are not combined for purposes of the \$200,000 withholding threshold if the payor is not a common paymaster

# .9% Medicare Tax – New Rules

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- ❖ *Fringe benefits.* The employer must withhold additional Medicare tax on total wages, including taxable noncash fringe benefits, in excess of \$200,000

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- ❖ IRS has just issued proposed regulations under IRC Sec(s). 1411 and 469 addressing the new 3.8% Medicare tax.
  - ❖ These are PROPOSED regulations; they are not effective any earlier than when finalized. However, they may be used as guidance .

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❖ Net Investment Income (section 1411 overview):

(i) . Interest, dividends, annuities , royalties and rents , other than such income derived in the ordinary course of a business not described in (ii) below ( Basically non - passives)

(ii). Passive activity income ( section 469) and income from the trade or business of trading in financial instruments or commodities(Section 475(e)(2))

(iii). Net gain other than for gain on property held in a trade or business not described in (ii)

- Less allowable deductions

# 3.8% Medicare Tax

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## Unearned Income Medicare Contribution Tax

- 3.8% surtax is imposed on net investment income:  
Interest, dividends, royalties, rents, capital gains, non-qualified annuities, passive income from a trade or business or income from the business of trading in commodities or financial instruments
- Excluded items:  
Wages, unemployment compensation, interest on tax-exempt bonds, Social Security, alimony, non-taxable gain on the sale of a principal residence, non-passive trade or business income, S/E income, Alaska Permanent Fund dividends and retirement plan distributions( **Can increase MAGI though**).
- This tax is in addition to the additional Medicare tax of .9%.

# 3.8% and .9% tax

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- ❖ Income from the following should be exempt from both the .9% and 3.8% tax:
- ❖ Activities that do not rise to the level of a trade or business, eg.. Executor
- ❖ S income for an active owner
- ❖ Covenant - not –to compete
- ❖ Income earned by an active limited partner that is not a guaranteed payment. Note : Be careful of a service based LLC.



# 3.8% Medicare Tax

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## Unearned Income Medicare Contribution Tax

- Distributions from the following retirement plans are excluded:
  - Qualified pension, profit sharing and stock bonus
  - Qualified annuity
  - Qualified annuity plans for tax exempts
  - IRA' s
  - Roth IRA' s
  - Deferred compensation plans of state and local governments and non profits

# Health Care 2013 – 3.8% Medicare Tax on Net Investment Income 28-30

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- The Medicare contribution tax is imposed on individuals, estates, and trusts.
- For an individual, the tax is 3.8% of the lesser of either:
  - 1) net investment income or
  - 2) the excess of modified adjusted gross income (MAGI) over the threshold amount.
- The threshold amount is \$250,000 for joint return or surviving spouse, \$125,000 for marrieds filing separate return, and \$200,000 for all others.

# Health Care 2013 – 3.8% Medicare Tax on Net Investment Income 28-30

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**Example 1:** For 2013, Kayla, a single taxpayer, has net investment income of \$100,000 and MAGI of \$220,000.

The tax is imposed on the lesser of net investment income (\$100,000) or MAGI over \$200,000 (\$220,000 – \$200,000)

The surtax is  $\$20,000 \times 3.8\% = \$760$

**Example 2:** Assume that in the previous example MAGI was \$300,000.

MAGI exceeds threshold amount by \$100,000.

The surtax is:  $\$100,000 \times 3.8\% = \$3,800$

*Observation: The surtax is not deductible*

# Health Care 2013

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## ❖ Observations:

- ❖ Top tax bracket will be :  $39.6\%+3.8\%=43.4\%$
- ❖ The potential increase over last year is  $23.8\%-15\%=8\%$
- ❖ Invest in municipal bonds
- ❖ Invest in retirement plans
- ❖ Passive income planning
- ❖ Estate planning- no kiddie tax rules here

# 3.8% Medicare Tax

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- ❖ The IRS will closely review transactions that manipulate a taxpayer's net investment income to reduce or eliminate the amount of tax imposed by section 1411. In appropriate circumstances, the IRS will challenge such transactions based on applicable statutes and judicial doctrines.

# 3.8% Medicare Tax –

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- ❖ Pass-through entities :
- ❖ If income is “ investment income “ at the entity level it will be” investment income “for the owners.
- ❖ If the income is not investment income to the entity it would be investment income to a passive owner
- ❖ If the pass –through is not a trade or business the income could be category (i) or (ii)

# 3.8% Medicare Tax –

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- ❖ Flow- Through Example: An S Corp. has \$10,000 in interest and a \$7,000 loss allocable to a passive member.

The \$10,000 of interest flows through subject to the NII tax. If the \$7,000 loss is suspended under 469 it will have no effect on the 1411 NII tax.

# 3.8% Medicare Tax

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### 3. What individuals are subject to the Net Investment Income Tax?

Individuals will owe the tax if they have Net Investment Income and also have modified adjusted gross income over the following thresholds:

Filing Status	Threshold Amount
Married filing jointly	\$250,000
Married filing separately	\$125,000
Single	\$200,000
Head of household (with qualifying person)	\$200,000
Qualifying widow(er) with dependent child	\$250,000

Taxpayers should be aware that these threshold amounts are not indexed for inflation.

If you are an individual that is exempt from Medicare taxes, you still may be subject to the Net Investment Income Tax if you have Net Investment Income and also have modified adjusted gross income over the applicable thresholds.



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## 5. What Estates and Trusts are subject to the Net Investment Income Tax?

Estates and Trusts will be subject to the Net Investment Income Tax if they have undistributed Net Investment Income and also have adjusted gross income over the dollar amount at which the highest tax bracket for an estate or trust begins for such taxable year (for tax year 2012, this threshold amount is \$11,650). There are special computational rules for certain unique types of trusts, such as Charitable Remainder Trusts and Electing Small Business Trusts, which can be found in the proposed regulations (see # 19 below).

## 6. What Trusts are not subject to the Net Investment Income Tax?

The following trusts are not subject to the Net Investment Income Tax:

- a. Trusts that are exempt from income taxes imposed by Subtitle A of the Internal Revenue Code (e.g., charitable trusts and qualified retirement plan trusts exempt from tax under IRC section 501, and Charitable Remainder Trusts exempt from tax under IRC section 664);
- b. A trust in which all of the unexpired interests are devoted to one or more of the purposes described in IRC section 170(c)(2)(B);
- c. Trusts that are classified as “grantor trusts” under IRC sections 671-679;
- d. Trusts that are not classified as “trusts” for federal income tax purposes (e.g., Real Estate Investment Trusts and Common Trust Funds).

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## 9. What kinds of gains are included in Net Investment Income?

To the extent that gains are not otherwise offset by capital losses, the following gains are common examples of items taken into account in computing Net Investment Income:

- a. Gains from the sale of stocks, bonds, and mutual funds;
- b. Capital gain distributions from mutual funds;
- c. Gain from the sale of investment real estate (including gain from the sale of a second home that is not a primary residence);
- d. Gains from the sale of interests in partnerships and S corporations (to the extent you were a passive owner).

