

O'MALLEY NEWS & VIEWS

Summer 2010



a publication by

O'MALLEY & O'MALLEY, LLP
A Family Business since 1945
AICPA Members

Accounting and Tax Preparation for Today
Website: www.omalleycpa.com
3112 Woodland Drive
TEL (856) 829-9100

- Certified Public Accountants
- Certified Financial Planners
- Licensed in NJ & PA
- Financial Planning for Tomorrow
- E-mail: omalleycpa@comcast.net
- Cinnaminson, NJ 08077
- Fax (856) 829-4422

©Copyright 2010

WASHINGTON WATCH

by Charles K. O'Malley, CPA, CFP®

While I was doing research for this edition, I was tempted to change the column's name to, "...INTERNET WATCH".

In the past, when clients would tell us or ask us about strange, unusual, far-fetched taxation ideas and issues, we would assume that unknowledgeable persons were inventing ideas and possibly rendering bad tax advice. However, now there is apparently a more authoritative source of misinformation...THE INTERNET. Tweeting and blogging has allowed anyone with access to a computer to become a self proclaimed tax and/or political expert.

Recently, our office has been receiving a substantial increase in e-mails and phone calls from clients referencing scary, misleading tax information that they read on the internet or received in a chain e-mail. Cyberspace is loaded with misstatements, exaggerations and untruths about taxation and political issues.

The Annenberg Public Policy Center of the University of Pennsylvania, created

www.factcheck.org

Why? To issue corrected comments when politicians misspeak or exaggerate the facts and truths and/or debunk faulty, misleading internet postings or chain e-mail statements. It is a very informative and accurate website. You can even use their search section to ask a question and get a factually correct answer. Check it out. You now have the opportunity to get the real truth while you are reading that questionable internet posting or scary chain e-mail.

One of the scariest rumors is that your employer-paid healthcare insurance premium (including retired employees) will now be part of your W-2 or 1099-R Form and added to your taxable income. **Wrong!**

Beginning in 2011, the forms will show the value of your employer's paid health insurance premium, but **it will not be added to your taxable income**. This is just one of many changes that will be phased in over several years as the result of the recently passed Health Care Reform Act.

See the enclosed separate page for a summary of the new Health Care Reform Act.

On March 23, 2010, President Obama signed "The Patient Protection and Affordable Care Act" (Health Care Reform Act) and seven days later he signed the "Health Care and Education Reconciliation Act of 2010", known as the "Fix-It Bill". Obviously, I was preoccupied with the final days of the tax season, but I did manage to download a lot of health care reform facts as the bill(s) were bouncing back and forth between the Senate and the House of Representatives. The ultimate passing of this bill did not follow the normal routine of a House/Senate conference committee to reconcile any differences, because it was anticipated that the Senate could not get sixty votes in March 2010 to pass a revised health care bill.

For many (even those in favor of some form of healthcare reform), its complicated passage was not pretty. The best taxpayer's quote on this may have been in the AARP Bulletin.

*"Both parties failed in their responsibilities to the American People.
I resented the obstructionist tactics by the Republicans –
and the Democrats with their special deals to secure votes."*

Since last summer, there have been so many misstatements and falsehoods about the Bill's contents, (over 2,000 pages), that I became a frequent visitor to "www.factcheck.org"

"...There will be death squads... Granny will die... "
"...Premiums will go up... Premiums will go down..."
"...Medicare will be cut...The doughnut hole will be reduced..."
"...It will lower taxes... It will raise taxes..."
"...It's government run health care..."

The list is too long to repeat, but the one that really got me was when a former US Surgeon General made assertions that many would be "too old to qualify" for joint replacements and pacemakers, and **factcheck.org** said, "...**Wrong!**" I began to wonder, who can we believe? The multiple counter claims in paid TV advertising were even more confusing. It reminded me of the lobbyist in the movie scene from *The Distinguished Gentleman*, "...Senator, what's your position on this? ... I have PAC money for and against..."

