Obamacare Part 1- Increased Taxes

The Patient Protection And Affordable Care Act (PPACA), affectionately known by its political opponents as Obamacare, survived its scare with the Supreme Court and its now time to examine it's impacts on you. I'll do this in three parts: First, in this post I'll look at its effects on you as a taxpayer. In part 2, I'll examine its effects on you as a consumer of health care. In the final post, I'll look at its effects on your medical practice.

PPACA and Me

The biggest disappointment for me with PPACA was that it didn't solve the biggest issues with health care in this country- the rapidly increasing cost of obtaining needed health care. The best way to do this is to allow market forces to act by increasing transparency of pricing and ensuring cost sharing for everyone, which will not only increase competition, but more importantly, allow economics to affect decision making so people will actually choose not to consume some types of expensive medical care. I have mixed feelings about those two things happening, however, since it seems there is a good chance that true reform like that could also heavily impact my compensation.

The second biggest disappointment for me with PPACA is that my taxes are probably going to go up to pay for it. The $250K "definition of wealthy" now constantly discussed in Washington didn't seem to be an issue when I was making $20K as a med student, $40K as a resident, or $100K as a military doc. But now that I've finally reached my career peak earnings, much of our society seems to have decided that making a lot of money is a bad thing and those who do so need to pay more taxes. Rant over. Now on to the meat.

Increased Medicare Tax

The main way my taxes are going to go up is through increased Medicare taxes. You currently pay 2.9% of your wages in Medicare tax and you pay 0% of your investment income in Medicare tax. Beginning in 2013, you will pay 2.9% on your first $200K ($250K if married) of wages, and then 3.8% on everything above that. In addition, you will pay 3.8% on all of your investment income if your wages are higher than $200K ($250K if married.) If your wages are less than $200K/$250K, then you would pay the tax only on the portion of your investment income that when combined with your wages exceeds $200/$250K.

So consider a doctor with a taxable wage income of $300K per year plus another $50K in investment income. His tax bill would be $50K*.009+$50K*.038= $2350 higher in 2013 than it was in 2012.

That doesn't seem too bad until you consider four other facts. First, if Congress doesn't act before the end of the year, the "Bush tax cuts" which lowered the capital gains tax rate from 20% to 15% will expire. Combine those two changes and you could face a capital gains tax increase of 8.8%, increasing the taxes owed by the doctor in the example from $2350 to $4850.

Second, you may also owe capital gains tax when you sell a house. The first $250K ($500K if married) in gains on the sale of your main home is exempt from tax, so most Americans and many doctors will never owe. For example, a $500K house could double to $1 Million and you still wouldn't owe any taxes on its sale. But what if you owned a house in the Bay Area you bought 30 years ago for $200K that is now worth $2.2 Million? What kind of a tax bill would you be looking at on that?

Assume $250K in taxable wages and no other investment income. $2.2 Million minus $200K minus the $500K exemption (luckily you're married) leaves you with $1.5 Million in taxable capital gain. The tax bill on that sale could be as high as $357K in 2013, whereas it would be just $225K in 2012. That's a pretty serious tax increase.

Third, there's a serious marriage penalty inherent in this tax. A couple of doctors living together making $300K each would owe this tax on $200K total in income. A married couple making $300K each would owe on $350K in income, which would cost them $1350, more if there were investment income involved as there should be among people with these incomes.

Last, these income limits ($200K single/$250K married) are NOT subject to inflationary increases. Just like the alternative minimum tax, this tax will eventually hit the middle class due to bracket creep. So even if you can avoid this tax today, you may still get hit with it a decade from now.

FSA, HSA, and HRA Changes

If you use a Flexible Spending Account (FSA), in 2013 you'll notice its limits have decreased from technically unlimited (although many employers often set the limits at $5000 year) to $2500 a year. Critics have called this the "special needs kid tax" since many families use an FSA to pay for the education of their special needs children.

Health Savings Accounts (HSA) used to charge you an extra 10% in tax if you used the money on something besides health care, at least before retirement. Beginning this year that penalty doubles to 20%. You can still use an HSA as a Stealth IRA, but raiding it prior to retirement just became even more painful.

Beginning last year, you can't use an FSA, an HSA, or a Health Reimbursement Account (HRA) to pay for over the counter medications.

Insurance and Medical Deductions Changes

These changes are unlikely to affect you. If your employer provides really expensive medical insurance (more than $10,200 in annual premiums for an individual or more than $27,200 for a family), you're probably going to get less expensive insurance because otherwise your employer and the insurance company will get hit with a huge 40% tax on the premiums above the threshhold. This provision is really aimed to curb abuse by unions and executives who are basically getting tax-free income by routing it through their health insurance plans.

If you are unfortunate enough that you actually spent more than 7.5% of your income on health care, you used to be able to deduct the amount over 7.5% on Schedule A. That amount increases to 10% starting next year. This won't hit most doctors who have health insurance, but retirees could pay more due to lower income and higher health care expenses. This won't affect many though, since retirees are less likely to itemize than someone in their peak earning years with a large mortgage.

Various other taxes

There are many other, less important taxes that could affect you. They're aimed primarily at businesses that will pass them on to you in the form of higher costs. The 10% tanning tax is the most well-known, but there are also taxes aimed at insurance companies, drug companies, and medical device makers.

The Mandate

If you should choose not to buy health insurance, either as an individual or as an employer of more than 50 employees (not that hard of a threshold to cross if you are a partner in a large medical group), and you don't qualify for an exemption (poverty, hardship, religious objector, Native American, prisoner, or illegal immigrant), then you're looking at paying some more money starting in 2014. The individual mandate ranges from $95 to $2085, or 1%-2.5% of your income, whichever is higher, per year. The employer mandate can be as high as $3000 per employee. Even delaying enrollment can cost you $400-600 per employee.

How To Avoid The Taxes

Like with any tax, the more familiar you are with the tax code the easier it is to lower your tax bill. You can avoid the mandate pretty easily by doing what you should be doing anyway- buying health insurance for you and your employees. The FSA/HSA restrictions aren't too bad, unless you have a disabled child. The main tax to worry about is the increased Medicare tax. You can lower your taxable income by deferring more money into 401Ks and cash balance plans, perhaps even keeping you under the $200K/$250K threshold. Incorporating to save on Medicare taxes is becoming a much less useful strategy, at least for those with taxable wages well above $250K. If you live in a very expensive house that you've been in long enough to actually have significant capital gains, and you plan to move in the next few years, you may wish to sell your home in 2012 rather than waiting. Finally, you always have the surefire way to pay less in taxes- make less money. While you never pay more in taxes than you make, time off may appeal more to you than paying 40-50%+ of your marginal earnings in taxes.

Next time I’ll look at PPACA as a consumer of health care.

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