The Effect of Federal Healthcare Legislation on Family Law

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Unless the U.S. Supreme Court rules the new federal health care law unconstitutional, it is repealed, or Congress does not fund it the Patient Protection and Affordable Care Act (P.L. 111-148) as amended by the Health Care and Education Reconciliation Act of 2010 (P.L. 111-152) will, for the most part, go into effect in 2014.

It is now the law and to avoid nasty surprises, it is not too early for the bench, family law attorneys, tax attorneys and other professionals to now consider the new law when drafting orders, judgments and decrees and marital termination agreements.

A. This presentation does not cover the entire 2010 Federal Health Care Legislation. Excluded topics are:

    1. "Large Employer" (50 or more fulltime employees) mandates, subsidies and penalties.
    2. "Small Employer" (25 or less fulltime employees) with average annual compensation between 25K to 50K eligible the 35% health insurance premium tax credit.

    NOTE: for both large and small employers in the year 2012 and in future years health flexible spending arrangement (FSA) salary reduction plans for medical expenses are capped at $2,500.00 per year adjusted for inflation commencing in 2014.

    3. Pharmaceutical, Medical Device, Health Insurance Taxes, Regulations and Excise Tax on "Cadillac" Health Plans.
    4. Medicare, Parts A (hospitalization), Part B (physicians, outpatient hospital services and durable medical equipment), Part C (Medicare advantage plans and the like), Part D (drugs).

NOTE: I have included with my materials [Form SSA-44, revised May, 2010] which permits a request for reduction of Medicare Part B income related insurance premium. For taxpayers with AGI of $85,000.00 ($170,000.00 for joint returns) Medicare Part B premiums increase with income and can total as much as 4 times the regular premium roughly paralleling the ratio of the 75% general revenue subsidy to Medicare over Medicare taxes. The 2010 regular (not grandfathered monthly rate of $96.40) monthly premium is $110.50; plus maximum income based increase in monthly premium of $243.10 = total monthly premium of $353.60.

Beginning in 2011, per P.L 111-148 § 3308 (a) the increased income adjusted premium for Medicare Part D (Drugs) was added by the 2010 legislation using the income thresholds for Medicare Part B. The average 2010 Medicare Part D premium is $31.94 and the income adjusted premium could be as much as $127.76.

When joint returns are filed, the lower income spouse could receive a massive Medicare premium increase. Be careful. The Medicare Part B provision was enacted into law prior to 2010. The Medicare Part D provision is new.

5. Many other miscellaneous provisions in the new legislation including new IRS Form1099 reporting requirements for businesses, new requirements for reporting health care payments on employees' W2 and beginning in 2013, the medical expense deduction threshold is increased from 7.5% to 10% of AGI except for persons over age 65 which are grandfathered in until 2016.
6. New taxes in 2013.

    a. .09% Medicare tax on wages and self employment income. Rate increase is only on employee share on incomes over $200k/ $250k joint returns.
    b. 3.8% Medicare tax on net investment income. Applies to incomes over $200K/ $250K joint return. Includes interest, dividends, annuities, royalties, rent and (capital gains?). Excludes IRA and qualified plan distributions but they are included in base income in computing $200K/ $250K threshold.

B. This Presentation includes:

The new Federal Health Insurance obligation imposed on individuals including the:

1. Mandate
2. Subsidy
3. Penalty

Obligations, Indemnity and Hold Harmless Agreement in Legal Separation and Dissolution of Marriage Decrees. See *Fast v. Fast* 766 N.W2d 47 (Minn App 2009) and their effect on medical insurance provisions in Judgments and Decrees.

YOUR QUESTIONS

The questions that you should now be asking in family law matters are:

1. Which party does federal law mandate to carry individual coverage for children?
2. On whom will the penalty fall if it does not occur?
3. On which party's income is the health insurance subsidy based?
4. How much is the subsidy?
5. What is the effect of the award of the right to claim the income tax dependency exemption on the health insurance mandate, penalty and subsidy?
6. What is the bankruptcy law effect of including a heath insurance requirement or an indemnification and hold harmless provision in a Judgment and Decree?
7. How should health insurance obligations, indemnification and hold harmless provisions be modified if inserted in judgments, decrees and orders?
8. How does the new healthcare law interrelate with Minn. Stat. §518A.41 dealing with medical support and, in particular, Minn. Stat §518A.41, subd. 4 relating to "ordering health care coverage"?
9. Will the IRS use the allocation of the dependency exemption as a weapon and not a benefit?
10. What if the divorced spouses live in different states, or one spouse later moves to another state with a much higher premium?