## 10. Does this tax apply to gain on the sale of a personal residence?

The Net Investment Income Tax will not apply to any amount of gain that is excluded from gross income for regular income tax purposes. The pre-existing statutory exclusion in IRC section 121 exempts the first \$250,000 (\$500,000 in the case of a married couple) of gain recognized on the sale of a principal residence from gross income for regular income tax purposes and, thus, from the NIIT.

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## 12. What investment expenses are deductible in computing NII?

In order to arrive at Net Investment Income, Gross Investment Income (items described in items 7-11 above) is reduced by deductions that are properly allocable to items of Gross Investment Income. Examples of properly allocable deductions include investment interest expense, investment advisory and brokerage fees, expenses related to rental and royalty income, and state and local income taxes properly allocable to items included in Net Investment Income.

## 13. Will I have to pay both the 3.8% Net Investment Income Tax and the additional .9% Medicare tax?

You may be subject to both taxes, but not on the same type of income.

The 0.9% Additional Medicare Tax applies to individuals' wages, compensation, and self-employment income over certain thresholds, but it does not apply to income items included in Net Investment Income. For more information on the Additional Medicare Tax, see [HERE](#)

# 3.8% Medicare Tax

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- ❖ Deductions:
  - ❖ Only the portion exceeding the 2% threshold is allowed.
  - ❖ The 2% reduction must be allocated proportionately to all miscellaneous itemized deductions.
  - ❖ Phase out under section 68- Adjustments must be made to take this into account

# 3.8% Medicare Tax

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General tax principles will continue to apply. For example...

- ❖ 453 -installment sales
- ❖ 1031-Like Kind Exchange
- ❖ 1033- Deferral of casualty loss
- ❖ 121- Sale of a principal residence
- ❖ Deferral or disallowance provisions (e.g. PAL limit or investment interest)
- ❖ Deduction carried over to a tax year (even if from a pre-effective date tax year) if allowed for AGI – also allowed for NII calculation.

# 3.8% Medicare Tax – New Rules

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## **How the Net Investment Income Tax is Reported and Paid**

### **14. If I am subject to the Net Investment Income Tax, how will I report and pay the tax?**

For individuals, the tax will be reported on, and paid with, the Form 1040.

For Estates and Trusts, the tax will be reported on, and paid with, the Form 1041.

### **15. Is the Net Investment Income Tax subject to the estimated tax provisions?**

The Net Investment Income Tax is subject to the estimated tax provisions.

# 3.8% Medicare Tax

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- ❖ The 3.8% applies to a trade or business ONLY if it is a Sec. 469 “passive activity” of the taxpayer OR an IRC Sec. 475(e)(2) financial instruments or commodities trading business.
  - ❖ The tax DOESN’ T apply to non-passive trades or businesses conducted by a sole proprietor, partnership (LLC), or S corporation BUT income, gain, loss on working capital IS subject to the tax.

# 3.8% Medicare Tax

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Passives...

- ❖ A “passive activity” is any activity that involves the conduct of a “trade or business” in which the taxpayer does NOT materially participate.
- ❖ Generally , any rental activity (payments are principally for the use of tangible property that is used or held for use by customers) is inherently PASSIVE.



# 3.8% Medicare Tax – New Rules

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- IRC 469 → death to tax shelters
- Creates “baskets of activity”
  - Passive
  - Portfolio
  - Non-passive
- Losses and credits are segregated
- So what’s a passive activity?
  - Rental activities, generally
  - Activities involving trades or business in which taxpayer does not materially participate
- \* GAO- 53% misreported rental real estate

# 3.8% Medicare Tax – New Rules

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Meet 1 of 7 tests

1. Participate in activity > 500 hrs per year
2. Be the only one participating in the activity
3. More than 100 hrs participation, nobody does more
4. Where there are significant participation (>100 hour) activities and aggregate participation > 500 hrs
5. Taxpayer materially participated in for 5 out of 10 years
6. It's a personal service activity, and taxpayer materially participated in at least 3 years at some point (not necessarily consecutive)
7. Facts and circumstances indicates regular, continuous and substantial participation (!)

# 3.8% Medicare Tax – New Rules

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- Activity vs. an Undertaking
  - Why is this important?
    - If suspended losses are freed up when an activity is disposed of....not an undertaking
    - Two undertakings are part of an activity, only necessary to prove material participation in one
  - Group undertakings into activities....
    - By common control
    - By geographical locations
    - Interdependence between activities
    - Combining rental activities with trade/business
      - Must be appropriate economic unit
      - One is insignificant compared to other

# 3.8% Medicare Tax – New Rules

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- Alex has 100% ownership in an S corporation that makes ceramic pottery. He materially participates on a full-time basis. His supplier is facing difficult financial times and may close his business. To protect his source of supply Alex buys 80% of the supplier's company. Alex can't spend much time in the new business .
- Alex does not meet the material participation standards for the supply company. However he can choose to treat the supply company and S corp. as one activity because there is an interdependence between the two.

# 3.8% Medicare Tax – New Rules

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- TJ operates a sole proprietorship that supplies computer hardware and parts to small businesses . He establishes an S corp. with some friends to refurbish computer hardware. He purchases hardware from the S corp. to use in sole proprietorship.
- Although TJ does not participate in the S corp. operations ,the two companies are considered an appropriate economic unit for him. He may treat the activities as one.

# 3.8% Medicare Tax – New Rules

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- Combining rental activities with trade/business
  - Must be appropriate economic unit
  - One is insignificant compared to other
  - The two are inter-related (rental of items to the trade/business)
  - No mixing of rental of realty & rental of personal property
- Once you group, must stay that way
  - Unless there is a material change or
  - Original grouping was inappropriate
  - IRS can re-group at will
  - (Candeleria)

# 3.8% Medicare Tax – New Rules

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- ❖ The PAL grouping rules apply in determining whether the trade or business is a passive activity for purposes of Code Sec. 1411(c)(2).
- ❖ Noting that Code Sec. 1411 may cause taxpayers to reconsider their previous grouping determinations under the PAL rules, the proposed regulations provide a regrouping “fresh start” for certain taxpayers, allowing them to regroup their activities for any tax year that begins during 2013 if Code Sec. 1411 would apply to the taxpayer without regrouping.

# 3.8% Medicare Tax – New Rules

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- ❖ A taxpayer may only regroup activities once, and any regrouping will apply to the tax year for which the regrouping is done and all later years.
- ❖ The regrouping must comply with the disclosure requirements under Rev. Proc. 2010-13, 2010-4 IRB 329 and Reg. 1.469-4(e).



# 3.8% Medicare Tax – New Rules

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**Example (2).** Application of grouping rules under section 469. April, owns an interest in SKS, a partnership for Federal income tax purposes. SKS is engaged in two activities ,Dancing is Fun, and Catch a Salmon, , which constitute trades or businesses, and neither of which constitute trading in financial instruments or commodities. April has properly grouped Dancing is Fun and Catch a Salmon (the grouped activity).

# 3.8% Medicare Tax – New Rules

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**Example (2).** April participates in Dancing is Fun for more than 500 hours during the year and would be treated as materially participating in the activity. April only participates in Catch a Salmon for 50 hours and, but for the grouping of the two activities together, April would not be treated as materially participating in Catch a Salmon within the meaning of Reg. 1.469-5T(a). However, April materially participates in the grouped activity, and therefore, neither company is a passive activity with respect to April and the 3.8% tax will not apply.