As Taxpaying citizens of the United States, we should demand honesty in politics!

That would be refreshing!

There has been talk of repeals, court challenges and withholding funds to pay for it, but my guess is, because of the delayed phase in dates, this law will become a work in process and depending on the results of the 2010 and 2012 elections, we may see some more "Fix-it Bills".

Currently there is a lot of chatter about tax increases in 2011

The reason for this alarming tax chatter is the failure of Congress to pass any extension to the 2001 and 2003 "Bush Tax Cuts" that expire at the end of 2010. President Obama wants to continue these tax cuts for individuals making less than \$200,000 and families making less than \$250,000 annually, approximately 97% of the tax paying public, but Congress is in gridlock over this and many other issues.

**At this point in time, your 2010 tax return will be prepared with
substantially the same rules and tax rates as were in effect for 2009.**

On August 26th, Howard Gleckman, a resident fellow with the Urban Institute and editor of TaxVox, the blog of the nonpartisan research organization Tax Policy Center made the following statements:

"...not a single important Democrat favors letting all the Bush tax cuts expire at the end of the year... Obama's 2011 budget explicitly calls for extending nearly all of those tax cuts (except for the highest-earning 3% of taxpayers...Leading Democrats Finance Committee Chairman (Senator) Max Baucus, Senate Leader Harry Reid, House Speaker Nancy Pelosi and Ways and Means Chairman (Representative) Sandy Levin all favor continuing the tax cuts, at least for the middle-class. Relative to current law, this would cut taxes by \$3 trillion over 10 years...So to say that 'on Jan. 1, 2011, Democrats will drop a \$3.8 trillion tax increase on American small businesses and families' is – not to put too fine a point on it – a lie..." - Mr. Gleckman's words, not mine!

The political statement that allowing all the "Bush Tax Cuts" to expire will in fact create, "...the largest tax hike ever...", is also questionable. Allowing all of them to expire would be a big tax increase, raising revenues by about 2% of gross domestic product, but not the biggest ever.

In 2006, Jerry Tempalski at the Treasury Department measured the relative size of all major tax bills since 1940 (the last 60 years, pretty much fits the definition of “ever”) and found the following:

- The Revenue Act of 1941 raised taxes by an average annual rate of 2.2% of GDP, with an 81% tax rate on income over \$5,000,000. More than the impact of letting all the Bush tax cuts expire.
- The Revenue Act of 1942 was bigger. It raised taxes by a whopping 5% of GDP, with an 88% tax rate on income over \$200,000. But this was during World War II (in the old days – when everybody sacrificed and pitched in, instead of leaving the bill to their grandchildren.) This is one of the many reasons why they have been called ... “The Greatest Generation”.
- The three major tax increase bills signed by President Reagan – TEFRA of 1982, the Social Security Amendments of 1983 and the Deficit Reduction Act of 1984 – raised taxes by a combined 1.6% of GDP, with a 50% tax rate on income over \$162,400. Slightly less than allowing all of the “Bush Tax Cuts” to expire but substantially more than President Obama’s tax plan.
- President Clinton’s 1993 tax increase, actually raised taxes by 0.6% of GDP, with a 39.6% tax rate on income over \$89,150. It ultimately created four years of budget surplus.

Estate Tax (Death Taxes) is another taxation topic that needs Congressional attention. The “Bush Tax Cuts” systematically reduced estate taxes through 2009, and eliminated them completely for 2010. Now, for 2011, the expired “Bush Tax Cuts” will reinstate the pre-2001 estate tax rules which tax estates in excess of \$ 675,000 with tax rates as high as 55%. Congress has had nine years to write a new estate tax law to fix this expiration problem; another case of gridlock.

This failure to extend and/or write new tax law provisions has caused a lot of uncertainty and much speculative hype.

The biweekly Kiplinger Tax newsletter has been following and reporting on these and other tax issues regularly throughout this year and following their progress through the Committees, House and Senate.

