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CPA
Client Bulletin

Smart Tax, Business & Planning Ideas *from your* Trusted Business Advisor[sm]

June 2010

# How the New Health Insurance Laws Will Affect You Now

President Obama has signed into law the Patient Protection and Affordable Care Act of 2010 along with the Health Care and Education Tax Credits Reconciliation Act of 2010. These two new laws will dramatically change health insurance in the United States.

Together, the new legislation includes more than 2,000 pages and many provisions. The most prominent features of the new laws may be the requirement for individuals to purchase health insurance and federal subsidies to help some people with low or moderate income pay for the required coverage. Those provisions won't be effective until 2014, however.

Provisions of the new legislation that are effective immediately or later this year generally place restrictions on health insurers. Insurance companies

- won't be able to limit lifetime payouts to specific policyholders.
- must comply with annual payout limits, which will be described by federal regulations.
- won't be allowed to drop policyholders; however, they will be able to cease coverage for individuals who commit fraud or intentional misrepresentation.
- must cover preventive services such as checkups without copays, coinsurance, or deductibles.
- can't exclude children from coverage because of pre-existing medical conditions.
- must allow children to remain on their parents' policies until they reach age 26.

Additionally, two programs will be established in 2010 and remain in effect through 2013. One of these programs enables adults with pre-existing medical conditions to obtain health insurance in a high risk pool. The other will assist companies in maintaining health coverage for former employees between ages 55 and 65, until they qualify for Medicare.

Also, the federal government will pay a $250 rebate in 2010 to Medicare beneficiaries who reach the so-called "donut hole" for the year. Many Medicare enrollees buy a Part D plan to provide coverage for prescription drugs. After they spend $2,830 for prescription drugs under the plan (in 2010), these seniors must pay full price

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## Tax Savings Tip

*Combining business and pleasure travel might make some summer vacation costs tax deductible.*

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until they reach $4,550 in outlays and insurance coverage resumes. This coverage gap is the donut hole. Other provisions in the new legislation will completely close the donut hole by 2020.

## New tax credit

One provision effective for 2010 is a tax credit for small companies that provide health insurance to employees.

*Which companies qualify?* To get the full tax credit, a company must have 10 or fewer employees and the average annual wage must be less than $25,000. Partial credits are available to companies with as many as 25 employees and average wages up to $50,000.

*What are the credits worth?* The maximum credit is 35% of premiums paid. The calculation is far from simple, though. Only nonelective employer contributions count as premiums paid. That is, contributions made to a salary reduction arrangement under a cafeteria plan don't count.

The nonelective contributions must then be compared to the average health insurance premium for the small group market in the company's state. The smaller number will be used as the base for determining the tax credit.

**Example:** ABC Corp. has 8 full time employees and a total payroll of $190,000 per year (an average of $23,750 per employee per year). The company pays $20,000 a year for employee health insurance, a number that is smaller than the state average for small groups. Therefore, the company qualifies for a tax credit of $7,000 in 2010, 35% of $20,000.

In calculating the tax credit, premiums paid to cover some employees don't count. This group includes seasonal workers, self-employed individuals, shareholders who own 2% or more of an S corporation, and owners of 5% or more of a small business. Premiums paid to cover this group's dependents or other household members won't count either. Our office can help you determine whether your business qualifies for this tax credit and make the required calculation.

As previously mentioned, these tax credits will be offered from 2010 through 2013. Starting in 2014, a new program will take effect, offering tax credits of up to 50% of premiums paid.

Next month's *CPA Client Bulletin* will include detailed coverage of the key elements of the new legislation that will take effect in future years. ■

### Did You Know?

In households where one person receives Social Security benefits, the average monthly payment is $1,152. When a retired worker and a spouse age 62 or older receive benefits, the average monthly payment is $1,892. The largest monthly check in 2010 is $3,119, payable to high income workers who wait until age 70 to collect benefits.