STATUTORY STRUCTURE OF THE NEW FEDERAL HEALTHCARE LAW

To understand the answers to the above questions, one must first generally grasp the statutory structure of the law. There are three basic concepts:

1. Mandate. Generally, the new law requires individuals to carry a certain prescribed level of health insurance for the individual and the individual's dependents unless they are covered under other qualifying health insurance, such as employer-based health insurance or certain other qualifying governmental plans.
2. Subsidy. The subsidy for the mandated health insurance is created in new IRC § 36B "REFUNDABLE CREDIT FOR COVERAGE UNDER A QUALIFIED HEALTH PLAN." The subsidy for the mandate is created and administered through the filing of tax returns, is a refundable tax credit referred to as the "premium assistance credit" and is steeply and inversely graduated based on the "household income" of the taxpayer starting at 2% of household income up to 133% of poverty line income and rising to 9.5% of household income for incomes up to 400% of poverty line income (See IRC § 36B(b)(3)(A)).
3. Penalty. To enforce the mandate, IRC § 5000A, subd. (b) provides that if a taxpayer fails to meet the mandated coverage for the taxpayer or a dependent of a taxpayer as defined in IRC§152 the taxpayer, or the taxpayer and the spouse with whom the taxpayer files a joint return, is liable for a penalty for each month (after three months) in which the coverage is not in effect. Note that the penalty is tied to the dependency exemption. The penalty must be "included" with the taxpayer's return for the taxable year of the period of non-coverage.

An easy way to remember these three key terms is the acronym "MSP," Mandate-Subsidy-Penalty, as in Minneapolis/St. Paul airport.

THE MANDATE

IRC § 5000A requires an individual to "... ensure that the individual, and any dependent of the individual ... is covered under minimal essential coverage ..." The language in this section is odd because the statute does not require an individual to provide coverage but only to "ensure" the coverage. The words "shall" or "must" are not used. It is peculiar terminology and one wonders whether in the context of a dissolution of marriage proceeding, for example, that obtaining a court order ordering a party to provide the coverage would be sufficient to "ensure" the coverage.

THE SUBSIDY

The federal subsidy for the cost of qualifying health insurance premiums is in the form of a refundable tax credit to be claimed by the individual taxpayer on the taxpayer's income tax returns commencing in 2014. Hence, the subsidy is primarily administered by the IRS. Under some circumstances the tax credit can be determined and paid in advance, presumably directly to the insurance company.

To compute the subsidy, initially 2012 income is used for the 2014 subsidy. If income for 2014 is actually higher than 2012, the taxpayer will have to repay the subsidy (repayment capped at $250.00 for individuals and $400.00 for a family if income is less than 400% of the poverty line. If actual 2014 income is over that, 100% of the claimed credit must be paid back without limit). A refund can be claimed if 2014 income is actually lower than 2012.

Basically, the way the system is intended to operate is that beginning in 2014, each state must set up an Exchange, which is essentially a market by which private insurance companies will offer individual coverage of health insurance, which must contain certain levels of "essential benefits." There are four benefit levels to be available, referred to as "bronze," "silver," "gold" and "platinum" levels. The benefit level of each of these plans increases from the lowest "bronze" level to the best or "platinum" level. The insurance companies will then compete as to price for each of these offerings. The subsidy (tax credit) is based on the second lowest cost "silver" plan available in the Exchange in the state where the taxpayer resides. If divorced spouses live in different states, the comparative cost of qualifying coverage can be dramatic.