The following is a quote from their September 3, 2010 Tax Letter:

“...The latest tax overhaul debate is under way, now that President Obama’s economic recovery board has issued its final report on options for tax reform. But Congress won’t take action this year. Lawmakers have too much remaining on their plate to tackle reform, especially since they’re still stuck on what to do about extending the Bush tax cuts. Still, tax writers will eye many proposals from the board once they get serious about reform...”

Most decisions have become politically motivated and are currently on hold pending the outcome of the November mid-term elections. Because several long term members of both the House and Senate have either decided to not run for re-election or were defeated in their party’s primary, the control of Congress may change, depending on how many “Tea Party” supported candidates are elected to replace these moderate and/or liberal members.

What tax rules will be in effect for 2011 is currently pure speculation.

We will be watching all reliable sources and will report tax changes as soon as they become law. In the meantime check out www.factcheck.org anytime you read or hear alarming tax news from any unreliable source, and **call us before you change your current tax planning.**

We live in a world of instant gratification. We want everything done immediately! Short term planning and short term results have replaced long term planning and no one is willing to wait

for long term results. This is true in the business world, our personal lives and in the way we view our government. Cooperating, negotiating and compromising are required necessities in all forms of our lives. Buying and selling items, dealing with family, friends and neighbors, managing a business, including dealing with customers and employees, and yes, even in running a government, they all demand cooperation, negotiation and compromise. It's a known fact that, you can't satisfy all of the people all of the time.

Both political parties talk of control, but in our democratic system, absolute control does not exist. Our form of government is not a dictatorship, so the minority party (the one out of control) still has many methods to prevent the party that is in control from having it all their way. The parties must cooperate, negotiate, and yes, compromise, in order to get anything done, including passing laws and keeping our country running in the right direction. Sometimes it appears that the extreme groups (right or left) are the most vocal and able to whip up the crowd to promote their agenda, even though it may not be the agenda of the silent majority.

**We need our political leaders to become a universal voice of reason.
That will require them to cooperate, negotiate and compromise.**

Tuesday, November 2, 2010 is Election Day. All of the House and one third of the Senate, plus thirty-seven Governors and several State Legislatures will be decided. Do your research on who is running in your state and district, including verifying their statements and claims on **www.factcheck.org** and then vote your best choice. No matter how discouraged or disappointed you are with the political system, **it is your civic duty to vote.**

The Patient Protection and Affordable Care Act (Health Care Reform Act) Including the Health Care and Education Reconciliation Act of 2010

TIMELINE: HOW HEALTH CARE REFORM WILL AFFECT YOU

During 2010 / 2011 (Within the first year)

- Young adults will be able stay on their parents' insurance until their 26th birthday.
- Seniors will get a \$250 rebate to help fill the "doughnut hole" in Medicare prescription drug coverage, which falls between the \$2,700 initial limit and when catastrophic coverage kicks in at \$6,154.
- Insurers will be barred from imposing exclusions on children with pre-existing conditions. Pools will cover those with pre-existing health conditions until health care coverage exchanges are operational.
- Insurers will not be able to rescind policies to avoid paying medical bills when a person becomes ill.
- Lifetime limits on benefits and restrictive annual limits will be prohibited.
- New plans must provide coverage for preventive services without co-pays. Plans must comply by 2018.
- A temporary reinsurance program will help offset costs of coverage for companies that provide early retiree health benefits for those ages 55 to 64.
- New plans will be required to implement an appeals process for coverage determinations and claims.
- Adoption tax credit and assistance exclusion will increase by \$1,000. The bill makes the credit refundable and extends it through 2011.
- A 10 percent tax will be imposed on amounts paid for indoor tanning services on or after July 1st.
- Businesses with fewer than 50 employees will get tax credits covering 35 percent of their health care premiums, increasing to 50 percent by 2014.