# 3.8% Medicare Tax – New Rules

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- Rentals are assumed to be passive, except:
  - Rental of personal property (tools, DVDs, etc.)
  - Average period of use is 7 days or less
  - Customers rent for 30 days or less and services are provided (i.e., room service)
  - Extraordinary personal services are provided
    - i.e., hospital (see *Assaf* case)
  - Rental is incidental to another activity
    - Accountant rents out space to another

# 3.8% Medicare Tax – New Rules

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**Example (1).** Rental activity. Jason, a single guy , rents a commercial building to Traci for \$50,000 . Jason's rental activity does not involve the conduct of a section 162 trade or business, but under section 469(c)(2), Jason's rental activity is a passive activity. Jason's rental income of \$50,000 is not derived from a trade or business. However, Jason's rental income of \$50,000 will still constitute gross income from rents.

# 3.8% Medicare Tax

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- 
- ❖ The proposed regulations provide that if a taxpayer meets one of the rental activity exceptions under Reg. 1.469-1T(e)(3)(ii), the rental activity exceptions will also apply to determine whether the activity is a passive activity under Code Sec. 1411(c)(2).
  - ❖ However, a taxpayer who meets one of these exceptions *isn't necessarily engaged in a trade or business* under Code Sec. 162.

# 3.8% Medicare Tax – New Rules

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- ❖ So, even if the taxpayer meets one of these PAL exceptions, if the taxpayer's activity isn't a Code Sec. 162 trade or business, gross income from rents from the activity (rent) may be subject to Code Sec. 1411(c)(1)(A)(i) because the activity doesn't meet the ordinary course of a trade or business exception.

# 3.8% Medicare Tax – New Rules

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**Example (3).** Application of the rental activity exceptions . George , who is single, is a partner in JMS, which is engaged in an equipment leasing activity. The average period of customer use of the equipment is seven days or less (and therefore meets the exception in Reg. 1.469-1T(e)(3)(ii)(A)). George materially participates in the equipment leasing activity (within the meaning of Reg. 1.469-5T(a)). The equipment leasing activity constitutes a trade or business within the meaning of section 162.

# 3.8% Medicare Tax – New Rules

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**Example (3).** George has modified adjusted gross income of \$300,000, all of which is derived from JMS. All of the income from JMS is derived in the ordinary course of the equipment leasing activity, and all of JMS's property is held in the equipment leasing activity. Of George's allocable share of income from JMS, \$275,000 constitutes gross income from rents.

While \$275,000 of the gross income from the leasing activity meets the definition of rents, the activity meets one of the exceptions to rental activity treatment and George materially participates in the activity.



# 3.8% Medicare Tax – New Rules

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**Example (3).** Therefore, the trade or business is not a passive activity with respect to George, and because the rents are derived in the ordinary course of a trade or business, the ordinary course of a trade or business exception in applies, which means that the rents are not subject to the tax.

Furthermore, the \$25,000 of other gross income is not subject to the 3.8% tax.

Finally, gain or loss from the sale of the property held in the equipment leasing activity will not be subject to the 3.8% tax.

# 3.8% Medicare Tax

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- 
- Real Estate Professionals
    - Deduct all real estate rental losses
  - What is a Real Estate Professional?
    - Real property development, construction acquisition, conversion, operation, rental, management or brokerage
    - Must devote more than 50% of personal services
    - Must devote more than 750 hours

# 3.8% Medicare Tax – New Rules

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- Must materially participate
  - Elect to aggregate all rentals as one activity
- Attach statement to original return:
  - Qualify as RE professional
  - Treating all rentals as one activity
  - Applies for current and all future years
  - Failure to elect = need material participation in each property

# 3.8% Medicare Tax – New Rules

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- ❖ If a taxpayer meets the requirements to be a real estate professional under the PAL rules, the taxpayer's rental real estate activities will not be passive activities if he materially participates in the activities.
- ❖ The proposed regulations provide that IF the rental real estate activities are Code Sec. 162 trades or businesses, the PAL rules will apply in determining whether the rental real estate activity is a passive activity for purposes of Code Sec. 1411(c)(2)(A).

# 3.8% Medicare Tax – New Rules

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- ❖ However, if the rental real estate activities aren't Code Sec. 162 trades or businesses, the gross income from rents derived from the activity will not be excluded by the ordinary course of a trade or business exception.
- ❖ That exception is inapplicable because rents aren't derived from a trade or business and will therefore be subject to Code Sec. 1411.
- ❖ The proposed regulations do NOT include an example for these taxpayers.

# 3.8% Medicare Tax – New Rules

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- **Self Rental:**
- Occurs when taxpayer rents property to trade or business he/she materially or significantly participates in
- Does not apply if written binding contract existed before 2/19/88
- Rental income is **NOT** passive
- Rental loss is passive

# 3.8% Medicare Tax – New Rules

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If less than 30% of the unadjusted basis is subject to depreciation any net income is treated as nonpassive

# 3.8% Medicare Tax – New Rules

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In most cases, these items will be subject to section 1411 if the item of income constitutes gross income from one of the items described in proposed § 1.1411-4(a)(1)(i) and the item of income is not derived in the ordinary course of a trade or business.

For example, if a taxpayer has gross income from rents from an activity described in § 1.469-2(f)(6)(self rental) that is not derived in the ordinary course of a trade or business, the gross income from rents will be subject to section 1411.



# 3.8% Medicare Tax – New Rules

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- ❖ The taxpayer rented property to his S corporation which in turn rented out the property to unrelated third parties.. The IRS took the position that the rentals to the corp. came under the purview of the self-rental rule.
- ❖ The court ruled the self-rental rule couldn't apply since the corp.'s use of properties for rent to others couldn't by definition be considered use in a trade or business .

Francis J. **Dirico**, et ux. v. Commissioner, 139 TC No. 16)

# 3.8% Medicare Tax – New Rules

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Rental income excluded for regular tax purposes under the 14 day rule is also excluded from the 3.8 % tax

# 3.8% Medicare Tax

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- 
- Gains are taxable , including :
  - Gains from the sale of stocks, bonds, and mutual funds;
  - Capital gain distributions from mutual funds (i.e., regulated investment companies (RICs));
  - Gain from the sale of investment real estate (including gain from the sale of a second home that isn't a primary residence);
  - Gains from the sale of interests in partnerships and S corporations (to the extent the taxpayer was a passive owner).
  - Capital gain dividends from real estate investment trusts (REITs) and undistributed capital gains from RIC's

# 3.8% Medicare Tax – New Rules

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- Gains are taxable , including :
- Gains from the sale of passive activities and from the business of trading in financial instruments or commodities
- Distributions in excess of basis for an S shareholder

# 3.8% Medicare Tax – New Rules

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- Gains can't be less than zero
- Although a \$3,000 excess capital loss is allowed for regular tax purposes for NII purposes it cannot offset category (i and ii income)
- . Net gain includes gain or loss attributable to the disposition of property from the investment of working capital. (Prop Reg § 1.1411-4(d)(3)(i))

# 3.8% Medicare Tax – New Rules

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- In 2013 Fred realizes a \$40,000 capital loss on the sale of Apple stock and a \$10,000 capital gain on the sale of Pear stock, resulting in a net capital loss of \$30,000. Fred has \$300,000 of wages and also earns \$5,000 in interest.
- Under section 1211(b) Fred can use \$3,000 of the net capital loss against other income, with the remaining \$27,000 being a capital loss carryover. For **Code Sec. 1411** purposes, Fred's \$10,000 gain on the Pear stock sale is reduced by his \$40,000 loss on the Apple stock sale.
- However, because net gain can't be less than zero, he can't reduce his net investment income by the \$3,000 of the excess of capital losses over capital gains allowed for income tax purposes under **Code Sec. 1211(b)**

# 3.8% Medicare Tax – New Rules

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- In 2014, Fred has a \$30,000 capital gain on the sale of stock in Mango, Inc. For income tax purposes, Fred can reduce the \$30,000 gain by the 2013 Code Sec. 1212(b) \$27,000 capital loss carryover
- . For Code Sec. 1411 purposes, Fred's \$30,000 gain may also be reduced by the \$27,000 capital loss carryover from 2013. Therefore, In 2014, Fred has \$3,000 of net gain under Prop Reg § 1.1411-4(a)(1)(iii).