To be eligible for the tax credit, the taxpayer's household income must be no more than 400% of the federal poverty line for the family size involved. Those at or below poverty level will probably be shifted to the new and expanded medical assistance program. Those with incomes above the 400% poverty level are not entitled to the credit. Set forth below is the 2009 U.S. HHS poverty guidelines for the 48 contiguous states:

The 2009 Poverty Guidelines for the 48 Contiguous States and the District of Columbia			
Persons in family	**Poverty guideline**	**Persons in family**	**Poverty guideline**
1	$10,830	5	25,790
2	14,570	6	29,530
3	18,310	7	33,270
4	22,050	8	37,010
For families with more than 8 persons, add $3,740 for each individual person.			

SOURCE: *Federal Register*, Vol. 74, No. 14, January 23, 2009, pp. 4199–4201

The higher the taxpayer's household income and the lower the number of individuals in the "household," the lower is the premium assistance credit.

To be eligible for the credit, taxpayers who are married at the end of the year must file a joint income tax return. No credit is allowed to any individual for whom a dependency exemption deduction is "allowable" to another taxpayer (apparently, without regard to whether the other taxpayer actually claims the dependency exemption). Compare the dependency exemption language to depreciation recapture for depreciation "allowed or allowable". Note that in other provisions of the law, determinations are not based on whether the dependency exemption is allowable, but based on whether it is allowed, i.e. actually claimed. Perhaps the IRS will force a taxpayer to claim it.

The family size in calculating "household income" is determined by the number of individuals for whom the taxpayer is actually "allowed" personal exemptions. For example, in a family of four with two spouses and two minor children, all of whom are claimed exemptions on a joint return, the family size would be four.

"Household income" is the taxpayer's adjusted gross income increased by tax exempt interest and the foreign earned income and foreign housing expenses excluded from gross income for taxpayers residing outside the United states or actually working outside the United States for extended and specific number of days. This is referred to as modified adjusted gross income. The refundable tax credit diminishes as the taxpayer's household income increases because the tax credit is based on a percentage of the taxpayer's income, which increases from 2% to 9.5%.

Essentially, the subsidy is the amount by which a qualifying premium payment exceeds the product obtained by multiplying the applicable percentage by the household income.
Reprinted below is a table set forth in IRC § 36B(a)(3)(A).

(A) APPLICABLE PERCENTAGE.

(i) In general – Except as provided in clause (ii), the applicable percentage for any taxable year shall be the percentage such that the applicable percentage for any taxpayer whose household income is within an income tier specified in the following table shall increase, on a sliding scale in a linear manner, [emphasis mine] from the initial premium percentage to the final premium percentage specified in such table for such income tier:

In the case of household income [Emphasis mine] (expressed as a percent of poverty line) within the following income tier:	The initial premium percentage is –	The final premium percentage is –
Up to 133%	2.0%	2.0%
133% up to 150%	3.0%	4.0%
150% up to 200%	4.0%	6.3%
200% up to 250%	6.3%	8.05%
250% up to 300%	8.05%	9.5%
300% up to 400%	9.5%	9.5%

These amounts are to be indexed in future years as well as indexed for the rate of premium growth. Further, all of the computations to be made in determining the tax credit will be done on a monthly basis, but for simplification in this presentation annual amounts are used. Also, the break points in the percentages will be smoothed by the "linear" "sliding scale" by regulations.

If the "second lowest cost silver plan" premium is used, there is disregarded premiums for benefits offered by an insurer in addition to the required essential health benefits and there is also disregarded any premiums for state mandated benefits in addition to the essential health benefits. Some pediatric dental coverage is included.

In all cases, the computations must be made for both the taxpayer's own coverage ("self-only coverage") and family coverage. "Household income" is defined as "modified adjusted gross income" of the taxpayer and all individuals for whom a dependency exemption deduction was "allowed" and who were required to file a tax return for that year. Hence, even though a claim for a dependency exemption may have been allowable, if it was not claimed and allowed, the dependent's income would not be included and if a dependent (or for that matter, the taxpayer) was not required to file a tax return because the person's income did not meet the filing threshold (in 2010, $9,350.00 for a single person or married person filing separately, or $18,700.00 for married person filing jointly), the income of those individuals is not included. (There is discussion that by 2014 almost every adult must file some income report with the IRS if no tax return is required or filed).

There is no distinction between the income of a spouse or a dependent and so, presumably, if the exemptions are not claimed the income of the spouse or dependent would not be included. Finally, the credit cannot exceed the lesser of the actual premium for the qualified health plan paid by the taxpayer or the monthly premium that would have been paid for the <u>second lowest cost</u> "silver" plan.