During 2011

- Medicare will provide free annual wellness visits and personalized prevention plans.
- States can offer home- and community-based services to the disabled through Medicaid rather than institutional care beginning October 1st.
- A 50 percent discount will be provided on brand-name drugs for Prescription Drug Plan or Medicare Advantage enrollees. Additional discounts on brand-name and generic drugs will be phased in to completely close the "doughnut hole" by 2020.
- Additional tax for health savings account withdrawals before age 65 for nonqualified medical expenses will increase from 10 percent to 20 percent. Additional tax for Archer medical savings account withdrawals not used for qualified medical expenses will increase from 15 to 20 percent.
- A plan to provide a vehicle for small businesses to offer tax-free benefits will be created. This would ease the small employer's administrative burden of sponsoring a cafeteria plan.
- The Medicare payroll tax will increase from 1.45 percent to 2.35 percent for individuals earning more than \$200,000 and married filing jointly above \$250,000.

(See below for future years)

During 2013

- Health plans must implement uniform standards for electronic exchange of health information to reduce paperwork and administrative costs.
- Contributions to flexible savings accounts will be limited to \$2,500 per year, indexed by the Consumer Price Index in subsequent years.
- The Employer Medicare Part D subsidy deduction will be eliminated. Employers will lose the tax deduction for subsidizing prescription drug plans for Medicare Part D-eligible retirees.
- There will be increases to the income threshold from 7.5 percent to 10 percent of adjusted gross income; those older than 65 can claim the 7.5 percent deduction through 2016.
- The hospital insurance tax will increase 0.9 percentage points for those earning more than \$200,000 (\$250,000 for married filing jointly), and it includes net investment income.
- A 2.9 percent excise tax on the first sale of medical devices will be established. Excepted are eyeglasses, contact lenses, hearing aids or other items for individual use.

During 2014

- Citizens will be required to have acceptable coverage or pay a penalty of \$95 in 2014, \$325 in 2015, \$695 (or up to 2.5 percent of income) in 2016. Families will pay half the amount for children, up to a cap of \$2,250 per family. After 2016, penalties are indexed to Consumer Price Index.
- Workers who are exempt from individual responsibility for coverage but don't qualify for tax credits can take their employer contribution and join an exchange plan.
- Companies with 50 or more employees must offer coverage to employees or pay a \$2,000 penalty per employee after their first 30 if at least one of their employees receives a tax credit. Waiting periods before insurance takes effect is limited to 90 days. Employers who offer coverage but whose employees receive tax credits will pay \$3,000 for each worker receiving a tax credit.
- Insurers can no longer refuse to sell or renew policies because of an individual's health status. Health plans can no longer exclude coverage for pre-existing conditions. Insurers can't charge higher rates because of health status, gender or other factors.
- Health plans will be prohibited from imposing annual limits on coverage.
- Health insurance exchanges will open in each state to individuals and small employers to comparison shop for standardized health packages.
- Credits will be available through exchanges for those whose income is above Medicaid eligibility and below 400 percent of poverty level who are not eligible for or offered other acceptable coverage.
- Medicaid eligibility will increase to 133 percent of poverty for all nonelderly individuals to ensure that people obtain affordable health care in the most efficient and appropriate manner. States will receive increased federal funding to cover these new populations.
- An annual health insurance provider fee will be imposed across the health insurance sector according to insurers' market share to companies whose total premiums exceed \$25 million.

During 2018

- 2018 Taxing "Cadillac" plans: An excise tax will be imposed on high-cost, employer-provided health plans beyond \$27,500 for family coverage and \$10,200 for single coverage; it will increase to \$30,950 for families and \$11,850 for individuals, retirees and employees in high-risk professions.

Sources: House Ways and Means, Energy and Commerce, and Education and Labor Committees; Kaiser Family Foundation

SPECIAL EDITION OF O'MALLEY NEWS & VIEWS

This newsletter is designed to provide general information about the subject matter. It does not constitute professional advice. As required by United States Treasury regulations, you should be aware that this communication is not intended to be used, and it cannot be used, for the purpose of avoiding penalties under the United States federal tax laws. If you would like to discuss a particular item of interest, please call us!