# 3.8% Medicare Tax – New Rules

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- Variation:
- Assume the same facts as before except for 2013 Fred also realizes \$20,000 of gain on the sale of rental property (all of which is treated as ordinary income under Code Sec. 1250). Fred could use \$3,000 of the net capital loss against other income for income tax purposes, with the remaining \$27,000 being a capital loss carryover.
- For Code Sec. 1411 purposes, Fred's \$10,000 gain on the Pear stock sale is reduced by his \$40,000 loss on the sale of the Apple stock. His \$20,000 gain on the sale of rental property is reduced to the extent of the \$3,000 loss allowed under Code Sec. 1211(b)



# 3.8% Medicare Tax

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- ❖ *Dispositions of partnership and S corporation interests.* Code Sec. 1411(c)(1)(A)(iii) generally applies if the property disposed of is either not held in a trade or business, or is held in a trade or business described in Code Sec. 1411(c)(2) and Prop. Reg. 1.1411-5 (i.e., a passive activity or trading in financial instruments or commodities).

# 3.8% Medicare Tax – New Rules

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- ❖ If the property disposed of is held in a trade or business that ISN'T described in Prop. Reg. 1.1411-5 , net investment income DOESN'T include gain attributable to the property.
- ❖ If an individual, estate, or trust holds an interest in a pass-through entity and the entity disposes of its property, the determination of whether property is held in a trade or business that is a passive activity is made at the taxpayer level (held in a trade or business of trading in financial instruments or commodities at the entity level.)

# 3.8% Medicare Tax – New Rules

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- ❖ IRS says that in most cases, an interest in a partnership or S corporation ISN'T property held in a trade or business, and so gain or loss from the sale of such is subject to Code Sec. 1411(c)(1)(A)(iii).

# 3.8% Medicare Tax – New Rules

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- ❖ Under Code Sec. 1411(c)(4), gain or loss from a disposition of an interest in a partnership or S corporation is taken into account by the partner or shareholder as net investment income only to the extent of the net gain or loss that the transferor would take into account if the entity had sold all its property for fair market value (FMV) immediately before the disposition.

# 3.8% Medicare Tax – New Rules

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- ❖ Code Sec. 1411(c)(4) provides that gain is taken into account only to the extent of the net gain on the sale of all the partnership's or S corporation's property at its FMV immediately before the disposition of the interest.
- ❖ Gain or loss on the sale of an interest in the entity and a sale of the entity's underlying properties do not always match.

# 3.8% Medicare Tax – New Rules

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- ❖ There may be disparities between the transferor's adjusted basis in the partnership interest or S corporation stock and the transferor's share of the entity's adjusted basis in the underlying properties.
- ❖ Or the sales price of the interest may not reflect the proportionate share of the underlying properties' FMV with respect to the interest sold.

# 3.8% Medicare Tax – New Rules

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- ❖ To remedy this, Code Sec. 1411(c)(4) is applied on a property-by-property basis, and a determination must be made on how the property was held in order to determine whether the gain or loss to the transferor from the hypothetical disposition of such property would have been gain or loss subject to Code Sec. 1411(c)(1)(A)(iii).

# 3.8% Medicare Tax – New Rules

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- ❖ Under the proposed regulations, a transferor computes the gain or loss from the sale of the underlying properties of the partnership or S corporation using a deemed asset sale method (Deemed Sale), and then determines if, based on the Deemed Sale, there is an adjustment (either positive or negative) to the transferor's gain or loss on the disposition of the partnership or S corporation interest for purposes of Code Sec. 1411(c)(1)(A)(iii).
- ❖ A positive adjustment reduces a loss on the disposition of the interest, and a negative adjustment reduces the gain on the disposition of



# 3.8% Medicare Tax – New Rules

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- ❖ If a transferor has a \$100,000 gain on the disposition of S corporation stock, the Code Sec. 1411(c)(4) adjustment cannot result in a gain for Code Sec. 1411 purposes greater than \$100,000.
- ❖ A similar rule applies to losses-A loss cannot be increased by the adjustment

# 3.8% Medicare Tax – New Rules

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## ❖ Summary of steps:

1. Compute gain to shareholder
2. Compute theoretical S corp. sales price on each asset according to its FMV
3. Compute theoretical gain/loss on each asset sold
4. Allocate gain/loss to each shareholder.

# 3.8% Medicare Tax – New Rules

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## ❖ Summary of steps:

5. Determine if the asset sold would have been excluded as Net Investment Income to the shareholder

6. Add up the deemed S corp. gains for all assets that would not be NII to the shareholder.

7. Reduce the gain on the sale of the S corp. stock that the shareholder would otherwise have to report as category (iii) income.

# 3.8% Medicare Tax – New Rules

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- ❖ Example: Ben owns and actively participates in his 100 % owned S corp. He sells his stock for \$100,000 which has a basis of \$85,000 generating a \$15,000 gain.
- ❖ How much of the gain must Ben include as Net Investment Income?
- ❖ Assume a deemed asset sale by the S corp. of \$100,000 with a basis to the corp. of \$85,000 with a theoretical passed through gain of \$15,000.
- ❖ Ben could exclude the entire gain if the property was used in the S Corp. trade or business

# 3.8% Medicare Tax – New Rules

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- ❖ Variation: Assume Ben had acquired his stock by purchase and has a basis of \$80,000 instead of \$85,000. He would recognize \$20,000 of gain.
- ❖ He could exclude \$15,000 of the gain from the theoretical S corp. gain.
- ❖ He would have \$5,000 of Net Investment Income tax gain

Note: We need to attach an explanation as to how we calculated the adjustment

# 3.8% Medicare Tax – New Rules

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❖ There are special rules for:

- Controlled Foreign Corporations and PFIC's(1297(a))

# 3.8% Medicare Tax – New Rules

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## ❖ Net Operating Losses:

- ❖ A has a \$20,000 NOL carryover, \$200,000 of wages, \$100,000 of gross income from a trading activity, \$80,000 of income from his sole proprietorship, and \$10,000 in trading activity expense deductions. For income tax purposes, A's \$20,000 net operating loss carryover will be allowed as a deduction. In addition, under § 1.1411-2(c), A's \$20,000 net operating loss will be allowed as a deduction in computing A's modified adjusted gross income

# 3.8% Medicare Tax – New Rules

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- ❖ Self- charged Interest for an S corp. shareholder :
- ❖ If Passive won't be a problem
- ❖ If Active is an issue



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❖ We will now examine the individual mandate:

- The requirements
- The penalty
- Premium Assistance Credit

Note: Not like a normal credit. The money goes directly to the insurance company.