The best way to show how the premium credit works is by the following Example. Assume that the second lowest cost silver plan for family coverage is $12,000.00 per year for a family of four and the taxpayer actually purchased that insurance:

1. Assume that the taxpayer is married and has filed a joint return with the spouse as required.
2. Assume that the taxpayers actually claimed as dependency exemptions their two minor children.
3. Assume that the children did not have any income (and that there was no "kiddie tax" imputed income to the parents) and therefore were not required to file tax returns themselves.
4. Assume that the taxpayer's and spouse's combined household income was $80,000.00. This would put them in the range for claiming the tax credit. If their household income was below $22,050.00, they would likely be on Medical Assistance, would not be purchasing the insurance on the Exchange and therefore would not be entitled to a credit. If their combined household income was over $88,200.00 (4 x the 22,050 poverty line for a family of four), the taxpayers would not be entitled to the healthcare tax credit because their household income would be over 400% of the poverty line.

5. The healthcare credit is computed by first multiplying the taxpayers' household income of $80,000.00 by 9.5% (The percentage used when the taxpayers' household income lies between 300% and 400% of the poverty line.). The product of this multiplication is $7,600.00. The refundable healthcare credit then would be $12,000.00 minus $7,600.00 or $4,400.00.

DIVORCED PARENTS AND PATERNITY CASES

Let us examine the after tax credit cost of an Exchange purchased health insurance policy for divorced or unmarried parents. First, the following observations should be made:

1. Household income does not include child support.
2. Household income includes spousal maintenance to the recipient because spousal maintenance is included in gross income, but is excluded from the household income of the payor because spousal maintenance is deducted from gross income in computing adjusted gross income.
3. In computing household income for purposes of the applicable percentage of the poverty line, the family size to be used depends on which of the parents is "allowed" to deduct the dependency exemption for the children. Therefore, if the non-custodial parent is granted the right to claim a child as an exemption (for example, the custodial parent executes IRS Form 8332 granting to the non-custodial parent the right to claim the exemption), the poverty line percentage for the custodial parent (assuming the custodial parent is not remarried and has no other children) would then be determined based on a household of one whereas the non-custodial parent's percentage would be based on a household of two.
4. If the household income of one parent is below the poverty line and that parent is mandated to "ensure" that the child has the insurance, that parent would likely pay nothing for health insurance. Using the facts in the Example above, except that the parties are divorced and the non-custodial parent claims the two children as exemptions, if the non-custodial parent had a household income of over $73,240.00 (four times the $18,310.00 poverty line for a family of three), that parent would have no subsidy for an annual $12,000.00 health insurance premium covering the parent and the two children. IRS § 5000A imposes the penalty for

failure to have the minimum insurance on the taxpayer on whom the child "is a dependent (as defined in § 152)." Note that the child under 18 penalty is only one-half of the adult penalty.

5. If the higher income parent claims the dependency exemption for a child, then that parent must pay the penalty. If the lower income parent claims the dependency exemption, then the lower income parent must pay the penalty.
6. If the parents live in different states, the subsidy is based on the premium in that state.
7. If there is more than one child, and the parents either split the right to claim the children as exemptions between them or if the right to claim a dependency exemption is alternated between parents, then the mandate, subsidy and penalty must be done for both parents. This could lead to great confusion and even chaos.

THE PENALTY

By the year 2016 individuals who fail to maintain the minimum essential coverage are subject to a penalty under IRC § 5000A equal to the **greater of** (1) 2.5% of household income in excess of the minimum income required to file a tax return (In 2010 the income tax return filing threshold is $9,350 for a single person and married persons filing separately and $18,700 for married persons filing jointly and persons filing head of household) **or** (2) $695 per uninsured adult in the household and one-half of that amount for each household member under age 18. The total household penalty may not exceed $2,085. Further, the total annual household penalty may not exceed the national average premium for a "bronze level" health plan (not to be confused with the second lowest cost "silver level" health plan, which is used to compute the healthcare tax credit subsidy under IRC § 36B(b)(2)(B)(i)).

