Chapter 2: Affordable Care Act Update

Substantial proposed regulations have been issued by the Treasury Department in connection with various aspects of healthcare reform over the course of late 2012 and the first part of 2013. At the time this book was published, there was still significant uncertainty with regard to the application of several areas of the law that will require further guidance and clarification.

Moreover, the Department of Health and Human Services (HHS) has also issued proposed rules that must work in conjunction with the rules that the Treasury Department has proposed. Both the Treasury Department and HHS released substantial guidance on February 1, 2013. Throughout 2013, administrative procedures, forms, and lines of communication between governmental agencies continue to be developed.

Although this chapter refers to the recent regulations issued by the Treasury Department and HHS as “proposed,” much of this guidance is subject to change and may become final by the time this book is published.

Because it is impractical to cover all areas of the proposed regulations, this chapter focuses on the proposed regulations that are most relevant to the tax practitioner. Proposed guidance in the following four key areas is covered in this chapter.

- The 3.8% net investment income tax (effective January 1, 2013)
- The 0.9% additional Medicare tax (effective January 1, 2013)
- The individual mandate to maintain healthcare coverage (effective January 1, 2014)
- The employer mandate for healthcare coverage (effective January 1, 2014, with enforcement delayed until January 1, 2015)^1

Please note. Corrections for all of the chapters are available at www.TaxSchool.illinois.edu. For clarification about acronyms used throughout this chapter, see the Acronym Glossary at the end of the Index.

The Health Care and Education Reconciliation Act of 2010\(^2\) created chapter 2A of the Code, which presently consists of only one section: IRC §1411. Under §1411, effective January 1, 2013, a new Medicare tax — the “net investment income tax” (NIIT) — applies to certain types of income received by the taxpayer. In order to understand the scope of the NIIT, it is necessary to have a working knowledge of several definitions and concepts, including the following.

- The types of taxpayers subject to this tax
- The definition of “net investment income” to which this tax applies
- The important exceptions to the application of this tax

On December 5, 2012, proposed regulations\(^3\) were released that provide additional details and guidance regarding many of the key definitions and concepts that define the scope of this new tax.

The proposed regulations indicate that some terms used within §1411 are those that are customary within the area of federal taxation and are construed or defined in accordance with their common meanings. Other terms, however, have been defined in the proposed regulations in a manner designed to promote fair administration of this tax and prevent circumvention of its application.\(^4\)

**TAXPAYERS AFFECTED**

The 3.8% NIIT applies to three types of taxpayers.\(^5\)

- Individuals
- Trusts
- Estates

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\(^2\) PL 111-152 (Mar. 30, 2010).

\(^3\) REG 130507-11, Federal Register, Vol. 77, No. 234.

\(^4\) See Preamble, REG 130507-11, Federal Register, Vol. 77, No. 234.

\(^5\) Ibid.
Individual Taxpayers

For purposes of the NIIT, an “individual” generally refers to any natural person.

IRC §1411(a)(1) states that the 3.8% NIIT applies to the lesser of:

- The taxpayer’s net investment income (NII) for the year, or
- The amount of modified adjusted gross income in excess of the taxpayer’s threshold amount.

Modified adjusted gross income (MAGI) is defined as adjusted gross income (AGI) without regard to the impact of the foreign earned income exclusion (FEIE) or the amount of deductions or exclusions that might otherwise be claimed for the FEIE. The customary definition of AGI is adopted as defined in IRC §62; this is the amount that is shown on the 2013 Form 1040, line 37.

The taxpayer’s threshold amount depends upon the individual taxpayer’s filing status, as follows.

<table>
<thead>
<tr>
<th>Filing Status</th>
<th>Threshold Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Married Filing Jointly (MFJ), Qualifying Widow(er) (QW)</td>
<td>$250,000</td>
</tr>
<tr>
<td>Married Filing Separately (MFS)</td>
<td>$125,000</td>
</tr>
<tr>
<td>Single (S), Head of Household (HoH)</td>
<td>$200,000</td>
</tr>
</tbody>
</table>

Observation. The threshold amounts are not indexed for inflation under current tax law.

Example 1. Miguel is a single individual with a 2013 MAGI of $150,000, which includes NII of $40,000.

I. NII for the year $40,000

II. MAGI in excess of threshold:
   MAGI $150,000
   Less: applicable threshold for filing status (200,000)
   MAGI in excess of threshold $ 0 $ 0

Lesser of I or II: $ 0

Because the lesser of I or II is $0, the 3.8% NIIT does not affect Miguel for the 2013 tax year.

Example 2. Use the same facts as Example 1, except Miguel has 2013 MAGI of $210,000, which includes $20,000 of interest income reported on line 8a of Form 1040 and $20,000 of dividend income reported on line 9a.

I. Net investment income for the year $40,000

II. MAGI in excess of threshold:
   MAGI $210,000
   Less: applicable threshold for filing status (200,000)
   MAGI in excess of threshold $ 10,000 $10,000

Lesser of I or II: $10,000

IRC §1411(d).