- Exceptions to the penalty
- Define Minimum Essential Coverage

# The Individual Mandate

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- ❖ Small Business Health Options Programs (SHOP) exchanges also called : Health Insurance Marketplace
  - For individuals and small businesses with up to 100 employees
  - Some states can limit this to 50 EE companies through 2016
  - Companies that grow can be grandfathered in

# Penalty for Remaining Uninsured

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- ❖ Minimum essential coverage is required to avoid the penalty

Note : Insurance bought through an exchange will meet the Minimum Essential Requirements.

- ❖ The penalty imposed on the uninsured under 18 is one-half of that imposed on adults
- ❖ A taxpayer is responsible for providing coverage if they are able to claim a personal exemption for the person
- ❖ Exempted from penalties (See later)
- ❖ The penalty is the greater of a Percentage of the Taxpayer's Income or a Flat Dollar Amount

# Penalty For Remaining Uninsured

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Penalty for remaining uninsured ;

## The Individual Shared Responsibility Penalty

- The per adult annual penalty is phased in:
  - 2014: Greater of 1% of applicable income\* or \$95
  - 2015: Greater of 2% of applicable income or \$325
  - 2016: Greater of 2.5% of applicable income or \$695
  - 2017 and beyond: Indexed for inflation from \$695
- ❖ Applicable Income: Excess of household income over the threshold filing amount.
- ❖ Example on next slide

# Penalty for Remaining Uninsured

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- ❖ Example: Dennis and Susan have \$125,000 of household income. Assume the threshold filing amount for MFJ is \$19,500. The applicable income is:  
\$105,500(\$125,000-\$19,500)
- ❖ The Penalty is \$1,055 which is the greater of :  
 $1\% \times \$105,500 = \$1,055$ , or  
 $\$95 \times 2 = \$190$

# Penalty for Remaining Uninsured

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- ❖ The Flat Dollar amount is capped at 300% of the adult penalty( without regard to dependent's )
- ❖ For 2016 : 2.5% of household income or \$2,085 ( 3x\$695)
- ❖ Note: The penalty cannot exceed the cost of a bronze level plan
- ❖ The penalty applies to any period essential coverage is not maintained (monthly)
- ❖ The penalty is to be assessed through the IRC( no liens or levies allowed)

# Penalty For Remaining Uninsured

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Example 1 Facts: Steve is single no dependents.

In 2016 he has no insurance. His household income is \$120,000 and filing threshold is \$12,000. National average bronze plan premium is \$5,000

Flat Dollar Amount	\$695
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Not more than  $3 \times \$695 = \$2,085$

Percentage of Income Amount	
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$(120,000 - 12,000) \times 2.5\%$	\$2,700
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Penalty	\$2,700
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(greater of \$695 or \$2,700 but not more than \$5,000)

# Penalty For Remaining Uninsured

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Example 2 Facts: Steve is single no dependents.

In 2016 he has insurance Jan-June. His household income is \$120,000 and filing threshold is \$12,000. National average bronze plan premium is \$5,000

Flat Dollar Amount ( $\$695 \times 6/12$ ) \$348

Not more than  $3 \times \$695 \times 6/12 = \$1,043$

Percentage of Income amount

$(120,000 - 12,000) \times 2.5\% \times 6/12$  \$1,350

Penalty \$1,350

(greater of \$348 or \$1,350 but not more than \$2,500)



# Health Care 2014

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Example 3 Facts: Steve is married with three dependents two under 18. No insurance in 2016. The household income is \$120,000 and filing threshold is \$24,000. National average bronze plan premium is \$20,000

Flat dollar amount ( $\$695 \times 3 + \$695 / 2 \times 2$ )	\$2,780
Maximum amount ( $\$695 \times 300\%$ )	\$2,085
Percentage of Income amount ( $(120,000 - 24,000) \times 2.5\%$ )	\$2,400
Penalty (greater of \$2,085 or \$2,400 but not more than \$20,000)	\$2,400

# Premium Assistance Credit

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- ❖ Tax credit available for those with incomes up to 400% of the federal poverty level—currently: \$44,680 (single) \$92,200 (family of four)
- ❖ Not eligible for Medicaid or affordable employer insurance
- ❖ These people will have to obtain insurance through an exchange
- ❖ Based on income level two years before the enrollment period
- ❖ Eligibility is determined month –by-month
- ❖ Cant be eligible to be claimed as a dependent

# Premium Assistance Credit

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The taxpayer is only eligible for the credit if ER coverage is unaffordable

- The ER plan is unaffordable If the EE must pay (self-coverage only) premiums that exceed 9.5% of household income

# Premium Assistance Credit

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## Example:

Rob and Liisa are married and his ER plan requires him to contribute \$6,000 which is 10% of their household income of \$60,000.

At first glance they would seem to qualify for the credit. However the self only coverage for Rob is \$4,000 which is only 6.7% of household income.

Therefore Rob and Liisa do not qualify for the credit since the self only coverage does not exceed 9.5% of household income

# Premium Assistance Credit

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- ❖ Household Income:
  - AGI plus
    1. Tax exempt income ,
    2. Foreign earned income and housing excluded under section 911, and
    3. Excluded Social Security benefits
- ❖ Note: Also include the AGI of dependents who are required to file a return

# Premium Assistance Credit

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How it works:

- ❖ Jim buys insurance at the exchange
- ❖ The exchange makes advance payments on behalf of Jim
- ❖ Note: The exchange will determine Jim's eligibility
- ❖ At tax time Jim reconciles the actual credit for the tax year computed on his 1040 with the amount of advance payments made on his behalf.
- ❖ If the credit exceeds the amount of advance payments he gets a refund.
- ❖ If the advance payments exceed the credit he owes.

# Premium Assistance Credit

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How it works ( continued):

- ❖ Repayment of excess- The repayment limitation is between \$600 -\$2,500 (\$300-\$1,250 single)

# Premium Assistance Credit

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## Calculating the credit

The credit is the lesser of:

- The premiums for the month or
- A calculation based on your Household Income (Excess of “adjusted monthly premium” for a “benchmark plan” over  $1/12$  of the product of household income and the “applicable percentage”)



# Premium Assistance Credit

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Calculating the credit

Definitions:

- “Adjusted monthly premium” – monthly premium adjusted for ages of covered individuals
- “Benchmark plan” – Silver plan (second lowest) offered by an exchange
- “Applicable percentage” – ranges from 2% to 9.5% See next slide

# Premium Assistance Credit

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Applicable percentage:

<u>Household income as % of FPL</u>	<u>Percentage</u>
Less than 133%	2.0 – 2.0%
133% to 150%	3.0 – 4.0%
150% to 200%	4.0 – 6.3%
200% to 250%	6.3 – 8.05%
250% to 300%	8.05 – 9.50%
300% to 400%	9.50 – 9.50%
Over 400%	N/A