*Source:* Social Security Administration

# New Tax Breaks Make Long-Term Care Packages More Appealing

If you'll need to go into a nursing home some day or hire a caregiver in your own home, you'll probably have to pay substantial amounts. (For more information on the costs of long-term care, please see the article "Higher Costs for Long-Term Care" in the December 2009 issue of *CPA Client Bulletin*.) Long-term care (LTC) insurance policies are available, but many people are reluctant to buy this coverage. Fortunately, several provisions of the Pension Protection Act of 2006 just took effect in 2010; they can make it more practical to obtain LTC insurance by combining it with life insurance or an annuity.

## Use it or lose it

Depending on the level of coverage you select and how old you are when you buy an LTC insurance policy, you might pay more than $2,000 a year. Married couples could pay over $4,000 to cover both spouses. That's a considerable expense for many people, especially retirees who are living on a fixed income.

Moreover, you'll pay those thousands of dollars without a guarantee that you'll get any benefits from your LTC insurance. Some seniors use little to none of their long-term care benefits during their lifetimes. Paying steep premiums for an LTC insurance policy you'll never use is less than desirable. You may wish to look for another type of coverage.

## Combination coverage

As an alternative to a "straight" LTC policy, you can obtain LTC coverage as an addition to your life insurance policy. That way you'll know that at least someone will benefit from the premiums you pay.

**Example 1:** Steve Clark buys a $500,000 insurance policy on his life, payable to his two children. He chooses to add an LTC rider to this policy. If Steve needs care, the policy will pay a benefit to help him with the cost. However, such payments probably will reduce the death benefit that Steve's children eventually will receive.

If Steve never needs long-term care, his children will receive the life insurance policy's full death benefit when he dies. Therefore, the premiums that Steve pays for this policy eventually will generate a payout.

You also can buy a deferred annuity with an LTC rider. A deferred annuity is an investment that can earn income but delays income tax until you withdraw money.

**Example 2:** Janette Rogers invests $100,000 in a deferred annuity and selects an LTC rider. As is the case with all deferred annuities, any earnings on that $100,000 will not be taxed until Janette takes money from the annuity. The LTC rider will pay Janette a benefit if she needs care; however, such payments will reduce the amount of money available to Janette as an annuity.

If Janette does not need long-term care, she will be able to tap the full amount of the deferred annuity for living expenses. Depending on the choices Janette makes with her deferred annuity, her beneficiaries may receive a benefit upon her death. By choosing an annuity/LTC insurance combination product, Janette gets LTC coverage along with the assurance that her premiums ultimately will deliver a financial benefit.

## Delayed gratification

Life insurance/LTC insurance and annuity/LTC insurance combination products have been around for a while. They were enhanced by several of the recently effective tax provisions of the Pension Protection Act of 2006.

- *Annuities with LTC riders are explicitly recognized in the tax code.* Previously, the tax benefits of life insurance/LTC policies were spelled out but annuity/LTC combinations didn't garner the same recognition. The new law makes it clear that annuities with LTC riders can make tax free payments for coverage under the LTC rider.
- *Internal cash transfers can be tax free.* In many of these combination products, you pay a premium for the life insurance policy or the annuity, and then the company makes a bookkeeping entry that pays for LTC coverage. Under prior law, you might have been taxed as though money had been withdrawn from the life insurance policy or annuity. The new law removes the tax on such phantom income.
- *LTC insurance joins the 1035 club.* For many years, Section 1035 of the tax code has allowed consumers to make tax-free exchanges of life insurance policies and annuities. Now, LTC insurance policies also are on the list.

**Example 3:** Phil Allen owns a deferred annuity that he no longer needs. Phil can exchange this annuity for an LTC insurance policy. To effect the exchange, Phil can apply for an LTC insurance policy. Once the LTC insurance company approves Phil's application, he can transfer his annuity to the LTC insurer, which will surrender the annuity and use the money it receives to fund the LTC insurance policy. Phil won't owe tax on any earnings accumulated within the deferred annuity.

The new law allows an exchange into an LTC insurance combination product or a policy that provides only LTC insurance. Either way, you're using money that you've already spent to buy LTC coverage.