The per adult penalty is phased in: $95 for 2014; $325 for 2015; $695 for 2016; thereafter the penalty is indexed to the CPI. The percentage of income penalty is also phased in: 1% for 2014; 2% for 2015; 2.5% beginning in 2016. Married persons filing joint returns are jointly liable for the penalty. The penalty is calculated on a monthly basis and essentially does not begin to run until there is a lapse of insurance for three months. The penalty is assessed through the Internal Revenue Code and is treated as an additional amount of tax owed. The penalty must be paid upon notice and demand by the IRS and is assessed and collected in the same manner as most other assessable penalties. Although the IRS is not authorized to file tax liens or seize property for collection of the tax, nor is noncompliance with the individual responsibility to carry health insurance subject to criminal or civil penalties and interest does not accrue on the failure to pay the assessment, the tax must be reported on the individual income tax return and certainly, if there is any estimated or withheld taxes paid, it will be used to pay the penalty. See Joint Committee on Taxation, Act §1501 (JCT Rep. NO JCX – 18 – 10). My guess is that the penalty could be discharged in bankruptcy if a bankruptcy petition is filed three years after the date of assessment like other income tax liabilities except as affected by a dissolution decree or other court order.

Household income is defined as adjusted gross income (AGI) of the taxpayer plus the AGI of all individuals in the household who are required to file a tax return for that year. Household income is increased by tax-exempt interest and the foreign earned income exclusion.

If family coverage is not affordable (i.e. (a) the required employee contribution to an employer health plan or (b) the net cost of the <u>actual</u> premium after the federal subsidy through the refundable tax credit for an Exchange based plan for the <u>lowest cost</u> "bronze level" health plan exceeds 8% of the taxpayer's household income (increased by any salary reduction arrangement, such as a cafeteria plan)), the taxpayer is exempt from the penalty.

Also, if an employee (depending on his exact income) with a family is offered self-only coverage from the employer costing 5% of income and family coverage costing 10% of income, the employee may not be eligible for the tax credit for self-only coverage because it costs less than 9.5% of household income. However, the employee is not exempt from the penalty for failure to purchase self-only insurance because the self-only insurance costs less than 8% of income.

The minimum coverage required by the law is met (and no penalty is imposed) by coverage through eligible employer sponsored plans, grandfathered group health plans, Medicare, Medicaid, CHIPS insurance, U.S. Military and veteran's health insurance. These plans are listed in IRC § 5000A(f). Limited scope plans such as dental and vision benefits, coverage for specific medical conditions, per diem hospital indemnities and Medicare supplemental health insurance do not qualify.

If an individual is a dependent of another taxpayer, the other taxpayer is liable for any penalty payment with respect to the individual. Therefore, a minor child claimed as a dependency exemption on a parent's return is not subject to the penalty but the parent is. One possible circumstance is, for example, when the child graduates from college, has attended college for five months of the year of graduation and the child leaves college, but then no longer has health insurance; if the parent claims the child as a dependency exemption for that year, then the parent will be liable for the penalty for the adult child.

The penalty does not apply to individuals whose household income is below the income threshold for filing income tax returns. It does not apply to an individual who is a member of an Indian tribe. It does not apply for periods of less than three months. There is a hardship exception. Illegal aliens are generally excluded from the law.

Every person (i.e. insurance company) who provides insurance coverage for an individual must report the coverage to the IRS. The IRS is required to send notification to each individual who files an individual income tax return and who is not enrolled in the minimum coverage.

An individual's family size is equal to the number of personal exemptions the taxpayer is allowed for the tax year including dependency exemptions. Adjusted gross income also includes the imputed income from the so called "kiddie tax" whose unearned income must be reported on the parent's tax return. Household income is that which the IRS determines in the most recent year for which the information is available, (which is oftentimes two years old). For the years 2014, 2012 income is tentatively used. See discussion above.

If an individual is eligible for employer coverage because of a relationship to an employee of that employer, affordability is determined by reference to the required contribution by the employee and not the individual for whom the coverage is to be obtained. For example, if a child is eligible for coverage through a non-custodial parent's employer, affordability is determined by reference to the non-custodial parent, even though the custodial parent might claim the dependency exemption and therefore is liable for the penalty with respect to the child if the non-custodial parent doesn't enroll the child in the plan. IRC § 5000A(e)(i)(C).