# Premium Assistance Credit

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Calculating the credit – Example

Household income for family of 3 is \$50,353  
(275% of FPL on the next slide)

Silver plan premium for family is \$12,000

Applicable percentage is in range 8.05-9.5%

275% is halfway between 250-300% -

use 8.78% (half way between 8.05% and 9.5%)

Premium credit is \$7,579 lesser of :

- Silver premium \$12,000
- or
- Silver premium \$12,000  
   minus household income X 8.78% (4,421)  
\$7,579

# Premium Assistance Credit

Federal poverty level for 2013 (per HHS)

<u>Family size</u>	<u>100%</u>	<u>400%</u>
1	11,490	45,960
2	15,510	62,040
3	19,530	78,120
4	23,550	94,200
5	27,570	110,280
6	31,590	126,360
7	35,610	142,440
8	39,630	158,520
Each additional add	4,020	16,080

*Note Alaska and Hawaii are higher*

## Cost-Sharing Reduction Subsidy

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- ❖ Those with income that does not exceed 250% of the FPL can qualify for a reduction in the amount of out-of-pocket expense they could incur
- ❖ Applies to deductibles and co-pays
- ❖ Must buy insurance through an Exchange

# Exemption from Mandate Penalty 52

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1. Religious reasons
2. Member of Health care sharing ministry
3. Indian tribes
4. No tax return filing requirement
5. Short coverage gap( you went without coverage for less than three consecutive months)

Warning: The short coverage gap only applies to the first gap

6. Unaffordable coverage options – The minimum amount you must pay for premiums is more than 8% of your Adjusted Household Income
7. Incarceration
8. Not a US citizen, a US national nor an alien lawfully present in the US

# Exemption From Penalty -8%rule

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If the premiums exceed 8% of Adjusted Household Income the taxpayer is exempted from penalties

- ❖ Adjusted Household Income:
  - AGI plus
    1. Tax exempt income and
    2. Foreign earned income and housing excluded under section 911
- ❖ Subtotal is called: Household Income
- ❖ Add back premiums paid through a salary reduction plan ( e.g. Cafeteria plan)
- ❖ Total is : Adjusted Household Income

# Exemption From Penalty -8%rule

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- ❖ Note: Also include the AGI of dependents who are required to file a return
- ❖ Observation: Do not add in nontaxed Social Security benefits as we do with the Premium Assistance Credit
- ❖ Observation: If an individual can only buy through an Exchange the cost is based on Bronze level premiums



# Exemption From Penalty -8%rule

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❖ Example: Tim has gross salary of \$50,000 , bank interest of \$3,000 , tax exempt muni interest of \$2,000 and is offered insurance through a salary reduction plan of \$4,000

❖ Gross salary	\$50,000
Less: pretax insurance \$(4,000)	
Plus : Interest income <u>3,000</u>	
AGI	49,000
Plus: Muni bond interest 2,000	
MAGI ( Household Income)	51,000
Plus: Pre tax insurance premiums	4,000
Adjusted Household Income	55,000

# Exemption From Penalty -8%rule

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- ❖ Result: Tim's required contribution is 7.27% ( \$4,000 of premiums / \$55,000 of Adjusted Household Income .  
Tim is subject to the penalty if he decides not to buy insurance through the exchange

# Exemption From Penalty

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## **8. Are children subject to the individual shared responsibility provision?**

Yes. Each child must have minimum essential coverage or qualify for an exemption for each month in the calendar year. Otherwise, the adult or married couple who can claim the child as a dependent for federal income tax purposes will owe a payment.

## **9. Are senior citizens subject to the individual shared responsibility provision?**

Yes. Senior citizens must have minimum essential coverage or qualify for an exemption for each month in a calendar year. Senior citizens will have minimum essential coverage for every month they are enrolled in Medicare.

# Exemption From Penalty

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## **11. Are US citizens living abroad subject to the individual shared responsibility provision?**

Yes. However, US citizens who live abroad for a calendar year (or at least 330 days within a 12 month period) are treated as having minimum essential coverage for the year (or period). These are individuals who qualify for an exclusion from income under section 911 of the Code

## **12. Are residents of the territories subject to the individual shared responsibility provision?**

All bona fide residents of the United States territories are treated by law as having minimum essential coverage. They are not required to take any action to comply with the individual shared responsibility provision.

# Minimum Essential Coverage

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- ❖ Minimum essential coverage includes at a minimum all of the following:

Employer-sponsored coverage (including COBRA coverage and retiree coverage)

Coverage purchased in the individual market

Medicare coverage (including Medicare Advantage)

Medicaid coverage

Children's Health Insurance Program (CHIP) coverage

Certain types of Veterans health coverage

TRICARE

# Minimum Essential Coverage

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## **13. If I receive my coverage from my spouse's employer, will I have minimum essential coverage?**

Yes. Employer-sponsored coverage is generally minimum essential coverage. If an employee enrolls in employer-sponsored coverage for himself and his family, the employee and all of the covered family members have minimum essential coverage.

## **14. Do my spouse and dependent children have to be covered under the same policy or plan that covers me?**

No. You, your spouse and your dependent children do not have to be covered under the same policy or plan. However, you, your spouse and each dependent child for whom you may claim a personal exemption on your federal income tax return must have minimum essential coverage or qualify for an exemption, or you will owe a payment when you file.

# Minimum Essential Coverage

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**15. My employer tells me that our company's health plan is "grandfathered." Does my employer's plan provide minimum essential coverage?**

Yes. Grandfathered group health plans provide minimum essential coverage.

**16. I am a retiree, and I am too young to be eligible for Medicare. I receive my health coverage through a retiree plan made available by my former employer. Is the retiree plan minimum essential coverage?**

Yes. Retiree health plans are generally minimum essential coverage

**17. I work for a local government that provides me with health coverage. Is my coverage minimum essential coverage? Yes, generally**

# Minimum Essential Coverage

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**18. Do I have to be covered for an entire calendar month in order to get credit for having minimum essential coverage for that month?**

No. You will be treated as having minimum essential coverage for a month as long as you have coverage for at least one day during that month.

**19. If I change health coverage during the year and end up with a gap when I am not covered, will I owe a payment?**

Individuals are treated as having minimum essential coverage for a calendar month if they have coverage for at least one day during that month. Additionally, as long as the gap in coverage is less than three months, you may qualify for an exemption and not owe a payment.



# Minimum Essential Coverage

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## 20. If I think I qualify for an exemption, how do I claim it?

It depends upon which exemption it is.

The religious conscience exemption and the hardship exemption are available only by going to a Health Insurance Marketplace, also known as an Affordable Insurance Exchange, and applying for an exemption certificate. .

.The exemptions for unaffordable coverage, short coverage gaps, and individuals who are not lawfully present in the United States can be claimed only as part of filing a federal income tax return. The exemption for those under the federal income tax return filing threshold is available automatically.