All LTC insurance products can be complex. Combining them with life insurance or annuities may make them even more difficult to understand. If you are interested in LTC coverage, working with an experienced insurance agent is a good idea. Our office can help clarify the costs and possible benefits of a particular policy while reviewing the impact of the new tax provisions. ■

## Trusted Advice

### Long-Term Care Qualifications

- The new tax benefits for long-term care (LTC) insurance are available only if the policy is "tax-qualified."
- To be tax-qualified, a policy must pay benefits only when a licensed health care practitioner asserts that at least two activities of daily living (ADLs) can't be performed without substantial assistance.
- ADLs include eating, bathing, dressing, getting in and out of beds and chairs, and using the bathroom.
- For people who can perform their ADLs, an LTC policy may be tax-qualified if it pays benefits in cases of severe cognitive impairment.
- The conditions requiring care must be expected to last for at least 90 days.
- Most LTC insurance policies now sold are tax-qualified.

# Tax Strategies for Unmarried Couples

Typically, married couples pay lower taxes if they file joint returns rather than filing separately. However, if a couple is living together but not married, the two taxpayers can't file jointly.

Nevertheless, there are ways for unmarried cohabitants to reduce the household's income tax bill.

## Determining the deductions

The higher your tax bracket, the more tax you'll save from a deduction that reduces your income.

**Example:** Alice Johnson expects to have around $200,000 in taxable income this year, which will put her in a 33% federal tax bracket. She lives with Richard Smith, who expects to have taxable income of $50,000, which will put him in the 25% tax bracket.

This couple decides to contribute $1,000 to their favorite charity. If Alice writes the check, she'll reduce her taxable income by $1,000 and save $330 in tax, at a 33% rate. If Richard writes a $1,000 check, he'll save only $250. Therefore, it makes sense for Alice to make the couple's charitable donations.

Similarly, if this couple uses a mortgage to buy a home, Alice should write the checks to take the deduction at her tax rate. If they take out the mortgage loan together, it is a good idea for Alice to contact the lender to make sure that her Social Security number is on the report of mortgage interest that it files with the IRS.

## Alternative solutions

In keeping with the previous example, in most cases Alice should also pay the real estate property tax to get the deduction in her higher tax bracket. However, Alice may find herself subject to the alternative minimum tax (AMT). Many moderate income and high income taxpayers owe the AMT if they use certain tax credits and deductions. Taxpayers who are subject to the AMT are allowed no federal tax deductions for state or local tax payments. As long as Richard is a co-owner of the house and not subject to the AMT, he can pay the property tax bills and take deductions to cut his federal income tax.

Richard also should pay for items that qualify as miscellaneous itemized deductions, such as investment publications and tax preparation software. Miscellaneous deductions only save tax to the extent that they exceed 2% of your adjusted gross income, and Richard is more likely to clear that hurdle than Alice.

## Capital idea

For some unmarried couples, income differences may be even greater than they are for Alice and Richard. One partner may earn income while the other stays home to manage the household. In such situations, the high bracket partner might transfer appreciated assets to the low bracket partner before an intended sale. As long as the low bracket partner has taxable income of no more than $34,000 (in 2010), any gains on assets with a holding period longer than one year will not be taxed.

Transfers of assets between unmarried partners may have gift and estate tax consequences. Our office can help with those issues as well as other tax matters that may arise for unmarried couples. ■

## TAX CALENDAR

### JUNE 2010

**June 15**

**Individuals.** If you are not paying your 2010 income tax through withholding (or will not pay enough tax during the year that way), pay the second installment of your 2010 estimated tax.

If you are a U.S. citizen or resident alien living and working (or on military duty) outside the United States and Puerto Rico, file Form 1040 and pay any tax, interest, and penalties due for 2009. If you want additional time to file your return, file Form 4868 to obtain four additional months to file. Then, file Form 1040 by October 15th, 2010.

**Corporations.** Deposit the second installment of estimated tax for 2010.

**Employers.** For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in May if the monthly rule applies.

### JULY 2010

**July 15**

**Employers.** For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in June if the monthly rule applies.

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