When and if the federal health legislation becomes effective in 2014, Minn. Stat. §518A.41, subd. 4 relating to Court orders for health insurance for children should be amended to reflect what I call a "marshalling of assets" approach to health insurance for minor children because of the vast disparities of cost of health insurance depending on the parents' respective incomes. For example, it is senseless to order a parent whose income is over four times the poverty rate to carry health insurance and pay $12,000.00 per year in premiums when the other parent's income is below the poverty rate and would get the insurance for free. It equally makes no sense to order the parent with a higher income to provide the insurance and for whom a smaller tax credit would be available rather than the lower income parent who would be eligible for a larger tax credit. The Court could make compensatory adjustments elsewhere in the decree or order.

Obligations, Indemnity and Hold Harmless Agreements in Legal Separation and Dissolution of Marriage Decrees. See <u>Fast v. Fast</u> 766 N.W.2d 47 (Minn App 2009) Holding:

> "The current version of section 523 (a)(15) of the bankruptcy code specifies that obligations to a spouse resulting from separation agreements and dissolution judgments are not dischargeable. Spouses are no longer required to participate in the bankruptcy proceedings to preserve their rights to enforce such marital obligations."

Therefore a dissolution of marriage decree that ordered a husband to pay a debt stating that the husband "…shall also assume full responsibility for all business debt holding [wife] harmless therefrom" was not discharged in bankruptcy as to the wife. This case applies to not only health insurance obligations but all other obligations imposed by a judgment and decree. Proceed with extreme caution on including health insurance obligations, including indemnifications and hold harmless obligations in a judgment and decree or MTA.

Recommendations to Implement Now

1. Because of the uncertainty in how the new law will work, if your client claims a child as a tax exemption or is obligated to carry health insurance for a child, you should do one or more of the following:

    a. Not impose as a mandate that your client provide the insurance. Leave wiggle room.

b. Reserve the right to your client to change the order without a showing of a substantial change in circumstances to reallocate the exemption and the health care obligation to obtain health insurance at the lowest cost after considering the Federal subsidy and the expanded medical assistance. Law changes are usually not considered as a valid basis for a substantial change in circumstances motion.
c. Avoid any indemnification, hold harmless or contingent obligations (such as if one party loses group health insurance, that party or the other party must provide individual health insurance.

2. A divorce decree or child support order should provide that if one parent is subject to the penalty for failure to ensure that a child has health insurance because the other parent was obligated to, but did not provide it, the decree or order should provide for indemnification of the penalized parent of the penalty amount.
3. Consider that when the decree or order divides dependency exemptions between parents (when there are two or more children) or alternates every other year the right of the parents to claim a dependency exemption, one may be creating unintended consequences and even chaos. The insurance policy should not change every year. The benefit to a party of claiming the dependency exemption and the $1,000.00 child credit that goes with it may be less than the cost of the mandate or penalty, imposed on the party who claims the dependency exemption.
4. A reservation clause should be included in the decree or order, which would provide that the relative obligations of the parties commencing in 2014 to pay for health insurance coverage must be based on a "marshalling of assets" concept whereby the dependency exemption, mandate, penalty and subsidy through the tax credit must be allocated in such a way as to reduce the total amount of the out-of-pocket health insurance costs to both parties and to take full advantage of the federal subsidy for the health insurance.
5. Reservation of health insurance obligations should be triggered if a parent moves to a different state.
6. A judgment and decree or other order converts what might be an otherwise dischargeable obligation into a non-dischargeable obligation. The drafter should provide escape clauses or contingencies to avoid this.

CONCLUSION

Health insurance orders in dissolution and paternity cases should focus on:

1. The specific needs of children.
2. Allocation of responsibility for premium payment between the parties.
3. Assignment of authority to one or both parents to choose and monitor coverage.
4. "Marshalling Assets" of the parties to fully utilize federal benefits.

The new health care law does none of this because its basic architecture is the Internal Revenue Code, based on "the allowed" or "allowable" dependency exemptions. Practitioners should attempt to achieve reasonable decrees and orders under state law even through our hands may be tied by federal preemption.

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