# Employer Mandate

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## Large Employer Play or Pay

- ❖ A large employer is one that had at least 50 FTE (average at least 30 hours per week or 130 hours per month) during the previous calendar year ( Do not include leased , 2%S, Sole Proprietors or partners)
- ❖ Part-time workers – In determining whether a company is a large employer the employer will take the aggregate number of hours of part-time employees  $\div$  120 and add this to the number of FTE

Note: An exemption applies where

- The workforce exceeds 50 FTE for no more than 120 days, *and*
- The employees in excess of 50 were seasonal

# Employer Mandate

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**Example:** Rainbow, Inc. has a workforce comprised of 30 people who work 40 hours per week and another 80 people who average 20 hours per week. Assuming the part-timers worked 20 hours for four weeks in that month:

$$80(\text{people}) \times 20 \times 4 (\text{weeks}) = 6,400 \text{ hours}/120 = 53.33$$

$$53 \text{ equivalent full-time} + 30 \text{ full-time} = 83$$

**Result:** Rainbow is considered a large employer

# Employer Mandate

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## ❖ What hours of service are counted?

Include all hours for which the employee is paid not just the actual working hours :

This includes sick pay, military duty, vacation, holiday, jury duty , disability leave, etc..

## ❖ When must coverage begin?

For full-time employees within 90 days of employment

# Employer Mandate

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- ❖ What if I am not sure an employee is full-time?
  - If employees work at least 30 hours per week during the measurement period then they are treated as full-time during the stability period regardless of how many hours they work.

# Employer Mandate

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- ❖ Standard Measurement Period- A three-six month period where an employer can look back. The employer can choose the length of time. The length of time needs to be consistent with employees in the following categories :
- ❖ salaried and hourly employees,
- ❖ employees of different entities,
- ❖ employees in different states , and
- ❖ collectively bargained and noncollectively bargained employees

# Employer Mandate

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## ❖ Stability Period :

- A period of time where employees determined to be full-time in the measurement period must be offered insurance.
- The Stability period must be for at least six consecutive calendar months and is no shorter than the Measurement Period

# Employer Mandate

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- ❖ What about new hires that are variable-hour or seasonal employees?
  - Generally an employer must cover new employees within 90 days of hire if they expect the employee to be full-time
  - An employer can use an Initial Measurement Period that is between three-twelve months
  - Administrative Period for new employees- In addition to the Initial Measurement Period and employer can have an administrative period of up to 90 days before the Stability Period starts.



# Employer Mandate

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- ❖ Example: Kalama Kings restaurant is an applicable large employer that hires Spencer on January 14, 2014. The restaurant uses a six month Initial Measurement Period that begins on the first day of the calendar month after the start date.

The initial measurement period is from 2/01/2014-7/31/2014. During that time Spencer worked at least 30 hours per week and so is considered full-time.

Kalama Kings offers coverage that starts on 10/1/2014. The administrative period is not more than 90 days : 18 days (1/14-1/31) + 61 days (8/1-9/30) = 79

# Employer Mandate

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There are two potential penalties:

❖ A “no coverage penalty”

- Where an employer does not offer minimum essential insurance to at least 95% of its full-time employees (in 2015 this includes dependents) and at least one employee qualifies for the Premium Assistance Credit

❖ A “Lacking Minimum Value or Unaffordable Penalty”

-Where an employer does offer minimum essential coverage to at least 95% of the full-time but at least one employee qualifies for the Premium Assistance

# Employer Mandate

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There are two potential penalties ( continued):

- ❖ Dependents include children under 26 years of age.
- ❖ The spouse is not considered a dependent of the employee

# Employer Mandate

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“ No coverage “ penalty

- ❖ Penalty for not offering minimum essential coverage

Does not offer coverage to at least 95% of its FTE( in 2015 this includes dependents),

- ❖ The penalty will only apply if at least one FTE is enrolled in a health insurance exchange to which a premium tax credit or cost-sharing reduction is allowed

- ❖ The penalty is calculated on a monthly basis—  
 $1/12 \times \$2,000$

- ❖ There is a 30-person threshold before the penalty kicks in

# Employer Mandate

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**Example:** In 2014, Chinook, Inc. fails to offer minimum essential coverage. The company has 100 FTE, ten of whom receive a tax credit for enrolling in a state-exchanged offered plan. For each employee over the 30-employee threshold, the company owes \$2,000 for the year.

- The total penalty will be \$140,000 ( $70 \times \$2,000$ )
- The penalty is assessed on a monthly basis

# Employer Mandate

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## “Inadequate or Unaffordable Insurance”

- ❖ Penalty on employer who does offer coverage to at least 95% of the FTE but is still penalized .
- ❖ The penalty applies where the insurance
  - a. Is unaffordable ,or
  - b. Lacks minimum value

At least one FTE receives a premium tax credit or cost-sharing reduction through a state exchange
- ❖ The penalty is assessed monthly at a rate of  $\$3,000 \div 12$
- ❖ The maximum penalty is capped at the \$2,000 per employee failure to provide essential coverage

# Employer Mandate

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**Example:** In 2014 Coho, Inc. offers minimum essential coverage and has 100 FTE, 20 of whom receive a premium tax credit for enrolling in a state program.

- For each employee receiving a premium credit the penalty is \$3,000 for a total of \$60,000 ( $20 \times \$3,000$ )
- The penalty is capped at the failure to provide coverage rate of 70 ( $100 - 30$ )  $\times$  \$2,000 = \$140,000
- The penalty is assessed monthly

# Employer Mandate

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## 11. How does an employer know whether the coverage it offers is affordable?

If an employee's share of the premium for employer-provided coverage would cost the employee more than 9.5% of that employee's annual household income, the coverage is not considered affordable for that employee

- If an employer offers multiple healthcare coverage options, the affordability test applies to the lowest-cost option available to the employee that also meets the minimum value requirement



# Employer Mandate

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## 11. How does an employer know whether the coverage it offers is affordable?(continued)

Because employers generally will not know their employees' household incomes, employers can take advantage of one of the following safe harbors :

### a. Form W-2 Determination Method :

Self- Only coverage does not exceed 9.5% of the W-2 as reported in Box 1.

This is determined at the end of the year on an employee-by-employee basis.

The employee's required contribution must remain consistent throughout the year.

# Employer Mandate

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## 11. How does an employer know whether the coverage it offers is affordable?(continued)

### b. Federal Poverty Line Method :

The cost does not exceed 9.5% of the Federal Poverty Line.

### c. Rate of Pay Method:

The cost does not exceed 9.5% of 130 hours x employee's rate of pay as of the first day of the coverage period.

Use monthly salary for salaried employees.

Note: This method could be helpful where the workforce hours fluctuate.

# Employer Mandate

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## **12. How does an employer know whether the coverage it offers provides minimum value?**

A minimum value calculator will be made available by the IRS and the Department of Health and Human Services (HHS).

Employers can input information and determine if the plan provides minimum value by covering at least 60% of the expected costs

# Employer Mandate

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## Other Employer Mandate Issues:

- ❖ Testing Periods- The ER can use any consecutive six month period in 2013 to measure the number of employees in 2013 for the 2014 year.
- ❖ Aggregation rules- Controlled and Affiliated group rules apply
- ❖ Benefits provided through an association: The determination of large employer status is made at the employer level

# Employer Mandate

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## **8. Are companies with employees working outside the United States subject to the Employer Shared Responsibility provisions?**

Not necessarily. For example, if a foreign employer has a large workforce worldwide, but less than 50 full-time (or equivalent) employees in the United States, the foreign employer generally would not be subject to the Employer Shared Responsibility provisions.

