From the Trenches of Pioneer Square

Relevant and Irreverent Information and Observations from a Business Lawyer

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HEALTH CARE LAW COMING!

The American people will soon feel the early impacts of a dramatic change in the health care delivery system in our country. The Patient Protection and Affordable Care Act (HR 3590) and the related reconciliation bill, the Health Care and Education Reconciliation Act of 2010 (HR 4872).

What price progress?

The new health care law dramatically expands federal responsibility for the cost of health care and health insurance coverage in America. There are two main cost-drivers. First, the expansion of Medicaid coverage to an additional 16 million people starting in calendar year 2014 will result in an estimated 5 and 3/4-year cost through FY 2019 of $434 billion, or an annual average of more than $75 billion. This provision expands the population covered by Medicaid by 45 percent.

Second, a system of income tax credits, administered by the IRS and new state-based health benefit exchanges, will be introduced in 2014 to serve as subsidies for many individual taxpayers who enroll in the new exchanges for health insurance coverage. By 2018, the CBO estimates that 19 million individuals will be eligible to receive the subsidies, which will cover costs related to premiums and copays of the enrollees. The subsidies, starting in calendar year 2014, have an estimated 5 and 3/4-year cost of $460 billion, or an average annual cost of $80 billion.

In short, the CBO estimates that these two programs will ultimately subsidize health care costs for 35 million more people at an annual average cost of $155 billion--exceeding $5,000 per subsidized person per year. In 2009, there were 141 million individual income tax returns filed. Thus, starting in 2014, the price tag for these programs is equivalent to adding $1,100 annually to the tax bill of every American taxpayer.

Small business wins big (at least for now) with a new tax credit for employer-paid health premiums. A third cost-driver, albeit on a far smaller scale, features a big benefit for small businesses. The new law provides, effective immediately, an income tax credit for eligible small businesses that purchase health insurance for their employees. To be eligible, an employer must have no more than 25 employees, and the average annual wages per employee must be less than $50,000.

The maximum credit--available to employers with 10 or fewer employees with average annual wages of less than $25,000 per employee--is equal to 35 percent of an eligible employer's premium costs. In 2014, the maximum credit will increase, but it will only apply to insurance purchased through one of the new exchanges. Also, it will be available to an employer for only two taxable years starting in 2014. The CBO estimates the cost of this tax credit program over 10 years at $40 billion, or an annual average of $4 billion. Furthermore, small businesses like these are exempt from penalties for not providing insurance to employees.

Other businesses aren't so lucky– they get penalties, not credits. While some small businesses might cheer because of the new tax credit for employer-paid health premiums, larger businesses are not so fortunate. Any business with more than 50 employees that does not offer health coverage may be subject to assessment of a tax penalty equivalent to $2,000 per full-time employee if even one of its employees receives a premium subsidy tax credit. Even if the business provides health coverage, it still can be subject to a minimum $3,000 tax penalty assessment if just one of its employees receives a premium subsidy tax credit. Employers with 50 or fewer employees are not subject to the penalty. But only employers with 25 or fewer employees are eligible for the tax credits.

Purchase of insurance coverage is mandatory for individuals. A simple, two-pronged approach supports the complex plan to achieve the goal of insurance coverage for all Americans. The first prong is to vastly expand eligibility for Medicaid coverage. The second is to mandate that all other individuals obtain health insurance coverage. An individual can get insurance through an employer or through an exchange or through a parent's insurance, but he or she must obtain minimum coverage.

Mandatory individual insurance goes into effect in 2014. The mandate will be enforced through the use of a tax penalty. The penalty for noncompliance will be the greater of a flat fee or a percentage of taxable income. The tax penalty will be phased-in as follows: In 2014, $95 per person (up to $285 per family) or 1.0 percent of taxable income; in 2015, $325 per person (up to $975 per family) or 2.0 percent of taxable income; and in 2016, $695 per person (up to $2,085 per family) or 2.5 percent of taxable income. Thereafter, the flat fee is annually adjusted for inflation.

The new law also prohibits insurance companies from denying coverage to an individual because of pre-existing conditions, rescinding coverage (except in cases of fraud); refusing to renew coverage, considering any factors other than age, geographic area, family composition and tobacco use for premium rating, imposing lifetime limits on the dollar value of coverage or dropping students from their parents' insurance plans before age 26. Every one of these prohibitions will tend to raise premium rates generally. Some of these provisions will go into effect within the next few months, too, so we will begin to feel the impact before the end of this year. Others go into affect in 2014.

The new revenues expected to cover the remaining costs of the new law include an excise tax on high-cost employer-sponsored health plans, excise taxes on health-related industries, and an increase of the Medicare portion of FICA tax--and an extension of the Medicare tax to apply to investment income as well as employment earnings--with respect to individuals with income over $200,000 annually.

While the president has indicated that there are more changes to come, it appears that the Americans can now expect to have health care coverage. But whom do they assume will be responsible for paying for it? Someone else?

Washington's Limited liability company ("LLC") law changed.

There are some recent changes to the Washington law regarding LLC's, or limited liability companies, effective July 1, which apparently do not affect some of the 'picking and choosing' available to businesses operating as LLC's or corporations which have elected to be treated as "pass-through" entities under Subchapter S of the Internal Revenue Code. Some of the features of the two entity types include:

Limited Liability Companies

- limited liability for owners;
- pass through of income to owners, avoiding double taxation (unless corporate treatment is elected);
- ease of operation–fewer filings, fewer forms, fewer start-up costs, fewer formal meetings and record keeping requirements;
- fewer profit-sharing restrictions–earnings distributed as members see fit;

not based on percentage of capital contributions;

- ♦ entire net earnings of LLC passes through to owners in the form of self-employment income subject to 15.3 percent SECA tax (self-employment tax for Social Security and Medicare).

"S corporations"

- ✓ limited liability for owners;
- ✓ pass through of income to owners, avoiding double taxation;
- ✓ the business exists independent and separate from the owner/shareholders;
- ✓ complex administrative operation–more forms and filings required, more formal meetings and record keeping requirements imposed (bylaws, meeting minutes, written resolutions, etc.);
- ✓ profit-sharing restrictions–earnings distributed proportionate to capital contributions of shareholders;
- ✓ flexibility in distributing earnings of the corporation by paying wages and salaries to owner/employees and passing-through other net earnings as passive income to owners.

An LLC is easier to manage than an S corp for operation and administration and beats an S corp for profit-sharing flexibility.

An S corp beats a typical LLC for flexibility in paying earnings to owners as either earned income in the form of salaries and wages or as passive income in the form of distributions.

Before choosing one of these options–or a combination of the two–you will need to determine the features that are most important to you and your business. Call (206)624-6761 and ask for a more detailed memo on the differences.

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