# Employer Mandate

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## **9. Are companies that employ US citizens working abroad subject to the Employer Shared Responsibility provisions?**

Yes , if the company had at least 50 full-time employees determined by taking into account only work performed in the United States.

The time spent working outside of the U.S. would not be taken into account for purposes of determining whether the employer owes an Employer Shared Responsibility payment or the amount of any such payment.

# Employer Mandate

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- 6. Do the Employer Shared Responsibility provisions apply only to large employers that are for-profit businesses or to other large employers as well?  
No, non-profit and governmental entities get hammered as well.**

# Employer Mandate

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**13. If an employer wants to be sure it is offering coverage to all of its full-time employees, how does it know which employees are full-time employees? Does the employer need to offer the coverage to all of its employees because it won't know for certain whether an employee is a full-time employee for a given month until after the month is over and the work has been done?**

An employer can use the look back method



# Employer Mandate

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## **16. How will an employer know that it owes an Employer Shared Responsibility payment?**

The IRS will contact employers to inform them of their potential liability and provide them an opportunity to respond before any liability is assessed or notice and demand for payment is made. The contact for a given calendar year will not occur until after employees' individual tax returns are due for that year claiming premium tax credits and after the due date for employers that meet the 50 full-time employee (plus full-time equivalents) threshold to file the information returns identifying their full-time employees and describing the coverage that was offered (if any).

Observation : We need to plan to minimize surprises

# Employer Mandate

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## 17. How will an employer make an Employer Shared Responsibility payment?

The IRS will send a notice and demand for payment.

That notice will instruct the employer on how to make the payment.

Employers will not be required to include the Employer Shared Responsibility payment on any tax return that they file.

# Employer Mandate

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**19. Is transition relief available to help employers that are close to the 50 full-time employee threshold determine their options for 2014?**

Yes. Rather than being required to use the full twelve months of 2013 to measure whether it has 50 full-time employees, an employer may measure using any six-consecutive-month period in 2013.

So, for example, an employer could use the period from January 1, 2013, through June 30, 2013, and then have six months to analyze the results, determine whether it needs to offer a plan, and, if so, choose and establish a plan.

# Other

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- ❖ For pass-throughs the tax is imposed on the entity (1120S or 1065)

# Employer Options

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- ❖ Split up entities to keep below 50 FTE- controlled group
- ❖ Keep employees below 30 hours per week- Hours could company over the top
- ❖ Use EE leasing companies- For which company is the worker a common law employee ?
- ❖ Use Independent contractors- no 530 relief
- ❖ Discriminate on insurance/pay - Insurance policies

Note: All of these options have issues

# Health Care 2018

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## Excise tax on Cadillac plans

- A 40% tax imposed on high cost employer-sponsored and self-insured plans
- The tax is levied on insurance companies and plan administrators
- It is applied to annual insurance premiums for those under 55 that exceed \$10,200 for individuals and \$27,500 for families
- For those aged 55 and above, the threshold is \$11,850 for individuals and \$30,950 for families
- There are age, gender and other adjustments

# Employee vs. Independent Cont.

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- Voluntary Classification Settlement Program (Announcement 2011-64)
  - Purpose is to encourage tax compliance
  - File form 8952
  - Pay about 1% of the prior year payroll
  - No interest or penalties due
  - No audits of payroll taxes for previous years
  - For the first three years after reclassification there is a six year statute

# Employee vs. Independent Cont.

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- Voluntary Classification Settlement Program  
(Announcement 2011-64)

-Requirements:

- Have consistently treated workers as IC' s.
- Have file all 1099' s for the last three years
- Not currently under audit by the IRS or DOL concerning the workers.



- Observations/ Concerns
  - Client may want to pass because they can cling to 530 relief
  - State law?
  - How might workers react ? Do they have a claim for past benefits?
  - Open to liability on torts for whom was previously an independent contractor

# Section 530 Relief - Safe Harbor

**Relief of retroactively being reclassified:**

- Business has consistently treated the workers in the same manner**
- Business has properly filed 1099s**
- Reasonable Basis**

# Section 530 Relief – Reasonable Basis Requirement

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**What is a reasonable basis?**

- \* Court Case or IRS ruling - It only takes one. Rulings to the contrary will not make the reasonable basis invalid**
- \* Prior Audit – A prior clean bill of health**
- \* Long Standing Industry Practice –25%**

# Application for Voluntary Classification Settlement Program (VCSP)

OMB No. 1545-2215

▶ See separate instructions.

**Caution.** Taxpayer must make certain representations in order to be eligible to participate in the VCSP. These representations can be found in Part V, below.

## Part I Taxpayer Information

1 Employer Identification Number (EIN)		2 Taxpayer Name	
3 Number and street (If a P.O. box, see instructions)		Room/Suite	
4 City, town, state, and ZIP code			
5 Telephone Number		File at least 60 days before treating workers as employees	
7 Fax Number (optional)			
9 Type of Entity. Check the applicable box			
<input type="checkbox"/> Sole proprietorship		<input type="checkbox"/> Cooperative organization described in section 1381 of the Internal Revenue Code	
<input type="checkbox"/> Joint venture		<input type="checkbox"/> Tax exempt organization	
<input type="checkbox"/> Partnership		<input type="checkbox"/> State or local government (for worker class or position not covered under a section 218 agreement )	
<input type="checkbox"/> C corporation		<input type="checkbox"/> Other (specify here) _____	
<input type="checkbox"/> S corporation			
10 Are you a member of an affiliated group filing consolidated returns for income tax purposes? <input type="checkbox"/> Yes <input type="checkbox"/> No If "Yes," complete the common parent information on lines 11-14. If "No," skip to Part II.			
11 Name of common parent of the affiliated group		12 Employer Identification Number (EIN) of common parent	
13 Number and Street (or P.O. box no. if mail is not delivered to a street address) of common parent			
14 City, town, state, and ZIP code of common parent			

## IRS Announcement 2012-46

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- IRS has temporarily expanded eligibility for Voluntary Classification Settlement Program (VCSP) that will be available through 6/30/2013. Temporary eligibility expansion makes modified VCSP available to otherwise eligible taxpayers that have not filed all required Forms 1099 for previous three years with respect to workers to be reclassified.



# Expansion of VCSP

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- A taxpayer who participates in the VCSP Temporary Eligibility Expansion agrees to prospectively treat the class or classes of workers identified in the application as employees for future tax periods.
- In exchange, the taxpayer pays 25 percent of the employment tax liability that would have been due on compensation paid to the workers being reclassified for the most recent tax year ,
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# Expansion of VCSP

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- Pays a reduced penalty, for unfiled Forms 1099 for the previous three years with respect to the workers being reclassified;
- Is not liable for any interest and penalties on the liability; and is not subject to an employment tax audit with respect to the worker classification of the class or classes of workers for prior years
- The taxpayer must certify as part of the VCSP Temporary Eligibility Expansion closing agreement with the IRS that it has furnished to the workers and has electronically filed all required Forms 1099 for the previous three years with respect to the workers being reclassified.

# Expansion of VCSP

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- Under the VCSP Temporary Eligibility Expansion, the penalty for unfiled Forms 1099 is graduated, based on the number of required Forms 1099 that were not filed for the previous three years with respect to the workers being reclassified, up to a maximum amount